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COUNCIL ON GOVERNMENTAL RELATIONS

**An Analysis of F&A Proposal Review
and Negotiation Topics from the
DCA Best Practices Manual**

-- COGR Interpretations --



December 2007

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-- COGR Interpretations --

The Council on Governmental Relations (COGR) is an association of leading research institutions. COGR's important activities include providing guidance on federal research rules and regulations, and assisting institutions to develop policies and effective practices that reflect the mutual interests of the research community (universities and research institutions, their representative associations, federal agencies, and other sponsoring entities).

The focus of the COGR Interpretations is to provide universities and research institutions with guidance specific to the "Best Practices Manual For Reviewing College and University Long-Form Facilities & Administrative Cost Rate Proposals", recently released (December 2006) by the Division of Cost Allocation (DCA), Department of Health and Human Services (DHHS). Hereafter, and for simplicity purposes, we refer to the DCA document as the "DCA Manual", or simply "the manual." (Note: the prior version utilized by the DCA was titled "Review Guide for Long-form Institutions." Most of the items addressed in the COGR Interpretations are responses to items appearing for the first time in the newest version of the DCA Manual. However, when appropriate, we have addressed items that appeared in the prior version and remain in the new version.)

The COGR Interpretations are designed to achieve the following objectives:

- 1) ***Identify specific sections of the DCA Manual that have the potential to produce a difference of interpretation between research institutions and the DCA.*** The COGR Interpretations include discussions related to those sections of the DCA Manual that have the potential to affect the Facilities & Administrative (F&A) rate proposal review and negotiation. At the same time, other topics have been included to provide clarification on important DCA requirements.
- 2) ***Present COGR's interpretations and positions on items where there are differences of interpretation.*** In defining COGR's responses and positions, references are made to the policy guidance in the Office of Management and Budget (OMB) Circular A-21. When Circular A-21 is not specific or silent on a particular issue, references are made to well-accepted and sound costing and financial methodologies.
- 3) ***Maintain a spirit of open communication with the DCA and other federal representatives.*** While some of the issues addressed in this document represent areas where there are differences of interpretation, the relationship between research institutions and the DCA historically has been positive and productive. As this document is available to the entire research community, it can serve to advance discussions in appropriate areas.
- 4) ***Provide an educational resource to universities and research institutions.*** Institutions can use the document as an internal reference and for guidance in further articulating their positions on selected items.

The interpretations and positions presented in this document are the result of discussions involving representatives from universities and research institutions, and other experts in the research community. ***While interpretations and practices vary among institutions, the interpretations and positions stated in this document, taken as a whole, represent those of the COGR membership.*** However, COGR cannot and does not represent the approaches and information

discussed in this paper as comprehensive legal and/or other professional advice. Accordingly, if legal and/or other professional advice is warranted, the advice of a lawyer or other professional should be obtained.

Why the DCA Manual is Important to Research Institutions

The practices defined in the DCA Manual represent DCA interpretations on F&A and cost-related issues, and are not meant to represent official policy associated with F&A cost reimbursement, which still resides in OMB Circular A-21. However, all institutions assigned to the DCA as their cognizant agency for negotiating Facility and Administrative (F&A) rates are affected by the new DCA Manual. And while institutions that are assigned to the Office of Naval Research (ONR) as their cognizant agency, technically, would not be subject to the DCA Manual, some practices defined in the manual could be utilized by ONR and ONR's audit arm, the Defense Contract Audit Agency (DCAA.)

The DCA Manual is an internal document that will be used by DCA staff to guide their reviews and negotiations of F&A rate proposals. The DCA Manual is a useful resource, and universities and research institutions appreciate the DCA's willingness to share and discuss its internal document with COGR and other groups.

From COGR's perspective, research institutions need to be aware of the DCA's positions on proposal review and negotiation. Ultimately, the DCA's positions can have a significant impact on the final negotiated F&A rate(s). Furthermore, institutions might incorrectly view the DCA Manual as official policy, and in turn, follow the policy interpretations in the manual that may unfairly penalize the institution when preparing and negotiating F&A rates.

In summary, while we recommend that institutions be conscientious of the positions defined in the DCA Manual, we also recommend institutions consider alternatives, and not abandon positions permitted by the policy guidance in Circular A-21. ***Furthermore, we suggest that the most important criteria institutions should meet when preparing an F&A rate proposal is to implement well-documented and defensible costing methodologies, while following the policy guidance in Circular A-21.*** If the institution advocates an approach different from a position defined in the DCA Manual, the institution must be able to provide a sound basis for its methodology, using specific references to Circular A-21, when applicable.

DHHS Departmental Grant Appeals Board

Only in rare and unusual circumstances would COGR recommend an institution utilize the Departmental Grant Appeals Board as a venue for resolving disagreements that arise in an F&A rate negotiation. The relationship between research institutions and the DCA has been a productive relationship, and in most instances, fair and equitable F&A rates are negotiated. However, in the exceptional situation where this could be an appropriate approach, appeals procedures are found under the Code of Federal Regulations, Title 45, Subtitle A, Part 16:

http://www.access.gpo.gov/nara/cfr/waisidx_05/45cfr16_05.html

Organization of the COGR Interpretations

The organization of the COGR Interpretations follows that used in the DCA Manual. There are twelve sections (sections I through XII) in the DCA Manual. For example, section VI of the DCA Manual is titled “Space,” and in the COGR Interpretations, section VI also is titled “Space.”

Sections III through XII of the COGR Interpretations include the most substantive issues and corresponding responses (sections I and II do not include the same depth of response, but include several talking points of interest). The topics addressed in these sections are highlighted as Topic 1, Topic 2, etc. Each topic is followed by the exact language (*in italics*) and the page number from the DCA Manual (direct quotes from Circular A-21, too, are *italicized*). The quoted language is followed by the COGR analysis of the issue. Topics are presented in the same order in which they are presented in the DCA Manual, and not by relative importance. Note, all references to the DCA Manual are applicable to the version of the manual released in December, 2006. If the DCA releases subsequent versions, COGR will communicate any changes to the COGR membership, accordingly.

If interested in obtaining a copy of the DCA Manual (or the DCA Frequently Asked Questions related to similar topics), go to:

<http://rates.psc.gov/fms/dca/C&U%20Review%20Manual.pdf> (DCA Manual)

<http://rates.psc.gov/fms/dca/faq-cu.pdf> (Frequently Asked Questions)

Recognition

COGR appreciates the contribution of all its members in bringing to the attention of its colleagues across the country new challenges, and strategies for addressing them. In creating this document, the COGR Costing Policies Committee, the COGR Board, and volunteers in the research community made important contributions. Special recognition is given to the Working Group, whose members dedicated many hours and significant effort to this project. The authors and contributors are shown on the final page.

I. INTRODUCTION

Section I of the DCA Manual provides an important narrative on the role of OMB Circular A-21, as well as a summary of revisions to the Circular since 1982. In addition, the Introduction to the DCA Manual makes three important statements.

