COUNCIL ON GOVERNMENTAL RELATIONS

One Dupont Circle, Suite 670 Washington, D.C. 20036 (202) 861-2595

April 17, 1991

TO: Board of Management

FROM: Milton Goldberg MG.

SUBJECT: COGR Statement on Reexamination of University Cost Principles

As directed by you, I presented the COGR statement on reexamination of university cost principles to the presidents at the AAU meeting on April 15 and 16 in Washington. I also discussed the statement with President Langenberg, Chairman of NASULGC. He in turn discussed the statement with several NASULGC presidents. There was a good mix of both AAU and NASULGC presidents in attendance. The discussion of indirect cost problems went on for a day and one-half and as you might imagine, it was lively, emotional and filled with a wide range of opinions.

In order to assure that the COGR statement was not objectionable, I revised it somewhat, in response to focused criticism. It is now offered to you so you might reaffirm your support. Accompanying the statement is a draft letter to Mr. Hodsoll offering our assistance. Our statement provides the vehicle whereby that offer can be made.

Events are moving rather quickly. Enclosed are several additional documents for your review and information: (1) testimony by Richard Kusserow before the House Subcommittee on Health and the Environment; (2) January 15, 1991 draft of the NIH Financial Management Plan; (3) DHHS Office of Inspector General strategic plan for audits of colleges and universities; (4) tentative witness list of April 23 and 25, 1991 hearings on costs of university research before House Subcommittee on Science; (5) Kusserow estimated cost savings from capping rates; and (6) AAU statement on indirect costs.

Please respond by FAX on the policy statement by Friday, April 19, 1991.

Enclosures

COUNCIL ON GOVERNMENTAL RELATIONS

One Dupont Circle, Suite 670 Washington, D.C. 20036 (202) 861-2595

April 15, 1991

DRAFT

Mr. Francis Hodsoll
Executive Associate Director and
Chief Financial Officer
Management
Office of Management and Budget
Old Executive Office Building
Room 260
Washington, D.C. 20503

Dear Mr. Hodsoll:

On April 12, 1991 the Board of Management of the Council on Governmental Relations adopted a statement on the stewardship of public funds, which was prompted by hearings held by the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations. The purpose of this letter is to bring this statement to your attention and to offer assistance in efforts to restore confidence in the management of research funds in areas where confidence has been eroded. We are aware of your initiative to convene a group to address this matter and we offer our knowledge and expertise to your group.

In that regard you will be interested in a booklet which specifies good management practices for externally funded projects at colleges and universities. We have made it available to our membership which consists of 136 major research universities in the United States, along with the statement cited above.

Please let us know how we can help.

Sincerely,

DRAFT

Milton Goldberg

Enclosures

cc: Board of Management
Allan Bromley, Office of Science and Technology Policy
Caspa Harris, National Association of College and University Business Officers
Robert Atwell, American Council on Education
Robert Clodius, National Association of State Universities and Land-Grant Colleges
Robert Petersdorf, Association of American Medical Colleges
Robert Rosenzweig, Association of American Universities

STATEMENT OF THE COGR BOARD OF MANAGEMENT

Recent hearings held by the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations have **raised questions about** ~~pointed out shortcomings in~~ university stewardship of public funds. The COGR Board recognizes the need for change in the system which is used to reimburse colleges and universities for the indirect costs of research. Any loss of public confidence in financial management at our institutions is particularly serious. Therefore, a comprehensive reexamination of the university cost principles, including the definition of allowable costs, is necessary at this time.

~~The status quo, which can produce wide variations in administrative cost rates, is no longer acceptable. COGR reiterates the endorsement of recommendations made by the White House Science Council in its 1986 report (Packard-Bromley) and the 1988 "Pings' Committee" report. These reports contain recommendations which would narrow the variances.~~

Recommendations contained in the report of the White House Science Council in 1986 (Packard-Bromley Report) and the 1988 "Ping's Committee" report offer thoughtful suggestions for change. COGR reiterates its endorsement of those reports.

The COGR Board urges **its member** ~~research~~ universities to affirm their responsibility to provide internal controls and **where** ~~make the~~ necessary, **make** investments to improve procedures to safeguard public funds.

It is time to address these issues. COGR is ready to assist in any effort to restore public confidence in our colleges and universities.

April 12, 1991

TESTIMONY

OF

RICHARD P. KUSSEROW

INSPECTOR GENERAL

DEPARTMENT OF HEALTH AND HUMAN SERVICES

BEFORE THE

SUBCOMMITTEE ON HEALTH AND THE ENVIRONMENT

COMMITTEE ON ENERGY AND COMMERCE

ON

INDIRECT COSTS

APRIL 16, 1991

GOOD MORNING, I AM RICHARD P. KUSSEROW, INSPECTOR GENERAL OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES. I AM HERE THIS MORNING TO DISCUSS WITH YOU OUR RESPONSIBILITY FOR AUDITING EXPENDITURES MADE UNDER GRANTS AND CONTRACTS AWARDED TO COLLEGES AND UNIVERSITIES. PARTICULARLY, I WANT TO SHARE WITH YOU OUR EXPERIENCES WITH INDIRECT COSTS ASSOCIATED WITH BIOMEDICAL RESEARCH AT THESE SCHOOLS AND SOME OPTIONS FOR CONTROLLING THESE COSTS.

OMB CIRCULAR A-88 GENERALLY ASSIGNS COGNIZANT AUDIT RESPONSIBILITY TO THE DEPARTMENT THAT HAS THE MOST MONEY AT RISK. MORE THAN 90 PERCENT OF THE COLLEGES, UNIVERSITIES AND NONPROFIT ORGANIZATIONS HAVE BEEN ASSIGNED TO THE JURISDICTION OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES. TWO HUNDRED SEVENTY-SIX OF THESE SCHOOLS RECEIVE VIRTUALLY ALL OF OUR FEDERAL RESEARCH DOLLARS. UNDER OMB CIRCULAR A-88 AND RELATED CIRCULARS, WE RELY, TO THE MAXIMUM EXTENT POSSIBLE, ON INDEPENDENT PUBLIC ACCOUNTANTS TO AUDIT FINANCIAL AND COMPLIANCE ISSUES AT COLLEGES, UNIVERSITIES AND NONPROFIT ORGANIZATIONS UNDER OUR COGNIZANCE.

OUR OVERSIGHT ROLE AND AUDIT WORK IN THIS AREA HAVE MADE US ACUTELY AWARE OF THE PRESSURES TO INCREASE INDIRECT COSTS, CERTAIN PROBLEMS IN THE WAY INDIRECT COSTS ARE ALLOCATED, AND THE EFFECT HIGH INDIRECT COSTS HAVE ON THE FINITE DOLLARS AVAILABLE FOR RESEARCH. THIS IS OF PARTICULAR CONCERN FOR BIOMEDICAL RESEARCH.

BACKGROUND

HISTORICAL DATA SHOW THAT THE VOLUME OF RESEARCH PERFORMED AND THE COST OF RESEARCH HAS CONTINUED TO RISE OVER THE YEARS. THERE IS NO REASON TO BELIEVE THAT THIS TREND WILL NOT CONTINUE. FISCAL CONSTRAINTS AND COMPETITION FOR SHRINKING BUDGET DOLLARS WILL RESULT IN MORE ATTENTION ON HOW TO INCREASE THE AMOUNT OF MONEY FOR DIRECT RESEARCH AT THE EXPENSE OF INDIRECT OR OVERHEAD COSTS.

TOTAL FEDERAL RESEARCH AND DEVELOPMENT OBLIGATIONS TO COLLEGES AND UNIVERSITIES HAVE INCREASED FROM $5.6 BILLION IN 1984 TO OVER $9.2 BILLION CURRENTLY. THIS REPRESENTS AN INCREASE IN FUNDING OF 64 PERCENT. INDIRECT COSTS PROVIDED TO COLLEGES AND UNIVERSITIES OVER THE SAME PERIOD HAVE INCREASED FROM $1.5 BILLION IN 1984 TO $2.5 BILLION. A MAJORITY OF THE GRANT MONEY COMES FROM THE PUBLIC HEALTH SERVICE OF OUR DEPARTMENT. THE NATIONAL INSTITUTES OF HEALTH (NIH) FUNDING ALONE CURRENTLY ACCOUNTS FOR $3.9 BILLION OF WHICH $1.25 BILLION IS FOR INDIRECT COSTS. FOR FY 1989, PHS PROVIDED 23,264 EXTRAMURAL AWARDS (RESEARCH GRANTS AND CONTRACTS) TO COLLEGES, UNIVERSITIES AND NONPROFIT ORGANIZATIONS AMOUNTING OVER $5 BILLION. THIS REPRESENTS AN INCREASE FROM FY 1988 OF 154 AWARDS AND $311 MILLION IN FUNDING.

I AM PROVIDING THE COMMITTEE WITH A LIST OF TWENTY MAJOR COLLEGES AND UNIVERSITIES RECEIVING THE LARGEST PHS GRANT FUNDS. AS THE

LIST ILLUSTRATES, INDIRECT COST RATES, AS A PROPORTION OF DIRECT COSTS, RUN FROM 38.5 PERCENT TO 70.5 PERCENT AT THESE INSTITUTIONS.

DIRECT AND INDIRECT COSTS

THE TOTAL COST OF ANY RESEARCH PROJECT INCLUDES BOTH DIRECT AND INDIRECT COSTS. DIRECT COSTS ARE THOSE THAT CAN BE IDENTIFIED SPECIFICALLY WITH A PARTICULAR SPONSORED PROJECT, INSTRUCTIONAL ACTIVITY OR ANY OTHER INSTITUTIONAL ACTIVITY; OR THAT CAN BE ASSIGNED DIRECTLY TO SUCH ACTIVITIES WITH A HIGH DEGREE OF PRECISION. EXAMPLES OF DIRECT COSTS INCLUDE SALARIES AND WAGES OF THOSE WORKING ON THE PROJECTS, LABORATORY SUPPLIES, EQUIPMENT AND SUBCONTRACTS. MODIFIED TOTAL DIRECT COSTS (MTDC) IS AN IMPORTANT SUBCATEGORY OF DIRECT COSTS. IT USUALLY INCLUDES ALL DIRECT COSTS EXCEPT EQUIPMENT AND THAT PORTION OF SUBCONTRACT COSTS IN EXCESS OF $25,000. MODIFIED DIRECT COSTS ARE SIGNIFICANT BECAUSE THEY ARE THE BASIS CURRENTLY USED TO DETERMINE THE EXTENT TO WHICH INDIRECT COSTS ARE ASSIGNED TO INDIVIDUAL FEDERAL GRANTS AND CONTRACTS.

INDIRECT COSTS ARE IN EFFECT UNALLOCATED OVERHEAD. THEY INCLUDE THOSE COSTS THAT HAVE BEEN INCURRED FOR COMMON OR JOINT OBJECTIVES OF THE UNIVERSITY AND THE RESEARCH EFFORT HOUSED AT THEIR FACILITIES. THEY CANNOT ALWAYS BE IDENTIFIED READILY AND SPECIFICALLY WITH A PARTICULAR SPONSORED PROJECT, OR INSTITUTIONAL ACTIVITY.

THE AVERAGE INDIRECT COST RATE FOR MAJOR RESEARCH UNIVERSITIES NEGOTIATED BY HHS HAS REMAINED FAIRLY STABLE AT 48 PERCENT IN 1985 TO ABOUT 51 PERCENT IN 1990. HOWEVER, MANY SCHOOLS OVER THIS PERIOD HAVE REQUESTED SIGNIFICANT INCREASES IN THEIR INDIRECT COST RATES. WHEN THIS OCCURS, THE DIVISION OF COST ALLOCATION IN OUR DEPARTMENT ENTERS INTO NEGOTIATIONS WITH THE INSTITUTION IN QUESTION. OUR AUDIT STAFF IS CALLED UPON TO SUPPORT THIS PREAWARD WORK. THE OVERALL EFFORT HAS GREATLY LIMITED THE RISE IN INDIRECT COSTS AT HHS COGNIZANT SCHOOLS.

OMB CIRCULAR A-21

OMB CIRCULAR A-21 (COST PRINCIPLES FOR EDUCATIONAL INSTITUTIONS) PROVIDES TO COLLEGES AND UNIVERSITIES, AS WELL AS FEDERAL AGENCIES, THE PRINCIPLES FOR DETERMINING THE COSTS APPLICABLE TO RESEARCH AND OTHER WORK PERFORMED UNDER FEDERALLY SPONSORED AGREEMENTS. THE PRINCIPLES ATTEMPT TO IDENTIFY THE EXTENT OF AGENCY AND INSTITUTIONAL PARTICIPATION IN FINANCING THE COSTS OF A PARTICULAR PROJECT. THE PRINCIPLES WERE DESIGNED SO THAT THE FEDERAL GOVERNMENT WOULD BEAR ITS FAIR SHARE OF TOTAL COSTS, DETERMINED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, EXCEPT WHERE RESTRICTED OR PROHIBITED BY LAW.

