

COUNCIL ON GOVERNMENTAL RELATIONS

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MANAGING THE DEPARTMENT OF DEFENSE 35-PERCENT INDIRECT COST (F&A) LIMITATION (CAP)

UPDATED: December 19, 2007

Below is guidance that COGR is providing to assist institutions with management issues related to the Department of Defense (DoD) indirect cost (i.e., facilities and administrative, F&A) limitation (cap). ***This guidance supersedes the guidance provided by COGR on December 6th.*** As appropriate, COGR will provide additional updates.

A. Official DoD Internal Guidance.

The COGR guidance is intended to expand on official DoD guidance issued to DoD personnel, which was released in early December. The DoD guidance can be found at:

http://www.dod.mil/ddre/doc/LABS_Memo_indirect_cost_limitation.pdf

B. FY2008 Department of Defense (DoD) Appropriations Bill, Section 8115.

“Notwithstanding any other provision of law, none of the funds made available in this Act may be used to pay negotiated indirect cost rates on a contract, grant, or cooperative agreement (or similar arrangement) entered into by the Department of Defense and an entity in excess of 35 percent of the total cost of the contract, grant, or agreement (or similar arrangement): Provided, that this limitation shall apply only to contracts, grants, or cooperative agreements entered into after the date of the enactment of this Act using funds made available in this Act for fiscal year 2008 for basic research.”

The bill was signed by the President on November 13, 2007, and is now law.

C. The Math of the Cap.

Institutions that have a negotiated F&A rate of 53.8 percent, or less, will be financially unaffected (i.e., F&A can not exceed 35 cents for every \$1 expended; therefore a ratio of 35 cents of F&A to 65 cents of direct costs is the conversion ratio to the “standard” F&A rate based on modified total direct costs. In situations where all direct costs on an award are F&A eligible, 53.8 percent is effectively the F&A rate cap).

Institutions with F&A rates greater than 53.8 percent will be affected on a award-by-award basis, depending on the composition of direct costs that are F&A eligible (e.g., salaries, supplies), versus F&A non-eligible (e.g., equipment, tuition remission, subawards > 25,000).

D. What DoD awards are affected? (TECHNICAL EXPLANATION)

- ✓ The DoD cap applies to contracts, grants, or cooperative agreements (or similar arrangements) entered into after enactment of the Act (i.e., awards made on or after November 14, 2007).
- ✓ Awards received between November 14 (the date the cap became effective) and December 1 (the date stamped on the DoD internal memo) may have to be amended to account for the cap. If your institution received an award in this time period, you should be aware of this.
- ✓ The DoD cap is applicable to FY08 appropriated funds that meet the criteria included in this document. The cap will be applicable to FY09 funds only if the same cap language is included in the FY09 DoD Appropriations Bill.
- ✓ Award renewals are not affected by the cap. For example, an award continuation made from FY08 DoD funds is not subject to the cap.
- ✓ Awards to Subrecipients (“subordinate instruments” per the DoD internal memo) are not affected by the cap. While this creates an inconsistency as to how the prime recipient and the subrecipient are treated, the DoD internal memo is clear in its directions.
- ✓ Some institutions have a DoD contract waiver as part of their F&A rate agreement that allows the institution to charge the uncapped administrative portion of their F&A rate on selected DoD contracts. In these situations, the same analysis and management of the 35 percent cap is applicable.
- ✓ The DoD cap is applicable to “basic research” that is funded from the DoD Research, Development, Test and Evaluation appropriation. This is known to many as “6.1 funds”. Awards made for “applied research” and “development” (“6.2 funds” and “6.3 funds”, respectively) are not affected.
- ✓ Congressionally Directed Medical Research Programs (CDMRP) encompass breast, prostate, and ovarian cancers, neurofibromatosis, military health, and other specified medical research areas. A small portion of CDMRP is funded from the Research, Development, Test and Evaluation appropriation, and is subject to the cap. The majority of CDMRP is funded from the DoD Operations and Maintenance appropriation, and is not subject to the cap.
- ✓ “Earmarks” that fund basic research can be funded from either the Research, Development, Test and Evaluation appropriation or the DoD Operations and Maintenance appropriation. If funded by the Research, Development, Test and Evaluation appropriation, then the earmark is subject to the cap.

E. What DoD awards are affected? (PRACTICAL ADVICE)

While the technical analysis may be relatively clear, in practice, the funding source / appropriation used for a DoD award normally is transparent to the recipient. Therefore, upon receipt of a DoD award the most important exercise is to carefully review the terms and conditions of the award. If the award is subject to the cap, it should be articulated in the terms and conditions.

