The “Ins” and “Outs” of F&A: The Basics

February 23, 2004
Overview

- Definition of F&A Costs
- The F&A Formula
- F&A Terminology
- Steps in Developing the Rate
- The Value of F&A Collections
- Questions
What are F&A costs?

• There are two kinds of F&A Costs:
  – Facilities Costs
  – Administrative Costs

• Annual Facilities and Administrative costs are aggregated and known as “Pool” costs. They are the numerator in the F&A formula.
The “Ins”: Facilities Costs

- Facilities costs- Relate to the space in which the awards take place.
  - Cost to Construct Building
  - Cost to operate building (ex- heat, power, custodial, repair, etc.)
  - Interest expense
  - Library
  - Equipment
  - Campus Infrastructure
The “Ins”: Administrative Costs

- Administrative costs- Include the expenses associated with the overall administration on campus as well as the costs of administering sponsored projects.
  - President’s Office
  - Legal
  - Human Resources
  - Sponsored Programs
  - Pre-award and Post-award Staff
  - Department Administrators
  - Financial Officers
  - Clerical and Support Staff
  - Data Management Professionals
  - Faculty Allowance
What does the F&A formula look like?

- F&A Research Rate =
  \[
  \frac{1 \text{ Yr of Facilities + Admin costs in support of research (Pools)}}{1 \text{ Yr of spending on all awards classified as research (Base)}}
  \]

- Even though the rate is based on a given year’s spending (known as the “base year”), it is often used for multiple years.
- The bigger the research base, the harder it is to move the research rate.
The F&A Formula

• Example:

Fac Costs ($50 mil) + Admin Costs ($60 mil) = Ttl Pool Costs ($110 mil)
Total spending on Research Awards ($240 mil)

Submitted F&A Rate = 45.8% or 45.8 points

$150 million of the $240 million in research spending is federal.

One point on the rate, applied to the federal awards of $150 million, is worth about $1.5 million to the university per year.
F&A Terminology

- **Sponsored Research**- Includes University research activities which are:
  - Organized and have established work programs and protocols
  - Separately budgeted and accounted for
  - Usually require unused monies to be returned to sponsors
  - Contain requirements for reporting
  - Awarded competitively
  - Sponsored by a third party

- **University Research**- Funded from internal resources. The monies are competed for by a formal plan of submission to a body of faculty. This body of faculty then award the dollars through a competitive process.
F&A Terminology

- **Instruction** - Teaching and training activities of an institution. Can be offered on a credit or a non-credit basis.
- **Departmental Research** - Research that is not separately budgeted for, absent of formal protocols, and without reporting requirements. Includes start up funds.
- **Other Sponsored Activities** - Projects that benefit the community at large such as community service, database construction, data collection, data dissemination, and education of the community on areas of public interest.
- **Other Institutional Activities** - Includes the operation of housing, residence halls, hospitals, clinics, patient care, student unions, intercollegiate athletics, bookstores, faculty housing, student apartments, guest houses, hotels, inns, conference centers, chapels, theaters, public museums, unallowable costs, practice plan activities, student clubs, and other miscellaneous activities.
F&A Terminology

- **Direct Costs** - Costs which can be identified with a specific project or that can be directly assigned to a specific activity. Examples: principal investigator salaries and lab supplies.

- **Modified Total Direct Costs** - All costs charged to a project with certain exceptions as set forth in OMB Circular A-21. These exceptions include but are not limited to capital expenditures, rent charged directly to awards, and subcontracts in excess of $25,000.

- **Indirect Costs (F&A Costs)** - Costs to the institution which are incurred for common or joint objectives and therefore cannot be readily identified with a particular sponsored project or activity.

- **On Campus** - Awards which occur in facilities owned by the institution and to which rent is charged directly to an award.

