



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 730.5.5.1

December 10, 2009
09-PPD-024(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Guidance on Department of Defense Indirect Cost Limitation for Basic Research Awards

SUMMARY

The Department of Defense (DoD) Appropriations Acts for 2008 and 2009 limits payments of indirect costs to 35% of the total cost of a DoD contract, grant, or cooperative agreement for "basic research." Auditors should request recipients of "basic research" awards to demonstrate their procedures for complying with this limitation. During the normal course of audits, auditors should review award briefings to verify awardees have appropriately identified the terms or conditions requiring compliance with the limitation and test for compliance during applicable audits of submissions, such as forward pricing proposals, annual incurred cost proposals, and interim and final billings. The Office of Naval Research (ONR) states that the majority of "basic research" is conducted by Educational Institutions. However, "basic research" may also be awarded to Non-profit and For-profit entities.

BACKGROUND

Section 8115 of the FY 2008 DoD Appropriations Act and Section 8109 of the FY 2009 DoD Appropriations Act places expenditure limitations as a condition of doing business with DoD for basic research. Sections 8115 and 8109 read as follows:

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 basic research.

The bill limits the amount of indirect costs the prime contractor can receive under certain DoD contracts, grants, and cooperative agreements to 35% of total cost. For the purposes of implementing the indirect cost limitation under Sections 8115 and 8109, USD(AT&L) issued guidance dated December 1, 2007 and October 28, 2008, respectively (Enclosures 2 and 3). The USD(AT&L) implementing guidance provides the following:

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- Indirect costs of a prime awardee are defined as follows:
 - **Universities**. All Facilities and Administration (F&A) costs as provided in the cost principles for educational institutions (see OMB Circular A-21/2 CFR Part 220).
 - **Non-profit Organizations**. Indirect costs are those as defined in disclosed and/or established accounting practices and as provided in the cost principles for non-profit organizations (see OMB Circular A-122/ 2 CFR Part 230) or FAR Part 31.2 for those Non-profit Organizations not subject to OMB Circular A-122 (see CFR Part 230.2(c)).
 - **For-profit Organizations**. Indirect costs are those as defined in disclosed and/or established accounting practices and as provided in the cost principles at FAR Part 31.2.
- For determining the 35% indirect cost limitation “total cost” has the meaning given in the Government-wide cost principles that apply to the particular awardee (see above).
- The indirect cost limitation applies to all awards (i.e., contract, grant or cooperative agreement) made with FY 2008 or FY 2009 appropriated funds for basic research.
 - For 2009, the limitation is effective on new awards made on or after September 30, 2008 (see Enclosure 2).
 - For 2008, the limitation is effective on new awards made on or after November 14, 2007 (see Enclosure 3).
- The indirect cost limitation applies only to the prime contractor as it does not flow down to subordinate awards.

GUIDANCE

Auditors should request recipients of “basic research” awards to demonstrate that award briefs (e.g., contract briefs) identify the subject indirect cost limitation as applicable. Also, auditors should verify that award recipients have a system in place that provides procedures to monitor charges on an award-by-award basis to ensure the 35 percent limitation is not exceeded.

Field Audit Offices should obtain from recipients (Educational Institutions, Non-Profits, For-Profits) performing research, a listing of awards (e.g., contracts, grants, and cooperative agreements) subject to the limitation. During the normal course of audits, such as forward pricing proposals, annual incurred cost proposals, and interim and final billings submitted to the Government, auditors should review award briefings to identify the term or condition containing the limitation and test for compliance. An example of the limitation terms for an award to a University follows:

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"This grant is funded with Fiscal Year 2008 basic research appropriations and is subject to the reimbursement limit on F&A costs set forth in Section 8115 of the Department of Defense Appropriations Act, 2008 (P.L 110-116). Payment of F&A costs for research with funds obligated by this action may not exceed 35% of the total costs provided under this grant action."

It is important to note that the limitation is not a cap on the awardees' indirect cost rates. Instead, the limitation restricts the amount of reimbursement for indirect costs on a contract, grant or cooperative agreement to 35% of the total cost of the award. The limitation applies to the indirect costs as recorded on the contractor's books and records as defined under the applicable regulation (e.g., FAR, OMB Circular A-21) and in accordance with its disclosed practice.

Since the statutory requirements are somewhat new, we invite you to forward any suggestions or best practices related to the implementation of this guidance to Policy and Plans Division, at (703) 767-2270 or by e-mail at DCAA-PPD@dcaa.mil.

CLOSING REMARKS

Field audit office personnel should direct questions regarding this memorandum to their regional offices. Regional offices should direct their questions to Policy and Plans Division, at (703) 767-2270 or by e-mail at DCAA-PPD@dcaa.mil.

/Signed/

Kenneth J. Saccoccia
Assistant Director
Policy and Plans

Enclosures: 3

1. Frequently Asked Questions on Basic Research Limitation
2. Memorandum from Under Secretary of Defense, dated October 28, 2008
3. Memorandum from Under Secretary of Defense, dated December 1, 2007

DISTRIBUTION: C

FREQUENTLY ASKED QUESTIONS BASIC RESEARCH LIMITATION

Question 1: How do I know an entity has awards subject to the indirect cost limitation?

