Background Talking Points

Indirect Costs

Indirect Costs are Real Costs. Indirect costs of research—laboratories, building operating and maintenance costs, depreciation, interest and debt service, utilities, research instrumentation and materials, and administrative and regulatory compliance costs—are real costs that are reflected in the facilities and administration (F&A) cost reimbursement rates that are regularly negotiated and audited by the federal government.

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 to reimburse for costs associated with research facilities, infrastructure and compliance. 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.

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 the Council on Governmental Relations (COGR) show that nationally on average, universities’ F&A rates have held constant at about 51 percent for at least the past six years.

F&A Costs are Regularly Negotiated and Rigorously Audited. A research institution typically negotiates its institution-wide F&A rate every three years with either the Division of Cost Allocation (DCA) at the Department of Health and Human Services (HHS), or the Office of Naval Research (ONR) at the Department of Defense. Approximately 40 institutions negotiate their F&A rates with ONR, while most of the remaining institutions negotiate their rates with DCA. Both DCA and ONR require a rigorous review and audit process of institutional indirect cost rates in order to ensure that universities are reimbursed strictly in accordance with federal requirements as delineated in OMB Circular A-21. OMB Circular A-21 outlines the specific facilities and administrative costs associated with the conduct of federal research for which the government believes it is reasonable and fair to reimburse universities.
The Proposed Cap of 20-Percent on DOD Basic Research Would 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.

Universities Have A Limited Number of Funding Sources: Research universities receive funding to perform their research and educational missions from tuition, research grants and contracts, philanthropy, endowment income, and, in the case of public institutions, state appropriations. When universities are unable to recover the costs of research, the strain on other funding sources increases. A cap on F&A costs might result in:

- institutions refusing to accept research awards that require significant institutional subsidy,
- the deterioration of research facilities as the risk becomes too great to invest institutional funds,
- a substandard compliance environment because institutions cannot afford to pay for mandated compliance costs, and
- increases in tuition rates to cover costs that have been shifted to the institution.

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