

# COUNCIL ON GOVERNMENTAL RELATIONS

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September 30, 1986

TO: PRIMARY REPRESENTATIVES OF ALL PARTICIPATING  
UNIVERSITIES

FROM: Milton Goldberg *mg.*

SUBJECT: Indirect Costs

I have been informed that the Office of Management and Budget will amend its June 9, 1986 revision of Circular A-21. The amendment is an improvement over its earlier version. The Association of American Universities which led efforts to improve the June 9 revision, issued a statement on September 29 which characterizes the OMB decision as "welcome news." That statement is attached.

The OMB revision would establish an allowance for the administrative effort of faculty, department heads and others conducting research and instruction with responsibilities equivalent to those of regular faculty members. The allowance for such costs is set at 3.6% of MTDC. OMB has modified the language offered on August 27, 1986, but their intent appears to be consistent with and in the spirit of the August proposal (sent to Primary Representatives on September 5, 1986). The new language is also attached.

We do not expect a statement from OMB with respect to the "understandings" sought on August 27, however, OMB has expressed strong support for permitting agreements already negotiated, to remain in force until they expire. Negotiators will also be encouraged to allocate cost to specific categories. This is aimed at stopping "bottom line" indirect cost rate setting, where neither party can know the value of individual cost pools.

OMB also expressed a strong interest in collecting certain data. They would like to collect data on: (1) the actual costs covered by 3.6 percent allowance; (2) the extent of institutional cost sharing in federally sponsored research; and (3) the costs to universities of federal requirements. At this point, we do not have additional details. Perhaps the Federal Register issuance will be more definitive.

Attachment

# *Association of American Universities*

*President*

## STATEMENT ON PROPOSED REVISION OF OMB CIRCULAR A-21

Robert M. Rosenzweig, President  
Association of American Universities  
September 29, 1986

The decision of OMB to amend its June 9 revision of Circular A-21 is welcome news. The new proposal (attached) is an improvement over earlier versions.

Reaching this agreement has been a long and difficult process. We are grateful for the assistance of OMB Deputy Director Joseph R. Wright, who helped, through discussions with the Government-University-Industry Research Roundtable, to seek balance among the concerns of government officials, university administrators, and faculty. The efforts of OMB to respond to university concerns affirm the importance of working together on important national research policy issues. We are extremely grateful to Members of Congress who encouraged and aided resolution of this contentious and complicated issue.

The original February proposal was published with no advance consultation with universities. Discussions since that time have improved the proposed revision. Nevertheless, it was clear from the start that the motivation for the change was budgetary and that a set of cost principles, developed over the years and closely linked to the nature of our peculiar system of higher education, was being used to "save" \$100 million without regard to any other consequences.

It is important to understand that university people view A-21 as a document grounded in management considerations that have fiscal implications, rather than the other way around. To reverse those, as seems to have happened this year, exposes universities to the risk of sudden, uncontrollable, and unpredictable change. That sense of risk was compounded by the fact that the people in OMB who have historically been concerned with A-21 changes were not involved in this one, and those who were involved, able as they are, were largely unfamiliar with the issues and were impelled by their view of what the budget required.

On one point there is unanimity among university presidents, and that is that future changes in A-21 must be considered outside the framework of the annual budget. Obviously, budgetary consequences are relevant, but changes proposed primarily in order to meet a budgetary target will be strongly resisted. The proper way to deal with the budget is through the budget and appropriations process, not by manipulating the accounting principles.

The special studies on which OMB and the universities have agreed to cooperate will help lay the foundation for better policy. Additionally, the work of the Government-University-Industry Research Roundtable shows promise of producing more efficient and effective relationships in the area of research administration. We hope that we can now move forward to improve the system so that basic scientific research and the universities in which it takes place will remain strong and vital.



**FILE COPY**

DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL  
REGION I

## Memorandum

Date : DEC 6 1985

From : Edward A. Parigian  
Regional Inspector General for Audit


Subject : Final Report - The Impact of Indirect Costs on Research Sponsored  
by the Federal Government at Universities and Colleges - Audit  
Control No. 01-61004

To : John Ferris, Director  
Grants and Internal Systems Division, OA

We are forwarding two copies of the proposed final report. The final report has been revised to some extent to include comments by members of Hank Kirschenmann's staff, namely Gary Talesnik and John Strauch.

We have also forwarded copies of the proposed final report to the Assistant Inspector General for Audit and to Gary Talesnik.

We have not included either a letter of transmittal or a distribution schedule. We will gladly prepare both if you advise us as to the addressee of the report and those organizations that are to receive copies.