THE PRINCIPLES IN A-21 FOR FEDERAL GRANTS WERE ESTABLISHED OVER 30 YEARS AGO WHEN THE RESEARCH ENVIRONMENT AND FEDERAL FUNDING WERE LESS COMPLEX. THE CIRCULAR HAS BEEN MODIFIED ONLY 8 TIMES OVER THE

YEARS AND HAS NOT KEPT PACE WITH CHANGES IN THE SCIENTIFIC RESEARCH ARENA AND WITH TODAY'S BUSINESS AND ACCOUNTING PRACTICES. BY CONTRAST, THE FEDERAL ACQUISITION REGULATIONS (FAR), RELATING TO CONTRACTS, ARE MODIFIED ALMOST MONTHLY TO KEEP UP WITH PROBLEMS AND CHANGING BUSINESS PRACTICES.

IN RESPONSE TO THE GROWING CONCERN OVER INDIRECT COST ISSUES, THE EXECUTIVE COMMITTEE OF THE ASSOCIATION OF AMERICAN UNIVERSITIES (AAU) CHARGED AN AD HOC COMMITTEE, IN 1988 TO REVIEW THE CURRENT SYSTEM, PARTICULARLY THE RULES SET FORTH IN CIRCULAR A-21 AND TO IDENTIFY SUGGESTIONS FOR CHANGE. ACCORDING TO THE COMMITTEE'S DRAFT REPORT, THE ENTIRE CONTEXT IN WHICH THE INDIRECT COST SYSTEM OPERATES IS CHANGING. IMPORTANT CHANGES INCLUDE PRESSURES ON UNIVERSITY FACULTY, CUMULATIVE EFFECTS OF CONFLICTS BETWEEN RESEARCH FACULTY AND UNIVERSITY OFFICERS OVER INDIRECT COSTS, INCREASING OBSOLESCENCE OF RESEARCH FACILITIES AND EQUIPMENT, AND THE BASIC RELATIONSHIP BETWEEN UNIVERSITIES AND THE FEDERAL GOVERNMENT'S SUPPORT OF RESEARCH.

RECENT OMB CIRCULAR CHANGES

OMB CIRCULAR A-110 (UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND OTHER AGREEMENTS WITH INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS AND OTHER NONPROFIT ORGANIZATIONS) CONTAINS GUIDANCE TO GRANTEES AND CONTRACTORS FOR FINANCIAL MANAGEMENT OF FEDERAL FUNDS RECEIVED. PREVIOUSLY, ATTACHMENT F OF CIRCULAR A-110 CONTAINED

PROVISIONS FOR ORGANIZATION-WIDE AUDIT AT COLLEGES AND UNIVERSITIES. HOWEVER, ATTACHMENT F WAS FOUND TO BE INADEQUATE. FOR EXAMPLE, IT DID NOT REQUIRE THE SCHOOLS TO SUBMIT THE RESULTS OF THEIR AUDITS TO THE FEDERAL GOVERNMENT. ALSO, THE AUDIT REQUIREMENTS LACKED SUFFICIENT DETAIL AND DID NOT REQUIRE THAT SUCH AUDITS BE DONE IN ACCORDANCE WITH GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS.

TO STRENGTHEN AUDIT REQUIREMENTS FOR COLLEGES AND UNIVERSITIES, OMB ISSUED CIRCULAR A-133 (AUDITS OF INSTITUTIONS OF HIGHER EDUCATION AND OTHER NONPROFIT INSTITUTIONS). OUR OFFICE WORKED CLOSELY WITH OMB TO DEVELOP THIS CIRCULAR WHICH ESTABLISHES AUDIT REQUIREMENTS AND DEFINES FEDERAL RESPONSIBILITY FOR COLLEGES AND UNIVERSITIES. THIS NEW CIRCULAR, EFFECTIVE IN 1990, REQUIRES THAT SCHOOLS HAVE AN AUDIT OF FEDERAL AWARDS EVERY 2 YEARS. THE FULL IMPLEMENTATION OF THIS CIRCULAR WILL SUBSTANTIALLY INCREASE AUDIT COVERAGE AT THESE INSTITUTIONS.

LESSONS LEARNED

THE DHEW AUDIT AGENCY WAS ESTABLISHED IN 1966 AND BECAME PART OF THE INSPECTOR GENERAL'S OFFICE IN 1976. OVER THESE MANY YEARS, WE HAVE PERFORMED THOUSANDS OF AUDITS IN COLLEGES AND UNIVERSITIES. BETWEEN FISCAL YEARS 1988 - 1990, WE HAVE PERFORMED, EITHER DIRECTLY BY OUR STAFF OR THROUGH NONFEDERAL AUDITORS, OVER 2,000 AUDITS. ONLY ABOUT 1 PERCENT OF THE DEPARTMENT'S OUTLAYS ARE IN

RESEARCH GRANTS TO UNIVERSITIES AND NONPROFIT AGENCIES. YET, WE DEVOTE APPROXIMATELY FIVE TIMES THAT RATE AS PART OF OUR AUDIT WORK PLAN. EVEN THIS RATE REPRESENTS ONLY A TINY FRACTION OF THE RESOURCES NEEDED TO AUDIT EFFECTIVELY ALL THE SCHOOLS ASSIGNED TO OUR DEPARTMENT. YET, IT RAISES SERIOUS CONCERNS IN OUR MIND AS TO WHETHER IT SERVES THE BEST INTEREST OF OUR DEPARTMENT TO DIVERT MORE RESOURCES FROM OTHER PARTS OF OUR DEPARTMENT, SUCH AS SOCIAL SECURITY, MEDICARE, SOCIAL PROGRAMS, ETC., IN ORDER TO INCREASE COVERAGE. THE BETTER ANSWER HAS TO BE IN HOW WE CONDUCT BUSINESS WITH THESE INSTITUTIONS.

OUR AUDIT FINDINGS HAVE PROVIDED US WITH MANY INSIGHTS INTO THE PROBLEMS IN FUNDING RESEARCH AND HAVE LED TO THE DEVELOPMENT OF A "LONG RANGE STRATEGY FOR REVIEWING THE FINANCIAL AND PROGRAMMATIC RESEARCH ACTIVITIES CONDUCTED BY COLLEGES, UNIVERSITIES AND NONPROFIT ORGANIZATIONS FOR THE FEDERAL GOVERNMENT" (WHICH WE ARE SUBMITTING FOR THE RECORD):

- OVER 85 PERCENT OF THE AUDIT FINDINGS DURING THE LAST 3 YEARS INVOLVED INTERNAL CONTROL PROBLEMS RELATED TO SPECIFIC COST ELEMENTS OR ACTIVITIES. WE IDENTIFIED OVER 2,200 SUCH PROBLEMS, ALL OF WHICH HAVE COST IMPLICATIONS. AN INTERNAL CONTROL SYSTEM IS AN OVERALL PLAN OF ORGANIZATION AND METHODS EMPLOYED TO ENSURE THE RELIABILITY OF ACCOUNTING DATA, SAFEGUARD ASSETS, PROMOTE EFFICIENCY AND ENSURE COMPLIANCE WITH ESTABLISHED POLICIES. AS AN

EXAMPLE, OUR AUDITS FOUND WEAKNESSES IN CASH MANAGEMENT WHICH RESULTED IN SCHOOLS REQUESTING CASH FROM THE FEDERAL GOVERNMENT IN EXCESS OF THEIR NEEDS. IN OTHER EXAMPLES, WE FOUND THAT SCHOOLS WERE IMPROPERLY RECORDING PURCHASES OF EQUIPMENT.

- OUR LONG RANGE STRATEGY DOCUMENT BUILDS UPON THIS BODY OF WORK AND IS DESIGNED TO ADDRESS THE SYSTEMIC INTERNAL CONTROL PROBLEMS UNCOVERED BY THESE AUDITS. IN THE LONG RANGE STRATEGY, WE DEFINE OVER 40 AUDIT AREAS WHERE OUR STAFF HAVE ONGOING OR PLANNED WORK. THIRTEEN AREAS WILL ADDRESS COST CONTAINMENT ISSUES. FOR EXAMPLE, WE WILL: (1) IDENTIFY EXISTING GOVERNMENTWIDE COST CONTAINMENT INITIATIVES WHICH HAVE BEEN EFFECTIVE AND DETERMINE IF THEY MIGHT BE APPLIED TO COLLEGES AND UNIVERSITIES; AND (2) REVIEW HOW NIH FUNDS ARE USED. THIS REVIEW WILL ALSO CONSIDER WHAT INFORMATION NIH NEEDS TO PROPERLY MONITOR RESEARCH COSTS.

WE HAVE REVIEWS UNDERWAY AT 13 SCHOOLS FOCUSING ON CHARGES MADE TO INDIRECT COST CENTERS. TEN AREAS WILL ADDRESS INDIRECT COST REIMBURSEMENT ISSUES. SEVENTEEN OF OUR AUDIT AREAS WILL ADDRESS THE FEDERAL SYSTEM FOR FUNDING RESEARCH AND THE ADEQUACY OF FEDERAL OVERSIGHT, AND WILL IDENTIFY ALTERNATIVE APPROACHES TO MONITORING RESEARCH EFFORTS.

THE MAJOR THRUST OF ALL OUR REVIEWS IS TO DETERMINE: (1) WHETHER SUCH CHARGES ARE ALLOWABLE AND APPROPRIATE UNDER A-21; AND (2) THE NATURE OF SUCH CHARGES AND THE DEGREE OF THEIR RELATIONSHIP TO ACTIVITIES WHICH SUPPORT RESEARCH EFFORTS.

OUR AUDIT FINDINGS OVER THE YEARS LEAD US TO BELIEVE THAT THERE MUST BE BETTER WAYS FOR THE FEDERAL GOVERNMENT TO DEAL WITH RESEARCH GRANTS. THERE ARE MANY OPTIONS FOR BETTER ENSURING THAT THE DOLLARS AVAILABLE PRODUCE THE MAXIMUM SUPPORT FOR SCIENTIFIC RESEARCH. AMONG THOSE OPTIONS THAT MIGHT BE CONSIDERED FOR FURTHER STUDY INCLUDE:

- SIGNIFICANTLY MODIFY, CLARIFY, OR REPLACE OMB CIRCULAR A-21. PRESENTLY, MANY BELIEVE THE CIRCULAR TENDS TO CAUSE MORE PROBLEMS THAN IT CURES.

- BLOCK GRANT RESEARCH DOLLARS TO UNIVERSITIES. UNDER THIS OPTION, INSTITUTIONS WOULD BE GIVEN A SET AMOUNT OF MONEY TO MEET THE JOINT GOVERNMENTAL INSTITUTION RESEARCH GOALS. THE INSTITUTION WOULD DETERMINE HOW MUCH WOULD GO FOR DIRECT AND INDIRECT COSTS.

- AWARD RESEARCH DOLLARS TO PRINCIPAL INVESTIGATORS. THE INVESTIGATOR WOULD THEN BE RESPONSIBLE FOR INCLUDING IN THEIR PROPOSALS THE INDIRECT COST COMPONENT AT THE SCHOOL

WHERE THE RESEARCH WILL TAKE PLACE. THE INVESTIGATOR AND THE SCHOOL WOULD BE FORCED TO NEGOTIATE DIRECT AND INDIRECT COSTS.

- MANDATE A STANDARDIZED ACCOUNTING SYSTEM FOR THE MAJOR COLLEGES AND UNIVERSITIES HOSTING FEDERAL RESEARCH GRANTS THAT WOULD REDUCE VARIATION AMONG SCHOOLS AS TO HOW THEY ACCOUNT FOR AND ALLOCATE COSTS.

- PLACE A CAP ON THE INDIRECT COST RATE. FOR EXAMPLE, LIMIT THE INDIRECT COST RATES TO 50 PERCENT OF THE DIRECT COSTS. UNDER THIS OPTION, THE SAVINGS FROM CAPPING THE INDIRECT COSTS WOULD INCREASE THE NUMBER OF GRANTS AND FUNDING LEVELS FOR SCIENCE.

- LIMIT THE INDIRECT COST RATE FOR GOVERNMENT RESEARCH GRANTS TO THE LOWEST LEVEL CHARGED BY THE INSTITUTION TO OTHER U.S. AND FOREIGN ENTITIES. BASED ON OUR EXPERIENCES, WE HAVE OBSERVED EVIDENCE OF A TREND TOWARD DIFFERENTIAL TREATMENT FOR RESEARCH FUNDED BY THE GOVERNMENT VS. RESEARCH PERFORMED FOR U.S. AND FOREIGN CORPORATIONS AND FOUNDATIONS.

- MANDATE "COST SHARING" FOR RESEARCH, I.E., THE SCHOOL WOULD CONTRIBUTE A PERCENTAGE OF THE TOTAL COST OF RESEARCH. THIS NOTION OF COST SHARING WAS IN PLACE BACK IN THE MID-EIGHTIES. IT WAS NOT EQUITABLE AMONG ALL SCHOOLS, SO THE

PRACTICE WAS DISCONTINUED. WITH ADDITIONAL THOUGHT AND WORK, COST SHARING MIGHT BE FEASIBLE.