While this manual is reasonably detailed and comprehensive, it is not intended to be a substitute for professional experience and judgment, nor does this manual set policy. (page 1)

On March 6, 1979, OMB revised the Circular ... On December 11, 1979, the Department's Office of Grant and Contract Financial Management (OGCFM) issued interpretations ... Those interpretations ... are considered Department policy, to the extent that they have not been superseded. (page 1)

The decision to perform an in-depth review and analysis by the DCA (including the need for team reviews) will be influenced by (a) deviation from the standard allocation methods prescribed in the Circular, (b) use of specialized costing studies, (c) use of outside consultants, (d) excessive costs assigned to research compared to the regional or national norm, (e) inadequate documentation, (f) overall level of the proposed rate, (g) total dollars at risk, (h) rate trends, (i) Disclosure Statement (DS-2) inadequacies or non-compliance and (j) A-133 or other Federal findings. (page 7)

Institutions should be aware of all three excerpts from the DCA Manual, as each excerpt provides important information:

- The first point reiterates that the DCA Manual is not a policy statement.
- The second point states that the 1979 Interpretations on OMB Circular A-21, though somewhat dated, are still valid (“to the extent they have not been superseded”). COGR’s understanding is that the 1979 Interpretations are selectively available in hard copy, but are not readily available in electronic format.
- The third point emphasizes that the DCA will use its discretion as to the need for a detailed proposal review. The ten factors (a through j) provide useful information. However, institutions should be aware that an in-depth review by the DCA could be triggered by variables that cannot always be easily predicted.

Also note, contact information for DCA staff is listed at the end of the Introduction for those institutions interested in communicating with DCA staff.

II. PRELIMINARY REVIEW

Section II of the DCA Manual describes several of the initial proposal review steps that will be taken by a DCA negotiator. Normally, these steps are conducted in the form of a desk review and might require additional documentation from the institution. The DCA Manual refers to six specific reviews conducted by DCA staff:

- A. *General Review*
- B. *Reconciliation of Cost Proposal to Financial Statements*
- C. *Review of Direct Cost Base*
- D. *Trend Analysis*
- E. *Cost Accounting Standards*
- F. *File Documentation*

Many of the points in this section highlight specific documentation requirements by the DCA. For example, part B, Reconciliation of the Cost Proposal to the Financial Statements, states that the “*The proposal is considered delinquent until the reconciliation has been received by the DCA*” (page 13). The reconciliation to the institution’s audited financial statements has always been a DCA requirement, and the new language in the DCA Manual reinforces this important rule in Circular A-21.

COGR generally views the preliminary review steps as reasonable, though some items in this section could generate spirited discussions between representatives from research institutions and the federal government. An example of such an item appears in part C, Review of Direct Cost Base, where the concept is introduced that “*Imputing salary for those room occupants who are not paid by the institution may be appropriate*” (page 16). This topic is addressed several times in the DCA Manual, and COGR’s comments are included in section VI. Space, later in this document.

Some other items that have been subjects of debate for many years are not addressed in detail in the COGR Interpretations. For example, also from part C, Review of Direct Cost Base, the treatment of salaries in excess of the NIH salary limitation (*The salary in excess of the NIH salary limitation must be included in the appropriate base ...* page 19) has been discussed in many forums, but is not addressed further in this document.

The remainder of this document addresses those items that COGR has selected as the most appropriate issues upon which to expand. The COGR Interpretations focus on those items where COGR has a difference of interpretation with the DCA’s interpretation of Circular A-21, or where Circular A-21 is silent and COGR advocates a position different from the position stated by the DCA. Furthermore, in some instances, COGR has addressed a topic to provide an educational perspective for the COGR membership, while in other situations, COGR believes a clarification in the DCA Manual is necessary. In these situations where a clarification is desired, COGR suggests that the appropriate federal officials be engaged.

III. DEPRECIATION AND USE ALLOWANCES

Section III of the DCA Manual describes the DCA's positions and interpretations related to building and equipment depreciation and use allowances. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: Federal funded equipment purchases exclusion.

The adjustment for Federal funded purchases should not be an elimination from the gross (total) university asset account because doing so may result in an excessive amount of the remaining assets being allocated to the organized research function when the allocation of the remaining assets is on a building, department or campus-wide square footage basis. If the university allocates equipment depreciation room by room, this specific functional adjustment is not necessary. (page 30)

This section of the DCA Manual is largely a carry-over from the DCA's previous version. Because some institutions could be adversely affected by this DCA methodology, COGR feels it is appropriate to comment. While Circular A-21 is silent on the allocation of equipment depreciation at the room level, this methodology is widely accepted by institutions and the DCA as the most sound methodology. When institution-funded equipment is identified accurately to a room (e.g., a research laboratory), there is no disagreement that the corresponding depreciation is allocable to the function of the room (e.g., research). Depreciation associated with federal equipment and other sponsored equipment (in most cases) is excluded from the F&A rate calculation, and is not applicable to the calculation of the equipment component.

If an institution does not allocate equipment at the room level, the depreciation on institution-funded equipment would be allocated on a more general basis, and the DCA's position is that some form of adjustment is necessary to correct for the less precise allocation methodology. For example, the institution may allocate equipment depreciation by department. After the allocable amount to research is determined (i.e., the sum for all departments), the total depreciation associated with the federal equipment purchases is offset against the total amount allocated to research. The DCA adjustment methodology can result in an equipment component that approaches zero.

The DCA adjustment methodology presumes that all federally funded equipment is for research. This is not always the case, as institutions receive federal funds for equipment in support of training grants and other sponsored activities. Furthermore, when the adjustment methodology results in an equipment component that approaches zero, there is no recognition that significant institutional funds may have been used to purchase equipment in support of research.

While COGR agrees with the DCA's position that the allocation of equipment depreciation at the room level is the most sound allocation methodology, COGR disagrees with the DCA adjustment methodology for those institutions that do not perform a room-by-room allocation. This method results in unrealistic and unfair equipment components, and is not supported in Circular A-21.

Topic 2: Matching funds on capital assets.

When the institution is required to provide matching funds for the acquisition of equipment on research awards, the cost related to the matching requirement must be excluded from the calculation of depreciation in order to avoid a CAS 502 violation for inconsistent costing. Where cost sharing is associated with buildings or equipment on construction awards, the cost shared amount may be depreciated unless specifically prohibited in the award. Where cost sharing is associated with equipment on instrumentation awards, allowability will be evaluated on a case-by-case basis. (pages 30-31)

The appropriate treatment of depreciation related to the institution's contribution to an asset has resulted in a varying range of interpretations. There have been precedents set in a number of situations where depreciation on the institution's share has been determined to be allowable, and not in violation of CAS 502. Subsequently, COGR recommends that institutions should pay close attention to the depreciation they are claiming, and if further review is required during the F&A proposal review, resolution should be handled on a case-by-case basis.

Topic 3: Advanced level building depreciation studies.

An advanced level (floor-by-floor, room-by-room, project-by-project, etc.) is not an acceptable methodology. (pages 35-36)

When buildings are constructed, costs can be segregated into individual components (e.g., shell, elevators, HVAC, fixtures, etc.) for purposes of assigning an appropriate useful life for each component. This approach is addressed in Circular A-21, J14d(4). The cost of each component is then allocated to the space that benefits from those costs, which in most cases, is the entire building. These forms of “componentization studies” have been accepted by the federal government for many years, and are not at issue.

