Memo

Wayne State University Law School

To: Budget Committee

From: Michael J. McIntyre, Chair

Subject: Proposed Changes in ICR Distribution Formula

Date: September 22, 2003

The Research Division has proposed a major change in the distribution of indirect cost recovery (ICR) funds, now called Facilities and Administration (F&A) funds. These funds are received from the Federal government and other institutions to pay for the indirect costs of funded research. The Research Division has prepared an unsigned and undated report that seeks to justify the changes it is proposing in the distribution of those funds. The document is unimpressive, to say the least. Although it includes much useful information, it fails to provide a sound justification for its key recommendations.

Recommendations of the Research Division

One of the key recommendations of the Research Division's report is to divert three percent (3%) of the total ICR funds to the operating budget of the Research Division. No justification is offered for this diversion other than an assertion that the Research Division wishes to avoid the impact of the budget cuts that have affected all other divisions and all of the schools and colleges in the University. The report does not specify the amounts of the budget cuts that were imposed on it or the amount of revenue it anticipates receiving from the three-percent diversion. I estimate the dollar amount of the diversion at $1.2 million for FY 2004. This proposal has no apparent relationship to the problem of poorly maintained research facilities.

The other key recommendation of the report is to establish a facilities fund to finance the repair and renovation of laboratories and other research facilities throughout the University. The claim is made that many of the University's research facilities used to generate research grants have not been properly maintained and upgraded over the years. To finance the proposed repairs and renovations, the University would take out loans of around $40 million and use the diverted ICR money, estimated at $2.73 million for FY 2004, to pay the debt service on those loans. Additional loans would be taken out in later years. The diverted ICR funds would represent seven percent (7%) of total ICR money. That seven percent would be placed in a special Facilities Fund.

Three basic approaches or budget models are being utilized by various research universities for the distributing of their ICR money. One approach is to distribute all of the funds to the colleges, with the colleges then assuming the responsibility for paying all of the costs of facilities and administration. Under this "every ship on its own bottom" budget model, the central administration receives funding for general overhead through a user charge imposed on all of the colleges. Another approach is for all of the ICR funds to go to the central administration, with the central administration assuming the responsibility for paying all costs of facilities and administration. The third method, employed at Wayne State and several other research universities, is for the central administration, the colleges, the departments, and the primary investigators (PIs) to share in the ICR revenues and also to share in the payment of associated costs. The effect is some decentralization of the research function at the University. A discussion of the politics leading to this experiment in decentralization during the Adamany years is outside the scope of this memo.

The table below shows the current distribution of ICR money and the changes in the distribution formula proposed by the Research Division. I calculated the percentage changes and dollar changes from information in the Research Division's report. As noted, by far the heaviest burden would be imposed on the PIs — the people who actually generate the ICR money in the first place.

Table 1
F&A (ICR) Distribution Formula, Research Division Proposal

Recipients of ICR Funds	Current	Proposed	Percentage Change	Dollar Change
PI	8.5%	5.0%	-41.2%	-$1,365,000
Department	15.0%	13.0%	-13.3%	-$780,000
College	10.0%	8.0%	-20.0%	-$780,000
Research Stimulation	10.0%	10.0%	0.0%	$0
General Fund	56.5%	54.0%	-4.4%	-$975,000
Research Division	None	3.0%		$1,170,000
Facilities Fund	None	7.0%		$2,730,000

No justification is offered in the report for the particular percentage cuts. There are two plausible grounds for reducing the amounts going to the current recipients. One ground would be that the amounts they were receiving exceeded the facilities and administration costs they were responsible for paying. This mismatch of revenues and obligation might be due to an initially flawed formula or to changes in circumstances since the formula was adopted. Needless to say, the Research Division's report provides no data showing the costs incurred for each unit or any changes in costs over time. Under this ground, the funds going to the research stimulation fund from the ICR funds would be eliminated.

Another rationale for cuts to the various units might be that some units were failing to make the appropriate expenditures for facilities in prior years, resulting in the deterioration of the research facilities. The report of the Research Division does not discuss this rationale or offer any data showing that particular recipients have been failing in their job. My general understanding, however, is that the Central Administration has been responsible for maintaining and upgrading research facilities out of its share of the ICR funds and that the colleges, departments, and PIs have been responsible primarily for administration costs and certain equipment costs. That is, it is the Central Administration, not the colleges, departments, and PIs, that has been eating the seed corn.

In addition to changing the distribution formula, the Research Division report recommends that money for the proposed Facilities Fund be obtained from putting a "cap" on the amounts distributed under the formula. Currently, the research funding agencies generally provide reimbursement of indirect costs equal to 49 percent of the direct amount of the grants. A new agreement with the Federal government has increased the recovery percentage to 51%, due to documented cost increases. The effect of the diversion of the "new" ICR funds is that all five of the current recipients of ICR funds (PIs, Departments, Colleges, Central Administration, and the Research Stimulus Fund) suffer a proportional cut in the funding that they would receive absent the cap.