- LIMIT INDIRECT COSTS TO ONLY THESE EXPENDITURES THAT ARE ADD-ON COSTS TO THE INSTITUTIONS FOR SUPPORTING THE RESEARCH. THOSE COSTS TO THE UNIVERSITY THAT WOULD BE INCURRED WHETHER OR NOT THE RESEARCH WAS BEING CONDUCTED WOULD THEREBY NOT BE ELIGIBLE FOR INDIRECT COST SUPPORT.

- INCREASE FUNDING FOR FEDERAL AUDIT AND COST ALLOCATION WORK IN ORDER TO PROVIDE MORE OVERSIGHT OVER INSTITUTIONS.

- DO AWAY WITH GOVERNMENTWIDE RULES, AND ALLOW GRANTING AGENCIES TO NEGOTIATE THE RATES FOR THEIR AGENCIES' GRANT PROGRAMS SEPARATELY. CURRENTLY, AT NIH, FOR EXAMPLE, SCIENTISTS SUBMIT PROPOSALS FOR NEW GRANTS TO SCIENTISTS. HOWEVER, THE INDIRECT COST RATES ARE NEGOTIATED WITHOUT EITHER SCIENTIFIC PARTY. IT TAKES PLACE BETWEEN THE ACCOUNTANTS AT THE UNIVERSITY FINANCE OFFICE AND THE ACCOUNTANTS FOR THE DEPARTMENT. THE PROPOSED OPTION WOULD MEAN AN AGENCY COULD NEGOTIATE A RATE FOR ALL THEIR GRANTS BY DISCIPLINE. IN THIS WAY, BIOMEDICAL RESEARCH AND SOCIAL RESEARCH COSTS COULD HAVE DIFFERENT RATES.

ANOTHER PROBLEM THAT WE HAVE ENCOUNTERED THAT MAY BE WORTHY OF FURTHER STUDY BY THE CONGRESS IS THE ISSUE OF RECOVERY OF

INAPPROPRIATE EXPENDITURES CHARGED AGAINST THE INDIRECT COST POOLS. CURRENTLY, WHEN OUR AUDITORS NOTE FINDINGS WHICH ARE SUSTAINED, THERE IS NO CHECK THAT IS TENDERED BACK TO THE PROGRAM FOR FUTURE USE IN SCIENTIFIC RESEARCH. THE GENERAL PRACTICE IS TO OFFSET THE AMOUNT AGAINST FUTURE INDIRECT COST RATES. IN SOME CASES THERE MAY BE ADJUSTMENTS BETWEEN THE DIRECT AND INDIRECT COST POOLS. THE NET EFFECT IS THAT THE MONEY SELDOM LEAVES THE CAMPUS. ON SOME FAIRLY RARE OCCASIONS, THERE HAVE BEEN CHECKS WRITTEN TO PAY BACK THE MONEY. HOWEVER, THE FUNDS DO NOT GO TO BE REPROGRAMMED FOR NEW RESEARCH, BUT TO THE GENERAL FUND OF THE TREASURY. IN OUR JUDGMENT, THE SYSTEM DOES NOT LEAD TO MUCH IN THE WAY OF ACCOUNTABILITY OR INCENTIVES FOR EFFICIENT USE OF THOSE FUNDS. CONGRESS MAY WISH TO EXPLORE A LEGAL MECHANISM THAT WOULD CAUSE THE ACTUAL RECOVERY OF FUNDS TO BE RETURNED FOR PROGRAMMING FOR FUTURE FUNDING OF SCIENCE.

THIS CONCLUDES MY TESTIMONY. I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

RESEARCH AND INDIRECT COSTS - TOP 20 COLLEGES AND UNIVERSITIES

SCHOOLS WITH HHS COGNIZANCE

(DOLLARS IN THOUSANDS)

INSTITUTION	TOTAL R&D AWARDS*	ESTIMATED INDIRECT COSTS	DIRECT COSTS	RATE AS A PROPORTION OF DIRECT COSTS
JOHNS HOPKINS UNIV.	211,879	83,467	128,412	65.00%
UNIV. OF WASHINGTON	203,691	70,560	133,131	53.00%
UNIV. OF CALIF. @ LOS ANGELES	170,839	55,407	115,432	48.00%
UNIV. OF MICHIGAN	167,865	62,290	105,575	59.00%
UNIV. OF CALIF. @ SAN DIEGO	166,601	54,788	111,813	49.00%
UNIV. OF CALIF. @ SAN FRANCISCO	159,027	44,206	114,821	38.50%
UNIV. OF WISCONSIN @ MADISON	150,474	45,978	104,496	44.00%
YALE	146,245	59,194	87,051	68.00%
HARVARD	141,760	58,616	83,144	70.50%
UNIV. OF PENNSYLVANIA	132,805	52,317	80,488	65.00%
UNIV. OF CALIF. @ BERKELEY	131,070	43,104	87,966	49.00%
UNIV. OF MINNESOTA	128,727	39,333	89,394	44.00%
UNIV. OF SOUTHERN CALIFORNIA	114,766	43,261	71,505	60.50%
DUKE	108,611	36,204	72,407	50.00%
WASHINGTON UNIV.	102,974	39,410	63,564	62.00%
UNIV. OF COLORADO	101,345	30,613	70,732	43.28%
UNIV. OF NO. CAR/CHAPEL HILL	93,244	28,715	64,529	44.50%
UNIV. OF PITTSBURGH	91,094	27,392	63,702	43.00%
UNIV. OF CHICAGO	90,611	35,695	54,916	65.00%
UNIV. OF TEXAS @ AUSTIN	84,619	27,055	57,564	47.00%
TOTAL	$2,698,247	$937,605	1,760,642	53.25%

*FY 1989

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

APR 15 1991

Mr. Milton Goldberg
Council on Governmental Relations
One Dupont Circle, N.W.
Washington, D.C. 20036

'91 APR 16 P12

Dear Mr. Goldberg:

Enclosed for your information is our strategic plan entitled, "Long-Range Strategies for Reviewing the Financial and Programmatic Research Activities Conducted by Colleges, Universities and Nonprofit Organizations for the Federal Government." This strategy paper outlines long-term initiatives planned to be undertaken by our office in order to fulfill its mission related to about $9 billion in annual Governmentwide research expenditures at colleges and universities. As the cognizant Federal organization for most audits of major research schools in this country, we are committed to ensure that costs charged to Federal research are reasonable, allowable and properly allocated and that research is conducted in an economical and efficient manner for the purposes intended.

This strategic plan is a long-range endeavor, one which we expect will be accomplished over a 5-year period. We hope to be able to work closely with you and your staff in the coming months and years to address a number of the issues outlined in this plan.

If you have any comments with regard to any of these initiatives, or would like more information, please contact me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3583.

Sincerely yours,

Thomas D. Roslewicz

Thomas D. Roslewicz
Deputy Inspector General
for Audit Services

Enclosure

Milt,
Thanks for the
information now
shared with me.
Tom R

Long-Range Strategies

for

Reviewing the Financial and
Programmatic Research Activities
Conducted by
Colleges, Universities and
Nonprofit Organizations
for the Federal Government

Office of Inspector General
Office of Audit Services
Public Health Service Audit Division

PREFACE

There were a number of developments during the late 1980s that have caused the Office of Inspector General *(OIG)* and the Office of Audit Services *(OAS)* to devote a larger portion of our resources to college, university and nonprofit organization audits. These included increased reports of scientific misconduct, intense congressional interest in the rising cost of research, the AIDS crisis and the attendant increase in research grants to address this problem, and increased requests by Federal grant and contract managers for more audit work to assist them in carrying out their management and stewardship responsibilities.

In 1988, the Inspector General reassessed this entire area and decided to create the Public Health Service Audit Division *(PHSAD)*. PHSAD was given the responsibility for audit oversight of Federal funds awarded to colleges, universities and nonprofit organizations. This was a logical transfer since the majority of the funds awarded by the Department to colleges, universities and nonprofit organizations are awarded by the Public Health Services' National Institutes of Health.

PHSAD was given the responsibility of providing direction and oversight of college, university and nonprofit organization audits performed by our regions and audits performed at the PHS headquarters level. In addition, PHSAD was required to include in its annual audit workplan assignments concerning research colleges, universities and nonprofit organizations. This strategic long-range plan is a first effort by PHSAD to meet this responsibility and to address its oversight role through the 1990s.

This plan outlines an approach that will differ somewhat from previous work done in the college, university and nonprofit audit arena. Events and changes in government policy have brought about some of these changes. For example, OMB Circular A-133 will have a major impact on our work, the Federal Managers Financial Integrity Act has placed a renewed emphasis on the need for internal controls systems that work, and Congress is becoming more and more concerned about the rising cost of research. We believe this plan will help PHSAD fulfill its organizational objectives and address these new concerns during the 1990s.

TABLE OF CONTENTS

Appendix 4
THE FIFTY GRANTEES WHICH RECEIVED MOST PHS GRANT FUNDS

Appendix 5
TRENDS IN INDIRECT COSTS RECIPIENTS OF PHS GRANTS AND CONTRACTS

Appendix 6
TARGETS OF AUDIT OPPORTUNITY

Appendix 7
AVERAGE INDIRECT COST RATE COMPONENTS FOR MAJOR RESEARCH UNIVERSITIES NEGOTIATED BY PHS

Appendix 8
MEMO REGARDING IDENTIFICATION OF POSSIBLE COLLEGES AND UNIVERSITIES FOR AUDIT

1 Introduction

The Public Health Service Audit Division (*PHSAD*) was established in October 1988 to provide increased audit emphasis to the programs of the Public Health Service. Responsibility for colleges, universities and nonprofit organizations was officially transferred to PHSAD effective June 1, 1989. The transfer provided PHSAD with the ability to combine in one audit division, internal and external audit work related to Federal research awards.

Specific audit functions were also transferred to PHSAD which included the direction and oversight of college, university and nonprofit audits performed by the Office of Audit Services regional offices and the preparation of a proposed annual workplan for colleges, universities and nonprofit organization audits. The workplan will coordinate plans for college, university and nonprofit organization audits with planned internal audit work at PHS and include plans for the performance of reimbursable audit work.

Total Federal research and development obligations to colleges and universities have increased from $5.6 billion in 1984 to $8.2 billion in 1989 *(see Appendix 1)*. This represents an increase in funding of 46 percent. Indirect costs provided to colleges and universities has increased from $1.5 billion in 1984 to $2.3 billion in 1989 *(see Appendix 2)*.

Total Federal obligations to nonprofit institutions for research and development have increased from $1.6 billion in 1985 to over $2 billion for 1989.

The Public Health Service provides funding to colleges, universities and nonprofit organizations for research and development through the National Institutes of Health *(NIH)*, the Alcohol, Drug Abuse, and Mental Health Administration *(ADAMHA)*, the Health Resources and Services Administration *(HRSA)*, the Agency for Health Care Policy and Research *(AHCPR)*, the Agency for Toxic Substances and Disease Registry *(ATSDR)*, the Centers for Disease Control *(CDC)*, and the Indian Health Service *(IHS)*. For FY 1989, PHS provided 23,264 extramural awards *(research grants and contracts)* to colleges, universities and nonprofit organizations amounting to $4.7 billion. This represents an increase from FY 1988 of 154 awards and $311 million in funding *(see Appendix 3)*. Attached is a list of the fifty grantees which received the most PHS grant funds for FY 1989 *(see Appendix 4)*. Statistics show that the average award increased by 6 percent in FY 1989. Trends in indirect costs for recipients of PHS awards for FY's 1983 through 1988 show that indirect costs for colleges,

universities and nonprofit organizations increased 2.3 percent and 3.5 percent respectively *(see Appendix 5)*.

Federal audit policy *(OMB Circular A-88)* places with the Department of Health and Human Services, Office of the Inspector General *(HHS\OIG)* responsibility for audit of all Federal funds for most colleges, universities and nonprofit organizations under its cognizance. Work performed by HHS\OIG for other Federal departments is reimbursed directly.

In accordance with Federal audit policy contained in OMB Circular A-88, OAS relies to the maximum extent possible on audits performed by independent public accountants to provide coverage of financial and compliance issues at colleges, universities and nonprofit organizations under our cognizance. OMB Circular A-133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.

Expenditures made under grants and contracts awarded to colleges and universities are subject to the cost principles contained in OMB Circular A-21. The principles attempt to identify the extent of agency and institutional participation in financing the costs of a particular project. The principles are designed so that the Federal Government bears its fair share of total costs, determined in accordance with generally accepted accounting principles, except where restricted or prohibited by law.

OMB Circular A-21 establishes principles for determining costs of grants, contracts, and other agreements with nonprofit organizations. The principles outlined in Circular A-21 and Circular A-122 shall be used by all Federal agencies in determining the propriety of costs claimed for research work.

Federal departments and agencies annually provide funding to institutions of higher education and nonprofit organizations to support a broad array of research activities. Research funding is provided through awards *(grants and contracts)* that include certain terms and conditions that must be met. These terms as well as administrative rules, cost principles, and specific statutory requirements outline the responsibilities imposed on the recipients of Federal funds. One of the principal purposes of OMB Circular A-133, Audits of Institutions of Higher Education and Other Non-Profit Institutions, is to require audits that will determine whether a grantee has internal accounting and other controls that provide reasonable assurance that it is managing Federal awards in compliance with these terms, applicable laws and regulations.