  
Edward A. Parigian  
Regional Inspector General  
for Audit

Enclosure - 2 copies of report

MLP:

Please do not distribute.  
Report will be issued in  
About 3 weeks

85 DEC 30 4 11 PM

RECEIVED

THE IMPACT OF INDIRECT  
COSTS ON RESEARCH SPONSORED  
BY THE FEDERAL GOVERNMENT  
AT UNIVERSITIES AND COLLEGES

The designation of financial and/or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the Office of Inspector General. Final determinations on these matters will be made by authorized HHS operating division officials.



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## EXECUTIVE SUMMARY

Our study of the indirect costs of Federally sponsored research at universities and colleges, giving recognition to recent analyses by the Office of the Assistant Secretary for Management and Budget (OASMB), confirmed the existence of opportunities to contain these costs and make about \$255 million available annually, or about \$1.3 billion over a 5-year period, to meet other budgetary needs of the Government, including the financing of thousands of unfunded research projects already approved for technical merit. The projected savings result from two methodologies which, in our opinion, represent the most viable and potentially timely solutions to a continuing problem of rising indirect costs. In this regard, we are recommending the following actions:

- o Establish a fixed allowance for the highly controversial departmental administration component of the indirect cost rate.
- o Expand the use of predetermined indirect cost rates and extend them to cover a period of 2 years or more.

Each year an increasing share of the funds appropriated by Congress for research at universities and colleges is being used to finance indirect costs (overhead) rather than being used in the laboratories for direct scientific research. The growth of indirect costs, as a share of total research grant costs, has been the subject of numerous studies over the last 10 years by universities, congressional committees, private organizations and Government agencies. With regard to the growth of indirect costs, we estimate that from 1978 through 1984, annual payments to universities and colleges for indirect costs increased from about \$900 million - an amount equal to 36 percent of the funds used for direct research in 1978 - to \$1.7 billion which is equivalent to 46 percent of the \$3.7 billion provided for direct research in 1984.

In reaction to concerns to reconcile the U.S. Department of Health and Human Services (HHS) budget constraints with the needs of research, we performed a study to seek out answers to questions such as the following:

- o What are the reasons for the increases in indirect costs over the past decade and how does one control and, if possible, even reduce them?



- o Where and to what extent are indirect costs which are not legitimate costs of research being charged to research?

Generally, we found that most increases in indirect costs are reasonable and beneficial to research sponsored by the Federal Government, except for those increases applicable to the pool of indirect costs referred to as "departmental administration". For the most part, increases in the other indirect cost pools were caused by inflation; special and scientific studies conducted by universities to relate buildings and equipment usage and related energy and fuel costs to Government sponsored research; and increased conversions from use allowances to depreciation.

With respect to the departmental administration cost pool, where payments increased from an estimated \$275 million in fiscal year 1978 to an estimated \$575 million in fiscal year 1984 - or to an amount equivalent to 15.4 percent of the direct cost of scientific research, we estimate that in fiscal year 1984 over \$300 million of such payments did not benefit Government sponsored research. Instead, the payments and related costs benefited and should have been allocated to the major university functions of instruction and other institutional activities. Departmental administration costs that we believe were not beneficial to Government sponsored research, although difficult to identify, quantify and challenge under the current provisions of Office of Management and Budget (OMB) Circular A-21, include (1) faculty salaries, (2) certain clerical and technical salaries and other operating expenses, and (3) certain costs allocated to departmental administration from other indirect cost pools.

Much of the difficulty with the departmental administration cost pool can be attributed to the fact that the types of costs included therein are extremely difficult to measure or evaluate in terms of their relevance to sponsored research projects. In addition, there is a lack of criteria within OMB Circular A-21 specifying the types of costs that can or cannot be included in departmental administration. For example, we found that, for the institutions reviewed, the total departmental administration rate, as a percentage of total direct costs, ranged from 9.0 percent to 24.80 percent. And, the percentage of faculty costs and other operating expenses included in the rate ranged from 0.00 percent to 5.88 percent and from 0.59 percent to 9.38 percent, respectively.

In order to contain the increasing allocations of departmental administration costs that do not benefit federally sponsored research programs, we are recommending that the amount of departmental administration expenses chargeable to sponsored research be established as a fixed allowance of 7 percent of the



direct cost of research. We believe this allowance will provide universities with reasonable reimbursement for research administration in academic units. The attendant reduction in departmental administration costs could be used by Government agencies to fund thousands of essential research projects which because of budgetary constraints have not been funded.