- **Off Campus** - Awards which take place in facilities rented by the institution. Also include programs which take place in donated or rent free space.
Steps in Developing the Rate(s)

1. Develop the Direct Cost Base
   • Determine how many rates are needed
     • Instruction/Training Rate
     • Research Rate
     • Other Sponsored Activities Rate
     • Off-campus rates for each of the above 3 rates
   • Define the research base (“Scrub the base”)
     • At many institutions, accounts classified as research in the F&A proposal may be different from accounts classified as research in the financial statements.
   • Quantify the value of cost sharing- 3 different types
     • Mandatory
     • Voluntary Committed
     • Salary in excess of the NIH cap
     • Note: OMB Circular A-21 does not require Voluntary Uncommitted cost sharing to be included in the direct cost base.
Steps in Developing the Rate(s)

2. Space

- Space drives the allocation for the facilities costs (not the admin costs).
- Facilities costs are not capped like the administrative costs. This makes space the most important individual component of the rate.
- Government spends the predominance of its review time on examining space.
- Two Space Survey Methods
  - Salaries and Wages
  - Functional Use Space Survey
Steps in Developing the Rate(s)

3. Production of Annual Financial Statements

- Proposal must be reconciled to the financial statements.
- Audit adjustments must be included.
- Identify and remove inappropriate cost.
  - Unallowables: Draw a share of University Overhead
  - Exclusions: Costs draw no overhead Allocation
The “Outs”: Unallowable Costs

- Service and Recharge Centers
- Fines and Penalties
- Alumni Activities
- Convocation Expenses
- Advertising and Public Relations
- Costs of Internal Publications such as Newspapers
- Promotional Items
- Costs of the Office of Public Affairs
- Lobbying Costs
- Civic and Social Memberships
- Alcoholic Beverages
- Personal Living Expenses for President or Faculty

- Patent or Copyright Costs
- Entertainment
- Costs of Defending Litigation
- Malpractice Insurance
- Fundraising / Development / Institutional Advancement Office Expenses
- Investment Advice
- Selling or Marketing Costs
- Departmental Parties
The “Outs”: Exclusions

- Costs of Capital Equipment > Capital Threshold
- Spending on Sub-Contracts > $25,000
- Tuition Remission
- Costs of Goods Sold
- Scholarships and Fellowships
- Patient Care
- Rental of Off-Campus Facilities Charged Directly to Grants
- Utilities Paid Directly by Grants
- Losses on Disposition of Equipment
- Bad Debt Provision on Actual Expenses
- Costs Representing Audit Adjustments from the Previous year
- Federal Portion of Federal Work Study
Steps in Developing the Rate(s)

4. Developing the F&A Pools
   • Facilities Costs
     • Operations & Maintenance
     • Interest Expense
     • Building Depreciation
     • Land Improvements
     • Equipment Depreciation
     • Library
   • Administrative Costs
     • General Administration
     • Department Administration
     • Sponsored Projects Administration
     • Student Services Administration (Some)
Steps in Developing the Rate(s)

5. Allocating Costs

• Once facilities and administrative costs have been quantified, the next step is to allocate them.

• End result is to allocate all costs to the four major functions of the institution:
  • Instruction
  • Research
  • Other Sponsored Activities
  • Other Institutional Activities
Allocation of Facilities Costs: By Space

• Salaries and Wages Method v. Space Study Method (Functional Use)

  – The S&W method is not the optimal method

  – Example:
    • Professor X’s salary is charged 50% to research and 50% to Instruction
    • The Professor has two work spaces- 300 sq ft classroom and 200 sq ft lab
    • When in the lab he uses it 90% for research
    • S&W Method= 50% of lab allocated to research * 200 sq ft in the lab which totals to 100 sq ft to research
    • Space Study= 90% of lab allocated to research * 200 sq ft in the lab which totals to 180 sq ft to research

  – This creates large differences in the recovery of costs in facilities used for research
Allocation of Facilities Costs: By Space

• Building Depreciation Costs
  – The ratable amount of depreciation of campus buildings
  – Useful lives vary- many schools use useful lives from 40-50 years
  – Any federal contributions received to construct the building must be subtracted before calculating depreciation
  – Costs allocated to the activities in each building based upon the square footage the function occupies within the building
    • Ex- If a space survey shows that 50% of the building’s sq ft are used for research, 50% of the building’s depreciation costs will be allocated to research.
Allocation of Facilities Costs: By Space

- Equipment Depreciation
  - Ratable amount of depreciation is spread over estimated useful life of a piece of equipment
  - Any Federally Funded pieces of equipment must be subtracted before calculating depreciation
  - Costs can be allocated by:
    - Total Campus Square Footage
    - Individual Building Square Footage
    - Departmental Square Footage
    - Room by Room Basis
  - Best results come when the room by room allocation method is used, but in order to do this, each piece of equipment must be assigned to a room number.
Allocation of Facilities Costs: By Space