OMB Circular A-133 requires that colleges, universities and nonprofit organizations:

- *arrange for audits by obtaining audit services from an independent public accounting firm or through intergovernment agreement or in response to statutory audit relationships (e.g., cases in which agencies are required to be audited by elected auditors or appointed legislative auditors);*

- *identify in their accounts all Federal funds received and expended and the programs under which they are received so that the independent auditor can determine which programs are major programs under applicable definitions and must be tested, and how to design audit tests considering various risk factors such as newness and changed conditions, the extent to which the program is subgranted or contracted out, the adequacy of controls, etc.;*

- *determine whether subgrantees to which they award $25,000 or more in Federal financial assistance have met the applicable federal audit requirements;*

- *determine whether subgrantees have spent Federal assistance funds in accordance with applicable laws and regulations through review of required audit reports or other means;*

- *submit within one year after the end of the period under audit copies of the audit report to each Federal agency (and any primary grantee that provided it with Federal assistance) and the U.S. Bureau of the Census' Single Audit Clearinghouse (if more than $100,000 in Federal assistance was received);*

- *comment on the findings and recommendations in the audit report, provide a corrective action plan and report on the status of corrective actions taken on prior findings;*

- *ensure that corrective action is taken on subgrantee audit reports that contain findings of non-compliance with Federal laws and regulations; and*

- *make audit reports available to the general public within 30 days after completion of the audit and retain reports for three years after their issuance.*

The rising costs associated with sponsored research has been the subject of continuing and extensive debate by the Congress, OMB, the President's Office of Science and Technology Policy, HHS, the National Science Foundation and numerous universities and their associations. The continuing debate has promoted attempts to better understand reasons for the increases in these costs.

According to the Council on Governmental Relations *(COGR)* an organization of research universities, the average cost of research grants has increased because of: (1) the accelerated pace of science and requirement for technologically advanced research instruments; (2) ever more sophisticated space requirements; (3) the impact of new regulations and increased safety, health and environmental standards; and (4) increased salary and employee benefit costs. These investments, however, give promise of greater dividends to society, according to COGR.

There have been a number of initiatives undertaken in the past several years, by both Federal agencies and the university community, to address concerns related to the cost of Federally sponsored research. We have provided a brief description of those efforts in the following paragraphs:

- In response to the growing concern over indirect cost issues, the Executive Committee of the Association of American Universities *(AAU)* charged an ad hoc committee to review the current system, particularly the rules set forth in Circular A-21 and to identify suggestions for change in December 1988. According to the Committee's draft report, the entire context in which the indirect cost system operates is changing. Important changes include pressures on university faculty, cumulative effects of conflicts between research faculty and university officers over indirect costs, increasing obsolescence of research facilities and equipment, and the basic relationship between universities and the Federal Government's support of research.

  The report states that the current system for identifying, allocating and recovering the costs of sponsored research should not be abandoned. However, changes should be made that would enhance the system's clarity and improve its credibility. The committee suggested changes for improving the system.

- Federal agencies have taken some steps to address concerns related to rising costs of research. Salaries charged as a direct cost to a grant, or contract awarded by the National Institutes of Health *(NIH)* and the Alcohol, Drug Abuse, and Mental Health Administration

(ADAMHA) in support of extramural activities are now limited to $120,000 per individual. NIH and ADAMHA are applying the limitations to all awards made after September 30, 1989. The $120,000 ceiling also applies to salaries paid under sub-awards made for substantive work under a grant or contract. It should be emphasized that institutions can pay researchers in excess of this ceiling. However, it cannot claim amounts in excess of $120,000 to Federal awards.

The National Science Foundation *(NSF)* has also implemented a similar salary limitation. Salaries are limited to $95,000 for grants only. This limitation was first imposed in its 1989 appropriations act and continued in its 1990 act.

- In addition to direct cost limitations, the Federal Government has revised OMB Circular A-21 cost principles to establish a fixed allowance on the reimbursement of costs associated with the administrative activities of academic department heads, faculty, and other professional staff. The salaries and fringe benefits of these individuals are allowed at a rate of 3.6 percent of modified total direct costs. This fixed allowance is a departure from A-21's normal cost reimbursement concepts.

- In March 1986, five Federal agencies and a group of universities in Florida began the Florida Demonstration Project which was designed, in part, to address the question of administrative requirements placed on research by the Federal government. Are these requirements excessive and/or unnecessary? In March 1988, the Presidential Task Force on Regulatory Relief approved the expansion of the Project, beginning October 1, 1988, to include research contracts as well as grants, and to include universities and research facilities outside of Florida. The initiative became known as the Federal Demonstration Project.

- During FY 1989 and 1990, the OIG performed a nationwide survey of Biomedical research at eight colleges and universities. This special initiative was requested by the House Committee on Appropriations for the Departments of Labor, Health and Human Services *(HHS)* and Education. The Committee was concerned with the increase in biomedical research funding estimated by NIH officials and their inability to know whether the cost increases incurred by colleges and universities were or were not justified. The OIG selected a sample of extramural awards *(grants and contracts)* to determine whether costs

are being well-managed, specifically addressing manpower utilization, salary growth and procurement practices. The results of this review were reported to the subcommittee and were intended to provide the basis for our ongoing comprehensive review of 24 research schools to identify potential areas for improved cost control and strengthened management efficiency.

- The OIG is currently performing joint reviews with the Division of Cost Allocation *(DCA)* at selected institutions on indirect cost negotiation issues. DCA finalizes indirect cost rates through the indirect cost negotiation and approval process. Under this process, colleges, universities and nonprofit organizations submit their indirect cost rate to their cognizant Federal agency for the purpose of establishing provisional or final indirect cost rates. DCA is responsible for the review and negotiation of the indirect cost submissions. The results of these assist audits have aided the DCA in reducing indirect costs. DCA is concerned with the rise in indirect costs at selected institutions and has provided the OIG "*Targets of Audit Opportunity*" for inclusion in our workplan *(see Appendix 6)*.

- Lastly, the OIG established a task group to develop a long-range strategy for reviewing the financial and programmatic research activities conducted by colleges, universities and nonprofit organizations for the Federal Government. This task group was comprised of audit staff from both regional offices and PHSAD. The task group met three times and has formulated this plan that outlines our audit strategy through the 1990s.

The task group identified 40 audit areas which fall under three main issues: Cost Containment, Indirect Cost Reimbursement Issues and Federal Oversight. In addition, this plan includes an overview of our role under OMB Circular A-133. The following four chapters address these four major issues.

2 Cost Containment

Historical data shows that the volume of research performed and the cost of research has continued to rise each year. We have no reason to believe this trend will not continue. We also believe that, because of the Federal deficit and the increased competition for shrinking budget dollars, pressure will continue to find ways to reduce costs. Therefore, innovative cost containment measures will be sought to control the rising costs of sponsored research.

The total cost of any research project includes both direct and indirect costs. Direct costs are those that can be identified specifically with a particular sponsored project, institutional activity or any other institutional activity; or that can be assigned directly to such activities with a high precision. Examples of direct costs include salaries and wages of people working on the projects, laboratory supplies, equipment and subcontracts. Modified total direct costs *(MTDC)* is an important subcategory of direct costs. It usually includes all direct costs except equipment and that portion of subcontract costs in excess of $25,000. MTDC is significant because it is the basis currently used to determine the extent to which indirect costs are assigned to individual Federal grants and contracts.

Indirect costs are those that have been incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project or institutional activity.

The cost principles for colleges and universities *(OMB A-21)* and nonprofit organizations *(OMB A-122)* provide that recipients of Federal awards will be allowed to fully recover its fair share of the costs of doing business. To develop cost containment measures related to these Circulars, the OIG will need to analyze what research costs are used for. This includes the review of individual items of cost and the current system in place for recovering these costs. Additionally, the OIG plans to survey current cost containment measures applied by other Federal agencies such as caps on direct costs and indirect cost rates for possible application to colleges, universities and nonprofit organizations.

Thirteen areas are proposed, in order of priority, under this cost containment initiative.

1. *Survey of Cost Containment Initiatives*

The purpose of this survey will be to identify existing governmentwide cost containment initiatives which have been effective and determine if they might be applied to the college and university area. This review will include a survey of cost control measures utilized in other Federal Departments by the university and nonprofit community, and the administration of other HHS programs.

2. *Survey of Application of Cost Caps*

This survey will determine the feasibility of caps for research salaries, other direct costs, and indirect costs. We will: a) survey other agencies and Departments regarding their application of caps on salaries and other costs, and b) determine which cost categories, if any, may be best controlled through the use of caps.

3. *Utilization of Research Equipment*

The purpose of this assignment will be to determine what happens to equipment purchased with Federal dollars. Is equipment that has been purchased being used? Do colleges and universities have a screening process to determine if equipment purchased for use on Federal research can be used on other grants and contracts? Recommendations could center around more effectively using equipment that is purchased with Federal funds, thereby reducing outlays for new equipment.

4. *Analysis of Research Expenditures*

This review will focus on how NIH funds are used. Budgets in the award documents contain costs by line item; however, there are no restrictions on moving funds by budget line item. Expenditure reports are not required to show how funds are actually spent. Are we getting what we intended to pay for? Our review will also consider what information NIH actually needs to properly monitor research costs. We will begin this initiative by creating a national data base of expenditures by cost element.

5. *Review of Fringe Benefits*

This review will determine whether fringe benefits are being claimed at higher than actual rates. We will do this by comparing proposed fringe benefits with actual rates. More importantly, we also plan to look at selected fringe benefit costs actually charged to Federal awards to determine their allowability and reasonableness.

6. *Review of the Claiming Process Related to Subgrants*

Indirect costs should be claimed on only the first $25,000 of subcontract costs. There are concerns that indirect costs are claimed multiple times on $25,000 of subcontract costs. For example, indirect costs could be claimed on the first $25,000 incurred in each year of a multi-year subcontract. We would also determine if combining subgrants into one instrument would help reduce indirect costs and overall research costs in this area.

7. *Review of the Impact of Federal Regulations on Research Costs*

Some in the research community have argued that environmental controls, lab safety regulations, animal care regulations, and the like, are contributing unreasonably to the increase in research costs. We will determine to what extent this is true and what can be done to reduce or contain these types of costs. An inventory of certification requirements and regulations will be developed during this review.

8. *Review of Small Purchases Process at Selected Institutions*

The main purpose of our review would be to determine whether small purchases are being accomplished in a manner that is effective, efficient, economical and in accordance with procurement regulations. We will determine if goods and services purchased are appropriate, comply with Federal procurement regulations, and are in the best interest of the Government.

9. *Analysis of Salaries: Public vs. Private Schools*

Salaries and wages account for about 60 to 65 percent of the direct cost of research. This assignment will compare the salaries of researchers in public colleges and universities with those of researchers in private institutions. This review will analyze differences found in salary levels and whether any cost savings measures might exist that can be applied to both sectors.

10. *Off-Campus and On-Campus Indirect Rates*

The purpose of this review will be to determine how institutions are charging Federal grants overhead related to on-campus and off-campus projects. The review will encompass a review of university guidelines concerning the applicability and use of off-site rates. A review of on-campus projects from certain institutions may be necessary to verify and determine the correctness of rate applications.

11. *Review of Extra Compensation to Researchers*

The objective of this review will be to identify instances involving extra compensation and determine the relative impact on the cost of Federal research. Extra compensation may occur when a principle investigator receives extra pay or bonuses which are directly related to his success in obtaining awards of Federal grants and contracts. At one time these types of payments were specifically precluded by Federal cost principles. We will determine the propriety of these payments and their impact on the total cost of Federal projects.

12. *Review of Dual Compensation Paid to Researchers*

The objective will be to determine the impact of dual compensation on Federal research projects. Physician faculty members at University medical schools perform teaching and research as well as practice clinical medicine. Clinical income is normally collected and controlled by the university or an affiliated corporation. This review will examine the full compensation package of these faculty members and the methods used to allocate their personal service and other costs to Federal research grants and contracts.

13. *Training Grants*

This project will review the justification for the 8 percent cap on training grants. We will also analyze the controls for precluding the assignment of students to research projects for the purpose of qualifying for the higher indirect cost rate applicable to research.

3 Indirect Cost Reimbursement Issues

This chapter outlines ten audit initiatives that address indirect cost reimbursement issues. The average indirect cost rate for major research universities negotiated by HHS has increased from 47.8 percent in 1985 to 49.6 percent in 1989 *(see Appendix 7)*. Although on an aggregate basis this increase is not significant, these are individual schools where increases appear unreasonable.

One of the reasons for this rise in indirect costs at certain schools is the use of special studies for the allocation of the cost of utilities, the largest expense in the operation and maintenance of the facility. In these special studies, the university identifies where and when the utilities are being used by means of engineering studies, regression analysis or some other method. As a result, utility costs allocated to research are often two or three times the amount allocated to instruction and other institutional activities. One of our initiatives is to review these special studies at selected institutions.