In addition to the above recommendation on departmental administration, we are also recommending the expanded use of predetermined indirect cost rates extending over periods of 2 years or more. Predetermined rates are established for specific future periods based on estimates of cost for that period. The rates are ordinarily not subject to adjustment. We believe a number of benefits will accrue to universities and to the Government through use of such rate setting practices. For example, all parties will know in advance what the recovery and funding rate will be - they can plan for it, indirect cost rate proposals and negotiations will be needed less frequently, and there will be a downward pressure on rate creep.

To be most effective, the establishment of predetermined rates should take place only after moves are made to eliminate subjectivity from the departmental administration component of the rate.

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In response to the draft report, the HHS Assistant Secretary for Management and Budget and staff, and representatives of the Office of Inspector General met with staff of the Office of Science and Technology Policy (OSTP) and the Associate Director for Management of the Office of Management and Budget (OMB) to discuss our recommended changes to Circular A-21 on departmental administration costs as well as a similar recommendation by OSTP to establish a fixed allowance for all university administrative costs. As a result of this meeting, OMB has agreed to seriously consider (1) a revision to Circular A-21 to establish a fixed allowance for all university administrative costs, and (2) a future reduction in the fixed allowance in line with the recommendation in this report relative to departmental administration costs. The change to the Circular would also eliminate the requirement for all effort reporting to support charges for administrative costs as suggested in the report.



## BACKGROUND

### What are Direct and Indirect Costs?

The total cost of any sponsored research project usually includes direct and indirect costs described as follows:

1. Direct costs are those costs that can be identified specifically with a particular sponsored project, an 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 people working on research projects, laboratory supplies, equipment, and subcontracts. Modified total direct cost (MTDC) is an important subcategory of direct cost. It usually includes all direct costs except equipment and that portion of subcontracts 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.

2. 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, an instructional activity, or any other institutional activity. OMB Circular A-21 contains principles for the identification and allocation of indirect costs. At universities and colleges, indirect costs are usually included in pools identified as follows:

. . . Depreciation and Use Allowance - Compensation for the use of an institution's buildings and equipment, provided they are needed and used for institutional activities and are properly allocable to sponsored agreements.

. . . Operations and Maintenance - Expenses incurred by a central service organization or by a department for the administration, supervision, operation, maintenance and protection of an institution's physical plant. Specific items include utilities, janitorial services, fire protection, etc.

. . . General Administration - Expenses incurred for general executive and administrative offices and other expenses of a general character. Specific activities include the office of the president, chancellor, vice-presidents and treasurer and other activities such as personnel, accounting, etc.



. . . Sponsored Projects Administration - Expenses incurred by separate organizations established to administer sponsored projects, including such functions as grant and contract administration, special security, publishing of research reports, etc.

. . . Library - Expenses incurred for the operation of libraries including salaries and wages, fringe benefits, cost of books and library supplies, etc.

. . . Departmental Administration - Expenses incurred for administrative and support services that benefit common or joint departmental activities or objectives in academic deans' offices, and academic departments and divisions. These expenses include salaries, wages, and fringe benefits of deans, departmental chairpersons, and clerical and technical staff and the cost of office supplies, travel, etc. The expenses also cover the portion of faculty and professional salaries related to administrative activities.

The costs in each of the above indirect cost pools are allocated to each major university function (instruction, sponsored research, other sponsored activities, and other institutional activities) on the basis of benefits derived or traceable cause and effect relationships. For example, Operations and Maintenance costs are usually allocated to major functions based on square footage of space used by each major function, while Library costs are usually allocated based on the number of students and staff utilizing the facility(ies). All of the indirect costs finally allocated to the research function are generally divided by the MTDC of research to obtain the grantee's research indirect cost rate which is applied to individual grant awards to determine the amount of indirect costs chargeable to the awards.

#### Efforts to Resolve the Problem of Rising Indirect Costs

The problem of rising indirect costs has been the subject of continuing and extensive debate by the Congress, the Office of Management and Budget, the President's Office of Science and Technology Policy, HHS, the National Science Foundation, and numerous research universities and their associations. The continuing debate over indirect costs has prompted attempts to design alternatives promoting a better understanding of these costs and an understanding of what distribution of responsibility for the overall cost of research is fair. None of the alternatives promoted over the years have been adopted.



## OBJECTIVES AND SCOPE OF STUDY

In fiscal year 1984, estimated payments to universities and colleges for indirect costs totaled about \$1.7 billion or 46 percent of an estimated \$3.7 billion used for direct scientific research within the educational environment. Recognizing the adverse effect on direct research of such a high ratio of indirect costs to direct research costs, the HHS Office of Inspector General, initiated a study to develop input for a Government-wide effort to resolve this problem.

