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October 8, 2002

Mr. Gilbert Tran
Office of Federal Financial Management
Office of Management and Budget
Room 6025,
New Executive Office Building
Washington, D.C. 20503

Subject: Proposed Revisions to OMB Cost Principles:
Circulars A-21, A-87, and A-122
(August 12, 2002, Federal Register Notice)

Dear Mr. Tran:

On behalf of the 150 research-intensive universities in the Council on Governmental Relations, I provide comment on the proposed revisions to OMB cost principles, with particular focus on revisions that would affect Circular A-21. We have previously expressed our support for the P.L. 106-107 initiative (letter dated March 19, 2001) and for updating OMB Circular A-21 (letter dated July 3, 2002). COGR has a long-standing interest in and a commitment to streamlining all aspects of the financial and administrative management of federal awards.

The comparison of the cost principles in the three circulars has initiated a lively discussion in our community. In reviewing OMB's proposed changes, we find certain areas in which the revisions will provide some clarity. However, after comprehensive assessment, we conclude that the current OMB proposal to streamline the cost principles is reaching too far and clearly crosses over into the area of policy change. It may be that this well intended initiative has not received the right degree of consultation and we urge OMB to withdraw it for the present. Our detailed comments illustrate that the added requirements affect not only our constituency but also the federal agencies that would now be required to adopt new, costly management procedures that have no value added. Given the current constraints in Federal and State budgets, such considerations gain increased importance.

The Proposed Revisions Do Not Meet OMB's Stated Goals

OMB has referenced P.L. 106-107 as the framework for streamlining the cost principles. The statute requires the federal agencies to streamline their pre and post award administrative requirements, in order to provide better services to the public and to relieve the public from unnecessary variance between agency practices. In this context, OMB believes that it is useful also to review the cost principles underlying Federal awards to ensure that they are current, consistent and appropriate for covered recipients. This is a reasonable position and could be viewed as an extension of the statute to "further its objectives".

However, we are concerned that instead of simplifying the cost circulars, OMB is attempting to contrive uniformity with three very different constituencies. We believe that the State and local governments, the independent research institutes and the university community are far too different from one another to operate well under uniform cost principles. We suggest that a better way to achieve the goals of currency and appropriateness would be a review of each circular separately, in cooperation with the respective constituency. After successful completion of such a process, one might then consider the relationship with the cost principles that apply to other constituencies.

Impact on Grant Administration

OMB specifically states that its objective does not include adding restrictions or modifications to current requirements. However, restrictions and modifications have been introduced into A-21, which amount to significant policy changes. We discuss these in detail in the appended pages. For the universities, the number of new prior approval and notification requirements, such as J.31 Pre-award Costs and J.46 Foreign Travel Costs, are of particular concern. They turn back the clock by eliminating administrative simplifications, which were introduced a decade ago based on proven assessment of the benefits to the government and university research partnership.

The result of these changes will be to further complicate the existing fragmented administration of federal awards to universities. OMB Circular A-110 seeks to provide consistency and uniformity among federal agencies. Unfortunately, while it provides authority for waivers of prior approvals, agency implementation currently is far from uniform. It ranges from some agencies that grant waivers, including Federal Demonstration Partnership (FDP) approvals, which in themselves vary among agencies, to other agencies that grant none. This confusing picture need not be further clouded by introducing the additional A-21 approvals.

It must also be noted that any potential waivers that currently may apply under OMB Circular A-110 to grants do not extend to contracts. The same cost item may require approval under a contract, for which approval is waived under a grant. This hardly constitutes streamlining. The

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potential impact on costs as well as on frustration among universities, especially faculty, is obvious.

Impact on Facilities and Administration Costs and Grant Accounting

Other policy changes will impact current practice in financial systems, requiring changes that will be unnecessarily disruptive and costly with respect to rate negotiations and audit. Examples are J.16 Equipment Costs; J.22 Interest; J.24 Idle Facilities; J.37 Relocation/Recruiting and J.44 Specialized Service Facilities, described in detail in the attachment to this letter.

