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REPORT BY THE

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Indirect Costs Of Health Research-- How They Are Computed, What Actions Are Needed

The Congress has expressed concern that indirect costs of health research have been escalating rapidly. This report

- describes the system used to compute these costs and shows why they are increasing rapidly,
- explains why indirect cost rates cannot be meaningfully compared among grantees, and
- demonstrates inconsistencies in principles and practices used to make indirect cost determinations.

Action is needed to make indirect cost principles more consistent and to use audit staffs more effectively in verifying grantees' data used to negotiate indirect cost rates. If Federal participation in health research costs is to be limited, it should be done through some formal ceiling on Federal reimbursement, such as by requiring minimum mandatory grantee participation in total costs, rather than as a restriction on indirect costs.



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HRD-79-67

JULY 27, 1979



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-117219

The Honorable Henry A. Waxman
Chairman, Subcommittee on
Health and the Environment
Committee on Interstate and
Foreign Commerce
House of Representatives

HSE02304

Dear Mr. Chairman:

In response to the former Subcommittee Chairman's September 30, 1977, request, we reviewed various aspects of indirect costs associated with Federal health research grants. The report discusses (1) congressional concern over indirect costs and the causes of their rapid increase, (2) the reason why it is not meaningful to compare indirect cost rates among institutions, (3) inconsistencies in Federal guidelines' indirect cost principles, and (4) variances in audit frequency and negotiation practices in determining indirect costs.

We recommend improving the content and use of Federal guidelines on indirect costs and making Federal audits of indirect costs more effective. We also recommend that, if Federal participation in research costs is to be limited, it should be done through some formal ceiling on Federal reimbursement, such as by requiring minimum mandatory grantee participation in total costs, rather than limiting Federal payment of indirect costs. We obtained written comments from the Office of Management and Budget, the Department of Health, Education, and Welfare, the Department of Defense, the National Science Foundation, and the Committee on Governmental Relations of the National Association of College and University Business Officers.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

James A. Stueck

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE SUBCOMMITTEE ON
HEALTH AND THE ENVIRONMENT,
HOUSE COMMITTEE ON INTERSTATE
AND FOREIGN COMMERCE

INDIRECT COSTS OF HEALTH
RESEARCH--HOW THEY ARE
COMPUTED, WHAT ACTIONS
ARE NEEDED

D I G E S T

2-12-98

Congressional concern has been voiced at the

--large proportion of health research funds
spent for indirect costs,

--wide range in indirect cost rates among
institutions,

--methods used to determine such rates, and

--Federal audit and negotiation process.

Questions also have been raised as to whether
Federal limits on indirect cost reimbursement
should be reinstated. (See p. 11.)

Indirect costs, an accounting term, are costs
for goods and services which cannot be iden-
tified readily with specific projects. For
this reason, accountants have devised methods,
based on estimates, to distribute these common
costs among individual projects. Depending on
circumstances, one organization could charge
an item of cost directly to projects; another
might choose to charge the same item in-
directly. (See p. 4.)

For many years Federal reimbursement of
grantees' indirect costs was limited to a
specified percentage. Since 1966, appro-
priation act language has provided that the
Federal Government will not reimburse a
grantee the entire cost of a research
project. Cost sharing continues to be re-
quired on research grants and no limits
have been reimposed on indirect cost reim-
bursement. (See p. 2.)

Federally sponsored health research has increased from \$1.6 billion in 1973 to an estimated \$2.7 billion in 1978. Indirect costs associated with this research are taking a greater share of each research dollar. (See p. 1.)

GAO asked National Institutes of Health 1977 grantees what caused the greatest increase in their indirect research costs. Responses from 444 grantees, or 74 percent, showed that the most frequently mentioned factors were utilities and compliance with Government mandated programs and administrative requirements. GAO's work at 14 of the larger grantees supported utilities as a cost-increasing factor. Lack of specific records prevented GAO from determining the extent of the effect of complying with Government requirements. Indirect costs for supplies and materials, and books and periodicals also have increased greatly in recent years. (See p. 8.)

Comparing indirect cost rates among institutions is not meaningful for measuring the relative efficiency of research activities. Many factors, such as the age and type of facilities used, accounting system differences, the type of research performed, and a host of other considerations, cause wide variations in indirect cost rates. (See p. 15.)

