

COMPUTING INDIRECT RESEARCH COSTS:

A NON-TECHNICAL GUIDE
FOR COLLEGE AND UNIVERSITY
PRESIDENTS

National Education Industry Group
Coopers & Lybrand



I. TOTAL RESEARCH COSTS: COST COMPONENTS

Total Research Costs are the sum of the total direct costs of conducting a research project, and the total indirect costs attributable to a research project:

$$\begin{array}{r} \text{Total Direct} \\ \text{Research Costs} \end{array} + \begin{array}{r} \text{Total Indirect} \\ \text{Research Costs} \end{array} = \text{Total Research Costs}$$

Direct costs are costs readily identified with, and directly chargeable to, a specific grant or contract. Indirect costs are more difficult to identify with a specific project.

II. INDIRECT RESEARCH COSTS: DEFINITION AND CATEGORIES

Definition

Indirect research costs are the costs incurred by a university which cannot readily be identified with a specific grant or contract and which benefit or support multiple activities.

Indirect Cost Categories

Indirect research costs are grouped into the following cost categories:

o General University Administration

Costs incurred by the executive and administrative offices including: the president, the provost or chancellor, vice-presidents, accounting, payroll, purchasing, and personnel.



o Academic Departmental Administration

Costs incurred for the time spent by academic deans, department chairpersons, and their respective faculty and staffs on administrative functions, including budget planning, space planning, personnel activities, etc. To be included in this cost category, these activities must benefit joint or common objectives of the department, college, or university.

o Operations and Maintenance

Costs incurred in the operation and maintenance of physical plant, including utilities, buildings and grounds maintenance, engineering services, janitorial services, and police and fire protection.

o Sponsored Projects Administration

Costs incurred by an office established primarily to support and manage sponsored research projects. Portions of faculty and other academic staff salaries may be included in this cost category if the costs are supported by an acceptable effort reporting system.

o Libraries

Costs incurred in operating libraries, including the purchase of books and other materials, and the staffing, operations and maintenance of the facilities.

o Student Services

Costs incurred administering and providing student services by such offices as: dean of students, admissions, registrar, counseling and placement, and student health care.

o Buildings and Equipment Costs

Costs incurred for the annual use of equipment, buildings, and capital improvements to land and buildings, provided that the facilities are needed in the institution's activities, and are used in the performance of sponsored agreements.

The costs may be computed using either use allowance or depreciation. The same method must be consistently used for similar classes of assets within each institution, and must be based in all cases on the acquisition cost of the asset, less federal contributions.

Annual building use allowance costs are calculated at 2% of the sum of construction and subsequent capital improvement costs.

Annual equipment use allowance costs are calculated at 6-2/3% of the acquisition cost of equipment.

Building and equipment costs can also be depreciated (in lieu of use allowances) if the assets' useful life is used to determine the annual expense.

III. CALCULATING INDIRECT COSTS: OBJECTIVES, PROCEDURES AND COMPUTATION

Objectives

The objective of calculating indirect costs is to fairly allocate this class of costs among research and other university activities. Once this calculation is made, the amount of governmental reimbursement of these costs can be determined based on the level of sponsored activity. Government regulations prescribe the method for calculating and allocating these costs.

Procedures for Calculating Indirect Cost Rates

Developing research indirect cost rates includes the following procedures: cost identification, cost allocation, and rate determination.

o Cost Identification

- (1) Identify total university indirect costs by category (e.g., general administration, academic departmental administration, operations and maintenance, etc.)



- (2) Identify total direct costs of sponsored research and other agreements, instruction, and other university activities. Deduct costs which are not reimbursed by the government, such as the costs of fund raising, public relations, investment management, interest expense, etc. A-21 does not permit recovery of these operating costs.

o Cost Allocation

- (1) Allocate general administration and academic departmental administration indirect costs to sponsored research on the basis of the proportion of total university expenditures spent on sponsored research.
- (2) Allocate operations and maintenance, and use allowances and depreciation charges on buildings and equipment to sponsored research on the basis of the proportion of total university space used for sponsored research.
- (3) Allocate library and student service indirect costs to sponsored research on the basis of the proportion of the user population associated with sponsored research.

Universities may use more sophisticated methods of cost allocation if these methods are adequately documented.

o Indirect Cost Rate Determination

- (1) University-wide sponsored research indirect cost rates are determined by dividing indirect costs supporting sponsored research by total direct research costs (less equipment costs and sub-contracts over \$25,000)¹:

$$\begin{array}{l} \text{Indirect Costs} \\ \text{Supporting} \\ \text{Research} \end{array} \div \begin{array}{l} \text{Total Direct Research} \\ \text{Costs (less equipment} \\ \text{costs \& sub-contracts} \\ \text{over \$25,000)} \end{array} = \begin{array}{l} \text{Sponsored} \\ \text{Research} \\ \text{Indirect Cost} \\ \text{Rate} \end{array}$$

An example of a university-wide sponsored research indirect cost rate determination is presented below:

Direct Costs Supporting Research

Total Direct Research Costs	\$38,000,000
Less Equipment	(7,000,000)
Less Sub-contracts over \$25,000	<u>(1,000,000)</u>
Modified Total Direct Costs	<u>\$30,000,000</u>

¹Total direct research costs less equipment and sub-contracts over \$25,000 is known as the "modified total direct cost".