In principle, the increased ICR money derived from the change in the reimbursement formula ought to go to those recipients that are expected to have an increase in their indirect costs. The Research Division's report, however, provides no information on how the additional costs are expected to be distributed. As a result, it gives no rational basis for the diversion of the new money to the proposed Facilities Fund. The apparent rationale appears to be purely political — that the diversion may not upset expectancies in ways that would generate strong opposition.

Working Towards a Short-Term Solution

Notwithstanding the many weaknesses in the report of the Research Division, there does appear to be a broad consensus, at least among the research community, that something must be done to finance the repair and refurbishing of research facilities at the University. Solving the problem is difficult and will require shared sacrifice.

There is no comparable consensus that the Research Division should be able to avoid budget cuts imposed throughout the University by diverting ICR funds to its own operating budget. Like all other divisions, and all the schools and colleges, the Research Division would like more revenues. It should not be permitted, however, to subvert the budget process by capturing revenue streams outside of the budget process. A necessary first step in promoting a spirit of shared sacrifice within the University is to take this unwarranted and unsupported recommendation off the table.

What must remain on the table is the proposal for revising the ICR redistribution formula to fund the renovation of research facilities. The information provided so far in support of a reallocation of ICR funds is inadequate to justify a reallocation. The University has apparently decided, nevertheless, to move forward with its basic bonding proposal, with the servicing on the bonds to come from a reallocation of ICR funds. It announced at the July 28, 2003, meeting of the BOG's Budget and Finance Committee, however, that the specific reallocations proposed by the Research Division were illustrative only and could be adjusted as appropriate after consultation with the faculty.

I suggest that a short-term revised plan would contain two elements. First, any revision of the current allocation formula should be for a limited period, with any long-term change made only after the Administration provides detailed information on which recipients of the ICR funds are actually bearing the indirect costs that the ICR funds are intended to finance. To guarantee that this hastily arranged temporary solution does not become permanent, the Administration should not be permitted to issue bonds for the repair and renovation of research facilities with a term in excess of five years.

Second, the reallocation of ICR funds should be based on the principle of shared sacrifice. That is, all of the current recipients of ICR funds should take a hit that is proportional to their current ICR revenues. In the long run, a reallocation should be based on the costs for facilities and administration that the current recipients of ICR funds are expected to incur. Unfortunately, that information is not currently available. In the absence of that information, the shared-sacrifice approach is the least bad option.

As noted above, the shared-sacrifice approach has already been approved by the Administration for the allocation of revenues received in excess of the 49% reimbursement cap. That is, the effect of the cap is to reduce the ICR funds going to each of the current recipients of ICR funds in proportion to their percentage share of the total ICR funds. The following table shows the change in the allocation formula that would be needed (1) to create a pool of money for renovation of research facilities equal to seven percent (7%) of total ICR funds and (2) to impose equal sacrifice on all current recipients of ICR funds.

Table 2
F&A (ICR) Distribution Formula, Equal-Sacrifice Approach

Recipients of ICR Funds	Current	Equal-Sacrifice Approach	Percentage Change	Dollar Change
PI	8.5%	7.9%	-7.0%	-$232,050
Department	15.0%	14.0%	-7.0%	-$409,500
College	10.0%	9.3%	-7.0%	-$273,000
Research Stimulation	10.0%	9.3%	-7.0%	-$273,000
General Fund	56.5%	52.5%	-7.0%	-$1,542,450
Research Division	None	None		$0
Facilities Fund	None	7.0%		$2,730,000

One problem with the reallocation indicated in Table 2 is that it requires funding from the General Fund in excess of the amounts contemplated in the FY 2004 Budget. As shown in Table 1, the proposal of the Research Division calls for a contribution of $975,000 from the General Fund, which represents a reduction in the ICR funds going into the General Fund of 4.4%. The equal-sacrifice proposal would require a contribution from the General Fund of $1,542,450, which presumably is $567,450 greater than the amount provided in the FY 2004 Budget. If the reduction in ICR funds going to the General Fund is frozen at $975,000, then the other current recipients of ICR funds would need to take a greater hit. Table 3 shows the reductions that would result under a modified equal-sacrifice approach that froze the reduction to the General Fund at $975,000 (4.4%

reduction) and imposed proportional cuts on the other recipients sufficient to generate the target amount of $2,730,000 for the Facilities Fund.

Table 3 F&A (ICR) Distribution Formula, Modified Equal-Sacrifice Approach				
Recipients of ICR Funds	Current	Modified Equal-Sacrifice Approach	Percentage Change	Dollar Change
PI	8.5%	7.65%	-10.0%	-$342,931
Department	15.0%	13.5%	-10.0%	-$605,172
College	10.0%	9.0%	-10.0%	-$403,448
Research Stimulation	10.0%	9.0%	-10.0%	-$403,448
General Fund	56.5%	54.0%	-4.4%	-$975,000
Research Division	None	None		$0
Facilities Fund	None	7.0%		$2,730,000

One reasonable short-term solution would be to adopt the distributional formula embodied in Table 3 for FY 2004. For subsequent fiscal years, the formula embodied in Table 2 would be utilized.