Answer: Defense Procurement and Acquisition Policy (DPAP) directed program and awarding offices to include a term or condition in affected awards requiring compliance with the DoD Appropriations Acts for 2008 and 2009 (see example condition below). Field Audit Offices should obtain from recipients (Educational Institutions, Non-Profits, For-Profits) performing research, a listing of awards subject to the limitation. During the normal course of audits, auditors should review award briefings to identify the term or condition requiring compliance with the requirement.

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 basic research.

Question 2: What DoD awards are affected by the indirect cost limitation?

Answer: As provided in the terms and conditions of award, indirect cost reimbursement is limited to 35 percent of total costs under DoD contracts, grants, cooperative agreements (and similar arrangements) for basic research that are—

- New awards made after November 13, 2007 using FY 2008 funds
- New awards made after September 30, 2008 using FY 2009 funds
- Incremental funding actions made after September 30, 2008 using FY 2009 funds if the incremental funding action pertains to a new award as described in the first bullet above

Question 3: Where can I find the DoD Appropriations requirement?

Answer: See Pub. L. 110-116, Division A, Section 8115, Department of Defense Appropriations Act, 2008 and Pub. L. 110-329, Division C, Section 8109, Department of Defense Appropriations Act, 2009.

FREQUENTLY ASKED QUESTIONS BASIC RESEARCH LIMITATION

Question 4: What is “basic research” or “6.1 funds?”

Answer: “Basic research” is the study designed to expand knowledge rather than to invent or create a process or product. The DoD indirect cost limitation applies to all FY 2008 or FY 2009 “basic research” appropriations obligated by an award, i.e., procurement contracts, grants, or cooperative agreements, or other agreements/transactions entered into after enactment of the Act. These Budget Activity 1 Basic Research funds are known as “6.1 funds.” Awards made for “applied research” and “development” (“6.2 funds” and “6.3 funds,” respectively) are not affected.

Question 5: Does the indirect cost limitation apply to all “basic research” awards entered into after the date of the enactment of Sections 8115 and 8109 of the Department of Defense (DoD) Appropriations acts?

Answer: No. The limitation on payment of indirect costs applies only to awards using basic research funds made available using the DoD appropriations Act for FY 2008 or FY 2009. For example, a 2008 award using FY 2007 appropriated funds would not be subject to the limitation. Also, the limitation on payment of indirect costs applies only at the prime contractor level. It does not apply to subcontractors.

Question 6: Is the 35% basic research limitation considered an indirect rate cap?

Answer (example): No. The limitation restricts the amount of reimbursement for indirect costs on a contract, grant or cooperative agreement to 35% of the total cost of the award (i.e., indirect costs cannot exceed 35 cents for every \$1 expended) calculated, as follows:

On a \$100,000 award, \$35,000 in indirect costs is the maximum allowed per the limitation (\$100,000 x 35%).

If \$35,000 is the indirect cost, \$65,000 is the direct cost; resulting ratio is
 $\$35,000 / \$65,000 = 53.846\%$

Thus, 35% Total Costs = 53.846% of Direct Costs

In locations where all direct costs on an award are eligible for application of indirect allocations, 53.8 percent is effectively the indirect rate cap.



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE
3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

OCT 28 2008

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 organizations within your Military Department or Defense Agency that may obligate or transfer for obligation Basic Research appropriations, to comply with the requirements of section 8109 of the Department of Defense Appropriations Act, 2009 (Division C of the Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009, Public Law 110-329). Section 8109 states:

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 basic research.

For the purposes of implementing section 8109:

- Basic Research means funds in programs within Budget Activity 1 of the Research, Development, Test and Evaluation appropriation.



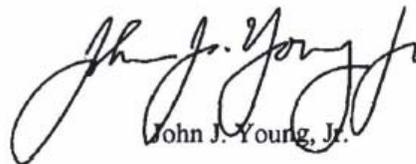
- The restriction on payment of indirect costs applies to all FY 2009 Basic Research appropriations obligated by any award (i.e., procurement contract, grant, cooperative agreement, or other obligational arrangement) to a non-Federal entity, or awardee.
- The limitation on payment of indirect costs applies 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 Federal cost principles that apply to the particular awardee (2 CFR part 220, 225, or 230, or 48 CFR part 31). "Indirect costs" are 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 to affected program and awarding offices to include a:

- Term or condition requiring compliance with section 8109: (1) in each new award entered into using FY 2009 Basic Research funds; and (2) as a matter of policy, in any modification – e.g., incremental funding action or exercise of an option – that obligates FY 2009 Basic Research funds for an award made in FY 2008, if the FY 2008 funding under the award is subject to the limitation on indirect costs in section 8115 of the Department of Defense Appropriations Act, 2008 (i.e., the award was made on or after November 14, 2007, using FY 2008 Basic Research funds).
- Statement in each document transferring FY 2009 Basic Research funds to another Federal agency for obligation to a non-Federal entity, to require the agency to include a term or condition requiring compliance with section 8109 in any new award or modification that meets the criteria in the previous paragraph.

My points of contact are Dr. Mark Herbst (703-588-1377, mark.herbst@osd.mil) for grants or cooperative agreements and Ms. Sandra Morris (703-602-0296, sandra.morris@osd.mil) for procurement contracts.



John J. Young, Jr.



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE
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DEC 01 2007

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.



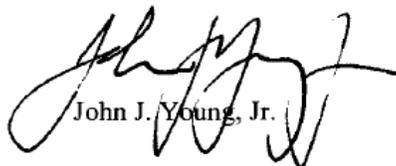
For the purposes of implementing Section 8115:

- 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.



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