The DCA, however, takes exception to “advanced level building depreciation studies” that go beyond the componentization studies described above. COGR disagrees with this position. For example, COGR maintains that when a renovation project is completed (e.g., a floor of an existing building), identifying individual components and unique useful lives is still appropriate. Furthermore, some institutions allocate the renovation costs to the space that benefits from those costs (i.e., the assignable square footage of the renovation project). This allocation methodology is consistent with the principles in Circular A-21, E2d, which state that costs should be allocated to the functions that benefit from those costs:

(1) Actual conditions must be taken into account in selecting the method or base to be used in distributing individual cost groupings. The essential consideration in selecting a base is that it be the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable.

(2) Where a cost grouping can be identified directly with the cost objective benefited, it should be assigned to that cost objective.

Circular A-21, F2b provides guidance on the identification and assignment of costs for buildings, capital improvements, and equipment. However, the language in F2b does not differentiate between building and equipment depreciation methodologies, and as a result, institutions have employed

methodologies using a combination of guidance in F2b with guidance from E2d (i.e., costs should be allocated to those cost objectives where a cause and effect relationship can be established).

In the case of equipment depreciation (moveable, as well as fixed equipment), institutions and the DCA agree that a room-by-room allocation is the most accurate methodology (see “Topic 1: Federal funded purchases exclusion” response). It would seem to follow that a room-by-room or floor-specific renovation allocation methodology for building depreciation would be appropriate when the depreciation can be definitively associated with a corresponding space. Using another perspective, if a room-by-room or a floor-specific renovation were applicable to instruction only, it would be unfair to the federal government to allocate a portion of the depreciation to research by using the space of the entire building. Both perspectives support a room-by-room or floor-by-floor allocation as a fair and equitable allocation methodology.

Acceptance of the room-by-room equipment depreciation methodology is predicated on the institution demonstrating that the location of the equipment identified to particular rooms is accurate. The same burden of proof should exist for building depreciation. It is up to the institution to demonstrate a clear link between costs incurred for a particular project and the space benefiting from that project. If the institution can meet that standard, this results in the most accurate depreciation allocation. Circular A-21 does not preclude the use of advanced level building depreciation allocations, and in fact, supports the use of methods allocating costs to the functions that benefit directly from those costs. An advanced level building depreciation allocation is consistent with good cost accounting principles, and should be permitted.

Topic 4: FASB 143 and FIN 47; Accounting for Conditional Asset Retirement Obligations.

The increase in depreciation expense related to FASB 143 is unallowable because the depreciation costs cannot exceed the acquisition costs of the asset and this is an estimated liability that is not part of the acquisition cost of the asset. (page 37)

This is a new section in the DCA Manual and clarification will be helpful for universities and research institutions. FASB 143 and FIN 47 require institutions to estimate and account for the cost and the timing of future projects. A good example is an asbestos remediation project. Given the difficulty in estimating the cost and timing of such a project, it is understandable the DCA would have concerns about including these expenses as allowable costs at the time they are recognized under FASB 143 and FIN 47.

However, any costs that are incurred in the future, when the project is underway, should be allowable. These costs would represent actual expenses, not estimated expenses. The costs incurred for this project would be a reconciling item to the financial statements, since they would not be recorded as an expense, but instead as a reduction in the liability (i.e., the conditional asset retirement obligation). Therefore, COGR’s interpretation of this situation is that when the actual costs are incurred (i.e., through the reduction of the liability), they should be considered allowable expenses.

IV. INTEREST

Section IV of the DCA Manual describes the DCA's positions and interpretations related to interest. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: General obligation bond (GOB) interest and the Statewide Cost Allocation Plan.

All GOB interest included in the F&A rate proposal must be part of an approved Statewide Cost Allocation Plan. This can be verified with the respective DCA Branch Chief for State and Local Governments. If the interest expense was not approved as part of the State Wide Cost Allocation Plan, then the DCA should eliminate the proposed GOB interest expense from the F&A rate proposal. (pages 38-39)

COGR has addressed this topic to reiterate the importance of having appropriate documentation when the institution claims interest on state-issued general obligation bonds (GOB). Circular A-21, C6, allows public institutions to claim costs incurred or paid by state or local governments. This would include interest related to state-issued GOB. However, both the new language in the DCA Manual and the policy guidance in C6b preclude an institution from recovering GOB interest, unless this interest is "properly supported by cost allocation plans" (i.e., generally understood to be the Statewide Cost Allocation Plan).

Institutions that do not support GOB interest through a Statewide Cost Allocation Plan should work with individuals in the state government to provide any documentation that could be helpful in recovering legitimate GOB interest. While the DCA's acceptance of other documentation would be uncertain, COGR recommends that affected institutions contact the DCA to describe their situations and determine if there are alternative arrangements that can be made, on a temporary basis, which would serve the same purpose. In addition, institutions should work with the appropriate individuals in the state government to ensure inclusion of these costs in future Statewide Cost Allocation Plans.

Topic 2: Interest on fully depreciated assets.

The Circular states that interest attributable to fully depreciated assets is unallowable. Interest expense incurred due to financing terms that exceed the depreciable life of an asset should be adjusted downward to reflect the interest expense that would be allowable if the financing term was equal to or less than the life of the asset. For interest associated with buildings that have been componentized, the interest should be allocated to the three primary component categories. The allowable interest should then be the lesser of the interest that would result from the amortization of the loan over the different component useful lives or the interest that is being incurred over the current financing term. (page 40)

Section J26c(2) in Circular A-21 was added in May 2004 and stated: "Interest attributable to fully depreciated assets is unallowable." The new language in the DCA Manual was added in support of this addition to the Circular.

This is complex discussion that requires further clarification. COGR does not believe that J26c(2) was intended to reduce, adjust downward, include a lesser amount, or restrict the amount of allowable interest an institution could claim. Instead, COGR suggests that J26c(2) was intended to address the simple situation where (for example) a 30-year debt financing agreement exists, however, the building has been fully depreciated and is no longer usable (for example) after 25 years. The interest, in this simple situation, associated with the final five years of the debt financing agreement

would be unallowable. However, the simple situation is normally not applicable, as buildings can exceed their original useful life through capitalized renovations and improvements

COGR disagrees that J26c(2) was intended to restrict interest expense associated with a building that has been componentized (e.g., shell, elevators, HVAC, fixtures, etc.). The DCA suggestion that “*interest should be allocated to the three primary component categories*” is not consistent with how institutions utilize debt to finance their buildings, as most financing arrangements are applicable to the entire building or project, not to specific components. However, and in consideration of the DCA approach, one reasonable methodology that an institution could use would be to relate interest to an average useful life of the entire building. While this would not meet the DCA interpretation of allocating interest to each component, this approach could be a manageable solution that addresses DCA concerns.

Another reasonable methodology would be that any debt and interest remaining after the shorter-lived components became fully depreciated would relate to the longer-lived components. This approach could be implemented, without significant burden, and be in compliance with J26c(2).

