

Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

DISCUSSION ITEM

For Meeting of November 17, 2010

ANNUAL REPORT ON NEWLY APPROVED INDIRECT COSTS AND DISCUSSION OF THE RECOVERY OF INDIRECT COSTS FROM RESEARCH

This report discusses the indirect costs of research at the University of California, with a particular focus on limitations to full indirect cost recovery. These limitations are twofold: the assignment of low indirect cost rates and the granting of indirect cost waivers. As a result of these limitations, the UC system incurs \$600 million in unreimbursed indirect costs every year. The University of California will have a difficult time keeping pace with peer institutions if it must supply an increasing amount of the costs of research from its declining general funds and fee revenues in absence of full indirect cost recovery.

BACKGROUND

The indirect costs of research (IDC), also known as overhead or as facilities and administrative (F&A) costs, are the costs that UC campuses incur in the conduct of externally sponsored research. Indirect costs are expenses that are shared across a large number of research projects. Shared expenses include administrative services, the cost of laboratories, shared research equipment, libraries, and the building maintenance, depreciation, and debt service taken on for new construction to provide the researchers with modern facilities.

Indirect cost rates (ICR) determine the fraction of a grant or contract that represents shared costs *on average*. These rates are applied to a portion of the direct costs called *modified total direct costs* (MTDC). MTDC includes the salaries of researchers, their benefits, materials and supplies, and the first \$25,000 of each research sub-award. Excluded from MTDC are graduate fees, research equipment, and the portion of sub-awards in excess of \$25,000. ICR takes into account both the facilities and administrative costs as described above. In an effort to keep indirect costs down, the Federal government caps the administrative portion of the indirect cost rate at 26 percent of MTDC.¹ It is worth noting that this cap applies only to research grants and contracts awarded to universities. Corporations and Federally Funded Research and Development Centers (FFRDC) such as the Jet Propulsion Laboratory or the Sandia National Laboratories are not affected by this cap. They generally have much higher rates of indirect cost reimbursement than institutions of higher education.

¹ The Federal government does not place an upper ceiling on the facilities component of indirect cost rates.

Most UC campuses derive the majority of their research funding from the National Institutes of Health. As such their rates are governed by the Division of Cost Allocation (DCA) of the Department of Health and Human Services.ⁱⁱ DCA sets the indirect cost rates for each campus every three to five years by examining the costs incurred for research in the previous period. A campus submits a rate proposal to the DCA with the total costs of facilities and administration recently incurred, and the DCA performs an audit of those costs, often through a site visit to establish its own assessment of reimbursable costs. The DCA subsequently decides the final rate and informs the university (it is not a negotiation). This rate then applies to all new grants and contracts going forward for the next three to five year period to recover expenses that have already occurred.

In fiscal year 2011, the DCA assigned rates to UC campuses for on-campus research ranging from 51.5 percent (UC Santa Barbara and UC Santa Cruz) to 54.5 percent (UC San Diego and UC San Francisco), with intermediate rates for the other campuses. With these rates, the UC system recovered \$878 million in indirect cost reimbursement in FY 2010.

The rates of UC campuses are lower than those of many of their peers, substantially lower when compared with private universities. For example, the University at Buffalo (SUNY) and the University of Illinois Urbana-Champaign each have rates at 58.5 percent, and the University of Massachusetts at Amherst and Virginia Tech are at 59 percent. The newest rates at Harvard and MIT are 68 percent, Yale and Tufts are at 65.5 percent, and Stanford, Caltech, Princeton, and Johns Hopkins have indirect cost rates in the range of 60 to 64 percent. Corporations and FFRDCs normally have even higher rates, often exceeding 90 percent. For example, the Gladstone Institute located in Mission Bay and affiliated with UCSF has an indirect rate of 92 percent, whereas the UC facilities in the same location with similar costs charge 54.5 percent.

The indirect cost rates assigned to UC campuses also are significantly lower than their proposed rates. At some UC campuses, the assigned rates are nearly twenty points lower than the proposed rates, reflecting a substantial disagreement with the DCA regarding allowable costs of research - a problem that has historically applied to public universities and especially to those assigned to the West Coast office of the DCA. The discrepancy between proposed and assigned indirect cost rates of public universities audited by the DCA was recently called out by a report from the Government Accountability Office (GAO) of the federal government as an area for reform of government practices.ⁱⁱⁱ In contrast, MIT's proposed rate for 2011 was 68 percent, and that was also their assigned rate (MIT negotiates its indirect cost rate with another federal agency, the Office of Naval Research). State and local governments reimburse UC at lower rates than the federal agencies, typically 26 percent or less, as a matter of longstanding policy. As a result, the UC system as a whole incurs an estimated \$300 million in unreimbursed indirect costs every year representing the difference between the proposed and assigned rates of recovery.