F. Implementation Issues for those Institutions Affected by the Cap.

- ✓ In the application stage, institutions should use their negotiated F&A rate when developing the budget proposal. If the budget proposal includes proposed costs that exceed the cap, see the next two bullet points below.
- ✓ Upon award, the awarding agency may inform the institution that the cap has been exceeded in the budget proposal. In these situations, the institution will need to adjust the budget proposal, accordingly.
- ✓ Upon award, the awarding agency may not indicate that the budget proposal should be adjusted. The institution still will be responsible for managing the cap. Subsequently, the institution may rebudget F&A costs in excess of the cap to an allowable direct cost category.
- ✓ To date, awards have been issued with the cap language included as a term or condition of the award. We recommend that you carefully review DoD award notices to confirm any terms or conditions associated with the cap.
- ✓ DoD has not issued guidance on billing procedures. Some institutions have contemplated a billing approach that could result in the cap being initially exceeded, but periodically adjusted in subsequent billings so that (in net) the cap is not exceeded. Institutions will need to weigh the potential audit risk if they are considering this approach.
- ✓ DoD should be contacted in all situations where there is uncertainty. COGR can assist in facilitating, when appropriate.

G. Next Steps.

While a majority of institutions are not financially affected by the DoD cap, we encourage everyone to stay focused on this issue. The DoD cap was legislated without any congressional hearings or evidence of unjustified F&A reimbursements. F&A caps are arbitrary, and threaten a fundamental principle in the government-university partnership: namely, the shared responsibility to provide for the critical research infrastructure necessary to maintain our scientific leadership in the world. The FY09 DoD Appropriations Bill will begin to be discussed as early as Spring 2008, and at that point in time, we will look for opportunities to revisit this discussion.



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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MEMORANDUM FOR SECRETARY OF THE ARMY
(ATTN: DEPUTY ASSISTANT SECRETARY OF THE
ARMY (PROCUREMENT))
SECRETARY OF THE NAVY
(ATTN: CHIEF OF NAVAL RESEARCH)
(ATTN: DEPUTY ASSISTANT SECRETARY OF THE
NAVY (ACQUISITION & LOGISTICS MANAGEMENT))
SECRETARY OF THE AIR FORCE
(ATTN: DEPUTY ASSISTANT SECRETARY OF THE AIR
FORCE (CONTRACTING))
DIRECTOR, DEFENSE ADVANCED RESEARCH
PROJECTS AGENCY
ASSISTANT TO THE SECRETARY OF DEFENSE FOR
NUCLEAR & CHEMICAL & BIOLOGICAL DEFENSE
PROGRAMS
DIRECTOR, DEFENSE THREAT REDUCTION AGENCY
DIRECTOR, WASHINGTON HEADQUARTERS SERVICES

SUBJECT: Indirect Cost Limitation for Basic Research Awards

Please expeditiously issue direction to all offices or laboratories within your Military Department or Defense Agency that may obligate or transfer for obligation Basic Research appropriations, to require compliance with the requirements of Section 8115 of the DoD Appropriations Act, 2008. Section 8115 reads:

SEC. 8115. Notwithstanding any other provision of law, none of the funds made available in this Act may be used to pay negotiated indirect cost rates on a contract, grant, or cooperative agreement (or similar arrangement) entered into by the Department of Defense and an entity in excess of 35 percent of the total cost of the contract, grant, or agreement (or similar arrangement): Provided, That this limitation shall apply only to contracts, grants, or cooperative agreements entered into after the date of the enactment of this Act using funds made available in this Act for fiscal year 2008 for basic research.



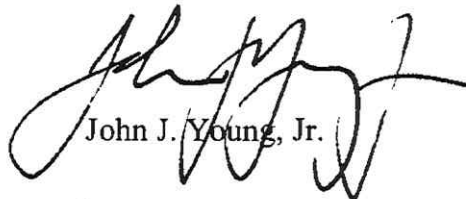
For the purposes of implementing Section 8115:

- Basic Research means funds in programs within Budget Activity 1 of the Research, Development, Test and Evaluation appropriation.
- The restriction on payment of indirect costs applies to all FY 2008 Basic Research appropriations obligated by any award – i.e., procurement contract, grant, cooperative agreement, or any other obligational arrangement – to a non-Federal entity, or awardee.
- The limitation on payment of indirect costs applies to an award entered into at the prime level only and does not flow down to subordinate instruments.
- For the restriction on payment of indirect cost as a percentage of total cost, “total cost” has the meaning given in the Government-wide cost principles that apply to the particular awardee (2 CFR part 220, 225, or 230, or 48 CFR part 31). “Indirect costs” are all costs of a prime award that are Facilities and Administration costs (for awardees subject to the cost principles in 2 CFR part 220) or indirect costs (for awardees subject to the cost principles in 2 CFR part 225 or 230 or 48 CFR part 31).

Please issue direction immediately to affected program and awarding offices to include a:

- Term or condition requiring compliance with Section 8115 in each new award made on or after November 14, 2007, using Basic Research funds made available by the DoD Appropriations Act for FY 2008. Section 8115 does not apply to obligations of FY 2008 funds for awards made before that date.
- Statement requiring compliance with Section 8115 in any document transferring FY 2008 Basic Research funds to another Federal agency for obligation to a non-Federal entity. The statement must require the other agency to include a term or condition, as described in the preceding paragraph, in each new award it makes using those funds.

My points of contact are Dr. Mark Herbst at 703-588-1377, mark.herbst@osd.mil, for grants or cooperative agreements and Mr. Bill Sain at 703-602-0293, bill.sain@osd.mil, for procurement contracts.



John J. Young, Jr.