Indirect Costs Supporting Research

General Administration	\$ 2,500,000
Departmental Administration	2,300,000
Operation and Maintenance	4,000,000
Sponsored Project Administration	800,000
Libraries	300,000
Student Administration & Services	200,000
Use-Allowance (or depreciation charges)	<u>2,100,000</u>
Total	<u><u>\$12,200,000</u></u>

$$\begin{array}{rclcl}
 \$12,200,000 & \div & \$30,000,000 & = & 40.6\% \\
 \text{Indirect} & & \text{Direct} & & \text{Indirect} \\
 \text{Costs} & & \text{Costs} & & \text{Cost Rate}
 \end{array}$$

o Application of the Indirect Cost Rate to Specific Projects

Indirect costs attributable to a specific sponsored research project are computed by multiplying the university-wide sponsored research indirect cost rate by the modified total direct costs of a specific research project:

$$\begin{array}{rclcl}
 \text{University-wide} & & \text{Modified Total} & & \text{Allocated} \\
 \text{Sponsored Research} & \times & \text{Direct Costs} & = & \text{Indirect} \\
 \text{Indirect Cost Rate} & & \text{of a Specific} & & \text{Costs} \\
 & & \text{Research Project} & &
 \end{array}$$

An example of indirect cost computation for a specific research grant or contract is presented below:

Total Direct Research Costs	\$150,000
Less Equipment	(30,000)
Less Sub-contract costs over \$25,000	<u> --</u>
Modified Total Direct Costs (MTDC)	\$120,000
Times University Indirect Cost Rate of 40.6% (see earlier example)	<u>X 40.6%</u>
Allocated Indirect Costs	<u>\$ 48,720</u>



Indirect costs computed by the method outlined above can generally be recovered from the federal government. By identifying and allocating indirect costs for each sponsored research project, a university will recover the maximum allowable amount from the government.

IV. INDIRECT COSTS AND FEDERAL AGENCIES

- o Indirect cost rates developed by colleges and universities must be approved by the federal government. Each college and university is assigned to a "cognizant" federal agency, which represents the interests of all federal agencies in financial matters concerning the university. The Department of Health and Human Services is the cognizant federal agency for most colleges and universities.

- o The cognizant federal agency has many responsibilities, including approving indirect cost rates proposed by colleges and universities. Each year, the cognizant agency reviews indirect cost proposals through either a review of work papers submitted by the university or an on-site audit. Differences between university proposals and agency findings are resolved through negotiation; resolutions are formalized in an "agreement" approving indirect cost rates for application to federal awards.

- o Awarding agencies have technical and day-to-day responsibilities for grants and contracts they fund. Awarding agencies often fund indirect costs in different ways. The National Institute of Health, for example, awards a "companion" grant to each direct cost award to fund indirect costs; the National Science Foundation awards a single amount which covers both direct and indirect costs.



V. INDIRECT COSTS RATES: VARIABLE OVER TIME AND BETWEEN INSTITUTIONS

Indirect cost rates vary over time and between institutions. This behavior is attributable to the following factors:

- o Each university has a unique (and shifting) mix of services which support research activities.
- o The rate of change in research activity varies among institutions. As research activity expands or contracts, attributable indirect costs change.
- o Research emphasis at a university sometimes shifts from one discipline to another. Different disciplines may have different support requirements and, consequently, a different mix of support costs.
- o Procedures for allocating indirect costs vary from university to university. Costs which some universities treat as direct costs, other universities treat as indirect costs. Also, some universities develop sophisticated cost allocation methodologies which they apply in lieu of government guidelines.
- o Some institutions are more aggressive than others in pursuing indirect cost recoveries from the government.

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PREFACE

- o Indirect costs for research are incurred in the support of sponsored activities but cannot readily be traced to specific grants or contracts. Library costs, student services, building maintenance, energy, and administration are examples of types of indirect costs.
- o The activities embraced by indirect costs are essential to the conduct of sponsored research, and hence represent true costs that must be understood.
- o Unless indirect costs are carefully computed and allocated, the full cost of conducting sponsored programs cannot be determined.
- o In the case of government sponsored research and other activities, not knowing these full costs can have an adverse financial impact in that the university may not recover the full amount of money it is entitled to from the government.
- o The government has promulgated regulations to assist colleges, universities, and other nonprofit organizations to calculate and recover some indirect costs. The major regulations include OMB Circular A-21, which defines cost principles and identifies cost allocation methods, and OMB Circular A-110, which establishes systems and control standards for institutions receiving federal grants, contracts and other awards.
- o This paper presents a broad, introductory outline of indirect cost identification, computation, and allocation, primarily for sponsored research grants and contracts. If you have any questions concerning issues raised in this paper, or would like more detailed information, please contact a Coopers & Lybrand office convenient to you.

