

## Indirect Cost Recovery/Overhead Distribution

### Summary by University Committee on Research Policy (July 10, 1997)

The distribution of "**indirect cost**" (also called "**overhead**") funds received by the University of California as part of extramural grant and contract awards has long been one of the major issues of faculty confusion and discontent in the UC system. This was revealed again in a two-part study, completed in 1997, "The Deteriorating Environment for Conducting Research at the University of California (UC)," which was based on a survey of nearly 2,400 UC faculty members conducted by the University Committee on Research Policy (UCORP). See Part I at <http://apollo.gse.uci.edu/UCORP/climate.html> and Part II at <http://www.ucop.edu/senate/ucorprep.html>, or the PDF version at <http://www.ucop.edu/senate/ucorprep.pdf>). Faculty who generate indirect cost recovery as a result of grants/contracts received believe that they should benefit by receiving the services for which indirect costs are recovered. Departments are unable to support adequately their research administration and facilities because insufficient indirect costs filter down to the level of the grant-generating units. Given the persistence of these aspects of faculty dissatisfaction, UCORP has prepared the following overview of indirect cost recovery practices within UC, without lengthy historical discussion or background. No detail on individual campus practices is given, but faculty members may use the information provided here to pursue improved practices at the campus level.

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### What are Indirect Costs?

The resources required to conduct extramural research include those elements which are distinguishable on a project-by-project basis (such as consumable supplies, salaries of active participants, equipment purchased for the project) and those that are better calculated on an institutional basis rather than costed-out by project (e.g. research administration and accounting, purchasing, library, space, maintenance). The Federal Office of Management and Budget, in document OMB-A-21, defines allowable direct and indirect costs for federal grants and contracts. **Direct costs** are those that can be specifically identified with the project, whereas **Indirect cost** items are associated with general infrastructure support. Indirect costs are real costs to the University associated with carrying out extramurally funded research. There are eight areas of general infrastructural support described as indirect costs.

1. Departmental Administration: administrative support such as staff salaries, supplies, and other general expenses at the college, department, and program levels. This indirect cost pool is commonly the largest of the eight factors built into the indirect cost rate.
2. Building use: calculated using a depreciation schedule, and including debt service costs.
3. Equipment: calculated using depreciation schedules based on "useful life."
4. Operations and Maintenance: utilities, repairs, custodial, environmental health and safety, general facilities management costs.
5. Library: administration, purchase of books and periodicals.
6. General Administration: expenses of general administrative offices.
7. Student Service Administration: a portion of student services, including admissions, counseling, health services, etc.
8. Sponsored Projects Administration: typically, grant and contract office expenses and associated accounting.

In each of the areas 1-8, the proportion of the total expenditures that can be reasonably attributed to federally sponsored research activities is estimated on each campus for a given time period, and that amount is used to calculate the total institutional "overhead" negotiated periodically with the federal agencies. That total overhead, when compared to the total direct expenditures made on federally sponsored research activities during the same period, becomes that campus' "**indirect cost rate**" for subsequent years. On each UC campus the rate is different (the 1997 average was about 48% and range 44.5-52%). A lower rate applies to projects funded for "off-campus" sites, since costs of space may be part of the direct costs. Different rates may also apply to clinical study contracts, instruction, and other sponsored activities.

An important point, and the source of substantial faculty dissatisfaction, is that the University is not obligated to redistribute the indirect cost income it receives to the particular cost areas whose expenditures were used to develop the formula. For example, although departmental administration is a major element in the indirect cost rate calculation, Chancellors may choose not to distribute these funds back to academic units in proportion to the amount generated.

The funding of a proposal by an extramural agency should be regarded as a three-party agreement between the PI, the University, and the funding agency.

(1) The principal investigator (PI) agrees to undertake a best effort to accomplish the work described in the proposal, and attests that identified space, services, and facilities are available to allow the work to be done.

(2) The University, in approving the transmission of a proposal to an outside agency, agrees that the items on which the indirect cost rate is based will be provided to assist the PI in carrying out the research.