We used data covering a 6-year period, compiled from 13 of the top 100 research universities, as the primary basis for our study. Although approximately 650 of the nation's 2,700 universities and colleges receive research funds from the Federal Government, the top 100 receive about 85 percent of the total amount awarded. As part of our study, we developed a computer model to establish an average departmental administration rate that, in our opinion, will provide universities with a reasonable allowance for research administration at the departmental level.

The 13 universities included in our study received an estimated \$760 million in fiscal year 1984, or about 17 percent of the research funds made available by the Government to the top 100 schools. The ratio of indirect costs to direct research costs for the universities included in our review was about 51 percent in fiscal year 1984 as compared to 46 percent for all research universities and colleges. Under these circumstances, we believe the 13 schools included in our study are representative of the top 100 universities receiving research funds from the Federal Government. The schools are:

Harvard (PR)  
U. Iowa (P)  
Yale (PR)  
Washington U. (PR)  
Boston U. (PR)  
U. Missouri (P)  
U. Conn. (P)

Johns Hopkins (PR)  
UC - Los Angeles (P)  
U. Penn (PR)  
UC - Berkeley (P)  
Temple (P)  
U. Mass. (P)

(PR) = Private school

(P) = Schools wholly or primarily supported by State appropriations



During our review, we held discussions with and/or obtained data from representatives of the Office of Science and Technology Policy, National Science Foundation, Office of Naval Research, the Council on Governmental Relations, and HHS's Public Health Service, National Institutes of Health and Office of the Assistant Secretary for Management and Budget.

### DETAILS OF STUDY

As part of our study, we identified a number of possible cost saving opportunities. Of these, we are recommending two as being most desirable at this time in terms of changing, on a Government-wide basis, the method of reimbursing indirect costs to universities.

### ESTABLISH A FIXED ALLOWANCE FOR DEPARTMENTAL ADMINISTRATION

Data obtained from universities included in our review and from sources within the Government provided a basis from which to determine the ratio of indirect to direct costs and to determine the value of each indirect cost pool. These data were adjusted to reflect the national ratio of indirect to direct cost payments as shown in the Schedule below. In terms of the pools of indirect costs, payments for departmental administration evidenced the largest annual increase from fiscal year 1978 through fiscal year 1984, rising from \$275 million to \$575 million. As a percentage of the direct cost of research (modified), departmental administration rose from 11 percent to 15.4 percent.

Estimated payments of \$900 million and \$1.7 billion, respectively, for indirect costs in fiscal years 1978 and 1984 and the related percentages in terms of direct cost are shown by indirect cost pools:

<u>Indirect Cost Pool</u>	<u>Indirect Cost Payments (in millions)</u>		<u>Indirect Cost Payments As a Percentage of Direct Cost</u>	
	<u>1978</u>	<u>1984</u>	<u>1978</u>	<u>1984</u>
Departmental administration	\$275	\$575	11.0%	15.4%
Operations and maintenance	250	495	10.0	13.6
General administration	175	270	7.0	7.3
Depreciation/use allowance	100	170	4.0	4.6
Sponsored projects administration	45	115	1.8	3.1
Library/other	<u>55</u>	<u>75</u>	<u>2.2</u>	<u>2.0</u>
Total	<u>\$900</u>	<u>\$1,700</u>	<u>36.0%</u>	<u>46.0%</u>

The departmental administration and the operations and maintenance indirect cost pools accounted for almost two-thirds of the payments for indirect costs in fiscal year 1984. With regard to operations and maintenance, we found that the types of expenses



included, the increases in these expenses (such as, higher energy costs), and the assignment of greater portions of the costs to research as a result of special studies, were generally appropriate.

Unlike operations and maintenance costs, many administrative activities identified by universities as representing departmental administration expenses allocated to organized research sponsored by the Government raise serious questions as to whether they do benefit research, or if they do, to what extent. In addition, a significant portion of the costs assigned to departmental administration are derived by complex effort reporting systems which most faculty members and many university administrators characterize as meaningless. Furthermore, departmental administration, which accounted for payments equivalent to 15.4 percent of direct scientific research (modified) in 1984, is the least definitive component of indirect costs within OMB Circular A-21 in terms of the types and amount of costs which can be assigned thereto. There are no objective measurement techniques prescribed for the manner in which universities can assign costs to departmental administration. Consequently, an opportunity exists for universities to arbitrarily allocate more and more dollars to this cost pool and to research. Lastly, departmental administrative efforts identified as being research-related are in addition to 1) managerial and administrative efforts charged directly to Federal grants and contracts by principal investigators and other researchers, and often, by managerial and clerical staff working directly on grants and contracts; 2) research administration charged entirely to grants and contracts through the indirect cost pool called "sponsored projects administration;" and 3) university level administration charged to research, in part, through the "general administration" cost pool.