Various sets of Federal guidelines have been promulgated which set forth cost principles and negotiation instructions to be used for reporting and recovering research costs under grants and contracts. Government-wide guidelines have been issued for educational institutions and for State and local governments. The Office of Management and Budget (OMB) is in the process of developing guidelines for nonprofit research institutions. The Department of Health, Education, and Welfare (HEW) issued its own guideline for hospitals and another for nonprofit research institutions. The Department of Defense (DOD) has incorporated the OMB

guidelines for educational institutions and State and local governments into the Defense Acquisition Regulation, but it is silent on nonprofit research institutions and hospitals. (See p. 23.)

Cost principles are not always consistently stated among the various guidelines. For example, the basis that can or must be used for determining the indirect cost rate varies among the guidelines currently in effect. Also, there are many instances where the principles are ambiguous and contain editorial variations which can lead to differing interpretations on the allowability of certain costs. (See p. 24.)

OMB has recently revised its guideline applicable to educational institutions. These revisions will be a significant improvement over those previously used. The revisions provide more specific principles on distribution methods, identification and assignment of indirect costs, and standards for selected items of costs. However, inconsistencies with cost principles in other guidelines still exist. (See p. 28.)

GAO's review at 14 institutions having large health research activities showed significant differences in the extent of audit coverage requested and/or actually performed, and the methods used to negotiate indirect cost proposals. Questionnaire responses from 444 National Institutes of Health grantees suggest that differences in audit frequency and negotiation methods occur often.

The Defense Contract Audit Agency has a significantly higher frequency of indirect cost proposal audit coverage at grantee institutions than does the HEW Audit Agency. Although negotiators consider the results of audit reports in negotiating indirect cost rates, the benefits of these audits are not compiled and their cost effectiveness is uncertain. GAO is therefore unable to conclude whether Defense Contract Audit Agency audits of indirect cost proposals are too frequent or HEW audits are not frequent enough from

the standpoint of maximizing return on audit resources.

A variety of program priorities must be considered in directing the audit effort. The present system can be enhanced if a method is implemented which would allow both the negotiator and auditor to be more selective in choosing institutions for audit. One such method would require institutions to submit disclosure statements documenting their accounting systems and methods used to develop indirect cost proposals. (See p. 37.)

Agency negotiation officials generally negotiate indirect cost rates on an annual basis. Significant differences, however, were noted in the methods used to negotiate indirect cost rates. Some negotiators relied on their own desk reviews of institutions' proposals, others performed their own onsite audits, and still others relied on Federal audit agency reviews. Since GAO did not evaluate the quality of the indirect cost data submitted to negotiators by grantees, it did not evaluate the adequacy of the negotiation actions. (See p. 34.)

RECOMMENDATIONS TO AGENCIES

GAO recommends that:

- The Director of the Office of Management and Budget should require that there be a consistent presentation of principles in the guideline for educational institutions (Circular A-21), the guideline for State and local governments (Federal Management Circular 74-4), and the proposed guideline for nonprofit research institutions. (See p. 28.)
- OMB should work with HEW to encourage that the principles in its guideline for hospitals be brought into conformity with OMB guidelines. (See p. 28.)
- The Secretary of Defense should require that the Defense Acquisition Regulation incorporate the cost principles in HEW's guidelines for nonprofit research institutions

and hospitals. Since HEW has issued guidelines for these organizational types, DOD should adopt them until such time as OMB establishes Government-wide guidelines. (See p. 28.)

--The Director, OMB, should add a provision to its guidelines which would allow grantees to use a cost accounting system disclosure statement approach to identify accounting methods and changes made to them. Once grantees have established specified accounting practices and auditors and negotiators have determined them to be acceptable, subsequent reviews could be limited to system changes. GAO believes that this would allow already limited audit resources to be more effectively directed. (See p. 38.)

--The Secretaries of Defense and HEW, either jointly or separately, should analyze current practices for auditing indirect cost proposals related to research grants and contracts to identify the benefits derived. The results of the analyses would provide a basis to establish dollar thresholds for audit. When coupled with the "disclosure statement" approach recommended above, this could enhance the effectiveness of audit resources. (See p. 39.)

RECOMMENDATION TO THE CONGRESS

If the Congress should desire to further limit Federal participation in research project expenditures beyond the present legislative restriction, GAO recommends that this be achieved through some formal ceiling on Federal reimbursement, such as by requiring minimum mandatory grantee participation in total costs, rather than by limiting reimbursement on just the indirect cost portion of research. A reimbursement limitation imposed in this way would be more equitable among different institutions, since indirect cost rate comparisons are not meaningful and reflect a variety of accounting practices

and other differences. Further, limiting Federal reimbursement in this manner would avoid the possibility of costly accounting system changes to increase direct cost classifications which might result if limits were imposed on the indirect cost portion of total research expenditures. (See p. 13.)