Finally, it is not clear whether J26c(2) was meant to apply only to facilities financed after the rule was issued in May 2004, or retroactively to previously financed facilities. OMB has traditionally applied new interest rules (including the changes to the Circular in 1982 and 1996) only to debt incurred after the rules were issued. After the intent and application of J26c(2) is clarified, it would be helpful to confirm that J26c(2) was intended to be applied to future debt arrangements on a prospective basis, and that institutions will not be penalized for past transactions entered into in good faith before the policy was changed.

While COGR agrees that J26c(2) clearly specifies that interest cannot be claimed after an asset is fully depreciated (as demonstrated in the simple example), COGR does not interpret J26c(2) to create restrictions or additional requirements in situations where a building has been componentized. Further complicating the discussion is that buildings often exceed their original useful life through capitalized renovations and improvements. These points, in combination with the difficulty of linking multiple funding sources and debt agreements with building components, creates a situation that COGR believes requires further discussion and clarification between research institutions, and as appropriate, the DCA and OMB.

Topic 3: Interest-only debt financing.

Interest-only debt financing may not be equitable to the Federal government. This is inconsistent with the intent of the cost principles where interest is paid on a declining principle balance theory. Interest-only loans result in excessive interest payments because the principle loan balance does not decrease over the life of the loan. This will be analyzed on a case-by-case basis. (page 41)

A recent trend in financing is interest-only loans. These debt arrangements require no principal payments throughout the life of the loan. Instead, annual interest is calculated on the full principal amount that is due as a balloon principal payment at the end of the loan term. Traditional loans amortize the principal balance, causing interest expense to decrease throughout the life of the loan.

Universities and research institutions enter into interest-only debt financing as part of strategic financial management, and these arrangements are applied consistently to all functions, not just to research. Furthermore, Circular A-21 does not prescribe the terms of the debt arrangements into which an institution may enter.

Finally, the federal government is protected by language in Circular A-21 (J26b(5)), which requires an adjustment to interest expense when there is excess cash flow. This provision requires an adjustment to allowable interest expense when an institution's equity contribution is less than 25 percent, and the cumulative depreciation expense exceeds the cumulative principal payments (e.g., if in a given period, the cumulative depreciation expense exceeds the cumulative principal payments by \$1 million, the allowable interest expense would be reduced by an amount equal to applying the three-month Treasury bill closing rate as of the last business day of that month, to the \$1 million in excess cash flow.)

COGR disagrees with the need for any further adjustment, beyond what would be adjusted based on the cash flow analysis, and recommends that institutions clearly describe and document those situations where interest associated with interest-only debt financing is included in their F&A rate proposal.

V. OPERATIONS AND MAINTENANCE (O&M) EXPENSES

Section V of the DCA Manual describes the DCA's positions and interpretations related to operations and maintenance expenses. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: Non-capitalized expense and ancillary costs.

Non-capitalized expenditures, capital construction, renovation, alteration, equipment and similar accounts should be analyzed to assure the university is adhering to its' capitalization policies. Appropriate adjustments should be made for those costs that were expensed rather than capitalized in accordance with their capitalization policies. Be alert during the review to determine how ancillary costs to the main project costs are treated. Some institutions separate project costs into different components to keep the overall project costs under the established institutional capitalization level. For example, an institution with a \$75,000 capitalization level may choose to account separately for the actual costs of a new boiler (\$70,000), the costs for shipping and delivery (\$5,000) the installation costs (\$20,000) and the costs for peripheral hardware and setup (\$10,000). In this case the total cost would be \$105,000 and it should be capitalized rather than expensed. (pages 44-45)

During the course of any renovation or construction project, costs are incurred that are determined to be non-capitalized costs. These costs must be expensed in the year in which they are incurred, rather than capitalized and depreciated in future periods. Generally, these costs should be included as O&M costs in the year in which they are incurred, and institutions should include these costs in the appropriate O&M cost pools. Institutions should be sure that they have clear and comprehensive capitalization policies, and that the policies are being followed. If these policies are acceptable to the financial statement auditors, and are consistent with Circular A-21 section J18a(1), these costs are allowable O&M costs.

In the case of building renovations and similar projects, it should be recognized that the dollar threshold is only one aspect of a capitalization policy. Section J18a(1) defines these types of capital expenditures as "... expenditures to make improvements to capital assets that materially increase their value or useful life." Generally Accepted Accounting Principles (GAAP) establish the same criterion and may impose additional restrictions on capitalizing certain types of expenditures. A project cannot be capitalized unless these requirements are met, regardless of the dollar amount of the project. If the project cannot be capitalized, its cost is an appropriate current expense.

Circular A-21 is clear that the handling of ancillary charges, such as shipping and installation, is governed by institutional policy. Specifically, section J18a(1) states that "*Ancillary charges, such as taxes, duty and protective in transit insurance, freight, and installation may be included in, or excluded from the acquisition cost in accordance with the institution's regular accounting practices.*" If the institution's policies treat these costs as current expenses rather as part of the acquisition cost of an asset, they should be considered appropriate current expenses for the F&A proposal.

COGR believes that renovation costs, ancillary charges and similar expenditures that are not capitalized in accordance with A-21 Section J18a(1), GAAP and institutional policy are allowable as current expenses, generally as O&M costs in the F&A proposal.

Topic 2: Metering and the 1.3 percent Utility Cost Allowance (UCA).

Universities should not meter the utility costs to a finer level than building by building if they are eligible to receive the 1.3 percent UCA. The negotiator should determine if the university is potentially violating the intent of the UCA allowance by having more than one meter per building. With multiple meters per building, there is the potential of research receiving an excessive allocation of utility costs. Related to this issue, review the buildings to determine if the university has divided a building into multiple units so as to increase the metering and therefore the costs allocated to research. Furthermore, it is unacceptable for a university to meter for a selected period of time and project costs for the year. (page 46)

Prior to July 1, 1998, many institutions performed utility cost studies to allocate utility costs. These studies were often a matter of contention during negotiations and were disallowed in the 1998 revisions to Circular A-21 (see F4c.). These special studies were replaced by the 1.3 Utility Cost Adjustment (UCA), which was granted only to those institutions that had utilized a utility cost study in their most recently negotiated F&A rate proposal (these institutions are listed in Exhibit B of the Circular). Effectively, allocation of utility costs at a finer level than the building level (e.g., by room) was replaced by the UCA for the institutions listed in Exhibit B, according to the 1998 revisions.

However, metering at the individual building level is allowable in order to identify the correct utility costs to the individual buildings. Furthermore, if it is important from an institutional management standpoint to meter costs at a finer level (e.g., multiple meters within a building), the institution should do so. Note, once again, for the institutions listed in Exhibit B, these finer level results would not be accepted in their F&A rate proposal.