(3) The funding agency provides specified amounts for both Direct cost items, and Indirect Costs; for calculation of Indirect Cost, the Direct cost is typically modified by exclusion of certain items, e.g., equipment.

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### **How Does the University of California Distribute Indirect Cost Revenue?**

The indirect costs go to the UC Office of the President (UCOP) and are distributed in several steps:

(1) Allocation of the so-called Garamendi funds and funding for the UC Neuropsychiatric Institute (see Table 1 and the glossary for definitions).

(2) From the remainder, 19.9% is taken as **off-the top** funds for use by UCOP as well as for distribution to campuses (see below).

(3) After (1) and (2) are complete, 55% of the remainder goes to the **California State General Fund Contribution** described below.

(4) The remainder is called "**opportunity funds**" some of which is retained at UCOP and some distributed to campuses (see below).

By agreement with the state, a sizable fraction (approximately 42% overall) of federal indirect cost revenue collected by UC is reported to and treated as part of the approved state budget. This is called the **General Fund Contribution**. The details of subsequent distribution of this overhead portion become invisible because of the merger of these federally-derived funds with state general funds. It has been suggested that a separate account/fund number might be applied to this portion of the state UC allocation, so that uses of overhead would become visible, and thus make it easier to recognize the

significant role that indirect cost recovery plays in the operation of the University. UCORP supports this suggestion in principle, while noting that this change could add to the burden of record-keeping.

Table 1 summarizes the net effect of these distributions. Approximately 11% of the federal indirect cost recovery funds remaining at steps (2) and (4) above (about 6.6% overall -Table 1) are retained by UCOP for university-wide programs and management of their own offices, for example, the University Office of Research. The balance remaining from steps (2) and (4) is allocated to campuses as "off-the-top" and "opportunity" funds. Off-the-top and opportunity funds that are returned to campuses are distinguished for accounting purposes; off-the-top funds are intended to reimburse costs related to federally sponsored research activities. There are essentially no constraints on how opportunity funds may be used by the Chancellor on each campus.

The distribution of funds for the 1995-96 fiscal year is shown in Tables 1 and 2 in order to illustrate the effects of these distributions. Note that the total off-the-top plus opportunity funds available for distribution to the campuses by UCOP is less than 50% of the total indirect costs generated by the campuses.

**Table 1.** Summary of federally generated indirect cost disbursement within the University of California 1995-96 (based on actual receipts, as provided by the UCOP).

	\$ (Thousands)	% of Total Indirect Cost Income
Indirect Costs (IC) received	\$260,219	
Related investment and other income	<u>\$ 9,897</u>	
Total IC-related income	\$270,116	100%
Garamendi* and Neuropsychiatric Institute	\$ 7,693	2.8%
Contribution to State General Fund. Nominally 55% of IC recovery less "Off the Top" funds	\$111,251	41.2%
UC Office of the President and University-wide Programs	\$ 17,789	6.6%
Indirect costs returned to campuses and DANR**as:	\$ 85,762	49.4%

a) opportunity funds	\$ 47,621
b) off the top funds	\$133,383

Total Opportunity and Off the Top returned

\* *Garamendi* costs are those associated with repayment of loans funded under Garamendi legislation. Only specified buildings approved for this funding are involved, and the amounts vary considerably campus to campus. This may be regarded as a special kind of "off the top" funding, as is the funding specified for the Neuropsychiatric Institute; these amounts are not subject to the state general fund contribution, and they are subtracted from the gross indirect cost total to determine the base figure for application of the 19.9% off-the-top calculation.

\*\**DANR*. Division of Agriculture and Natural Resources.