Another reason for the increase in rates is the cost associated with the replacement of facilities. OMB Circular A-21 cost principles allows interest expense related to facilities replacement. DCA is concerned with the current reconstruction and replacement of facilities used to support research. They question the necessity of this cost. The OIG will address this concern.

The OIG plans to review similar cost areas that were identified as problem areas while reviewing State governments. The OIG is interested in how colleges, universities and nonprofit organizations are accounting for their capital leases and self-insurance funds.

We are interested in determining whether grantees are shifting expenses to avoid the 3.6 percent cap for departmental administration set by OMB Circular A-21. Our opinion is that shifting may be happening since rates have not decreased as expected by the implementation of the revision in July 1987.

We have allocated time for DCA audit assistance. We met with DCA officials and requested a list of colleges and universities where audit assistance would be useful. DCA provided a list of 19 colleges and universities, ranked by priority, by Region where audit assistance could be of help during FY's 1991 and 1992 *(see Appendix 8 for list)*. Our audit involvement would normally be limited in scope and would be performed on a team basis with DCA. The remaining initiatives

cover the feasibility of a cap on indirect cost rates, review of identification of total research effort indicating cost sharing, evaluation of DCA's reorganization and what is indirect cost recovery used for by colleges, universities and nonprofit organizations?

We believe that the ten audit initiatives summarized below will provide the coverage needed in addressing this issue.

1. *Review of the Departmental Administration Segment of Overhead Costs*

Effective July 1, 1987, Circular A-21 was revised to set a fixed overhead allowance for the administration of Federally sponsored grants by department heads and faculty. The fixed allowance equals 3.6 percent of modified total direct costs.

The purpose of this review is to determine how institutions are claiming departmental administration costs and to determine the reasonableness of the 3.6% allowance.

2. *Review of Expense Related to Capital Leases*

The purpose of this review is to determine if colleges, universities and nonprofit organizations are properly distinguishing between capital leases and basic rental agreements. Also to determine if colleges, universities and nonprofit organizations are accounting for their capital leases in accordance with generally accepted accounting principles *(GAAP)*.

3. *Review of Infrastructure - Facilities Replacement*

We plan to determine if new construction or reconstruction and remodeling of existing buildings is necessary in support of research. We will also review the impact of interest related to facility replacement on indirect cost rates.

4. *Review of Identification of Total Research Effort Indicating Cost Sharing*

The purpose of this review is to determine if colleges, universities and nonprofit organizations are properly identifying cost sharing on research projects and if colleges, universities and nonprofits are properly including cost sharing in the development of indirect cost rates.

Work performed directly on a research grant or contract that is not charged to the grant or contract is commonly referred to as cost sharing. According to OMB A-21 cost principles for colleges and universities and OMB A-122 for nonprofit organizations, cost sharing should be included as part of the organized research base for determining the indirect cost rate to be applied to grants and contracts.

Past reviews at colleges, universities and nonprofit organizations showed that cost sharing is not always properly identified and accounted for in the determination of the indirect cost rate. This can result in a negotiated rate which is inflated.

5. *Review of Self-Insurance Funds*

Under self-insurance programs, charges for insurance coverage are billed to users' departments within the institution. The Federal Government shares in the cost of self-insurance programs when grants and contracts are charged directly or indirectly for this cost. Self-insurance funds are intended to operate on a break-even basis through user charges for the risk coverage provided.

The purpose of this review will be to determine the need for the self-insurance funds, the basis on which each fund's reserve balance was established, and to identify the self-insurance funds which have generated excess reserve balances and determine the Federal equity in such balances.

6. *Review of Research Energy Costs*

One reason for rising indirect cost rates at colleges, universities and nonprofit organizations is the recently developed practice of using special studies to identify that portion of the cost of utilities and energy-related services to be allocated to Federal research. These

studies have typically resulted in a greater share of energy costs being attributed to activities supporting Federal research. The purpose of this review is to determine whether the documentation for special energy studies is adequate, statistically sound, updated or reviewed every two years, and is pertinent to the conditions at selected institutions. Also, we will ascertain whether energy-related costs are allocated to research in accordance with benefits derived and whether all applicable factors have been adequately considered in the allocation process.

7. *Division of Cost Allocation Reorganization*

The purpose of this review is to determine whether the Division of Cost Allocation can continue to provide timely and effective evaluations of indirect cost proposals. We will evaluate staffing levels, workload, organizational matters and potential alternative approaches to the accomplishment of goals and objectives.

8. *Feasibility of Cap on Indirect Cost Rate*

A study will be performed to determine if it would be feasible to develop a cap on indirect costs at the regional level and possibly at the national level.

9. *Indirect Cost Recovery*

Universities that keep all of their indirect cost reimbursement have a greater incentive to recover more indirect costs through negotiation of a higher rate than those public universities whose reimbursements flow back into the state treasury. At many universities, the institution allocates discretionary funds to a principal investigator in proportion to his or her success in obtaining external research funding. In some cases, this is described as returning part of the indirect cost recovery to the faculty member. Some universities establish research foundations to which Federal research funds are awarded. The foundations then pass on Federal funds to the appropriate university and department involved in the research. However, the research is performed at the university.

The purpose of this review is to:

- Determine whether the university's method of accounting for indirect costs is reasonable and results in the allocation of a fair share of operating costs to research.

- Determine the effect of the use of research foundations on the cost of research. Are the administrative costs of foundations increasing and if so is this having an adverse effect on the ability to perform research.

10. *Assist Audits to the Division of Cost Allocation on Indirect Cost Negotiation Issues*

Each year the DCA requests that we provide audit assistance on special indirect cost issues at selected institutions. In previous years we have responded to such requests to review library allocations, medical liability insurance, internal service funds, fringe benefit rates and space allocation. These assist audits have aided the DCA in substantially reducing indirect cost rates at the institutions reviewed.

4 Federal Oversight

An integral part of the OIG's effort in the college, university and nonprofit organization area is to ensure that the Federal Government, in cooperation with these entities, funds research projects which are well designed, cost effective, and efficiently and economically operated. Through a series of broad based reviews, the OIG plans to evaluate the Federal system for funding research, the adequacy of Federal oversight, and to identify alternative approaches to monitoring research efforts.

As a key element to this part of our review, the OIG plans to establish a nationwide data base of expenditures for colleges, universities and nonprofit organizations. Although much can be learned from this data base through trend analysis, cost comparisons, and other techniques, the data is just 1 of 17 initiatives planned by the OIG in the oversight area.

The OIG has planned a variety of reviews which range from limited scope audits, such as evaluating the monetary impact on Federal research related to the movement of a Principal Investigator from one university to another, to more complex audits such as evaluating cost reimbursement systems to identify strengths, weaknesses, and impact on the cost and quality of research. Many of these reviews will focus on alternative approaches to (1) the grant application and award process, (2) the grant evaluation and selection process, and (3) the administration of grants including the application of internal controls.

The OIG will also focus on the adequacy of other Federal oversight measures which ensure that Federal interests are adequately safeguarded. For example, we will evaluate the effect that scientific misconduct, conflict of interest, and the civil monetary penalties statute have had or will have on the Federal research effort.

Finally, the OIG also plans to study how other countries and private enterprise funds research. We will look for techniques used by non-Federal research organization that might be applied to the Federal sector.

The following is a summary of the 17 audits planned by the OIG in the Federal oversight area.

1. National Audit Data Base for Colleges, Universities, and Nonprofit Organizations -- Collecting, Analyzing and Maintaining Direct and Indirect Cost Data

The objective of this effort will be to establish a nationwide data base for colleges, universities and nonprofit organizations. This data base will be maintained by the OIG and will serve as the foundation for much of the OIG's future review efforts in the college, university and nonprofit organization area. The establishment of this data base will be a long range project that will be developed in stages.

2. Survey of Conflict of Interest Procedures at Colleges, Universities and Nonprofit Organizations

Conflict of interest is an issue of current and widespread concern in government. Colleges, universities and nonprofit organizations that participate in Federal grants and contracts are required to develop and implement procedures to avoid even the appearance of a conflict of interest.

The purpose of this review is to determine whether colleges, universities and nonprofit organizations have procedures in place to identify potential conflict of interest in Federally funded research and to assess the effectiveness of these procedures.

3. Reimbursable Audits

OMB Circular A-88 assigns audit cognizance for approximately 95 percent of the nation's nearly 3,000 colleges and universities to the Inspector General of the Department of Health and Human Services. Audit cognizance requires that we perform audits upon request, from Federal agencies, of funds awarded to colleges and universities by these agencies. We have budgeted nearly 3,000 staff days in FY 1991 to perform these audits. Audit requests will be scheduled based upon dollar amount of the proposal, sensitivity of issues to be reviewed, agency agreements and other work being done at an institution.

4. HHS - Pre-Award and Contract Close-out Audits

The Inspector General's largest client for pre-award and contract closeout audits is the Department's Public Health Service *(PHS)*. PHS agencies award over $4 billion to colleges, universities, and nonprofit organizations in FY1990 in the form of grants and contracts. While most of these awards are made to large well established entities and involve the continuation of previous agreements, some will be made to new individuals or involve items requiring audit attention. To assist contracting officers in evaluating proposals and managing these awards, we will schedule pre-award audits of these entities based on the contracting officer's concerns, the dollar amount of the proposals, and other work scheduled at the entity.

5. Special Initiatives

We occasionally receive special requests from Departmental, Congressional and OMB officials seeking specific information on issues of special concern at colleges, universities and nonprofit organizations. These requests generally carry a very high priority and are scheduled as received.

6. Review of Grant Application and Award Process

This review will analyze the grant application and award process at NIH to ascertain if criteria being used is effective and efficient. This review will ascertain (1) the number and type of applications received by NIH, (2) the processes NIH used to evaluate competing applications, and (3) how NIH determined who got an award. Our review will focus on identifying ways to streamline the application and award process as well as determining if feedback from grantees is being solicited and considered.

7. Review of Renewal of Research Projects

We will review NIH's system for renewal of research projects at colleges, universities and nonprofit organizations. This review will focus on how NIH evaluates the need for reviewing continuing projects. We will determine (1) if NIH has a formal system which documents those factors that are considered by NIH in this process and (2) the role past performance plays in the renewal process.

8. *Review of Misconduct in Science*

Several Congressional hearings have been held recently in which a few cases of alleged scientific misconduct have been described. Auditors would be at a distinct disadvantage if asked to identify and evaluate instances of scientific misconduct such as falsification of data. It would require a peer to identify most instances of misconduct in science, someone familiar with both research methods and the area of study. In an attempt to identify incidents of misconduct, each college, university and nonprofit organization is required to have a peer review process to help prevent falsification of data and other types of possible abuses. We will review the systems used by selected institutions to assess their ability to detect and deter misconduct in science.

9. *Review of Transfer of Principal Investigator*

Many universities actively recruit researchers from other universities. When a Principal Investigator (PI) leaves one university and its research facilities for another, he often does so only after the second university has committed to building new, state-of-the-art research facilities for his use. When this occurs, research facilities at two universities are usually depreciated in support of Federal research. The cost of both facilities will be included in the indirect cost rate of each university and the Federal Government, as a major consumer of research, will pay the bill for these facilities. We will conduct a survey to determine if the transfer of PIs results in excess facilities and equipment and contributes to the increase of research costs in this manner.

10. *Review of Research Performance*

We plan to survey Federal research efforts to ascertain if performance parameters could be established to enhance the selection process for Federal grants and contracts. This survey will entail determining how and what kind of performance parameters various Federal awarding agencies use. Once the data is obtained, comparisons will be made in an attempt to identify the strengths and weaknesses of the different systems. If appropriate, recommendations will be made to improve the review process.

11. Review of Research Expectations

We will determine if Federal agencies have established reasonable expectations for research funds and measure performance against expectations. We will contact several awarding agencies and ascertain if they established performance plans based on stated agency goals and objectives. We will also ascertain if these agencies have implemented internal evaluation systems to measure their performance against stated goals and objectives. If appropriate, we will recommend adoption of such systems by HHS.

12. Review of the Federal Demonstration Project

The Federal Demonstration Project is an outgrowth of the Florida Demonstration Project in which five major Federal agencies and nine institutions in the Florida State University system and the University of Miami participated. The 2-year study, which ended September 30, 1988, was designed to identify improvements to be recognized if post award administration was standardized and simplified. The NIH has established a task group to assess productivity, and to establish a system to determine the adequacy of administrative and financial systems, and institutional assurances. We will review the evaluation of project effectiveness and internal controls.

13. Survey of Research Papers

A survey will be conducted to determine how research papers are used to evaluate the effectiveness of a project and how such evaluations impact on the continuation of funding. We will analyze such factors as:

- who reads the papers,
- how are the results are validated,
- are results compared to other research, and
- are records maintained to show how the results of the research affected renewal decisions.

14. *Review of Multiple Principal Investigators*

Some research projects have more than one PI. With multiple PIs on a project there may be some uncertainty about which one is responsible for the overall administration of the research. We plan to review the effect that multiple principal investigators has on the integrity of Federal projects.