With respect to coverage, A-21 has served the government well. There is no evidence that the absence of some of the newly introduced cost principles has worked to the detriment of the government. We have previously suggested a review of A-21 for currency, consistency and appropriateness relative to today's research environment. However, we find that in these proposed revisions, OMB has limited its review. With respect to A-21, OMB has considered only section J. ignoring revisions in other sections that could significantly streamline the process, both for the government and for the covered universities. One item that is missing is the clarification of cost sharing, which OMB issued in January 2001. It is very important to the universities that this clarification be incorporated into Circular A-21.

Clarification Needed to Certain Proposed Revisions

There appear to be unintended drafting errors in the proposed revisions. We point out two of these errors in the attached pages, in our specific comments on the Interest provisions in J.22 with respect to the dates cited to determine allowability of interest costs. Similarly, the proposed revisions to J.1e, Advertising and Public Relations Costs, now contains a reference to Attachment A for the determination of allowability. However, Attachment A contains the general principles governing Circular A-122, which differ in many respects from the A-21 principles. We presume this is not intended, but indicates the need for very close scrutiny of every detail of the proposed revisions.


Also since OMB does not provide explanations, the appropriateness of certain revised provisions in the Circulars for their respective community are hard to determine. For example, it is not clear why OMB has not allowed certain types of costs for universities, which the other two constituencies are allowed to claim. Examples are J.34 Proposal Costs; J. 42 Selling and Marketing Costs and J.29 Meeting and Conference Costs.

In summary, the universities in our membership object strongly to the changes proposed to A-21 for a number of reasons. In their view P.L. 106-107 was not intended to add more burden and make policy changes that will have an adverse impact. If finalized as proposed, these changes to Circular A-21 would affect the entire institution, including faculty, administrators and financial

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officers. They will do damage because they drive accounting changes, which will in turn require the government to make further amendments to existing requirements. They contravene the concept of simplification, by burdening the faculty with prior approval requirements. Most importantly, ignoring the differences among research universities, independent research institutes and State entities denies the existence of fundamental differences between the structure, mission and needs of these diverse communities. OMB has previously recognized and respected these differences in its decision to keep the management circulars separate. We hope that OMB will reconsider, and include the university community in the future work of its task forces.

Sincerely,

A handwritten signature in black ink, reading "Katharina Phillips". The signature is written in a cursive style with a large initial 'K' and a distinct 'P'.

Katharina Phillips

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COMMENTS ON SPECIFIC PROPOSED REVISIONS TO THE COSTING CIRCULARS THAT IMPACT CIRCULAR A-21 (Note- Items appear in the order presented in the OMB Matrix)

Item 16 – Equipment

Comments:

Under the proposed revisions to part a.(1) and (2), the “original complement of low cost equipment” required to outfit a new facility / building would have to be capitalized, regardless of the cost. This would create a significant new administrative burden for universities – for every new facility, we would be required to capitalize, and more importantly, tag and track all the assets such as chairs / computers /tables, etc., regardless of cost. For some universities this might also be inconsistent with their financial statement treatment of these costs, requiring additional administrative effort to reconcile accounts.

In the revision to part b.(2), a sentence should be added at the end that states “For organizations subject to OMB Circular A-110, prior approval should not be required if the item of equipment was included in the approved proposal budget, or if the prior approval requirement is waived by the federal awarding agency under expanded authorities.”

Item 22 - Interest

Comments:

Section a.(1) has been revised to allow interest costs on capital assets acquired after July 1, 1982, costing over \$500,000, only if a lease/purchase analysis has been performed. The lease/purchase analysis requirement was added to A-21 on May 8, 1996, and only applied to capital assets acquired after that date. The proposed revision would now make interest costs incurred on assets acquired between July 1, 1982 and May 8, 1996 unallowable, or require universities to retroactively perform a lease/purchase analysis for such assets to determine allowability.

Sections b.(1) is new, and also has the effect of making currently allowable interest costs unallowable. May 8, 1996 was the date on which OMB revised the interest provisions of A-21 to establish more rigid criteria for reimbursement of interest costs, but the 1996 revision did not eliminate the allowability of interest costs incurred prior to that date.