Inevitably, this discussion turns to those schools not eligible for the 1.3 UCA, and whether or not they are allowed to conduct finer level utility metering for F&A rate proposal purposes. In theory, section F4d allows these institutions to apply for the UCA (“Beginning on July 1, 2002, Federal agencies may receive applications for utilization of the UCA from institutions not subject to the provisions of subsection F4c ...”). However, since this section of the Circular has not been implemented, for institutions not receiving the UCA, finer level utility metering may be an equitable solution. COGR believes some form of differential utility cost recognition should be available for those institutions not eligible for the 1.3 UCA, and as appropriate, COGR would welcome the opportunity to engage the DCA and OMB for further discussions.

In regard to the DCA’s position on partial year building metering, meters could be installed mid-year (particularly with new construction), or may occasionally be non-functional for a portion of the base year. When these situations occur, it would be appropriate for the institution to make reasonable estimates, and support these estimates in their F&A rate proposal. COGR believes it would be unreasonable for a negotiator to disregard partial year meter readings in these, and similar, situations.

Topic 3: Other Rates and the 1.3 percent Utility Cost Allowance (UCA).

Universities should not receive the 1.3 percent UCA for rates other than the organized research (page 46)

COGR believes the intent of this section of the DCA Manual requires minor clarification. Institutions that have more than one research rate (or similar rates), and are eligible for the 1.3 UCA, should continue to claim the 1.3 UCA on each unique research rate (or similar rates) where the UCA is applicable. COGR's understanding is that the DCA Manual language is directed to Instruction and OSA rates.

Topic 4: Departmental Paid O&M.

When a departmental O&M cost pool is proposed, the negotiator should request a schedule that lists the object or sub-account codes that are charged to academic departments. The schedule should show the total cost for each object or sub-account code and the amounts charged directly to Federal sponsored accounts, non-Federal sponsored accounts and unrestricted accounts. Depending on the materiality of charges to Federal accounts, an adjustment may have to be made to compensate for the inconsistent costing. (page 47)

Departmental O&M costs are operations and maintenance costs incurred at the departmental level, rather than as part of a central facilities organization. These costs may be a result of chargebacks to the departments from the central facilities department for maintenance items, or original departmental costs. The DCA recognizes that these are allowable O&M costs, but is concerned that some institutions may be treating these costs inconsistently.

Some O&M costs can legitimately be treated as direct and indirect where unlike circumstances exist. Equipment maintenance on a piece of equipment purchased and used solely on one project is a justifiable direct cost to the project, whereas equipment maintenance contract costs related to a piece of equipment shared by all of the researchers in a department normally would be considered indirect. Similarly, rent for an off-campus facility for the sole use of one project can be charged directly, whereas rent for a facility that houses multiple functions and projects normally would be considered indirect and included in the O&M pool.

Prior to submitting the F&A rate proposal, the institution should have a detailed understanding of what comprises the departmental O&M cost pool. If the institution identifies situations where like circumstances exist, it should adjust the departmental O&M pool to compensate for the inconsistent costing. Even if there is no evidence of like circumstances, the institution could adopt a conservative position by adjusting the departmental O&M pool to eliminate any possibility of inconsistent costing. However, if the institution believes an adjustment methodology is not appropriate, an adjustment may not be necessary to this cost pool. If, during the negotiation, the DCA adopts an "all or none" position (e.g., eliminate an entire expense item, or the entire departmental O&M pool), the institution may consider, at that time, counter-proposing an adjustment methodology, as appropriate.

COGR believes that institutions should not be discouraged from including departmental O&M costs in their F&A rate proposals, but should be prepared to support these costs and be able to provide the schedules that may be requested by the DCA negotiators. Institutions should have strong policies regarding the direct charging of these costs to federally sponsored awards, and direct charging should be done only when unlike circumstances can be documented.

Topic 5: O&M sub-pooling.

Institutions are increasing the number of O&M sub-pools which usually results in an increase of O&M costs allocated to organized research. Numerous O&M sub-pools may indicate a higher risk and therefore a more intense review and analysis is necessary. This is a form of "cherry picking" the O&M cost categories. (page 48)

Circular A-21, E2d(1) states that costs should be allocated to the functions that benefit from those costs (see "Topic 3: Advanced level building depreciation studies", for the exact Circular A-21 language). COGR supports a position that institutions should sub-pool whenever a more specific identification of benefiting space can be determined, as this will result in a more accurate allocation. Institutions should be consistent with their establishment of sub-pools. When costs are incurred that relate to a non-research function, these costs should also be sub-pooled, and not allocated to research.

VI. SPACE

Section VI of the DCA Manual describes the DCA's positions and interpretations related to space surveys and documenting research space. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: Documentation of Sponsored and Non Sponsored activity.

When rooms are coded to organized research, the university must also identify both sponsored and non sponsored accounts that fund the organized research in the room. (page 53)

Circular A-21 provides little guidance on documentation required to support space classified as organized research space. However, research institutions and the DCA have established some common ground on the importance of identifying occupants, and funding sources (i.e., sponsored and non-sponsored research accounts) of those occupants, for rooms classified as organized research.

COGR understands this section of the DCA Manual to indicate that all research projects, regardless if supported by sponsored or non-sponsored research accounts, must be identified if a room is classified as organized research. This is a reasonable requirement. In addition, COGR understand this section to imply that detailed account documentation for the non-research activity in the room is not required. For example, if an individual conducts all of his/her activity in a room, and that individual is funded 50% from research projects and 50% from non-research projects, detailed account documentation (i.e., sponsored and non-sponsored research accounts) is required only for the research projects.

Related to this discussion is the documentation required when an individual is funded 50% from a research project and 50% from a non-research project, but is engaged only in research when occupying the room in question. It would follow, again, that all research projects, regardless of whether they are supported by sponsored or non-sponsored accounts, must be identified to support the portion of the room classified as organized research. However, the 50% salary associated with the non-research project would not be applicable to the analysis, and COGR's understanding is that this portion of the salary need not be documented with detailed account information.

COGR supports a position wherein institutions provide the necessary documentation to satisfy reasonable data requests. However, it is important to appreciate that there can be significant variances in institutional space systems, and the ability to access certain data. Ongoing initiatives that clarify and simplify the space survey process, without compromising the important principle of supporting research space with the appropriate documentation, will minimize the points of contention during F&A rate negotiations.

Topic 2: Space survey invalidated due to intimidation.

If the negotiator feels that they are being intimidated and constantly interrupted for asking questions regarding the methodology used to assign functions to rooms, the negotiator may stop the space validation and the survey will be considered unacceptable. (page 56)

Professional courtesy is a desirable tone to establish for all F&A rate proposal reviews and negotiations. The responsibility to set that tone is shared equally by all parties. When the environment for a productive and successful negotiation does not exist, all parties should work to overcome their differences so that the proposal review and rate negotiation can still be accomplished.

COGR believes this language, however, introduces an arbitrary element to the acceptance of a space survey. The risk is that disagreements can be elevated to a personal level, at the expense of professional conduct and judgment. When an individual's behavior from either party is inappropriate and potentially affects the proposal review and rate negotiation, the immediate supervisors from both parties should be engaged. Providing a single party with the power to stop the space review is not a desirable approach to resolving these types of situations.

Topic 3: Alternate Space Methodology.