Although for many years, UCOP's distribution of opportunity and off-the-top funds benefited campuses with smaller research programs, there has been a change in recent years towards returning funds not absorbed by the State or UCOP to the campus which generated the funds. This information is summarized in Table 2 below. Thus, by 1995-96, no campus received less than 88% of the sum of off-the-top and opportunity funds (i.e. net funds that it generated after state and special set-asides were subtracted). A percent return of 100% means that approximately 49% of the total indirect costs generated were returned to the campus as off-the-top and opportunity funds. With the exception of Santa Cruz and Riverside the range of return to campuses of the sum of off-the-top and opportunity funds as a percentage of the total indirect costs that they generated was 43.8-53.8%.

Each Chancellor decides what use will be made of these funds according to whatever mechanism is operational on that campus.

Table 2. Relative distribution of combined off-the-top and opportunity funds to campuses.

(\$ in thousands)				
<u>Campus</u>	<u>Year</u>	<u>\$IC</u> 1	<u>\$Returned</u> 2	<u>%(\$Returned/ \$IC)</u> 3
UCB	1978-9	5,896	4,615	78.3
	1993-4	18,640	18,046	96.8
	1994-5	20,210	18,539	91.7
	1995-6	19,388	18,361	94.7

UCD	1978-9	2,706	2,927	108.2
	1993-4	10,328	10,843	105.0
	1994-5	10,716	10,853	101.3
	1995-6	10,674	10,919	102.3
UCI	1978-9	1,870	2,093	111.9
	1993-4	9,278	9,366	100.9
	1994-5	9,552	9,604	100.5
	1995-6	9,423	9,443	100.2
UCLA	1978-9	8,186	5,806	70.9
	1993-4	30,074	27,243	90.6
	1994-5	31,029	28,370	91.4
	1995-6	31,576	28,743	91.0
UCR	1978-9	676	1,186	175.4
	1993-4	2,501	3,132	125.2
	1994-5	2,757	3,084	111.9
	1995-6	2,863	3,342	116.7
UCSB	1978-9	1,098	2,168	197.4
	1993-4	5,932	6,822	115.0
	1994-5	6,239	7,151	114.6
	1995-6	6,905	7,553	109.4
UCSC	1978-9	506	1,338	264.4
	1993-4	2,382	3,878	162.8
	1994-5	2,548	3,896	152.9
	1995-6	2,711	3,594	132.6

UCSD	1978-9	7,502	3,981	53.1
	1993-4	28,385	24,077	84.8
	1994-5	29,932	23,681	79.1
	1995-6	29,720	26,748	89.7
UCSF	1978-9	6,112	2,100	34.4
	1993-4	26,550	22,085	83.2
	1994-5	27,445	21,492	78.3
	1995-6	27,697	24,540	88.6

*1) Gross Indirect Cost Recovery less Garamendi (construction loan payments), Neuropsychiatric Institute funding, and State General Fund Contributions. These distributions account for approximately half of the gross indirect costs recovered. In 1995-6 the campuses with Garamendi receipts were: UCB, UCD, UCI, UCSB, UCSD, and UCSF. Neuropsychiatric Institute funding occurs at UCLA and UCSF.*

*2) The \$ returned to campuses is the sum of off-the-top and opportunity fund allocations made to the campus by the UCOP, but does not include Garamendi and Neuropsychiatric Institute funding.*

*3) This % represents the ratio of the combined off-the-top and opportunity funds relative to the modified (see footnote 1) campus-generated Indirect Costs recovered.*

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### **How Do Campuses Distribute Indirect Cost Revenue?**

Chancellors have essentially two ways they can distribute the off-the-top and opportunity funds returned to them:

- (1) They can be used to fund (adequately or partially) those elements of infrastructure that were part of the real costs for conducting research, and from which the indirect cost rates were derived.
- (2) They can be used for "opportunities" to advance certain activities on the campus, whether related to research or not.