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We presume these two proposed revisions were unintended; **however, if correct as stated, we object in the strongest terms possible to such a material change in policy.**

Other Suggested Revisions for this Section:

We recommend that OMB eliminate the requirement in J.22.f.(1), with its corresponding reference to the requirements of Circular A-110, for a lease-purchase analysis for facilities costing more than \$500,000. First of all, leasing a major research facility is rarely an option – new buildings being constructed by universities have special requirements that cannot be met by existing commercial property, even if such property existed. Second, universities have incentives to find the lowest cost options because the federal government pays only a percentage of the total facilities costs. Finally the lease alternative is not likely to ever be less costly than purchase because of three factors, i.e., leases include profit, property taxes, and have a high cost of capital. Universities are nonprofit organizations, exempt from property taxes, and have access to cheaper capital through tax-exempt debt, therefore making the purchase alternative more economical.

We also recommend OMB eliminate or simplify the requirement in J.22.f.(5) to conduct a monthly cash flow analysis for debt arrangements over \$1 million where the institution makes an equity contribution of less than 25%. This is a detailed labor-intensive administrative effort that must be done for the life of the asset. One way to simplify this requirement, for example, would be to eliminate the requirement for a monthly cash flow analysis, and only require an analysis of the cash flow on an annual basis.

Item 31 - Pre-Award Costs

Comments:

This revision adds a new notification requirement, which contradicts authority universities currently have under OMB Circular A-110. We recommend the following wording:

b.(1) Pre-award costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and the costs are necessary to comply with the proposed delivery schedule or period of performance.

b.(2) Pre-award costs are allowable only with the written approval of the awarding agency.

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b.(3) If the entity is subject to OMB Circular A-110, prior approval is not required unless required by the Federal agency through a condition of the Federal award or program regulations.

Item 48 – Travel Costs

Comments:

This is another new requirement that would be a step backward in administrative streamlining. A new subsection (e) is added that states that that “Direct charges for foreign travel are allowable only when the travel has received prior approval of the awarding agency. Each separate trip must receive such approval.” Under authority provided in OMB Circular A-110, some awarding agencies have waived the prior approval requirements for foreign travel. To our knowledge there has been no abuse of this provision that would warrant such a new restriction. Therefore we recommend the following be added to subsection (e): “For organizations subject to OMB Circular A-110, prior approval should not be required if the foreign travel was included in the approved proposal budget, or if the prior approval requirement is waived by the federal awarding agency under expanded authorities.”

Item 24 – Idle Facilities and Idle Capacity

Comments:

This section is new to A-21. Of particular concern is the definition and restrictions surrounding “idle capacity” in Section 24.a.3, which seems oriented to the manufacturing environment. The insertion of this section into A-21 will enable federal F&A rate negotiators to develop new interpretations of what constitutes “idle capacity” which could result in disallowances, and further complicate the space allocation process. We recommend that part a.(3) of the proposed revision be modified by deleting the language that follows the first sentence in that part. It would then read “Idle capacity means the unused capacity of partially used facilities.” Also of concern is the definition of facilities in part a.(1). As proposed, facilities means “land and buildings *or any portion thereof* (italics added for emphasis).” We are concerned that this introduces the opportunity to develop approaches that require an examination of individual floors or rooms of a building, or items of equipment, to determine whether the “facility” is idle. We recommend that the phrase “or any portion thereof” be eliminated.

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Item 29 – Patent Costs

Comments:

This is a positive change. It recognizes in Circular A-21 the standard established in the Bayh-Dole Act that universities provide the federal government with a royalty-free license, not title to an invention.

Item 34 – Proposal Costs

Comments:

The proposed change would apply the current language from A-87 to A-122, but the language in A-21 would not be revised. The new wording is clearer than current A-21 language and allows direct charging with prior approval of the awarding agency. We recommend that this revision be incorporated in Circular A-21, with the following addition: "For organizations subject to OMB Circular A-110, prior approval should not be required if proposal costs were included in the approved proposal budget, or if the prior approval requirement is waived by the federal awarding agency under expanded authorities."

New Item – Publication and Printing Costs

2. In a new section to be added to A-21, "41. Publication and Printing Costs", part c. states:

"Publication and printing costs are unallowable as direct costs except with the prior approval of the awarding agency."