AGENCY COMMENTS

Agency officials generally agreed with GAO's conclusions and recommendations, but a few concerns were expressed.

While OMB believed the disclosure statement approach recommendation may have merit, it wanted to explore the matter further with the Federal agencies involved and with the universities because of additional paperwork that might be generated. The Committee on Governmental Relations of the National Association of College and University Business Officers endorsed the disclosure statement concept and offered to work with OMB to field test it. (See p. 39.)

DOD's Defense Contract Audit Agency stated that the disclosure statement will facilitate the audit process, but it should not be construed as a cure-all.

HEW agreed with GAO's recommendation to analyze current auditing practices to identify the benefits derived. DOD's Defense Contract Audit Agency stated that its present frequency of audit carefully considered the extent of risk and available resources and suggested that GAO delete its recommendation for a joint HEW/DOD analysis of practices for auditing indirect cost proposals. However, GAO found that the Defense Contract Audit Agency headquarters does not have information centrally compiled to show the cost/benefit of such audits. Accordingly, GAO believes that its recommendation to analyze current auditing practices to identify the benefits derived is appropriate. (See p. 39.)

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ABBREVIATIONS

DAR	Defense Acquisition Regulation (formerly titled Armed Services Procurement Regulation)
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
NIH	National Institutes of Health
NSF	National Science Foundation
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

The Chairman, Subcommittee on Health and the Environment of the House Committee on Interstate and Foreign Commerce, asked us to study various issues related to the calculation, payment, and use of indirect costs associated with Federal health research grants. (See app. I.) Primarily, we were asked to discuss:

- What can be considered indirect costs.
- What methods and personnel are used to determine indirect cost rates.
- How frequently indirect cost rates are renegotiated.
- Why indirect cost rates cannot be meaningfully compared.
- Why indirect cost rates vary so much among different grantee types.
- Whether indirect costs are increasing faster than direct costs.

Data from the National Institutes of Health (NIH) and its grantees were used as a basis for making our study.

FEDERAL PARTICIPATION IN RESEARCH

Government support of research at nonprofit institutions, including colleges and universities, has increased substantially over the past 4 decades. A National Science Foundation (NSF) estimate shows that in 1940 Federal expenditures for research and development at educational institutions were about \$15 million. By 1955, the amount had increased to \$150 million. During the last 5 years, health research alone has increased from \$1.6 billion in 1973 to an estimated \$2.7 billion in 1978.

The primary sources of Federal funding for research are: the Department of Health, Education, and Welfare (HEW), the Department of Defense (DOD), and NSF. Approximately 75 percent of HEW's research funds are distributed by NIH. From 1968 to 1977, NIH's total grant awards increased from \$0.5 billion to \$1.3 billion (an increase of 160 percent). During this same period, NIH indirect cost awards increased

from \$96 million to \$359 million (an increase of 274 percent). Proportionately, indirect costs have increased from 19 to 27 percent of total grant awards during this period, as illustrated on the following page.

REIMBURSEMENT LIMITS ON INDIRECT
COSTS OF RESEARCH GRANTS

For many years, Federal payment for indirect costs incurred in support of research grants was determined by certain agencies through application of a single flat rate. For example, before 1955 HEW's policy was to limit overhead costs on NIH research grants to 8 percent of direct project costs; after that date, HEW changed its policy to allow an amount equal to 15 percent.

In 1958, HEW proposed to increase the indirect cost allowance to 25 percent, but the House Committee on Appropriations refused to approve the increase. Instead, a statutory ceiling of 15 percent was imposed. In 1963, the Congress increased the maximum limit on indirect costs for research grants to 20 percent of direct project costs and applied this limit not only to HEW but also to DOD research grants. Independent agencies, such as NSF and the National Aeronautics and Space Administration, were also using a limit which was set in their appropriation act at 25 percent for 1963; for subsequent years the limit dropped back to the same 20 percent as applied to HEW and DOD.

The House Committee on Appropriations recommended a change in the fiscal year 1966 appropriation for HEW, from a statutory limitation on the amount of indirect costs for research grants to a cost-sharing arrangement. The ceilings were removed for 1966 grant awards and the following language was included in the appropriation act:

"None of the funds provided herein shall be used to pay any recipient of a grant for the conduct of a research project an amount equal to as much as the entire cost of such project."