The second major factor limiting the recovery of research costs is the allowance of indirect cost waivers. Many foundations and other non-profit organizations reimburse few if any of the

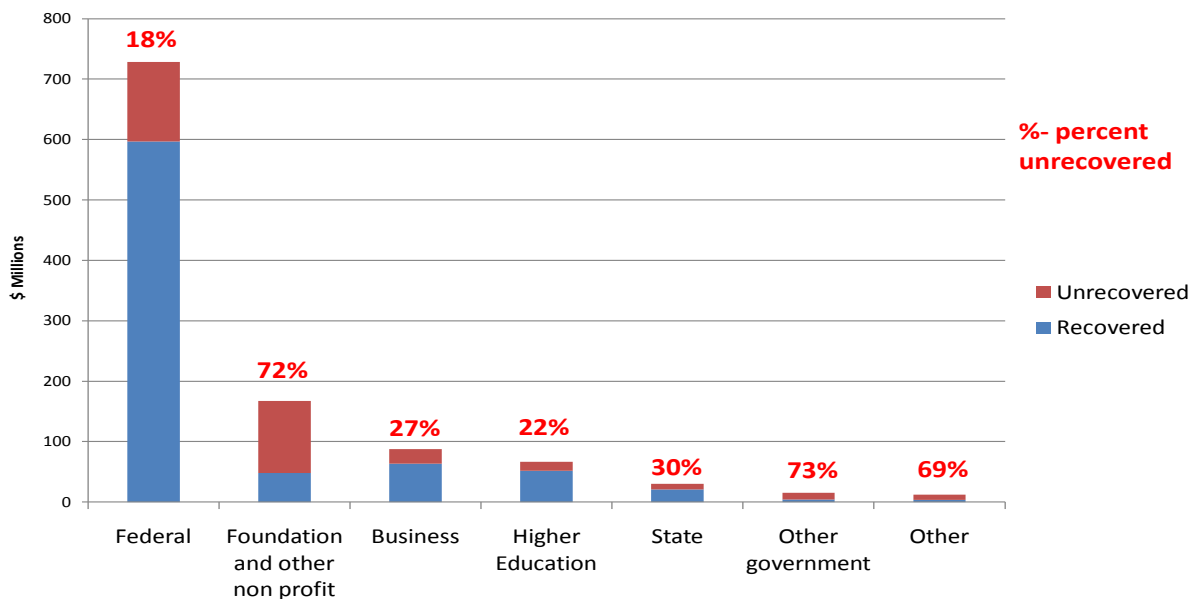
ⁱⁱ Universities that are mostly funded by the Department of Defense negotiate their indirect cost rates with the Office of Naval Research.

ⁱⁱⁱ United States Government Accountability Office, *University Research: Policies for the Reimbursement of Indirect Costs Need to be Updated*, September 2010.

indirect costs as a matter of policy, and some government sponsors require cost-sharing through waivers to award research money. Waivers are approved exceptions to the DCA assigned indirect cost rates.

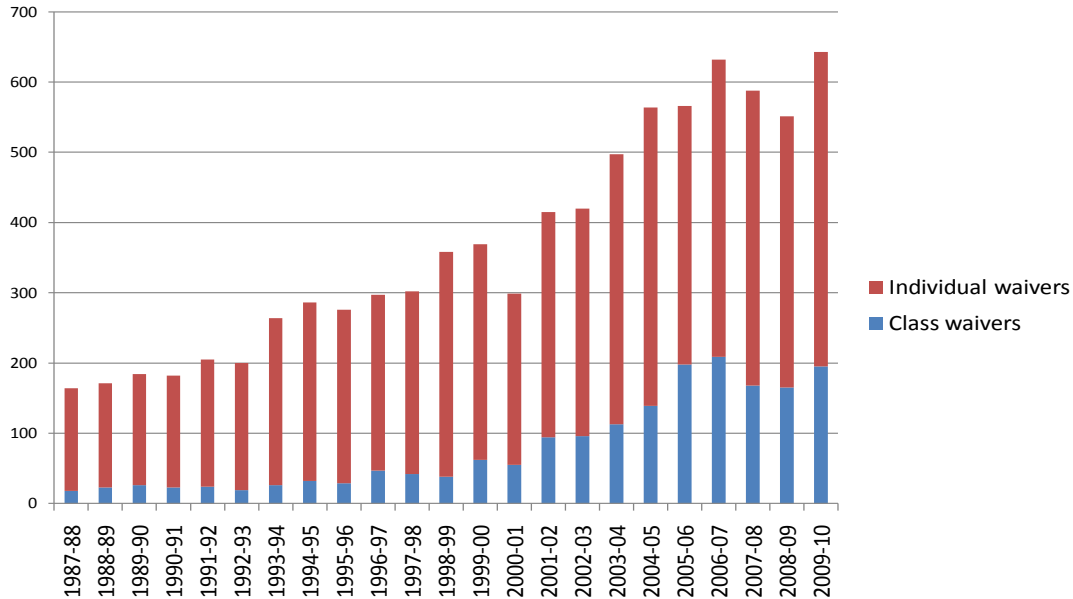
The UC system grants individual and class waivers to a variety of sponsors: Federal agencies, foundations, non-profits, corporations, and State and local governments. Individual waivers are for specific awards. Class waivers are for a group of research grants and contracts from the same sponsor. The class waivers are open-ended and apply to current as well as future awards. The UC system currently has 1910 active class waivers. The two justifications for waivers are sponsor policy, that is because the sponsors have a written policy in which they will not pay indirect costs, or campus vital interest for individual research projects that the campuses deem to be in their long-term interest to conduct.

