Talking Points

House 20 Percent Cap on DOD Basic Research Indirect Costs

The House FY08 DOD Appropriations Bill (H.R. 3222) Caps Indirect Cost Recovery for DOD Basic (6.1) Research at 20 Percent.  H.R. 3222 contains a statutory cap of 20 percent on the facilities and administrative (F&A) costs, often referred to as indirect costs, that universities negotiate and receive from the federal government for performing 6.1 basic research (see statutory and report language below). This is NOT the same as the 26-percent cap on university administrative cost recovery that currently applies to research compliance and administrative research costs under OMB Circular A-21.

The Department of Defense, the Office of Management and Budget (OMB) and the White House Office of Science and Technology Policy Have All Expressed Opposition to the Proposed 20-Percent Cap. The Statement of Administration Policy for H.R. 3222 says, “The Administration also opposes the Committee’s language imposing artificial, arbitrary caps on indirect costs of basic research.”

Indirect Costs are in Addition to the Direct Costs of Research. Rates are negotiated as a ratio of indirect costs compared to direct costs. For example, a 50-percent F&A rate would mean that for a research grant of $100,000, the federal government would provide an additional $50,000 for F&A costs to the institution where the research is performed. A 50-percent F&A rate is often misunderstood to mean that half of the total costs of a research project are devoted to indirect costs. This is a common misconception. Using a $100,000 grant as an example, the total costs are $150,000 and therefore 67 percent of the total research cost is applicable to direct research and 33 percent is applied to indirect costs.

A Cap on F&A Cost Recovery Threatens the DOD-University Partnership. Since World War II, this partnership has yielded many scientific and technological advancements, including lasers, stealth technology, global positioning systems (GPS), night vision, and the Internet. Neither the Pentagon nor research universities have ever considered their research partnership to be like a contract or a procurement. In this historic partnership, the federal government pays for the direct costs of conducting the research and reimburses the university for facilities and administrative costs. The universities pay the faculty salaries and benefits and provide time for the faculty to conduct the research. An arbitrary cut in fairly negotiated and rigorously audited F&A costs is an unjustified and unfair shifting of cost burden from the government onto research institutions.

A Cap on Indirect Costs Would Harm DOD’s Ability to Support Defense Basic Research. The proposed cap on DOD basic research F&A costs would result in universities reconsidering whether to encourage faculty to pursue DOD research grants. Universities already under-recover
the actual costs incurred while conducting DOD sponsored research, and a cap would only increase the amount by which universities subsidize DOD research. This is not a desirable or realistic proposition for universities, which have only a limited number of revenue streams from which to cover the costs associated with conducting research on behalf of the federal government.

**Universities Already Significantly Subsidize Research Performed for the Federal Government.** Universities are the second largest funding source for academic research after the federal government. In fact, universities provide more support for university research than states, industry, and private foundations combined. A great deal of universities’ support pays for research-related facilities and administrative and compliance costs that are not recoverable from the federal government. A RAND study in 2000 suggested that universities were subsidizing between $700 million and $1.5 billion of F&A costs associated with federal research projects. A 2000 analysis by White House Office of Science and Technology Policy concurred with the RAND study and argued against further caps and limitations. The Council on Governmental Relations (COGR) estimates that the subsidy that research institutions provide for federally funded research may exceed $3 billion in 2007. Furthermore, because of the 26-percent cap on administrative costs imposed by OMB Circular A-21, universities now absorb 100 percent of new regulatory and compliance costs. These include new rules and costs in such areas as auditing standards and rules, export controls, SEVIS, HIPAA, human subjects protection, conflict of interest reviews, research animal care, hazardous materials administration and disposal, and occupational health and safety standards.

**A Cap on Indirect Costs Would Harm Our Nation’s Innovation Capacity.** The science and technology sector that drives innovation and our nation’s economy rests upon the basic research conducted at universities. Universities take on the risk of building and maintaining high-technology laboratories and scientific equipment in order to compete successfully for federally sponsored research. If universities are unable to recover the costs they incur when investing in new research facilities and equipment, fewer state-of-the-art research facilities will be built, many adequate facilities will not be properly maintained, and inadequate research facilities will not be revitalized. A cap also reduces reimbursement available for assuring compliance with federal regulations.

**The Average F&A Rate Across Institutions has Remained Constant in Recent Years.** While report language to accompany the FY08 Defense Appropriations Bill suggests that indirect cost rates have been increasing, data collected by COGR show that nationally, on average, universities’ F&A rates have held constant at about 51 percent for at least the past six years.

**The Proposed Cap of 20-Percent on DOD Basic Research Will Increase University Under-recovery of Costs Required to Conduct Federal Research.** A 1991 revision to OMB Circular A-21 instituted a cap on the administrative portion of the F&A rate at 26 percent, while the facilities portion remained uncapped. New compliance requirements mandated by the federal government since 1991 have meant that 26-percent administrative cap already prevents universities from recovering the full administrative costs of research. More than 90 percent of all research institutions and universities spend more on administration and regulatory compliance
than is reimbursed under a 26-percent cap. Studies suggest that the actual administrative rate at most universities is close to 30 percent, which means that institutions are already subsidizing the difference. Capping the total F&A cost rate at 20 percent would further exacerbate the problem of under-recovery.

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**The Statutory and Report Language:**

**H.R. 3222: Sec. 8105** -- Notwithstanding any other provision of law, none of the funds made available in this Act may be used to pay negotiated indirect costs rates on a contract, grant, or cooperative agreement (or similar arrangement) entered into by the Department of Defense and an entity in excess of 20 percent of the total direct cost of the contract, grant, or agreement (or similar arrangement) if the purpose of such contract, grant, or agreement (or similar arrangement) is to carry out a program or programs of mutual interest between the two parties: Provided, That this limitation shall apply only to funds made available in this Act for basic research.

**H.Rept. 110-279, Page 7:**

Basic Research: In testimony received by the Committee, and through information provided by the Department and third-party groups, the Committee learned that the percent of basic research funding allocated to Department and research organizations' overhead costs has grown to unwarranted levels. To reverse this trend and ensure that the Department's basic research dollars are being used for the purposes intended by Congress, the Committee recommends a general provision limiting the percentage of overhead costs that can be covered in basic research contracts.

**H.Rept 110-279, Page 416:**

Section 8105 provides limitations on the use of funds made available in this Act to pay negotiated indirect cost rates on agreements or arrangements between the Department of Defense and certain entities conducting basic research.

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