Comments:

Like many of the proposed revisions, this adds a layer of administrative burden for the government and universities that is unnecessary. The following statement should be added: "For organizations subject to OMB Circular A-110, prior approval should not be required if publication and printing costs were included in the approved proposal budget, or if the prior approval requirement is waived by the federal awarding agency under expanded authorities."

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Item 37 - Recruiting

Comments:

The determination of allowable relocation costs has been greatly expanded and is very detailed and prescriptive. Any revisions intended to streamline the principles should rely on establishing allowability criteria and requiring the development of and adherence to institutional policy. We recommend that OMB use a framework similar to travel costs in establishing allowability for relocation costs.

Item 42 – Selling and Marketing Costs

Comments:

The second sentence of the revision that only applies to A-122 should also be applicable to A-21, with the following added language: “For organizations subject to OMB Circular A-110, prior approval should not be required if selling and marketing costs were included in the approved proposal budget, or if the prior approval requirement is waived by the federal awarding agency under expanded authorities.”

Item 44 – Specialized Service Facilities

Comments:

1. Motor pools have been added to the examples provided in section a. However, we believe motor pools are not and have never been considered specialized service centers. We recommend deleting motor pools as an example.
2. In section b.(ii), new language requires specialized service centers to undergo rate review and adjustment no less frequently than “bi-annually” –this is twice a year. Should this be biennially, meaning once every two years? If the intent of the revision is twice a year, this would constitute a major policy change. We recommend reconsideration to a more reasonable time period, as such a requirement could add significant administrative costs for universities.
3. The proposed change eliminates the current language in section 44 e. that permits alternative costing arrangements when it is in the best interest of the government and is approved by the cognizant federal agency. This is particularly troublesome in that it reduces flexibility and fails to recognize the real need to establish alternative costing arrangements for unusual situations. For example, this provision has been used to establish equitable costing mechanisms for those institutions that manage observatory facilities. We recommend that part e. be reinstated in the circular.

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Item 29 – Meetings and Conference Costs

Comments:

The original language in A-122 allowed costs associated with “meetings and conferences”. The proposed change applicable to all three Circulars splits out “Costs of meetings and conferences, the primary purpose of which is dissemination of technical information”, making them allowable, but goes on to state that “Costs of meetings or conferences held to conduct the general business of the non-federal entity” are allowable ONLY for A-122 entities.

Currently in A-21, Section J28, provides that costs for meetings for the dissemination of technical information are allowable, but this is in the context of “Professional activity costs”. A-21 is silent on meeting costs to conduct general business, and so they were in effect allowable in our administrative pools. The proposed change would take away that allowability for universities (and governments covered under A-87) by limiting it to A-122 entities only.

We recommend that OMB either remove the distinction between technical and general business meetings (revert to original A-122 language) or remove the “A-122 only” stipulation in the last sentence.

Item 41 – Scholarships and Student Aid Costs

Comments:

Agree – as stated in the preamble, this revision incorporates the OMB clarification on tuition remission costs.

Other Issues:

1. The OMB clarification referred to in revising cost item 41 on student aid also included important language regarding the proper treatment of certain types of cost sharing, and we recommend that clarifying language be added to the appropriate section of the circular.

2. We also recommend that OMB eliminate the requirement in Section J.12.f.(1) to provide an assurance that the depreciation amount recovered through the F&A rate be reinvested to acquire or improve research facilities. This requirement is unnecessary, inappropriate, and misrepresents the F&A rate process. F&A payments are partial reimbursements for costs already incurred to support the conduct of research. While universities do use some of the F&A cost reimbursements to acquire or improve research

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facilities, requiring this assurance not only gives the false impression that F&A payments are a source of additional revenues that must be strictly controlled, but also inappropriately shackles an institution's investment decisions.

3. In September 1997 OMB clarified a previous revision to the Circular, stating that provisional F&A rates do not meet the definition of a negotiated rate for purposes of determining future year funding of F&A costs in federal awards. We recommend this clarification be included in Circular A-21 Section G.7. We have already encountered situations where federal grant officials were unaware of the clarification and used provisional rates inappropriately in setting future year funding amounts, requiring unnecessary time and effort for institutions and grants officers to resolve and re-issue award notices.