15. *Survey of Civil Monetary Penalties Provisions*

A survey will be performed to determine if the application of civil monetary penalties provisions would act as a deterrent to scientific misconduct and misuse of Federal funds. One part of this evaluation would be ascertaining the success of civil monetary statutes in other areas, such as health care.

16. *Methods Used to Fund and Evaluate Research*

We will conduct a study to identify and compare the methods other industrialized countries and private enterprise use to fund and evaluate research and to recommend for consideration the adoption of those that might benefit research in this country.

17. *Review of Cost Reimbursement Methodology*

The current method of accounting for research funds has been called overly restrictive; not conducive to either cost containment or the achievement of scientific research; overly burdensome to PIs with administrative minutia; etc. We will conduct a survey of the Federal Government's cost reimbursement methodology to analyze its strengths, weaknesses, and impact on Federal research effort used to identify areas where improvements might be necessary.

5 Implementation of OMB Circular A-133

Universities, colleges and other nonprofit organizations receiving Federal awards must comply with the new audit requirements of OMB Circular A-133, Audits of Institutions of Higher Education and Other Non-Profit Institutions. The Circular's audit requirements are similar to those imposed on state and local governments by the Single Audit Act and OMB Circular A-128, Audits of State and Local Governments. The new requirements apply to audits of nonprofits' fiscal years beginning on or after January 1, 1990. Audits of earlier fiscal years may still be performed in accordance with OMB Circular A-110, Attachment F, which is superseded by Circular A-133.

Circular A-133 audit requirements will be implemented by revising the 45 CFR 74 section on nonfederal audits. Because these requirements involve nonfederal audits, our External Audit Resources *(EAR)* function will carry out the "*Cognizant Agency Responsibilities*" discussed in Section 3 of the A-133 document. These responsibilities include ensuring that departmental requirements are met, providing technical assistance to both the auditors and auditees, monitoring receipt of reports *(for cognizant assignments)*, evaluating audit quality, maintaining applicable OAS management information systems *(AIMS and CAMP)*, and reviewing the results of audits for systemic problems or trends.

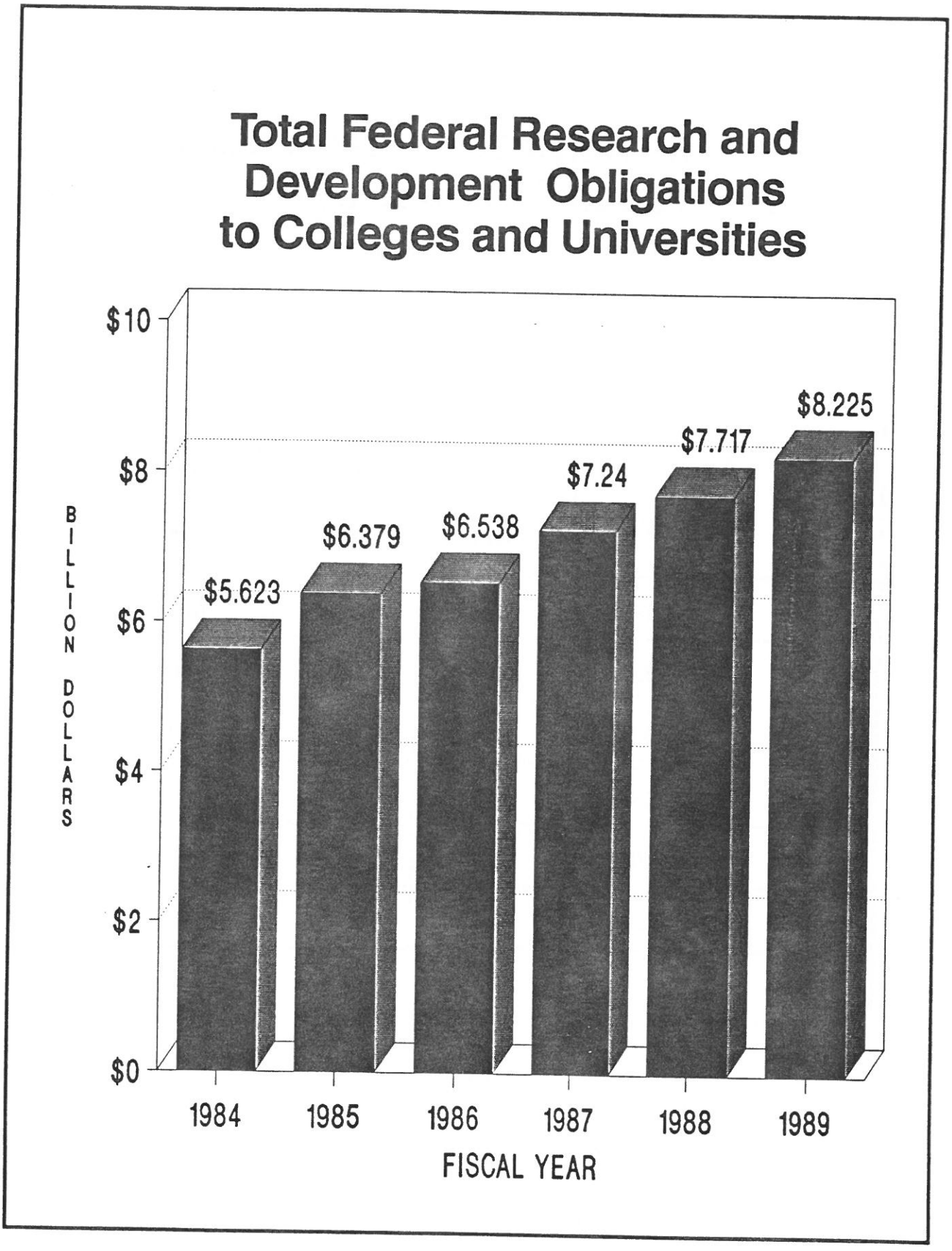
Headquarters responsibilities will include input *(in coordination with EAR)* to proposed compliance supplements. Also, we would determine, through AIMS and/or EAR, the status of A-133 audits at any university where we intend to do audit work outside the Circular. *(We need to avoid duplication and build upon work already done.)* This may involve contacting independent auditors to review their working papers. Likewise, we may want to advise independent auditors, in coordination with EAR, of special areas of audit concern.

Nonfederal auditors will be required to submit A-133 audit reports to the cognizant agency *(EAR for HHS assignments involving nonfederal audits)*. Specific responsibilities of the cognizant agency include (i) to determine whether reports meet Government Auditing Standards *(GAS)* and A-133 requirements, (ii) identification of findings for resolution, (iii) quality control reviews on a periodic basis and/or identified problem audit basis, and (iv) referral of any substandard audit work for appropriate disciplinary action.

Circular A-133 should ensure that, for the first time, uniform GAS audit coverage of major research universities will occur. As the audit process evolves, a major benefit to the management of this area will be the ability for OAS through AIMS *(and/or CAMP)* to monitor and analyze findings reported for potential audit leads and nationwide initiatives.

Circular A-133 introduces the concept of a "coordinated audit approach" in which the independent auditor and other Federal and nonfederal auditors consider each others work in determining the nature, timing and extent of auditing procedures to be used. While Circular A-133 audits are full financial audits performed in accordance with governmental standards and result in organization-wide reports for most covered entities, the coordinated audit approach is intended to reduce duplication of audit effort. Nonfederal auditors are permitted to rely on work of other auditors in much the same way that Federal auditors have relied on work of nonfederal auditors under Circular A-128.

APPENDICES


Total Federal Research and Development Obligations to Colleges and Universities
$10
$8
$6
$4
$2
$0
BILLION DOLLARS
$5.623
$6.379
$6.538
$7.24
$7.717
$8.225
1984
1985
1986
1987
1988
1989
FISCAL YEAR

Research and Development Awards to Colleges and Universities

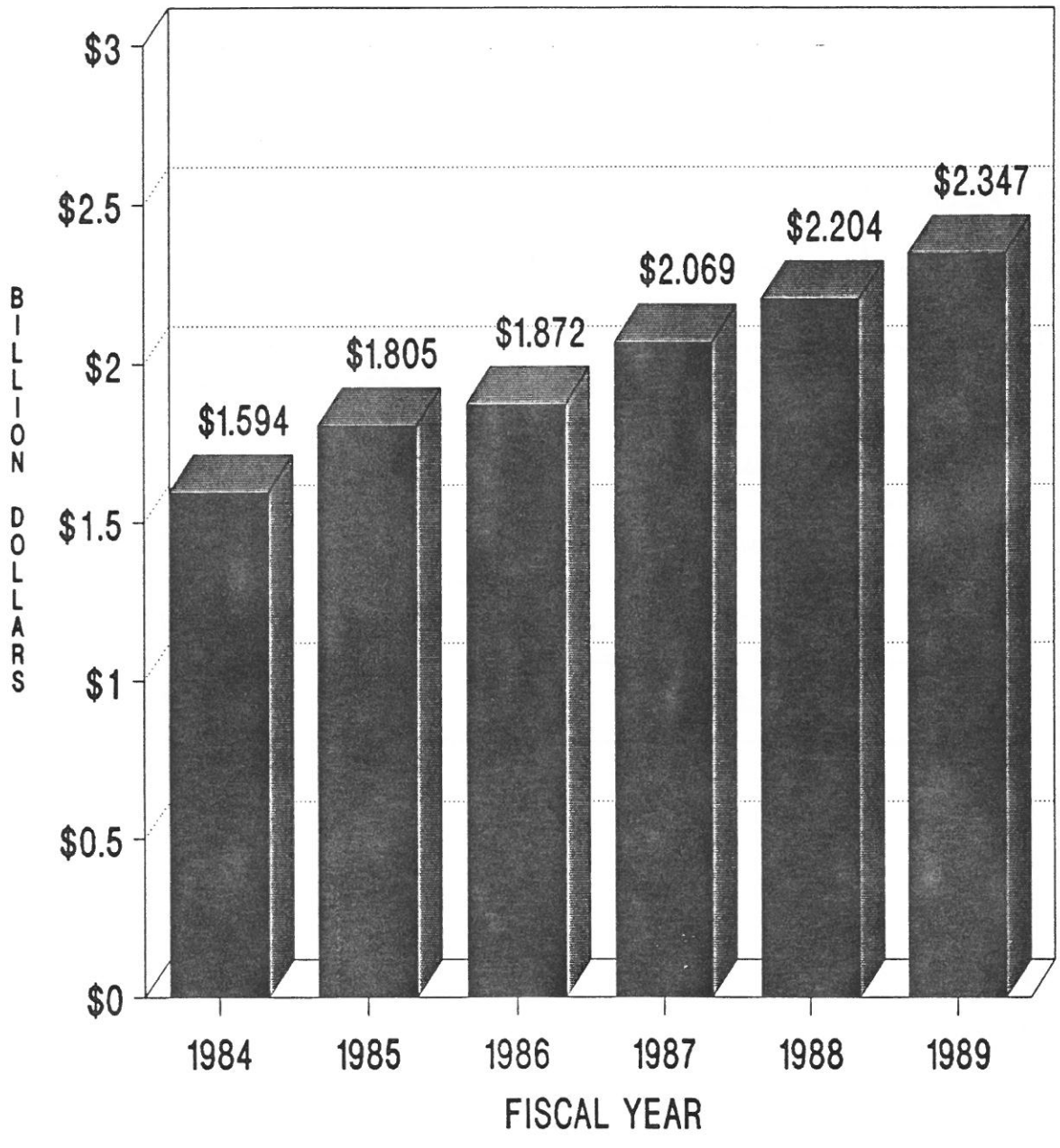
(in millions of dollars)

FISCAL YEAR	TOTAL	AWARDING AGENCY			
		HHS	DOD	NSF	OTHERS
1984	5,623	2,681	1,014	859	1,069
1985	6,379	3,099	1,041	1,011	1,228
1986	6,538	3,212	1,150	984	1,192
1987	7.240	3,834	1,099	987	1,320
1988	7,717	4,127	1,194	998	1,397
1989	8,225	4,443	1,298	1,009	1,475

Percentage of Federal Research and Development Obligations Paid to Public and Private Institutions

FISCAL YEAR	PUBLIC	PRIVATE
1986	*58.30%*	*41.70%*
1987	*57.90%*	*42.10%*
1988	*58.23%*	*41.77%*
1989	*57.63%*	*42.37%*

Estimated Amount Paid to Colleges and Universities for Indirect Cost Under Research and Development Awards



Research and Development Awards to Colleges and Universities

(in millions of dollars)

FISCAL YEAR	TOTAL	LESS USDA AWARDS	NET	PHS RATIO	ESTIMATED INDIRECT COST
1984	5,623	273	5,350	29.80%	1,594
1985	6,379	303	6,076	29.70%	1,805
1986	6,538	277	6,261	29.90%	1,872
1987	7,240	296	6,944	29.80%	2,069
1988	7,717	321	7,396	29.80%	2,204
1989	8,225	349	7,876	29.80%	2,347

