

WHAT DOES AN ANALYSIS OF INDIRECT COST RATES REVEAL?

An analysis of indirect cost rates reveals that:

1. Conflict over indirect costs stems from poor understanding between the government and universities or outright disagreement that research and instruction are inextricably intertwined and cannot be precisely separated.
2. A single uniform rate applicable to all universities and covering all indirect costs would be unsound and inequitable.
3. Even with the most specific guidance practicable, variations are to be expected in the levels and rates of indirect cost.
4. Continuing preoccupation with indirect cost rates is obscuring the much more fundamental issue of the state of health of the nation's university research capacity.
5. Indirect cost rates are not a measure of efficiency.
6. Comparing indirect cost rates among universities is not meaningful, because those rates vary as a result of different space related costs and the magnitude of university contributions to research.
7. A greater degree of comparability among university indirect cost rates is a desirable goal.
8. Departmental Administration costs are a large part of indirect expenses; whether these expenses benefit research or instruction or both is a source of continuing controversy.
9. Administrative costs consistently accounted for between 54 and 56 percent of all indirect costs for federally sponsored research between 1975 and 1984.
10. Indirect costs as a percentage of each federal research dollar rose from 22 percent in 1975 to 26 percent in 1984.
11. Rates for coming years will rise substantially as a result of investment in equipment and facilities.
12. Universities underrecovered or absorbed almost \$240 million in indirect cost in FY1983.
13. University indirect cost expenses are in line with all other recipients of federal funds and are lower than the expenses reimbursed to other nonprofits and commercial entities.
14. If reductions in research expenditures are necessitated by the Congress, such reductions should be achieved by limiting total expenditures, rather than limiting reimbursement or just the indirect cost portion of research.

-The Director, OMB, should add a provision to its guidelines which would allow grantees to use a cost accounting system disclosure statement approach to identify accounting methods and changes made to them. Once grantees have established specified accounting practices and auditors and negotiators have determined them to be acceptable, subsequent reviews could be limited to system changes. GAO believes that this would allow already limited audit resources to be more effectively directed.

-The Secretaries of Defense and HEW, either jointly or separately, should analyze current practices for auditing indirect cost proposals related to research grants and contracts to identify the benefits derived. The results of the analyses would provide a basis to establish dollar thresholds for audit. When coupled with the "disclosure statement" approach recommended above, this could enhance the effectiveness of audit resources.

If the Congress should desire to further limit Federal participation in research project expenditures beyond the present legislative restriction, GAO recommends that this be achieved through some formal ceiling on Federal reimbursement, such as by requiring minimum mandatory grantee participation in total costs, rather than by limiting reimbursement on just the indirect cost portion of research. A reimbursement limitation imposed in this way would be more equitable among different institutions, since indirect cost rate comparisons are not meaningful and reflect a variety of accounting practices.

**"Strengthening the Government-University Partnership in Science"
(National Academy of Sciences - 1983)**

Resolution of the conflict over indirect costs requires that representatives of all parties to the government-university relationship: Develop consensus on criteria for determining the actual costs of research, regardless of who pays; Examine current and alternative methods for apportioning costs among functions of the university and among individual projects; Agree on methods for determining and apportioning costs; Agree on the rationale for sharing of costs by government and the universities.

Imposition of a uniform indirect cost rate on all universities would be both unsound and inequitable.

A wider choice of mutually acceptable methods for treating indirect costs is needed. Such methods should include some that offer simplicity in accounting procedures in exchange for less than full recovery of costs.

**"Accountability: Restoring the Quality of the Partnership"
(National Commission on Research - March 1980)**

The commission recommends that government agencies and universities construct an option, analogous to the "standard deduction" in income tax calculation, to charge activity which is treated as indirect costs under sponsored agreements. The fixed percentage would be negotiated. It might either be uniform or vary from institution to institution. Some universities would not receive full credit for their allowable indirect

costs. However, accountability would be fully served and both government and universities would reduce the burden of detailed accounting and audit.

**"Assuring Reasonableness of Rising Indirect Costs on NIH
Research Grants--A Difficult Problem"
(General Accounting Office Report - March 16, 1984)**

Since departmental administration expenses are the largest category of indirect costs and consist of charges developed using subjective estimates that are not easily verified, they will undoubtedly be the source of continuing controversy.