#### Departmental Administration - Lacks Objective Measurability and Specific Criteria

Departmental administration differs uniquely from other indirect cost pools wherein activities performed are identifiable generally from the type of cost incurred (such as fuel and electricity) and by the organizational unit in which incurred. In the academic units a wide range of interrelated activities, the costs of which must be identified separately for indirect cost rate computation purposes, occur coterminously. These activities include instruction, research and public service both externally and institutionally sponsored, as well as departmental administration, sponsored projects administration and student services. The same individuals and the same individual kinds of support and expenses are usually involved in the performance of more than one of these activities. Other than specific direct charges to sponsored agreements and a relatively few single purpose items,



the amount of costs assignable to each of these activities is not identifiable by the normal accounting process, the nature of the cost, or the individual(s) involved.

In addition to these concerns, we found, as already mentioned, that universities have wide latitude to include within departmental administration whatever type and amount of expense they wish. In particular, the governing regulation for indirect costs, OMB Circular A-21, lacks specific criteria regarding departmental administration, requiring only that costs be incurred at school or departmental level and, with regard to salaries, that some kind of documentation exist to show the estimated percentage of effort expended on administrative activities. To determine what effect this lack of specific criteria had on research sponsored by the Federal Government, we analyzed data, shown in schedule 1 detailing the composition of costs included in Departmental Administration by 12 universities that furnished us information for this purpose.

The results of our analysis showed widely inconsistent treatment by universities of the same kinds of costs. For example, clerical and technical salaries charged (per dollar of MTDC) to Federal grants and contracts at one university were 2.8 times higher than clerical and technical salaries at another; other operating expenses at one university were 10.2 times those at another; and salaries of deans and departmental chairpersons at one university were 3.4 times higher than at another. The lack of consistency in the way universities assign costs to departmental administration is also reflected in the ratio of departmental administration to total indirect costs. While this ratio is now averaging about 36 percent at the 13 schools included in our review and about 34 percent nationwide, the ratios varied from 22 to 58 percent at the 13 schools included in our review.

To determine what criteria (standards and constraints) would ensure that Federal grants and contracts are charged only for departmental administration costs needed to perform research, we analyzed each expense area included within departmental administration. The following paragraphs summarize our findings.

#### Deans and Departmental Chairpersons

Our review disclosed that costs included in this category in fiscal year 1984 in the estimated amount of \$50 million nationwide represented payments for managerial and administrative duties related to overall activities at the school or departmental level. Generally, deans perform managerial and administrative duties on a full-time basis while departmental chairpersons receive approximately a 50 percent reduction from other duties, such as instruction.



Deans and departmental chairpersons are responsible for the overall administration of the instruction and research programs of their schools and departments. While the specific degree to which these efforts and related costs benefit research may be subject to question, we agree that this type of administrative effort generally is beneficial and necessary to the research function sponsored by the Government. Accordingly, we believe that the full amount of salaries and fringe benefits attributable to the administrative duties of deans and departmental chairpersons should be included in departmental administration.

### Faculty Salaries

Faculty salaries included in departmental administration and allocated to research sponsored by the Government in fiscal year 1984 totaled an estimated \$85 million. We believe faculty salaries should be excluded from departmental administration and included in instruction or other institutional activities because, with minor exceptions, the administrative work associated therewith either does not benefit sponsored research or is charged directly to individual research projects.

We found basic weaknesses in the system used to identify faculty effort assigned to departmental administration. The assignment of faculty (and clerical and technical) salaries was based on estimates made by individuals or by supervisory or administrative personnel as to how much effort was devoted to administration. The estimates were recorded, as part of a complex effort reporting system, on personal activity reports. These estimates are virtually impossible to objectively verify because of the interrelationship of the multiple activities performed by the individuals involved and the fact that there is seldom any specific identification of the detailed activities and amounts being charged. Our review of the personal activity reports confirmed that (1) information recorded is not susceptible to independent analysis or verification, (2) the system is subject to extreme inconsistencies whereby the same type of activity performed by different individuals can be charged as a direct cost to a research project or as administration and (3) the very concept of effort reporting is viewed by faculty members, many university administrators and by many Government officials as extremely unreliable.