Under-recovery of indirect costs through waivers, FY2009



The number of indirect cost waivers grew significantly over the last twenty years. In fiscal year 1988, UC granted 164 indirect cost waivers. By fiscal year 2010, the number of waivers grew to 643. The growth is particularly noticeable for class waivers. Eighteen class waivers were granted in fiscal year 1988, while 195 were granted in fiscal year 2010 – a growth by more than a factor of ten over a twenty-year period. This rate of increase is much greater than the rate of increase in sponsored research at UC which expanded by approximately a factor of four during the same period. Indirect cost waivers have the cumulative effect of greatly reducing the reimbursement of indirect costs incurred in the conduct of extramural research. It is estimated that, in addition to losses coming from low indirect cost rates, UC has approximately \$300 million in unreimbursed indirect costs stemming from waivers every year. These costs have to be met from other revenue streams such as UC general funds and fees.

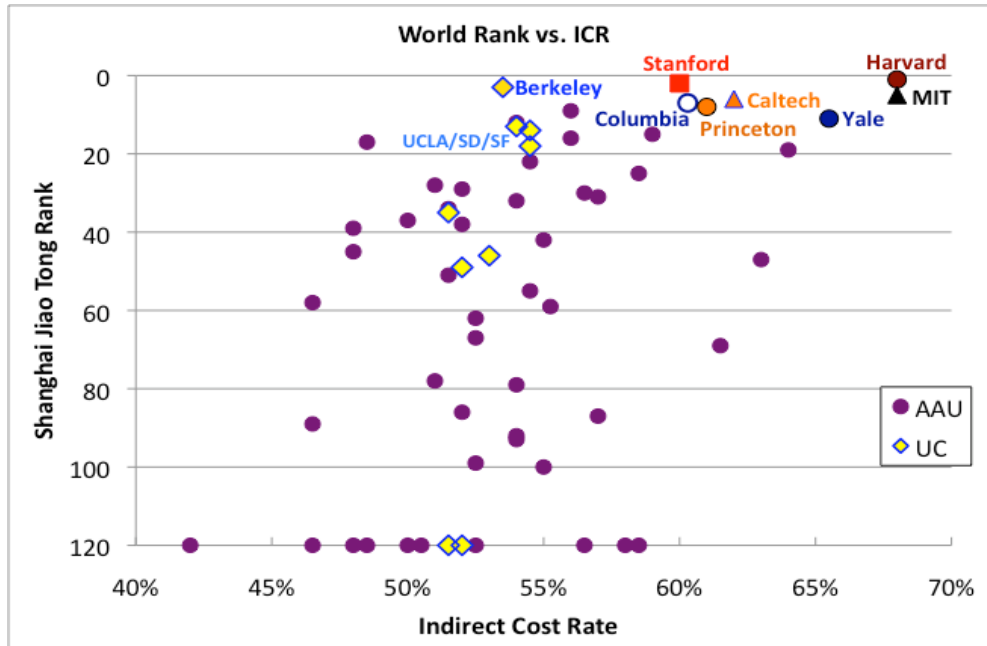
Indirect cost waivers, FY1988-2010



It is important to emphasize that indirect costs are *reimbursements* for costs already incurred by the university in the past applied to new grants and contracts. A common misperception is that the reimbursement of indirect costs is a revenue stream, much like student fees or returns on investments. In fact, the IDC funds that UC receives in any one year reimburse costs already incurred conducting research for their sponsors in previous years. For this reason, there is no restriction on how the university uses recovered IDC for its expenses.