Approximate Amount Paid to Colleges and Universities for Indirect Cost Components by All Federal Agencies

(in millions of dollars)

COST COMPONENTS	1985	1986	1987	1988	1989	5 Year Totals	5 Year Ratio
Use Allowances/ Depreciation on Buildings and Equipment	177	192	220	243	274	1,106	10.7%
Operation and Maintenance of Physical Plant	532	552	623	672	705	3,084	30.0%
General Adm	279	276	301	329	345	1,530	14.9%
Departmental Adm (including Deans' Office)	585	610	661	708	762	3,326	32.3%
Sponsored Proj. Adm	121	127	140	140	147	675	6.5%
Library	79	84	85	90	99	437	4.2%
Student Services	8	8	8	5	9	38	0.4%
Other	23	23	30	18	5	99	1.0%
Totals	1,804	1,872	2,068	2,205	2,346	10,295	100.0%

National Institutes of Health Award Analysis - Educational Institutions and Nonprofit Research Institutes - Fiscal Years 1988 and 1989

I. Total Funds Awarded and Total Number of Awards

	Total	Research Grants	Research Contracts	Training Grants	Other Grants
Total Funds Awarded (in thousands)					
Educational Institutions					
FY 1988	*$4,136,050*	*$3,730,997*	*$181,442*	*$217,267*	*$6,344*
FY 1989	*$4,444,948*	*$3,979,880*	*$204,377*	*$231,941*	*$28,750*
Nonprofit Research Institutes					
FY 1988	*$504,763*	*$413,776*	*$83,236*	*$7,751*	*(1)*
FY 1989	*547,417*	*$440,837*	*$95,380*	*$7,771*	*$3,429*
Total Number of Awards (actual figures)					
Educational Institutions					
FY 1988	*$23,982*	*$20,667*	*$471*	*$2,844*	*Not Available*
FY 1989	*$24,047*	*$20,792*	*$451*	*$2,804*	*Not Available*
Nonprofit Research Institutes					
FY 1988	*$2,107*	*$1,738*	*$189*	*$135*	*Not Available*
FY 1989	*$2,155*	*$1,823*	*$198*	*$134*	*Not Available*

II. Total Funds Awarded Under Research Grants (2) - Direct and Indirect Cost by Institution (in thousands)

	Direct	Indirect	Total
Educational Institutions			
FY 1988	*$2,438,918*	*$1,113,582*	*$3,552,500*
FY 1989	*$2,590,571*	*$1,198,710*	*$3,789,281*
Nonprofit Research Institutes			
FY 1988	*$259,908*	*$150,254*	*$410,162*
FY 1989	*$275,973*	*$164,164*	*$440,137*

(1) FY 1988 dollars awarded under the "Other" grant award category for nonprofit research institues are apparently included in the total for research grants (i.e., $413,776)

(2) Differs from totals for research grants in I. above because research grants on which no or reduced indirect costs were awarded are excluded.

The Fifty Grantees Which Received the Most PHS Grant Funds, by Agency, FY 1989

(dollars in thousands)

RANK	NAME	TOTAL	NIH	ADAMHA	HRSA	OTHER
1	Johns Hopkins University	$186,611	$153,508	$23,186	$4,186	$5,732
2	California State Department of Health	$172,717	—	$104,464	$32,945	$35,308
3	University of California - San Francisco	$159,661	$137,818	$14,283	$5,924	$1,636
4	University of Washington	$147,118	$123,017	$10,183	$9,603	$4,315
5	Yale University	$130,855	$111,506	$17,591	$1,208	$550
6	Stanford University	$122,917	$111,282	$8,141	$1,153	$2,341
7	University of California - Los Angeles	$119,123	96,319	$16,765	$3,926	$2,113
8	University of Michigan	$115,380	$95,691	$15,537	$1,534	$2,618
9	University of Pennsylvania	$112,436	$96,740	$12,101	$2,213	$1,382
10	Harvard University	$112,240	$98,397	$7,379	$2,256	$4,208
	Top 10 Subtotals	**$1,379,058**	**$1,024,278**	**$229,630**	**$64,948**	**$60,203**
11	Columbia University	$110,574	$97,290	$9,111	$2,538	$1,635
12	New York State Dept. of Health	$103,027	$22,698	$507	$44,032	$35,790
13	Washington University (Missouri)	$101,391	$92,104	$8,984	$302	$ —
14	Florida State Dept. of Health & Rehab. Services	$100,432	$ —	$49,220	$19,309	$31,904
15	University of California - La Jolla	$97,243	$83,262	$10,248	$1,119	$2,614
16	Duke University	$94,458	$84,459	$7,110	$1,953	$936
17	University of Minnesota	$92,008	$78,258	$8,976	$3,343	$1,431
18	University of Wisconsin - Madison	$89,742	$82,030	$4,459	$2,953	$300
19	University of North Carolina - Chapel Hill	$84,562	70,891	$5,159	$6,243	$2,268
20	Pennsylvania State Dept. of Health	$81,434	$143	$42,195	$22,177	$16,919
21	Yeshiva University	$74,446	$68,145	$4,226	$2,075	$ —
22	University of Pittsburg	$73,031	$50,738	$19,467	$2,758	$68
23	University of Rochester	$71,730	$64,780	$4,604	$1,224	$1,123
24	New Jersey State Dept. of Health	$71,582	$ —	$39,495	$12,501	$19,586
25	Cornell University	$70,136	$63,595	$6,154	$230	$157
	Top 25 Subtotals	**$2,694,854**	**$1,882,673**	**$449,545**	**$187,705**	**$174,932**
26	University of Chicago	$68,717	$64,015	$4,344	$359	$ —
27	University of Alabama	$67,967	$60,492	$743	$4,764	$1,969
28	Michigan State Dept. of Health	$66,963	$251	$27,432	$16,999	$22,281
29	New York University	$66,192	$53,492	$10,316	$2,324	$60
30	New York State Inter-Office Coordination Council	$65,794	$ —	$65,794	$ —	$ —
31	University of Colorado	$64,798	$50,706	$9,412	$4,680	$ —
32	Brigham and Women's Hospital	$61,323	$59,958	$397	$265	$703
33	Massachusetts General Hospital	$60,698	$56,344	$3,187	$931	$236
34	University of Southern California	$60,408	$53,355	$3,768	$2,692	$593
35	University of Iowa	$60,166	$51,906	$5,265	$2,515	$479
36	Baylor College of Medicine	$59,444	$57,304	$226	$1,594	$319
37	Texas Dept. of Health	$58,168	$426	$252	$27,755	$29,735
38	Case Western Reserve University	$57,923	$51,907	$3,129	$2,625	$262
39	Massachusetts Institute of Technology	$57,865	$56,806	$809	$ —	$250
40	Massachusetts Exec. Office of Human Services	$57,321	$85	$29,068	$12,232	$15,936
41	Vanderbilt University	$56,859	$53,315	$2,240	832	472
42	Scripps Clinic and Research Foundation	$55,343	$52,309	$2,932	$ —	$102
43	Georgia Dept. of Human Resources	$53,380	$164	$18,923	$14,716	$19,577
44	University of Texas - Dallas	$52,254	$47,451	$2,415	$2,098	$290
45	University of Miami	$51,685	$40,453	$7,732	$3,389	$111
46	University of Illinois	$50,436	$41,255	$4,267	$4,063	$851
47	Boston University	$48,075	$42,917	$3,302	$1,172	$683
48	Emory University	$46,490	$38,422	$4,281	$2,713	$1,074
49	North Carolina State Dept of Human Resources	$45,488	$253	$15,721	$15,579	$13,935
50	University of California - Berkeley	$43,804	$39,444	$2,539	$965	$856
	Total	**$4,132,416**	**$2,855,700**	**$678,040**	**$312,967**	**$285,709**

- In FY 1989 NIH awarded over half of its grant funds ($2,856 million) to 46 of the top 50 grantees. Johns Hopkins University received more NIH funds than any other grantee.
- ADAMHA awarded $678 million (44%) of its grant dollars to the top 50 recipients. HRSA awarded 23 percent ($313 million) of its grant dollars to 47 of the top 50 grantees.

The Fifty Grantees Which Received the Most PHS Grant Funds, by Major Category, FY 1989

(dollars in thousands)

RANK	NAME	TOTAL	RESEARCH	BLOCK*	TRAINING	HEALTH SERVICES	OTHER
1	Johns Hopkins University	$186,611	$167,739	$ —	$15,604	$1,267	$2,000
2	California State Department of Health	$172,717	$12,652	$121,967	$232	$33,129	$4,737
3	University of California - San Francisco	$159,661	$144,460	—	$13,404	$1,002	$794
4	University of Washington	$147,118	$126,438	—	$19,105	$943	$632
5	Yale University	$130,855	$118,809	—	$11,170	—	$877
6	Stanford University	$122,917	$111,988	—	9,287	—	$1,642
7	University of California - Los Angeles	$119,123	$106,732	—	$12,317	—	$75
8	University of Michigan	$115,380	$104,517	—	$10,032	—	$832
9	University of Pennsylvania	$112,436	101,693	—	$10,743	—	—
10	Harvard University	$112,240	94,995	—	$15,681	—	$1,564
	Top 10 Subtotals	**$1,379,058**	**$1,090,023**	**$121,967**	**$117,575**	**$36,341**	**$13,153**
11	Columbia University	$110,574	$99,549	—	$8,969	$828	$1,228
12	New York State Dept. of Health	$103,027	41,749	$40,971	$294	$16,108	$3,905
13	Washington University (Missouri)	$101,391	$92,202	—	$8,835	—	$354
14	Florida State Dept. of Health & Rehab. Services	$100,432	$15,095	$56,694	—	$26,966	$1,677
15	University of California - La Jolla	$97,243	$88,407	—	$7,505	$334	$997
16	Duke University	$94,458	$85,576	—	$7,642	$60	$1,180
17	University of Minnesota	$92,008	$83,773	—	$7,928	$307	—
18	University of Wisconsin - Madison	$89,742	$80,454	—	$8,095	$625	$567
19	University of North Carolina - Chapel Hill	$84,562	$72,909	—	$10,528	$1,125	—
20	Pennsylvania State Dept. of Health	$81,434	$6,734	$65,722	$70	$8,909	—
21	Yeshiva University	$74,446	$67,541	—	$5,324	$737	$844
22	University of Pittsburg	$73,031	$67,204	—	$5,799	—	$28
23	University of Rochester	$71,730	$65,628	—	$4,646	$673	$783
24	New Jersey State Dept. of Health	$71,582	$11,430	$44,476	—	$14,676	$999
25	Cornell University	$70,136	64,631	—	$4,678	—	$827
	Top 25 Subtotals	**$2,694,854**	**$2,032,906**	**$329,830**	**$197,888**	**$107,689**	**$26,542**
26	University of Chicago	$68,717	$61,446	—	$7,271	—	—
27	University of Alabama	$67,967	58,705	—	$8,264	—	$997
28	Michigan State Dept. of Health	$66,963	6,866	$47,382	—	$12,715	—
29	New York University	$66,192	$60,099	—	$6,093	—	—
30	New York State Inter-Office Coordination Council	$65,794	$ —	$65,794	$ —	—	—
31	University of Colorado	$64,798	55,981	—	$8,467	$351	—
32	Brigham and Women's Hospital	$61,323	57,383	—	$3,815	$125	—
33	Massachusetts General Hospital	$60,698	$56,446	—	$3,337	—	$915
34	University of Southern California	$60,408	$55,166	—	$5,242	—	—
35	University of Iowa	$60,166	$53,873	—	$4,994	$1,299	—
36	Baylor College of Medicine	$59,444	$55,594	—	$2,952	$448	$450
37	Texas Dept. of Health	$58,168	$9,753	$28,402	—	$18,098	$1,915
38	Case Western Reserve University	$57,923	$51,341	—	$6,422	$160	$ —
39	Massachusetts Institute of Technology	$57,865	$53,208	—	$4,658	—	—
40	Massachusetts Exec. Office of Human Services	$57,321	$8,509	$38,383	$187	$8,386	$1,856
41	Vanderbilt University	$56,859	$51,676	—	$5,182	—	—
42	Scripps Clinic and Research Foundation	$55,343	$53,462	—	$1,881	—	—
43	Georgia Dept. of Human Resources	$53,380	$6,638	$32,663	$ —	$13,561	$517
44	University of Texas - Dallas	$52,254	$47,018	—	$4,482	$477	$277
45	University of Miami	$51,685	$46,023	—	$5,256	$ —	$406
46	University of Illinois	$50,436	$43,857	—	$6,135	$444	—
47	Boston University	$48,075	$44,064	—	$3,910	$101	—
48	Emory University	$46,490	$41,342	—	$3,452	$808	888
49	North Carolina State Dept of Human Resources	$45,488	$3,137	$31,741	$ —	$10,388	222
50	University of California - Berkeley	$43,804	$36,701	—	$7,103	—	—
	Total	**$4,132,416**	**$3,051,195**	**$574,195**	**$296,992**	**$175,050**	**$34,984**

*Since some States have more than one agency administering the five funded block grants, the figures in this column may not represent the State's block grant total.