Institutions employing this alternate method will be held to strict standards. Institutions failing to provide accurate and fully supported space surveys, whether using this method or performing a complete space survey, will be subject to having all space related costs re-allocated using department salaries and wages or FTE. (page 57)

The alternate space methodology is an important innovation that eliminates some of the grey areas of the space survey, while making it a more manageable task. However, in several situations it can be overly prescriptive and may result in inequitable quantification of research space. For example, for the room types that the DCA has designated as 100% allocable to instruction (see page 60 of the DCA Manual, as well as the other examples on pages 58-62), the recommended treatment may not always represent the most accurate classification.

COGR agrees that institutions should be held to a high standard in terms of providing an accurate and fully supported space survey. This is applicable whether the institution uses the Alternate Space Methodology or conducts a complete survey of all rooms. However, the quality of the space survey is often open to subjective interpretation, and space surveys should not be dismissed, except in exceptional circumstances. While supporting cost-efficient solutions such as the Alternate Space Methodology, COGR believes that the methodology should not be overly prescriptive, and that there should be an opportunity for the institution and the DCA to consider exceptions on a case-by-case basis.

Topic 4: Imputing salaries and space adjustments.

All space that is classified as organized research must be supported with organized research accounts, gift account, university accounts or other accounts from which the room occupants are paid. Imputing salary for occupants not paid by the institution may be appropriate. (page 58)

Imputing salaries to account for individuals occupying space in a research room is referenced throughout the DCA Manual. In addition to the reference above, imputing salaries is referenced in section II.C, Review of Direct Cost Base, and in section XII.E, Tuition Remission Expense.

From the DCA perspective, salaries should be imputed in certain situations so that the research base can be matched with research space. Specifically, the imputed salaries would be an addition to the research base. The DCA Manual also indicates a research space adjustment, rather than imputing salaries, is an acceptable methodology to account for these types of situations.. Using this approach,

research space occupied by certain individuals (e.g., graduate students receiving tuition remission, as well as visiting professors, students working on their theses, etc.) would be reclassified as instruction or other institutional activity space.

COGR has concerns related to the treatment of tuition remission, as described in section XII.E (page 128) of the DCA Manual:

When tuition remission is excluded from the direct cost base, the negotiator should examine the space occupied by the individuals receiving the tuition remission. The space occupied by the individuals who are compensated by the tuition remission being excluded from the direct cost base, in lieu of salary and wage compensation, should be identified. This space should be classified as IDR or OLA. If an institution classifies the space occupied by these individuals as organized research, then the negotiator should either make an adjustment to the space classification or impute the salaries and wages plus applicable fringe benefits for these individuals and this calculation must be added to the organized research direct cost base. (page 128)

First, imputing salaries and adding them to the research base is of particular concern, as it relates to the discussion in section XII.E. Circular A-21, G2, specifically identifies tuition remission as an exclusion to the modified total direct cost base. Imputing salaries to account for tuition remission costs would result in increased research base costs, a reduction in the F&A rate, and no corresponding F&A recovery on the imputed salaries that were added back. Furthermore, salaries for those same graduate students receiving tuition remission, in almost every situation, have already been included in the organized research base. Adding back additional dollars as a proxy for tuition remission is excessive, and Circular A-21 provides no basis for including the tuition remission portion of the student's compensation in the organized research base.

Second, a space reclassification to account for tuition remission would be onerous, and once again, would have the same impact as imputing salaries and unfairly reducing F&A recovery. Artificial adjustments to "normalize" the research base with the research space should be minimized. When too many additional burdens are placed on the space survey, the complexity becomes too great, and innovations such as the Alternate Space Methodology (see "Topic 3: Alternate Space Methodology" above) lose their effect as cost-efficient solutions.

While COGR supports the general concept of correlating the research base and research space, COGR disagrees with the position defined in the DCA Manual, and believes this position is not supported by the policy guidance in Circular A-21.

VII. LIBRARY EXPENSES

Section VII of the DCA Manual describes the DCA's positions and interpretations related to library expenses. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: Separate libraries.

Determine if the university has separate libraries that serve specific areas of knowledge such as a health sciences or medical library, a law library or engineering library. If the operating costs are material, the university may choose to allocate these costs separately from the main library. This may only be considered when a library user study is performed. If a library user study is not performed, then all libraries must be allocated using the standard allocation method prescribed in the Circular. (page 64)

The first part of this step (“Determine if the university has separate libraries ... the university may choose to allocate these costs separately from the main library.”) seems reasonable and consistent with the general principle in Circular A-21, E2d(1) that costs should be allocated to the functions that benefit from those costs (see “Topic 3: Advanced level building depreciation studies”, for the exact Circular A-21 language). However, COGR disagrees with the statement, “This may only be considered when a library user study is performed.” Circular A-21, Section F8, Library expense, does not prohibit allocating the costs for a specialized library separately from the main library. In fact, this could represent a more accurate cost allocation methodology. COGR believes that establishing separate library allocations (regardless of whether or not a library study is performed) is consistent with the policy guidance in Circular A-21.

Topic 2: Library, outside users.

The other user category includes all users not included in the professional employees and student category, such as the general public, university alumni and friends of the library, guests, high school students, students and faculty from other colleges, medical professionals, and community professionals as appropriate.(pages 65-66)

While it is true that most institutions allow outside users access to library resources, it is important to note that not all users have equal access to resources. Electronic periodicals and journals, which are usually more expensive than other library resources, are restricted to valid subscribers, generally those individuals that have a university logon ID. Some on-line journals are further restricted to specific users or groups of users.

The general public, alumni, friends of the library, guests, high school students, students and faculty from other colleges, medical professionals, and community professionals may have access to the library, but not at the same level as faculty, staff, and students. Since faculty, staff, and students have access privileges that the majority of “outside users” do not, COGR supports a position where outside users of the library who do not have library privileges equal to those of faculty, staff, and students, should not receive full weighting when developing the library allocation statistics.

VIII. GENERAL ADMINISTRATION AND GENERAL (G&A) EXPENSES

Section VIII of the DCA Manual describes the DCA's positions and interpretations related to G&A expenses. At this time, COGR has not identified significant issues for further discussion.

IX. DEPARTMENTAL ADMINISTRATION

Section IX of the DCA Manual describes the DCA's positions and interpretations related to departmental administration expenses and the direct charge equivalent (DCE) methodology. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: Validity of the Direct Charge Equivalent (DCE) assumptions.

It is quite common for universities to charge sponsored projects directly for department administrative and clerical salaries and other administrative personnel. The remaining salaries for these administrative and clerical personnel are usually assigned to the DA cost pool before a similar charge or assignment of costs is made to instruction. This practice is referred to as inconsistent costing. (page 87)

Whether or not administrative and clerical staffs are considered appropriate to direct charge to "major" Federal programs under the Circular does not alleviate the need for the DCE adjustment. (page 88)

The DCE is among the least understood and most complex methodologies in the F&A rate calculation. While the DCE has been an accepted methodology in determining the departmental administration (DA) component of the F&A rate, the institution's DA component and overall F&A rate could be unfairly affected if the strict interpretations described in the DCA Manual are applied. Many institutions can support administrative rates above the 26-point administrative cap, so further discussion for them may be unnecessary. However, for other institutions, this discussion is important.

