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Universities and Sponsored Research: Indirect Cost Recovery and the Law of Diminishing Return

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Two recent reports, one from the Government Accountability Office (GAO) of the US government¹ and an editorial in the Proceedings of the National Academy of Sciences by Ronald J. Daniels, president of Johns Hopkins University,² underscore another major issue facing research universities. This issue concerns the recovery of indirect costs (IDC), or facilities and administration (F&A) costs, which sustain biomedical research in major research institutions. Because schools of medicine (SOM)—and other health science–related schools—are pivotal players in garnering research funds, SOM are caught between respective parent universities’ priorities, faculty who invariably will have lapses in (direct cost) research funding in this environment, and a “new normal” among federal agencies which traditionally could be counted on for IDC support.

Traditionally, SOM have received the bulk of direct and indirect dollars from the National Institutes of Health (NIH). In this financial climate, however, SOM—whether public or private—are facing simultaneous downward economic pressures from long-standing, traditional revenue streams. Dollars derived from clinical revenues at partner teaching hospitals, tuition costs for education, as well as direct costs for sponsored research can no longer be counted on to sustain the cost of doing research or supplement universities for other non-SOM-related missions. In the case of public universities, many states are sharply reducing financial support. This leaves SOM at major universities scrambling to seek additional funds, for example, by canvassing for donors so that endowments can generate higher interest income to make up for other financial shortfalls. While some SOM have been more successful in building their endowments, others have not. Most parent universities—seeking general revenues for necessary non-SOM academic functions—used to look to SOM for general funds derived from IDC recovery and for good reason. As an example, at the close of the fiscal year at Emory University (August 31, 2014), 93% of all university-sponsored research support was derived from the schools of the health sciences and nearly 67% of the health sciences–sponsored research was awarded to Emory University School of Medicine faculty (data from Woodruff Health Sciences Center of Emory University). I am not suggesting Emory or any other university redirect IDC from the health sciences, but because most stakeholders—including faculty and the NIH—are not exactly aware of how
most F&A dollars flow, clear accounting practices available for review might help universities and SOM go a long way in making their case.

The case that universities are making was detailed by Daniels of Hopkins. He contends the cost of sponsoring research in the United States is far outpacing the shared financial responsibility between the NIH and sponsoring institutions on which the nation’s biomedical research platform was initially established. He asserts that universities are paying more than their fair share. Is he correct? There are two financial components to F&A: a facilities component and an administrative component. The administrative component was set as a fixed rate of 26% for administrative reimbursement back in the 1990s. The facilities component is not fixed but is a negotiated rate between an individual university and the Department of Health and Human Services every 2 years. Because total direct costs awarded are ebbing downward, it would follow that there is also an overall decline in F&A to universities. However, university officials contend that even if direct funding were keeping pace with the rate of inflation, indirect costs are not keeping pace and are still falling behind. Many sponsored federal and nonfederal awards for junior faculty and postdoctoral research training have little, if any, F&A costs associated with them. Anyone who conducts research recognizes that administrative compliance with institutional review boards, animal care and use committees, etc. is very cumbersome. To accommodate the increasing regulatory burden, universities have hired additional administrators with specialized training and expertise to assure compliance with federal and state oversight. Finally, the rising cost of fringe benefits and gap funding for tenured faculty, who invariably in this environment will have lapses in extramural support, along with establishing and maintain state-of-the-art core facilities are also adding to research institutions’ F&A concerns. Data from the National Science Foundation further support universities’ concerns that their costs for sponsoring research on campus have significantly risen from 8.7% in 1962 to 19.4% in 2012.

The GAO report released in 2013 was requested by Jeff Sessions, R-AL, then the ranking member of the US Senate Budget Committee. The analysis was designed to specifically address the potential changes in reimbursement by the NIH to universities for IDCs, the key factors affecting NIH reimbursements to universities for such costs, and whether IDCs were having a negative impact on direct costs associated with the NIH’s extramural research mission. The GAO recommended that “the NIH Director should assess the impact of growth in indirect costs on its research mission … planning for how to deal with potential future increases in indirect costs that could limit the amount of funding available for direct costs of research projects.”

The GAO’s report “Biomedical Research: NIH Should Assess the Impact on Its Mission of Growth in Indirect Costs” was refuted by the NIH. The NIH disagreed with a key statement of the report: “According to … available data, indirect costs as a proportion of the NIH budget have remained below thirty percent over the past 25 years” and, “from FY 2002 through FY 2012”—the period for which the GAO conducted its independent study—“indirect costs remained at approximately 27%.” The NIH indicates that larger grant awards drove a proportionate, and not a disproportionate, increase in IDC expenses (a 28.1% increase for F&A over this period compared to 27% in direct costs). The NIH’s statements
would seem to support university presidents and deans that F&A have not kept pace with inflation.

These findings suggest that administrative costs associated with sponsored research are not sustainable. However, universities made a contract with society through the federal government. By pursuing federal contracts, universities are financial stakeholders of public resources, making sponsored research a shared responsibility. Financial transparency, not just with trustees but also with faculty and society at large, would go a long way toward convincing many that a financial “bailout” may be needed for research sustainability. Arguably, administrative costs should be more flexible and at the very least could be increased from the current rate. However, universities should examine more critically how they account for facility fees which are negotiable. Given the shrinking research workforce, it may no longer be prudent to pass on to taxpayers the cost of libraries and interest on debts incurred from building construction—costs associated with the facility fees. As universities become leaner and adopt fiscal restraint, they will need to revisit non–health science faculty policies as well as the economics of general operations. Universities should reveal to the government (federal and states), their faculty, and the American public a clear assessment of how IDCs are spent and apportioned within research-intensive universities. Finally, universities should be more forthcoming about how their endowments are structured because most people are not aware that the vast majority of endowed funds are restricted by donors. Because a major goal of a university is to generate knowledge, is it reasonable for universities to continue to pursue donations that are restricted when public funding of sponsored research is in a prolonged period of deflationary growth? A recent quote from a related article in the New York Times succinctly sums up the quandary with restricted philanthropy: “For better or worse, the practice of science in the 21st century is becoming shaped less by national priorities or by peer-review groups and more by the particular preferences of individuals with huge amounts of money.”

Finally, major universities should reexamine the cost of their own administrative structures and associated perks. While some may argue these costs are unlikely to provide additional funds directed at administrating research, these measures would go a long way toward stemming the silent crisis of morale among faculty and students, who are also research stakeholders in a very uncertain future.

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Abbreviations

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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>F&amp;A</td>
<td>facilities and administration</td>
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<td>GAO</td>
<td>Government Accountability Office</td>
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<td>IDC</td>
<td>indirect cost</td>
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