Another common misperception is that high indirect cost rates make principal investigators less competitive in their pursuit of Federal grants and contracts. In fact, the universities with the highest rates also tend to be ranked as the best institutions for research. The figure below shows the correspondence between the Academic Ranking of World Universities (Shanghai Jiao Tong) and the indirect rates charged by each institution, with the general trend that the highest rates correlate with the highest ranks by excellence of research. Reimbursement for the costs of research is an important component of an institution's ability to invest in its research enterprise and its researchers. UC will have a difficult time keeping pace with its peers if it must supply an increasing amount of the costs of research from its declining general funds and fee revenues in absence of full indirect cost recovery.

Indirect cost rate and world rank of leading American universities



Attachments:

1. Newly Approved Indirect Cost Rates, FY 2010
2. Indirect Cost Rates of UC Campuses, FY 1995-2014
3. Indirect Cost Rates for On-Campus Research of AAU Universities, FY 2007-2014

Indirect Cost Rates of UC Campuses, FY 1995-2014

On-Campus Sponsored Research Rates

	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Berkeley	49.5%	49.9%	49.9%	49.9%	50.4%	50.4%	50.4%	50.4%	51.5%	52.0%	52.0%	52.0%	52.0%	53.0%	53.0%	53.5%	53.5%			
Davis	44.0%	44.5%	44.5%	44.5%	44.5%	46.0%	46.5%	48.0%	48.5%	48.5%	48.5%	51.5%	51.5%	52.0%	52.0%	53.0%	53.0%	53.5%	54.0%	53.50%
Irvine	49.5%	49.9%	49.9%	49.9%	50.4%	50.4%	50.4%	50.4%	51.5%	51.5%	51.5%	52.5%	52.5%	52.5%	52.5%	53.0%	53.0%			
Los Angeles	49.0%	49.0%	49.0%	52.0%	52.0%	53.0%	53.0%	53.0%	52.5%	52.5%	53.5%	54.5%	54.5%	54.0%	54.0%	54.0%	54.0%			
Merced										50.0%	50.0%	50.0%	52.0%	52.0%	52.0%	52.0%	52.0%			
Riverside	46.0%	46.0%	47.0%	47.0%	47.0%	47.5%	47.5%	47.5%	47.5%	47.5%	49.5%	49.5%	50.0%	50.0%	50.5%	52.0%	52.0%	52.0%	52.0%	
San Diego	50.5%	51.0%	51.0%	51.5%	51.5%	51.5%	51.5%	52.0%	52.0%	52.0%	53.5%	54.0%	54.5%	54.5%	54.5%	54.5%	54.5%	54.5%	55.0%	55.0%
San Francisco	44.5%	45.0%	47.0%	47.0%	47.5%	47.5%	47.5%	49.0%	50.5%	51.5%	51.5%	51.5%	53.5%	54.0%	54.5%	54.5%	54.5%	54.5%		
Santa Barbara	45.5%	45.5%	45.5%	46.0%	46.0%	46.0%	46.0%	46.0%	47.5%	47.5%	47.0%	47.0%	51.0%	51.5%	51.5%	51.5%	51.5%			
Santa Cruz	47.6%	47.6%	48.5%	48.5%	48.5%	49.0%	49.0%	49.0%	49.0%	49.0%	49.0%	49.0%	51.0%	51.0%	51.5%	51.5%	51.5%			

Note: The indirect cost rates for Davis (FY2014), Los Angeles (FY2011), Merced (FY2011), and Santa Barbara (FY2011) are provisional.