First, appropriate direct charging of administrative and clerical personnel costs, under unlike circumstances, does not result in inconsistent charging (i.e., CAS 502 violation). In fact, if unlike circumstances exist, the cost is correctly classified as a direct cost. Accordingly, a DCE adjustment might not be appropriate in this situation.

Second, the funding approach utilized by many non-federal sponsors creates a challenge to certain assumptions of the DCE methodology. These sponsors often do not allow the institutions to recover their full F&A rates. However, they do allow an institution to recover administrative and clerical salaries as a direct charge. This treatment benefits the federal government in three ways:

- The administrative and clerical salaries, if not directly charged to non-federal sponsors, would have been eligible as DA costs to be included in the DA component. As direct charges to non-federal sponsors, they are excluded from DA.
- The base is inflated because these normally indirect costs are now charged directly.
- The administrative and clerical salaries are normally included in the numerator of the DCE, resulting in a DCE ratio that is overstated. Consequently, more administrative salaries remain in the instruction base (as calculated in the DCE), rather than being reclassified to departmental administration.

COGR understands that the DCE methodology was introduced to minimize the potential for over-recovery of DA costs. At the time the DCE methodology was introduced (in the late 1970s, prior to Circular A-21 restrictions on direct charging administrative and clerical salaries), direct charging of administrative and clerical personnel costs to federal projects was more common. This is no longer

the case. Moreover, since direct charging of administrative and clerical salaries is significantly restricted on federal projects, and is often permitted on non-federal projects, a federal activity DCE would result in a more equitable DA component.

COGR believes the DCA's approach to the DCE methodology: a) does not recognize those situations where unlike circumstances exist, and b) does not account for the benefits to the federal government in the F&A rate calculation when administrative and clerical salaries paid by non-federal sponsors are directly charged. These are important factors, and should be considered when reviewing and negotiating the DA component of the F&A rate.

Topic 2: Segregation of department support costs.

The DA costs for each academic department should be reviewed to determine if there are support costs related to patient care activity, faculty medical practice plans, or potential recharge activities such as electronics shops, paint shops and fabrication shops. Support costs related to these activities are not considered DA and should be eliminated from the departmental support costs before computing the DCE ratio for each department. (page 93)

COGR believes that institutions should utilize a costing methodology that results in the most accurate treatment of departmental support costs, and the exact methodology varies across institutions. This section of the DCA Manual is based on the presumption that departmental support costs for these types of activities can be segregated from other departmental support costs. In addition, it does not recognize that some of these departmental support costs could be shared between multiple activities, including research. If the DCA's prescribed solution is to reclassify departmental support costs to the activities listed above, it could result in an incorrect classification, and improper allocation, of departmental support costs.

Topic 3: Object code summaries to support a DCE for non-salary costs.

This summary should be by object or sub-account code for both salary and non-salary costs charged directly to sponsored accounts. Obtain a schedule that shows both Federal vs. non Federal sponsored account charges, unrestricted account charges and total costs for the object or sub-account code. (pages 93-94)

This section infers that a DCE calculation is the normal methodology for calculating the non-salary costs applicable to the departmental administration (DA) component. Using a DCE methodology to calculate non-salary costs assumes there is a similarity between the ratio of non-salary costs to faculty salaries for research, and the ratio of non-salary costs to faculty salaries for instruction. The composition of research and instruction costs can vary significantly, and a correlation may not necessarily exist.

As a result, a relationship between faculty salary and non-salary costs may not exist across functions in academic departments, nor across individual research projects. Each project budget is determined by the specific needs of the project, and may result in significant deviations in the ratio of salary and non-salary costs.

COGR believes that an institution should utilize a methodology that most accurately identifies non-salary DA costs. Often, a "simple proration" (i.e., calculating the ratio of DA salaries compared to non-sponsored salaries, and applying this ratio to non-salary costs) is most appropriate, and should be used. If a DCE on non-salary costs is most appropriate, then this methodology should be used.

Topic 4: Classification of job titles.

In those cases where the salary for job titles (classification) are included 100 percent in the DA pool and were also directly charged to sponsored activities, the DCE ratio is understated and the DA pool is overstated. Where a significant amount (over five (5) percent) of salary for a specific job title is directly charged to sponsored accounts then the salary associated with the job title (classification) must be adjusted through the DCE before assigning the remaining costs (if any) to DA. (page 94)

COGR suggests that utilizing a 5 percent threshold rule to determine the treatment of a specific job title in the DCE calculation is arbitrary, and does not take into consideration unlike circumstances where direct charging is appropriate. In addition, and as discussed under Topic 1, because non-federal sponsors often allow administrative and clerical positions to be direct charged, COGR believes a threshold analysis should be valid only for the direct charges to federal projects. When non-federal salaries are considered, the ratios can be distorted. Though a 5 percent threshold rule may be appropriate to trigger a closer review, the final treatment of the job titles in question should be based on a variety of factors, and not a simple threshold indicator.

X. SPONSORED PROJECTS ADMINISTRATION

Section X of the DCA Manual describes the DCA's positions and interpretations related to sponsored projects administration. At this time, COGR has not identified significant issues for further discussion.

XI. STUDENT ADMINISTRATION AND SERVICES

Section XI of the DCA Manual describes the DCA's positions and interpretations related to student administration and services. At this time, COGR has not identified significant issues for further discussion.

XII. OTHER AREAS

This section describes areas not covered in the previous sections, which could require special attention by the DCA staff. The additional areas include:

- A. *Fringe Benefits*
- B. *Specialized Service Facilities (SSF), and Special Consideration for Animal Research Facilities (ARF)*
- C. *Faculty Medical Practice Plans*
- D. *Medical Practice Insurance*
- E. *Tuition Remission Expense*
- F. *Contributed Effort (Cost Sharing)*
- G. *National Primate Research Centers*
- H. *Affiliated Hospital Space Including Veteran Administration Facilities*
- I. *Intergovernmental Personnel Act (IPA) Mobility Program Rates*
- J. *Facility Cost Projections*

The DCA's positions and interpretations related to Section E. Tuition Remission Expense include a discussion on imputing salaries and space reclassification, which COGR believes requires comment. This discussion can be found in section VI. Space (see "Topic 4: Imputing salaries and space adjustments").

COGR believes several of the DCA's positions and interpretations related to Section J. Facility Cost Projections require closer consideration. The items that COGR has identified as most significant for further discussion are shown below.

Topic 1: DCA acceptance of facility cost projections.

Remember, allowing facility projections to be included in future F&A rates is not a given and it is not a right. (page 140)

Including facility cost projections is an important costing practice at research institutions, and is consistent with the DCA's long-standing acceptance of negotiating prospective (i.e., predetermined) F&A rates. COGR believes that when a projection is reasonable and adequately documented, it should be included in the negotiation of future F&A rates. The sentence above from the DCA Manual might introduce an arbitrary element to the acceptance of facility cost projections, especially in those situations where a DCA negotiator and an institution have a disagreement on the facility cost projection methodology.

Topic 2: Facility cost projection example.