Indirect costs can be used to either directly support administration and facilities for faculty who are responsible for obtaining funding for sponsored research activities or in ways that benefit other parts of the campus as well, or instead. Arguments can be made for both approaches for distributing indirect cost recovery funds and a blend of the two is usual on each campus. For example, an obvious argument supporting reimbursement of units contributing to indirect

cost recovery is that these costs have been negotiated on the basis of supporting facilities and administration as discussed above. In the case of federal funding the use of direct costs for such purposes is not permitted. There are real costs that must be met from some source to fund administration of research at the college, school, departmental, division or unit level to service those units responsible for obtaining extramural funds. Further, such things as libraries, new laboratory construction, maintenance of existing facilities, central research administration, and the other elements contributing to indirect cost rate calculations should be supported by these funds. An argument supporting the second ("opportunity") approach is that Chancellors may have few other pools of flexible funds to meet non-research needs.

In UCORP's opinion (supported by the systemwide survey referred to above), most faculty objections to campus policies and practices for distributing these monies result from the deterioration in departmental support for academic units with successful grant programs. It is a widely held opinion that this infrastructure has deteriorated in recent years, especially cutbacks in staff support that are overhead-related. Faculty concerns are usually voiced in a local context, e.g., lack of adequate school and/or departmental staff assistance, lack of suitable space, lack of maintenance of laboratories, or inadequate maintenance of equipment and facilities. Because there may be no direct payback to departments in response to successful grant applications, the generation of extramural funds often results in inadequate infrastructure support for research that is funded. We believe that every effort must be made to provide this infrastructure support for investigators who are conducting research, writing grant and contract applications, and contributing strongly to fulfilling the research mission of the University. In the current climate of severely restricted state funding the need for adequate support of the infrastructure for which indirect costs are recovered should be top priority.

UCORP believes that it is important for the appropriate Divisional Senate committees to become as fully informed as possible about the methods used by each Chancellor and campus administration to decide the use of these funds, and we encourage both faculty and administration to work together to understand fully the issues and problems that are faced in difficult budgetary times. The Senate has an advisory role on budgets, and only a well-informed Senate can provide meaningful advice on campus distribution of overhead funds, down to the level of the generating unit. The faculty must in the process learn more about other pressing campus needs that might be addressed by these funds, and about the full context of making difficult funding decisions, whether we agree or disagree with the decisions that are ultimately made.



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## Definition of Terms and Abbreviations:

**Direct Costs** are those charges that can clearly be identified with the specific research project.

**Indirect costs** and **overhead** are synonymous terms.

**Indirect cost rate** is the percentage of the **modified direct cost** that is used to determine the indirect costs for a given proposal. Modification of the direct cost involves subtraction of such items as equipment, that are not subject to indirect costs.

**Garamendi** costs are those associated with repayment of loans funded under Garamendi legislation. Only specified buildings approved for this funding are involved, and the amounts vary considerably campus to campus. Garamendi cost payments may be regarded as a special kind of "off the top" funding, as is the funding specified for the Neuropsychiatric Institute; these amounts are not subject to the **state general fund contribution**, and both are subtracted from the gross indirect cost recovery to determine the base figure for application of the 19.9% calculation described next.

**Off-the-top** refers to recovered overhead funds that are not subject to the contribution to the state general fund. These include Garamendi costs and funding for the Neuropsychiatric Institute as described above, plus 19.9% of the remainder after these two items are accommodated. The proportion of Off-the-top funds that is returned to campuses is distinguished for accounting purposes, and is intended to reimburse costs associated with federally funded research activities.

**State General Fund Contribution:** By agreement with the State of California, 55% of the balance of indirect cost recovery, after subtracting all off-the-top funds, is reported to the state. See the text above for further explanation.

**Opportunity Funds:** This term is used to denote the remaining indirect cost funds after subtracting off-the-top and state general fund contributions. The total Opportunity funding is approximately 1.5 times the off-the-top funding. There are essentially no constraints on how these funds may be used by the Chancellor on each campus.

**OMB A-21**: This document, often-revised, is the direction provided by the Federal Office of Management and Budget for the designation of direct and indirect costs. It defines allowable direct and indirect costs, specifies accounting procedures, and must be followed by all universities that accept federal grant and contract funding.