Long-Term Solution

A sensible long-term response to the problem of inadequate research facilities cannot be developed fully at this time because the data needed to develop that response are not currently available. Here is a list of issues I would like to see addressed by the Administration before a long-term plan is formulated:

1. The Research Division's report shows that research funding at Wayne State University has gone up dramatically over the past decade, resulting in a major improvement in the University's ranking as a research institution. That success indicates that at least some parts of the current arrangement have been beneficial to the University. I understand that there is considerable sentiment in the research community that the decentralization of spending authority over the ICR funds has been an important contributor to the past successes. If the University is contemplating a major change in the current arrangement (such as reducing by 41% the ICR funds under the control of PIs), it ought to have some idea of the likely impact of that change on the University's research effort. The report of the Research Division does not even mention the possibility of negative effects of its recommendation and obviously has done nothing to provide a basis for predicting those effects.

2. The ICR funding over the past two decades ought to have been sufficient to cover the costs of repairing and renovating the University's research facilities. Obviously the money has been spent for other purposes. Indeed, 10% of the money is taken off the top for the research stimulation fund — a fund intended to promote new research, not to pay the costs of current research. The University needs to develop a system for guaranteeing that the ICR money

goes for its intended purposes. The research stimulation fund, for example, may be a good idea and may have had some successes. But if there is a sensible rationale for funding that operation out of the ICR funds, it has not been presented in the report of the Research Division.

3. The report of the Research Division recommends that the University embark on a long-term program of ever-increasing bonding to finance the refurbishment of research facilities. Bonding, however, is not always the best way to fund University operations. It would seem to be a particularly inappropriate way to fund repairs. In addition, the level of bonding at the University has increased sharply in recent years. Any serious analysis of potential solutions to the problems of inadequate research facilities cannot take as an assumption that more and more bonding is always a good thing. The University may have reached the point where additional bonding is a decidedly bad idea. Additional bonding, coupled with a reduction in bonding for other purposes, may make sense because the interest paid on bonding targeted for research facilities apparently can be treated as a research cost, thereby increasing the pool of ICR funds.

4. According to the report of the Research Division, the amount of ICR funds is based on documented University costs, audited in the typical case by the Federal government. Yet the report does not provide any useful information on which of the various recipients of ICR funds is bearing those documented costs. I assume that the research stimulation fund is not bearing any of those costs but that the PIs, the departments, the colleges, and the Central Administration are bearing some costs. What is needed is a report showing which recipients have the responsibility for paying various costs and which recipients are meeting their responsibilities. To generate such a report, the University may need to implement some new reporting requirements for recipients of ICR funds.

5. In the short term, changes in the allocation formula for ICR funds will apply *pro rata* to all colleges, departments, and PIs under the proposal I have advanced and under the Research Division's proposal. Yet not all funded research projects require equally-expensive research facilities. Some projects require very expensive facilities and some do not. A *pro rata* rule is necessary in the short term, due to the lack of data needed to implement a more refined system. In the long term, however, a *pro rata* rule is likely to be quite inefficient. It provides researchers with an incentive to contract for research projects that do not pay their own way. It also may discourage researchers from contracting for projects that actually are cost effective. The goal should be for each research project to contribute to a Facilities Fund in proportion to the costs of its use of research facilities.

6. To prevent a repetition of the current problems, the University community has to understand what went wrong in the past. The report of the Research Division implies that the problem is the decentralization of control over ICR funds, and its proposed solution is to place a greater portion of those funds under its own control. It offers no support, however, for its diagnosis of the problem. Indeed, it would appear from a careful reading of that report that the fault may lie almost exclusively with the Central Administration, which apparently has the responsibility for maintaining the research facilities and apparently has failed to

perform. The point of understanding the cause of past failures is not to point fingers and assess blame. It is to prevent a repetition of the same problems in the future. If the problem is that the Central Administration has been unable to resist the temptation to divert to other uses the ICR funds that were supposed to be used for research facilities, then some institutional arrangements need to be established to prevent future raids by the Central Administration on those funds. Otherwise, the Central Administration may respond to the new money going into the Facilities Fund by cutting back on its already inadequate funding of facilities renovation.

Concluding Note

According to the Research Division's report, many of the University's important research facilities are in a sad state of disrepair. Unfortunately, it has not developed a sound plan for funding the repair and refurbishment of those facilities. The report states that a new source of funding is needed for that purpose, but its idea of a "new" funding source is the funding currently being provided to the colleges, departments, and PIs for administering their research projects. For over two decades, the Central Administration has sought to solve its funding problems by extracting funds from the schools and colleges — funds that are needed by those units to run their programs. The Research Division's ICR proposal fits nicely within that regrettable tradition.