Through our analyses, we also found that committee work was the primary, and frequently the only, basis for charging faculty administrative actions to research. To determine the identification of committees charged to administration and the extent to which these committees benefited research, we interviewed faculty members serving on the committees, examined minutes of committee meetings, and reviewed the charters or mission statements that



describe the purpose and objectives of the individual committees. From this, we determined that the relationship to research is negligible, if it exists at all, for many of the committees used by universities as a basis for allocating faculty salaries to departmental administration, and thus to federally sponsored research. Following are examples of such committees where costs are currently charged in part to federally sponsored research through Departmental Administration:

Visiting Lecture Committee  
Graduate Student Recruiting Committee  
Graduate Admissions Committee  
Liberal Arts Self-Study Committee  
Seminar Committee  
Awards Evaluation Committee  
Faculty Search Committee  
Library Committee  
Promotion and Tenure Committee  
Graduate Council Committee

For many of these committees, we question whether any benefit accrues to sponsored research. For others, while there may be some benefit to sponsored research, we noted through visits to a number of universities and colleges with little or no research activity that they have established many of the same committees as part of a management structure for the schools' instruction function. Thus, serious questions are raised as to how much of such committee work is allocable to research when research is added to a school's activities.

In our opinion, faculty salaries, as a general rule, should not be included in indirect costs allocated to Federal research projects. To the extent faculty efforts respond to Federal regulations mandating oversight in the area of sponsored research and do, in fact, benefit sponsored research, we believe that such efforts should be directly charged (as much of it already is) or be considered as cost sharing by the universities.

#### Clerical and Technical Salaries

Clerical and technical salaries included in the departmental administration cost pool and allocated to research sponsored by the Federal Government in fiscal year 1984 totaled an estimated \$175 million. As a basis for evaluating this pool of costs, we used criteria in OMB Circular A-21 which provides:



"Where any type of expense ordinarily treated as general administration or departmental administration is charged to sponsored agreements as direct costs, expenses applicable to other activities of the institution when incurred for the same purposes in like circumstances must, through separate cost groupings, be excluded from the indirect costs allocable to those sponsored agreements and included in the direct cost of other activities for cost allocation purposes."

During our review, we determined that universities were routinely charging salaries for positions such as laboratory technicians, glassblowers, and electricians directly to federally sponsored research projects. Similar salaries were also charged to departmental administration. Under these circumstances, it appears likely that costs properly chargeable as direct costs of instruction or other institutional activities have instead been included in departmental administration.

In addition, many universities charged secretarial and clerical salaries directly to sponsored projects for work performed on those projects. They also charged some or all of the remaining secretarial and technical salaries to departmental administration either arbitrarily, or by the same type of effort reporting systems as discussed under Faculty Salaries. While some administrative activity on the part of secretarial and clerical staff obviously occurs, we do not believe that the current systems accurately measure it.

Like faculty salaries, the extent to which clerical and technical salaries included in departmental administration benefit organized research is extremely difficult to measure or verify. In the absence of information to analyze in detail the types and nature of job classifications and related costs assigned to departmental administration, we used a ratio to conservatively estimate nationwide what amount of clerical and technical salaries should be included in this cost pool for allocation to sponsored research. As a basis for the ratio, we assumed that the relationship of clerical and technical salaries to the modified total direct cost (MTDC) of instruction and other institutional activities should closely approximate the relationship of clerical and technical salaries to the MTDC of sponsored research.

Using our analyses which were based on information available for fiscal year 1983 from six of the 13 universities in our study, we estimate that nationwide, 54 percent, or \$95 million, of the \$175 million in clerical and technical salaries assigned to departmental administration in fiscal year 1984, were reasonable. The remaining 46 percent, or \$80 million, of the total charged to departmental administration and allocated to



sponsored research should have been charged directly to the benefiting university functions of instruction (including departmental research) and other institutional activities. (See schedule 2 for calculations relating to clerical and technical salaries. The percentage allocated improperly to research (46%), as shown in the schedule, was used as a basis for reducing the clerical and technical salaries weighted average of 5.81 to the recommended rate of 3.14 as shown on schedule 1.)

In our opinion, clerical and technical salaries charged to departmental administration should be limited to salaries applicable to activities such as those of the immediate secretarial and administrative staffs of deans and departmental chairpersons, departmental business managers and staff working in departmental stockrooms.

#### Other Operating Expenses

Other operating expenses (non-salary costs) were included in the departmental administration cost pool. For fiscal year 1984, we estimate that \$170 million in such costs were allocated to Federally sponsored research. In reviewing these costs, we found that most of them were direct expenses of instruction and other institutional activities rather than indirect administrative costs. In this regard, although we did find a few schools which limited these types of costs strictly to those which actually support administrative activities such as office supplies and certain types of telephone expenses, most schools included within the departmental administration cost pool every type of cost, mostly direct costs, not expressly prohibited by OMB Circular A-21. Following are examples of some of the direct costs noted: laboratory supplies, chemicals, glassware, honoraria, and medical services and supplies.