A summary facility cost projection spreadsheet must be submitted for proposed F&A rate projections. An example of a spreadsheet is included in this section. This spreadsheet is an example of a proposal presentation and by no means represents a negotiated or accepted projected increase. Supplementary information substantiating the projected costs that should be submitted on the spreadsheet include the estimated occupancy dates of the new facilities or remodeled space, the estimated useful lives assigned to the assets, the estimated usage of the space and which academic departments and research protocols will occupy the space. In addition, the negotiator should determine what will happen to the space being vacated, if applicable. (page 141)

The example referenced above is shown in the DCA Manual (pages 145-146) as an “Example of a Facility Cost Projection Proposal Worksheet”. While COGR supports the use of an example to provide institutions with a starting point to quantify the facility cost projections, there are a number of ways in which an institution could demonstrate the unique characteristics of its new research construction program. In addition, the supplementary information that is necessary to support the facility cost projection could be presented in a number of clear and insightful formats. COGR recommends that institutions present facility cost projections in a manner that enables the DCA to understand the important elements of the facility cost projection, and which establishes a foundation that allows for a fair consideration of the facility cost projection.

Topic 3: Treatment of O&M in the facility cost projection.

The projected costs should be identified by each applicable category such as building depreciation, capital interest and operating interest. (page 141)

The omission of O&M from the list of projected costs seems to be based upon the assumption that new construction will not result in a net increase in research space. If a new building was built to replace an old building (that is scheduled to be razed) of identical size, and the new building is to be occupied by exactly the same occupants, then the O&M allocable to research might be unchanged. However, in most instances, new facilities result in a net increase in research space. When there is a net increase in research space, there also must be a corresponding net increase in O&M costs allocable to research.

COGR believes that O&M should be included in the facility cost projection. In fact, many institutions are required to fully document projected cash outlays associated with new construction when supporting inquiries from state legislators or other governing bodies, and O&M is a real and additional cost that must be accounted for. If the institution’s facility cost projection accounts for and documents the net increase in research space, as well as the corresponding net increase in O&M costs allocable to research, then O&M should be accepted as a fair and reasonable component of the facility cost projection.

Topic 4: Projected increases to the MTDC base.

The MTDC base increases should be based on the average increase to the MTDC base over the last five (5) years. Any deviation from using the average actual increases should be fully explained. If the facility projections include a significant increase in the organized research space, the projected MTDC base should also reflect an increase associated with new researchers joining the institution that may bring new awards and funding opportunities that would not be included in the five year average increase. (pages 141-142)

Given changes in research funding, a five-year historical average may not be an appropriate method for projecting changes in the MTDC base. For example, for schools that rely heavily on NIH funding, significant increases may have occurred in fiscal years 2002, 2003, and possibly 2004, with much slower growth (if any) in fiscal years 2005 and 2006. Consequently, in this example, fiscal years 2002 through 2006 may not be a realistic predictor of future MTDC base increases. While it is important for institutions to develop a defensible MTDC base projection methodology, using the 5-year average may not be the appropriate solution.

If new researchers with existing awards will be joining the institution, this also should be considered when projecting MTDC base increases, as should the possibility of researchers leaving the institution. The rate at which new researchers join an institution can vary from institution to institution. Also, it is conceivable that a significant increase in research space will be caused by decompression (see Topic 5 discussion, below), rather than by new researchers joining the institution.

COGR recommends an approach where the institution estimates MTDC base changes according to careful analysis of its unique situation, rather than using assumptions that may not reflect actual conditions.

Topic 5: Decompression.

Although new facility space may be partially used for decompression, the ratio of the increase in space to the increase in the MTDC base should be comparatively similar. (page 142)

If an institution's primary purpose in constructing a new building is to decompress the use of space to relieve over-crowded conditions, the ratio of the research space to the research MTDC base could increase significantly. Furthermore, ratios can vary extensively from institution to institution, depending on unique circumstances, and this should be recognized. COGR believes that if the institution can support the assertion that the ratio of the research space to the research MTDC base has increased, then this should be considered in the facility cost projection.

Topic 6: Inflationary factors.

Inflationary factors should not be accepted since inflation affects both the F&A costs pools and the direct cost bases, and should, therefore, not cause an increase in the F&A rates. (page 143)

COGR agrees that in most situations, inflationary factors will not result in an increase in the F&A rate. However, if there are exceptional circumstances, COGR believes inflationary factors should be considered on a case-by-case basis.

Topic 7: Number of years in the rate agreement.

Remember, allowing facility projections to be included in future F&A rates is not a given and it is not a right. The costs must be specifically identified and properly documented. If the institution and the Federal government can not reach an agreement on the facility projection component, either party may elect to reduce the number of years to be included in the current negotiation. (page 143)

If the institution and the DCA do not agree on the amount of F&A rate points that should be attributed to the projection, both parties have the option to propose a shorter-term rate agreement (e.g., 2 years rather than 4 years).

However, differences of interpretation in methodology (e.g., inclusion of O&M, base projections, decompression assumptions, etc.) should be seen as an opportunity for open-minded discussion, and not be used to penalize an institution in either the amount of F&A rate points attributed to the

projection or the term of the rate agreement. COGR believes that both parties are best served by focusing on the facts and the quality of the facility cost projection documentation.

The period of time between proposal submission, proposal review, and formal negotiations should be considered when determining the number of years in the rate agreement. COGR appreciates the DCA's hard work and commitment to the process, and institutions should be sensitive to the DCA's timetable and backlog. Conversely, the DCA should work with institutions to negotiate rates within a reasonable time period. If the time period becomes protracted, this can put the institution in an unfair negotiating position.

In these situations, a shorter-term rate agreement may result in the institution being required to develop a new rate proposal almost immediately after negotiating the current rate agreement. This is not a desirable outcome of a good-faith negotiation, and should be avoided whenever possible. COGR recommends that the institution and the DCA maintain open communication throughout the proposal review process, and if there are forewarnings that the negotiation may become protracted, this be communicated as early as possible.

Concluding Thoughts

The most important recommendation for preparing an F&A rate proposal is that an institution implement sound, well-documented, and defensible costing methodologies, while following the official regulations in OMB Circular A-21. If an institution does so, it will remain in a strong negotiating position from which fair and equitable F&A rates can be established.

Institutions should be aware of the DCA's proposal review and negotiation positions, as articulated in the "Best Practices Manual For Reviewing College and University Long-Form Facilities & Administrative Cost Rate Proposals" (December 2006). However, institutions should also recognize that the DCA Manual represents the DCA's internal interpretations, and is not meant to represent official policy associated with F&A reimbursement. The official policy guidance remains in OMB Circular A-21.

Still, there are many grey areas in Circular A-21, and institutions must make strategic decisions about how best to approach methodologies where the Circular is not definitive in its guidance. The topics addressed in the "COGR Interpretations" include discussions that COGR believes could be beneficial to the research community. In situations where research institutions and the DCA have differences of interpretation, the research community is best served when both parties value one another as equal partners, respect the fact that differences of interpretation exist, and recognize that the goal of the process is to establish F&A rates that are fair and equitable to both parties.

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