GAO recommends that the Director, OMB, revise Circular A-21 to establish a fixed allowance for large institution's departmental administration expenses to replace the cost reimbursement method now used. Such an allowance could be computed in a manner similar to that permitted by Circular A-21 for small institutions and could vary, if necessary, on an institution-by-institution basis, depending on their individual circumstances.

In any event, a fixed allowance for departmental administration expenses should not require reliance on institutions' personnel activity reporting systems. Implementation of the recommendation should minimize difficulties encountered in independently verifying this category of indirect costs. Such an allowance should represent a reasonable amount needed for effective research administration at the departmental level of each institution. To the extent possible, the allowance should be relatively simple to compute and not result in disproportionate annual fluctuations compared to the direct costs of research.

**"The Impact of Indirect Costs on Research Sponsored by
the Federal Government at Universities and Colleges"
(Office of Inspector General/Office of Audit - December 1985)**

Establish a fixed allowance for the highly controversial departmental administration component of the indirect cost rate.

Expand the use of predetermined indirect cost rates and extend them to cover a period of 2 years or more.

**"A Renewed Partnership"
(White House Science Council - February 1986)**

The federal government should bear its full share of the cost of university research it supports.

Reimbursements for administrative costs within the indirect cost category should be fixed at a uniform percentage of modified total direct costs. That percentage should be the mean percentage over a five-year historical period, and the adjustments should be phased in over a two-year period to allow those universities now charging more than the new fixed rate to plan for reduction. This change will eliminate much of the need for faculty effort reporting.

The formal requirement for cost sharing should be eliminated.

The paperwork burden associated with grant and contract administration should be reduced to a minimum. In the Panel view, all faculty effort reporting should be eliminated.

All federal agencies supporting university research should adopt the NSF practice of including the indirect costs in the project budget subject to peer review.

The Panel recognizes that some universities will face reduced indirect cost reimbursement if our recommendation concerning administrative costs is implemented. We emphasize, however, that our recommendations concerning more realistic use allowances for facilities and equipment are designed, in part, to offset such reductions. It is therefore of special importance that our recommendations be considered as an integrated package; were they to be only partially or selectively implemented, they could result in significant damage to the academic enterprise.

"University Finances - Research Revenues and Expenditures"
(General Accounting Office Report - July 1986)

Indirect costs as a percentage of each federal research dollar rose from 22 percent in 1975 to 26 percent in 1984. Public institutions' overall level of indirect costs remained at a relatively constant 20 percent. Private institutions' indirect costs rose from 24 percent in 1975 to 31 percent in 1984.

The administration categories consistently accounted for between 54 and 56 percent of all indirect costs for federally sponsored research between 1975 and 1984. Operations and maintenance accounted for the next largest share, increasing from 24 percent in 1975 to 28 percent in 1984.

**"Trends in Indirect Costs Paid to Recipients of PHS
Grants and Contracts"**
(Public Health Service - March 1987)

Fiscal Year	Percent of Indirect to Total Costs				
	Universities	Hospitals	State & Locals	Other Nonprofits	Commercial Entities
1981	28.4	25.1	26.2	27.8	45.5
1982	29.0	25.2	27.0	29.4	46.9
1983	30.5	25.8	29.1	31.3	46.5
1984	31.5	27.8	31.0	32.4	47.3
1985	31.6	29.2	30.9	32.4	47.3
1986	31.8	30.3	30.8	32.7	46.7
Rate of Increase: 1981 to 1986	12.0	20.7	17.6	17.6	2.6

**"Indirect Cost Rates at Research Universities
- What Accounts for the Differences?"
(Council on Governmental Relations - November 1987)**

Based on an analysis of the data collected, it is evident that the principal differences in indirect costs result from the following: 1. Space Related Costs - the location, age, operation and maintenance of facilities; methods of financing facilities; use allowance versus depreciation recovery; mix of research; intensity of space; 2. Cost Recovery Policies - the magnitude of cost sharing (institutional contributions to research costs), particularly voluntary indirect cost sharing; 3. Other Factors - institutional policies and practices concerning direct versus indirect charging of certain costs and other components of the rate, including administrative costs.

**"Accounting for the Full Cost of Research
- A Study of Indirect Costs"
(Cornell University - 1987)**

Universities in the study underrecovered and absorbed \$226 million in indirect costs in FY 1983 and waived another \$13.1 million.