From data provided by universities, we identified those schools which did limit the assignment of other operating expenses to departmental administration to those supporting administrative activities. From these data, we devised a ratio by which we estimate that, nationwide, federally sponsored research projects were overcharged \$140 million (rounded) in fiscal year 1984. Schedule 1 reflects the impact of our estimated overcharges in terms of the rate we are recommending for this cost activity.

In consideration of our findings, we believe that other operating expenses included within the departmental administration cost pool should be limited to that portion of costs such as office supplies and telephone specifically used for administrative purposes.



### Costs Allocated From Other Cost Pools

In addition to the types of departmental administration costs already discussed, expenses from the depreciation/use allowance, operations and maintenance and general administration indirect cost pools were allocated to departmental administration in the estimated amount of \$95 million in fiscal year 1984. The allocations were made based either on salaries or on the combined basis of salaries and non-salary expenses. We believe the basic methodologies under which universities calculated the rates at which these other indirect costs were allocated to the departmental administration cost pool were generally acceptable. However, since departmental administration salaries, wages, and non-salary operating expenses to which the rates for those other indirect cost pools were applied were overstated, as discussed in preceding paragraphs, amounts allocated to departmental administration were inflated. In our opinion, federally sponsored research projects were overcharged an estimated \$60 million for costs allocated to the departmental administration cost pools.

### Summary

We believe departmental administration expenses represent an excessive and unnecessary burden to sponsored research activities because the Government is already being charged for research administration directly by principal investigators and staff working on sponsored projects, and through the sponsored project administration and general administration cost pools. Moreover, departmental administration is a cost pool which includes clerical and technical salaries, faculty costs, and other operating expenses which do not benefit research or at best have questionable benefit to research. We earlier suggested ways in which OMB Circular A-21 might be modified to correct problems with regard to each of the individual components of departmental administration. However, we do not believe that efforts to continue payments for departmental administration on a cost reimbursable basis will be effective in eliminating problems or attendant criticisms. Therefore, we are suggesting a fixed allowance for departmental administration.

Based on the previous discussions, we determined that a departmental administration allowance of 7 percent (rounded) of modified total direct costs, as shown below, would provide universities with the amounts needed for the administration of federally sponsored research at the departmental level:



<u>Category of Cost</u>	<u>MTDC Rate</u>
Deans, departmental chairpersons & laboratory directors	1.65%
Faculty salaries	0.00
Clerical and technical salaries and wages	3.14
Other operating expenses	0.85
Costs allocated from other cost pools	<u>1.13</u>
	<u>6.77%</u>
Total	
Total (rounded)	<u>7.00% *</u>

\* = The 7 percent MTDC allowance for departmental administration represents a 55 percent reduction in the 1984 weighted departmental administration average of 15.4 percent of MTDC for the top 100 universities and colleges receiving Federal research funds.

We estimate that about \$315 million will be accrued annually through the establishment of a fixed MTDC rate of 7 percent for departmental administration. These annual savings were determined by applying the 55 percent reduction in the departmental administration rate (see preceding schedule) to the \$575 million in payments received by universities and colleges in fiscal year 1984 for departmental administration activities. Over a 5-year period, we believe these savings would amount to about \$1.6 billion. A more recent estimate projected by the OASMB, using more current data and slightly different assumptions, indicates that the annual savings would be about \$255 million and savings over 5-years would approximate \$1.3 billion.

### Recommendations

Accordingly, we recommend that OMB Circular A-21 be changed to provide for a fixed allowance for departmental administration not to exceed 7 percent of MTDC. A General Accounting Office report issued in 1984 contained a general recommendation of the same nature. Our recommendation is also similar to one included as a principal long-term option in HHS' 1983 report on indirect costs to the House Appropriations Committee.

We also recommend that OMB Circular A-21 be amended to include a prohibition against the transfer of costs out of departmental administration to the general administration or sponsored projects administration cost pools. This could be done



by tightening the definitions of these two cost pools to prohibit the transfer of indirect costs from academic departments to general administration or sponsored projects administration.

We further recommend that the requirement by the Government for use of personal activity reports be eliminated for all university employees relative to the identification of administrative activities. Such action would substantially simplify university effort reporting systems and reduce paperwork.