- Interest
  - Costs of debt associated with buildings which house research and administrative activities
  - Identify interest expense to each bond
  - Identify bond expense to each building
  - Interest costs are allocated based on the percentage of activities housed in that building
Allocation of Facilities Costs: By Space

- Operations and Maintenance
  - Consists of all types of costs related to utilities, janitorial services, non-capital repairs and maintenance, engineers, architects, and grounds maintenance.
  - May allocate based on campus wide square footage or building by building statistics.
  - Best recovery results are when costs can be identified to individual buildings.
  - Recovery can be enhanced through individual metering.
Allocation of Facilities Costs

• Library
  – Expenses of operating the library(ies) including current year acquisitions or depreciation of books and periodicals, and library staff.
  – Divides costs between students and faculty based on full-time equivalents.
  – For costs allocated to faculty, costs are assigned to A-21 functions based on how the S&W of faculty members are charged.
  – Example: If 30% of all FTE’s are faculty members and 70% are students, and 15% of all faculty members salaries are charged to research accounts then the percentage of library costs to research would be 4.5% (30%*15%).
  – Improvements in allocations can sometimes be achieved by allocating general libraries and medical school libraries to different user bases.
Allocation of Administrative Costs

• The government imposed limitations on the amount they will pay for administrative costs.

• Limit: 26% of the research base. This is known as the administrative cap.

• Administrative costs in excess of this amount must be borne solely by the University.

• Institutions are appealing to the government to lift the cap due to continuing increases in regulations and cost of research compliance. This appeal is under review.
Allocation of Administrative Costs

• General Administration
  – Costs such as HR, president’s office, legal, purchasing, and central admin costs which benefit the university.
  – Costs are allocated across the institution based on the spending in the four major institution functions.

• Sponsored Project Administration
  – Costs of the offices of pre and post award, VP of research, IACUC, intellectual property, institutional review boards, and other costs incurred in support of sponsored programs.
  – Costs allocated across the spending of all sponsored programs.
Allocation of Administrative Costs

- **Departmental Administration**
  - Costs associated with operating individual departments including a portion of secretarial and clerical costs, operating supplies, dean’s offices, business officers, and the 3.6% faculty allowance.
  - Need complete payroll file with wages related to the fiscal year.
  - Costs are calculated for each department.
  - Allocated to the functions of the department based on the MTDC spending of that department in the four major functions of the institution.
  - Example:
    - If 30% of a department’s expenses are research, then 30% of the department administration will be allocated to the research function.
Example Allocation

Allowable Facilities Related Indirect Costs $150M

Allowable Administrative Indirect Costs $50M

Organized Research $100M Direct

Instruction $200M Direct

Other Sponsored Activities $10M Direct

Other Institutional Activities $90M Direct

$50M

$122M

$3M

$25M
Example Allocation Continued

- Allowable Facilities Related Indirect Costs $150M
- Allowable Administrative Indirect Costs $50M
- Organized Research $100M Direct

  $50M

  = 50% Indirect Cost Rate

  space allocations 20% to research

  MTDC allocations 40% to research
Steps in Developing the Rate(s)

6. Proposal Documentation

- Document the F&A submission and present a defensible proposal.
- Comply with the government format requirements.
- Revise submissions and respond to government requests on time.
7. Negotiations

- DHHS will submit written questions to the institution after the initial proposal submission, but before the campus visitation.
- DHHS has 6 months to review the proposal, make campus visitation, and negotiate rates.
- DHHS campus visits last up to five days.
- Department Visitations- The Federal government will spend a considerable amount of time reviewing space. This will necessitate that they visit with departmental representatives and “walk” the space.
- Expect no more than a three year, fixed rate.
- Rate increases during any one negotiation are 1-2 points.
Do universities recover all the costs they spend in support of research?

• No. Universities pay a significant portion of the costs of research and never receive reimbursement.

  – Some types of programs are restricted in the amount of F&A Paid (ex- Training Grants)
  – Cost Sharing
  – Negotiation of the proposed F&A rate with the government
  – Administrative Cap
The Value of F&A Collections

• Recovery of some of the costs expended in the support of the research mission.

• State’s are facing budget cuts and other revenue sources are becoming more critical.

• The economy has been draining resources for all schools- public and private.
Questions?

Contact:
Carrie Sudds
csudds@huronconsultinggroup.com
312-583-8765
Questions?