Indirect Cost Rates for On-Campus Research of AAU Universities, FY 2007-2014

	Private vs. public	Cognizant agency	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Brandeis University	Private	DHHS	N/A	N/A	N/A	58%	58%			
Brown University	Private	DHHS	57.5%	59%	60%	61.5%	62%			
California Institute of Technology	Private	ONR	62%	60.5%	60.5%	62%	62%			
Carnegie Mellon University	Private	ONR	47%	47%	47%	55.35%	55.35%	55.35%	55.35%	55.35%
Case Western Reserve University	Private	DHHS	54.5%	54.5%	57%	57%	57%	57%		
Columbia University	Private	DHHS	61%	61%	60.3%	60.3%	61%			
Cornell University	Private	DHHS	53.5%	53.5%	54%	54%	54%			
Duke University	Private	DHHS	55.5%	56%	56%	56%	57%	57%	57%	
Emory University	Private	DHHS	53%	54.5%	55%	55%	55%			
Georgia Institute of Technology	Public	ONR	50.3%	51%	51%	51%	50.5%			
Harvard University	Private	DHHS	66%	67%	67%	68%	68%			
Indiana University	Public	DHHS	51.5%	54%	54%	54%	54%			
Iowa State University	Public	DHHS	47%	48%	48%	48%	48%	48%		
Johns Hopkins University	Private	DHHS	63.5%	64%	64%	64%	64%	64%	64%	
Massachusetts Institute of Technology	Private	ONR	65%	68%	68%	68%	68%			
New York University	Private	DHHS	53%	53.5%	54%	54%	54%			
Northwestern University	Private	DHHS	51%	51%	52.5%	52.5%	52.5%			
Ohio State University	Public	DHHS	50%	50%	50%	52.5%	52.5%	52.5%		
Pennsylvania State University	Public	ONR	45%	47%	47.5%	48%	47.4%			
Princeton University	Private	DHHS	N/A	N/A	N/A	61%	61%	61%		
Purdue University	Public	DHHS	52.5%	52.5%	52.5%	52.5%	54%	54%	54%	
Rice University	Private	DHHS	51%	52.5%	52.5%	52.5%	52.5%	52.5%	52.5%	52.5%
Rutgers University	Public	DHHS	54%	54.5%	54.5%	54.5%	54%	54%		
Stanford University	Private	ONR	56.5%	58%	60%	60%	60%			
Stony Brook University - SUNY	Public	DHHS	55%	55%	56%	56%	57%			
Syracuse University	Private	DHHS	47.5%	46%	46%	46%	46%			
Texas A&M University	Public	DHHS	45.5%	46.5%	46.5%	46.5%	46.5%			
Tulane University	Private	DHHS	N/A	N/A	N/A	49%	50.5%	50.5%	50.5%	
University of Arizona	Public	DHHS	51%	51%	51%	51%	51.5%	51.5%	51.5%	
University of Buffalo - SUNY	Public	DHHS	58.5%	58.5%	58.5%	58.5%	58.5%			

	Private vs. public	Cognizant agency	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
University of Chicago	Private	DHHS	53.5%	53.5%	56%	56%	56%			
University of Colorado, Boulder	Public	DHHS	51.5%	51.5%	51.5%	51.5%	51.5%	52.5%	52.5%	
University of Florida	Public	DHHS	45%	46.5%	47%	47%	47%			
University of Illinois, Urbana-Champaign	Public	ONR	53%	55%	58.5%	58.5%	58.5%			
University of Iowa	Public	DHHS	47.5%	50%	50%	50%	50%	51%	51%	51%
University of Kansas	Public	DHHS	44%	46%	46%	46.5%	47%			
University of Maryland, College Park	Public	DHHS	48.5%	50%	50%	50%	50%			
University of Michigan	Public	DHHS	52%	52%	54.5%	54.5%	54.5%	55.5%	55.5%	55.5%
University of Minnesota, Twin Cities	Public	DHHS	49.5%	51%	51%	51%	51%			
University of Missouri, Columbia	Public	DHHS	49.5%	49.5%	49.5%	51.5%	51.5%	51.5%		
University of Nebraska, Lincoln	Public	DHHS	47.5%	47.5%	47.5%	48.5%	48.5%	48.5%		
University of North Carolina, Chapel Hill	Public	DHHS	46%	46%	47.5%	48%	48%	48%		
University of Oregon	Public	DHHS	48%	48%	42%	42%	42%			
University of Pennsylvania	Private	DHHS	57%	57.5%	57.5%	59%	60%	60%		
University of Pittsburgh	Private	DHHS	48.5%	48.5%	51.5%	51.5%	51.5%			
University of Rochester	Private	DHHS	N/A	54%	54%	54%	53%	54.5%		
University of Southern California	Private	DHHS	63%	63%	63%	63%	62%			
University of Texas, Austin	Public	DHHS	50%	52%	52%	52%	53.5%	54%	54%	54.5%
University of Virginia	Public	DHHS	51.5%	51.5%	51.5%	54%	54%			
University of Washington	Public	DHHS	55.5%	56%	56%	56%	56%			
University of Wisconsin, Madison	Public	DHHS	47%	48.5%	48.5%	48.5%	48.5%			
Vanderbilt University	Private	DHHS	53%	53.5%	53.5%	55%	55%			
Washington University in St. Louis	Private	DHHS	52.5%	52%	52%	52%	52%	52%	52%	
Yale University	Private	DHHS	65%	65%	65.5%	65.5%	65.5%			