#### EXPAND THE USE OF PREDETERMINED INDIRECT COST RATES

A predetermined indirect cost rate is established for a specific future period based on an estimate of the costs for that period, and is ordinarily not subject to adjustment. Predetermined rates can be used when there is reasonable assurance, based on experience and a reliable estimate of an organization's costs, that the rate will approximate the organization's actual rate. Currently, about 60 percent of the large universities are using predetermined rates, primarily for a 1-year period. HHS has been promoting a more universal use of predetermined indirect cost rates at universities under its cognizance.

We believe it would be beneficial if universities and cognizant Federal agencies, as a natural course of events, promoted the use of predetermined indirect cost rates. In our opinion, if predetermined rates are negotiated at more universities and extended to cover a period of 2 years or more, rather than a 1 year period, a number of benefits will accrue to the universities and to the Government as follows:

- o All parties will know in advance the recovery and funding rate and plan accordingly.
- o Indirect cost rate proposals and rate negotiations will be needed on a less-frequent basis.
- o Less frequent negotiations should promote better relationships between universities and the Government by reducing the number of confrontational involvements.

Additional benefits to the Government would include:

- o The likelihood of a slight downward pressure on rate creep.

- o The ability to target Federal audits at institutions, and within time periods, for most benefit.
- o Diversion of negotiation resources to areas of equal and perhaps even more importance such as, within HHS, the review of Public Assistance cost allocation plans and state central service operations.

Whereas use of longer term predetermined indirect cost rates has a number of benefits, it will not, by itself, be effective in eliminating charges for indirect costs which are not legitimate costs of research. In this regard, the establishment of predetermined rates should take place only after moves are made to eliminate subjectivity from the departmental administration component of the rate.

#### Recommendation

We recommend that universities and Federal negotiators be encouraged to expand the use of predetermined indirect cost rates and extend them to cover periods of 2 years or more.

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In response to the draft report, the HHS Assistant Secretary for Management and Budget and staff, and representatives of the Office of Inspector General met with staff of the Office of Science and Technology Policy (OSTP) and the Associate Director for Management of the Office of Management and Budget (OMB) to discuss our recommended changes to Circular A-21 on departmental administration costs as well as a similar recommendation by OSTP to establish a fixed allowance for all university administrative costs. As a result of this meeting, OMB has agreed to seriously consider (1) a revision to Circular A-21 to establish a fixed allowance for all university administrative costs, and (2) a future reduction in the fixed allowance in line with the recommendation in this report relative to departmental administration costs. The change to the Circular would also eliminate the requirement for all effort reporting to support charges for administrative costs as suggested in the report.





12 UNIV.	WEIGHTED	RECOMMENDED	AVERAGE	RATE
100	100	100	100	100

percentages shown for each "category of cost" were obtained by dividing the costs assigned to each category by the standard method for direct cost (MDC) of research. This is the standard method for setting indirect cost rates for Federal research projects.

setting indirect cost rates. The information shown on this schedule reflects fiscal year 1983 data, the latest complete fiscal year data available at the time of our review.



SCHEDULE 2

EXTENT TO WHICH ALLOCATIONS OF CLERICAL AND TECHNICAL SALARIES TO SPONSORED RESEARCH ARE POTENTIALLY OVERSTATED AT SIX UNIVERSITIES

	I	II	III	IV	V	VI	TOTAL
	(\$000)						
Clerical and technical salaries properly chargeable to instruction (per ratio analysis)	\$11,650	\$13,800	\$19,200	\$14,000	\$4,300	\$3,000	\$65,950
Clerical and technical salaries assigned to instruction by universities	<u>2,900</u>	<u>8,300</u>	<u>13,100</u>	<u>14,300</u>	<u>2,200</u>	<u>1,600</u>	<u>\$2,400</u>
Difference - clerical and technical salaries assigned to departmental administration rather than to instruction	8,750	5,500	6,100	(300)	2,100	1,400	<u>\$23,550</u>
Percentage of departmental administration charged to research	<u>16%</u>	<u>18%</u>	<u>31.5%</u>	<u>33%</u>	<u>50%</u>	<u>14.5%</u>	
Clerical and technical salaries allocated to research improperly (per ratio analysis)	<u>\$1,400</u>	<u>\$ 990</u>	<u>\$1,900</u>	<u>(100)</u>	<u>\$1,050</u>	<u>\$ 200</u>	<u>\$ 5,440</u>
Total amount of clerical and technical salaries allocated to research by universities							<u>\$11,863</u>
Percentage allocated improperly to research (\$5,440 - \$11,863)							<u>46% (rounded)</u>

The information shown on this schedule reflects fiscal year 1983 data, the latest complete fiscal year data available at the time of our review. Data such as the above was not available for seven schools included in our study.