- The 50 grantees receiving the most PHS grant funds in FY 1989 together accounted for 45 percent of the total PHS grant funds. Of the $5,970 million in PHS research grant dollars, the top 50 grantees received $3,051 million or 51 percent.
- The top 50 grantees received $574 million in block grants (43% of all PHS block awards) and $297 million in training awards (50% of all PHS training awards).

TRENDS IN INDIRECT COSTS
RECIPIENTS OF PHS GRANTS AND CONTRACTS
Fiscal Years 1983 - 1988
Percent of Indirect to Total Costs

FISCAL YEARS	COLLEGES & UNIVERSITIES	HOSPITALS	STATE & LOCALS	OTHER NONPROFITS	COMMERCIAL ENTITIES
1983	*30.5*	*25.8*	*29.1*	*31.3*	*46.5*
1984	*31.5*	*27.8*	*31.0*	*32.4*	*47.3*
1985	*31.6*	*29.2*	*30.9*	*32.4*	*47.3*
1986	*31.8*	*30.3*	*30.8*	*32.7*	*46.7*
1987	*31.7*	*29.5*	*29.6*	*32.0*	*48.0*
1988	*31.2*	*29.1*	*28.5*	*32.4*	*48.0*
RATE OF CHANGE:					
1983 to 1988	*2.3+*	*12.8+*	*2.1-*	*3.5+*	*3.2+*
1987 to 1988	*1.6-*	*1.4-*	*3.9-*	*1.2+*	*None*

The table shows that:

- *Between FYs 1983 and 1988, State and local governments was the only class of recipient which experienced a decrease in indirect costs (2.1 percent). The other four classes of recipients experienced increases ranging from 2.3 percent for colleges and universities to 12.8 percent for hospitals.*

Targets of Audit Opportunity Suggested by the Division of Cost Allocation

(General Topics for Discussion Purposes - Not Arranged in Any Priority Order)

FACILITIES RELATED:

Use Allowance/Depreciation

Purging of Old/Replaced Items From Asset Inventory Used to Calculate Use Allowances

Analysis of Actual Life of Assets by Classification vs. a Proposed Life

Componentization Issues

Conversion Issues

Assignment of Cost to Functional Areas

Operation and Maintenance:

Assignment of Space to Individual Functions

Treatment of Common Space
Treatment of Research Training Space
Effect of Predominate Use Policy
Treatment of Space Related to Special Facilities

Consistency of Costing "Charge-Out" Activities

Treatment of Energy Support Costs vs. Job Order Cost System Results

Other:

Identification/Assignment of Interest Costs on New Facilities

ADMINISTRATION RELATED:

General and Administrative

Elimination of (Insuring Consistent Treatment of) Revenue Producing Activities

Elimination of Unallowable/Unallocable Costs from G&A Pool

Duplication of Services in G&A/DA/SPA Pools

Consistent Treatment of "SPA" Type Activities Related to Non-Research Activities

Departmental Administration

Migration of Activities up to Deans' Office (Compare Activities Now and Prior to 3.6% Cap)

Appropriateness of DCE Methodology

Library

Actual Use by Research Personnel vs. Results of Proposed or Standard Methodology

Sponsored Projects Administration

Re-Assignment (Migration) of Activities to SPA from Departmental Level Since Implementation of 3.6% Cap

Establishment of "Discrete" SPA Units at Departmental Level

BASE RELATED:

Is It All There, Especially with Respect to Non-Research Side of Individual Allocation Bases

Consistency of Costing "GOCO" Administrative Dollars

Appropriateness of Reclassifications

OVERALL:

Inconsistent Costing Within/Between Departments and/or Subdepartments

Effect of Uncompensated Faculty on DA and Other Allocation Bases

Special Service Centers

Animal Care Facilities/Computer Centers

Consistent Treatment of

Fringe Benefits

Compensated Absences

Faculty Practice Plans

Malpractice Insurance

Effect of Medical School/Hospital Affiliations

Average Indirect Cost Rate Components for Major Research Universities Negotiated by HHS

COST COMPONENTS	1985	1986	1987	1988	1989
Use Allowances/Depreciation on Buildings and Equipment	*4.7*	*5.0*	*5.2*	*5.4*	*5.8*
Operation and Maintenance of Physical Plant	*14.1*	*14.4*	*14.7*	*14.9*	*14.9*
General Administration	*7.4*	*7.2*	*7.1*	*7.3*	*7.3*
Departmental Administration (including Deans' Office)	*15.5*	*15.9*	*15.6*	*15.7*	*16.1*
Sponsored Projects Administration	*3.2*	*3.3*	*3.3*	*3.1*	*3.1*
Library	*2.1*	*2.2*	*2.0*	*2.0*	*2.1*
Student Services	*0.2*	*0.2*	*0.2*	*0.1*	*0.2*
Other	*0.6*	*0.6*	*0.7*	*0.4*	*0.1*

- *Rates are expressed as a percent of total direct cost of organized research excluding capital expenditures, major subcontracts and other distorting items.*

DEPARTMENT OF HEALTH & HUMAN SERVICES — Office of the Secretary

Washington, D.C. 20201

JAN 11 1991

TO: Frank Zuraf, Director
Health Resources Services Delivery, Financial and Colleges/Universities

FROM: Edward M. Tracy, Director
Division of Cost Determination Management

SUBJECT: Identification of Possible Colleges and Universities for Audit

The following list identifies those institutions ranked by priority within each region where audit assistance would be of help during the next two years.

Region	Institution	Estimated Audit Start Date
I	Dartmouth College	March 1, 1991
	Yale University	May 1, 1991
II	Rutgers University	May 1, 1991
	Rockefeller University	March 1, 1991
III	Johns Hopkins Univ.	June 1, 1991
	Univ. of Pittsburgh	April 1, 1991
	Univ. of Pennsylvania	January 1, 1992
IV	Vanderbilt University	April 1, 1991
	Emory University	March 1, 1991
V	University of Chicago	February 1, 1991
	University of Michigan	March 1, 1991
VII	Washington University	March 15, 1991
VIII	Utah State	May 15, 1991
IX	University of Arizona	March 1, 1991
	Univ. of California at San Diego	March 1, 1991
	Univ. of California at Irvine	March 1, 1991
X	Oregon State	February 15, 1991

Audit involvement will normally be limited in scope, probably to one component of the rate. The review will be performed on a team basis with the DCA, similar to the approach taken at UCLA. Of course, all cost savings will be shared with the IG's office.

There is a possibility that indirect cost rates will be negotiated before audit assistance is provided. When this happens, the Regional DCA staff will contact your staff and we may identify an alternative institution. The regional IG and DCA staffs should contact each other to arrange for the performance of these reviews.

Mr. Kusserow talked about options for containing indirect costs at colleges and universities; below are estimates of savings to the government if caps were in place.

ESTIMATED SAVINGS FROM CAPPING INDIRECT COSTS AT CERTAIN RATES

RATE CAP	NUMBER OF GRANTEES AFFECTED	< ------- MILLIONS ------- > <--GRANT DOLLARS AFFECTED--> DIRECT	INDIRECT	TOTAL	ESTIMATED COST SAVINGS
70%	5	213.6	134.4	348.0	9.8
65%	9	318.8	195.0	513.9	21.3
60%	19	724.0	413.2	1,137.2	46.9
55%	24	883.2	494.2	1,377.4	81.4
50%	34	1,159.2	618.7	1,777.9	125.1
45%	43	1,488.0	756.0	2,244.0	183.7
40%	55	1,895.0	908.9	2,803.8	260.4
35%	56	1,992.4	939.7	2,932.1	344.2
30%	56	1,992.4	939.7	2,932.1	429.3
25%	56	1,992.4	939.7	2,932.1	514.3
20%	56	1,992.4	939.7	2,932.1	599.4
15%	56	1,992.4	939.7	2,932.1	684.4

SCOPE: LIMITED TO 56 OF THE 442 (12.7%) INSTITUTIONS INCLUDED IN THE NIH LISTING FOR THE FY90 RESEARCH GRANT AWARDS TO COLLEGES & UNIVERSITIES.

THESE 56 SCHOOLS RECEIVED ABOUT 75% OF THE INDIRECT COSTS ON THIS NIH LISTING.

	DIRECT	INDIRECT	TOTAL
56 SCHOOLS IN SCOPE	1,992.4	939.7	2,932.1
TOTAL -- NIH LISTING	2,697.6	1,251.0	3,948.6
	73.9%	75.1%	74.3%

THE MOST CURRENT INDIRECT COST RATES(FY91) WERE USED FOR THIS SCHEDULE TO COMPUTE THE ESTIMATED COST SAVINGS.

HHS FUNDING REPRESENTS ONLY ABOUT 1/2 OF ALL AWARDS TO COLLEGES AND UNIVERSITIES (DOD, ENERGY, EPA, ETC. PROVIDE THE OTHER HALF).

THUS WE MIGHT DOUBLE THE PROJECTED SAVINGS SHOWN, SINCE ALL FEDERAL AGENCIES USE THE SAME RATES.

Subcommittee on Science

Hearings on
Costs of University Research

TENTATIVE WITNESS LIST

APRIL 23, 1991

Panel 1

Dr. Roland W. Schmitt
President
Rensselaer Polytechnic Institute
Troy, New York

Panel 2

The Honorable Richard Darman
Director
Office of Management and Budget
Washington, D.C.

Panel 3

The Honorable Kevin E. Moley
Asst. Secretary, Management & Budget
Dept. Health & Human Services
Washington, D.C.

Rear Admiral William C. Miller
Chief of Naval Research
Arlington, Virginia

Mr. Fred J. Newton
Deputy Director
Defense Contract Auditing Agency
Alexandria, Virginia

Panel 4

Dr. Frederick M. Bernthal
Deputy Director
National Science Foundation
Washington, D.C.

Dr. Charles E. Hess
Asst. Secretary, Science & Education
U.S. Department of Agriculture
Washington, D.C.

APRIL 25, 1991

Panel 1

Mr. David Packard
Chairman of the Board
Hewlett-Packard Company
Palo Alto, California

Dr. Cornelius J. Pings
Provost
University of Southern California
University Park, California

Dr. Robert Johnson
Vice President for Research
Florida State University
Tallahassee, Florida

Panel 2

Dr. John H. Marburger, III
President
State Univ. New York at Stony Brook
Stony Brook, New York

Professor Jon Clardy
Chairman
Department of Chemistry
Cornell University
Baker Laboratory
Ithaca, New York

Professor Howard K. Schachman
Dept. Molecular and Cell Biology
Stanley Hall
University of California at Berkeley
Berkeley, California

AAU Statement—Final Draft

Some aspects of the system used by the government and universities for determining the costs of federally sponsored research and some practices of our institutions in accounting for these costs have been called into question. The members of the Association of American Universities affirm our responsibility to work with the federal government to resolve these problems, to provide appropriate internal controls within our universities for such expenditures, and to correct errors which call into question our commitment to contain and monitor prudently and responsibly the costs of conducting sponsored research.

We believe that a comprehensive review of pertinent federal rules and university practices is timely and pledge ourselves to make whatever revisions may be necessary to achieve the soundest possible policies for support of research in universities and the research needs of our nation. Therefore, we ask the Chairperson of AAU, President Hanna Gray of the University of Chicago, to appoint a representative committee of presidents of AAU universities to meet at the earliest possible date with appropriate federal officials to discuss this matter so critical to the interests of both partners and to the viability of the nation's research capability.

Nearly one-half century ago, as the Second World War was coming to a close, the federal government resolved to expand the nation's basic research capability, to commit federal funds for this purpose, and to engage the nation's universities in behalf of this objective.

This decision has had a profound and positive effect on our country: widening the doors of educational opportunity, broadening the scientific and technical base of our workforce, and creating the new knowledge that has informed and invigorated American industry and commerce, the professions, the non-profit sector, and government itself. The national interest has been and will continue to be well served by this partnership.

April 16, 1991

COGR
an organization of research universities

COUNCIL ON GOVERNMENTAL RELATIONS
One Dupont Circle, N.W., Suite 670
Washington, D.C. 20036
(202) 861-2595
(202) 331-8483 FAX

STATEMENT ON REEXAMINATION OF UNIVERSITY COST PRINCIPLES
COGR BOARD OF MANAGEMENT

Recent hearings held by the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations have raised questions about university stewardship of public funds. The COGR Board recognizes the need for change in the system which is used to reimburse colleges and universities for the indirect costs of research. Any loss of public confidence in financial management at our institutions is particularly serious. Therefore, a comprehensive reexamination of the university cost principles, including the definition of allowable costs, is necessary at this time.

Recommendations contained in the report of the White House Science Council in 1986 (Packard-Bromley Report) and the 1988 "Pings Committee" report offer thoughtful suggestions for change. COGR reiterates its endorsement of those reports.

The COGR Board urges its member universities to affirm their responsibility to provide internal controls and where necessary make investments to improve procedures to safeguard public funds.

It is time to address these issues. COGR is ready to assist in any effort to restore public confidence in our colleges and universities.

April 12, 1991