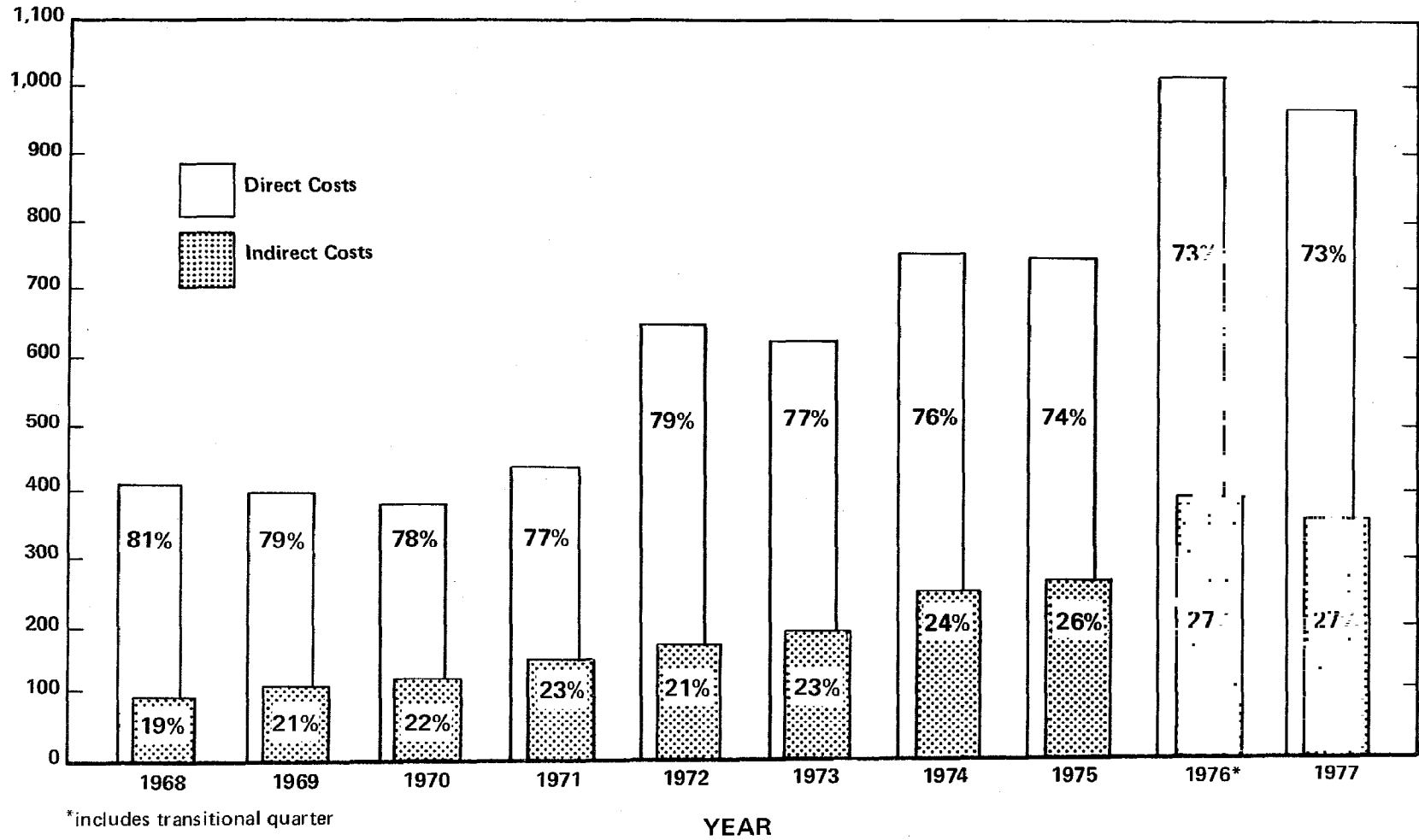
Similar language was included in the acts appropriating money for DOD and independent agencies. Cost sharing continues to be required on research grants, and no limits have been re-imposed on indirect cost payments.

TREND OF NIH GRANT AWARDS

1968 To 1977

PERCENT OF DIRECT AND INDIRECT COSTS TO TOTAL DOLLARS AWARDED

DOLLARS AWARDED (in millions)



WHAT ARE INDIRECT COSTS?

A great deal of confusion exists over the accounting term--indirect costs. The total costs of any product or service (including research) are usually grouped into two broad categories--direct and indirect. With regard to research, direct costs are readily identifiable with the performance of a research project and can be easily and accurately assigned to it by the accounting system of the institution. Direct costs ordinarily include

- salaries and wages of persons directly engaged in research,
- related employee benefit expenses,
- materials and supplies consumed,
- special equipment purchased,
- travel expenses, and
- other costs which may be identified directly with a given research project.

Indirect costs cannot practically be identified directly with specific projects. They are costs which are incurred for goods and services that benefit more than one activity or project. Indirect costs for research at an educational institution usually include expenses for

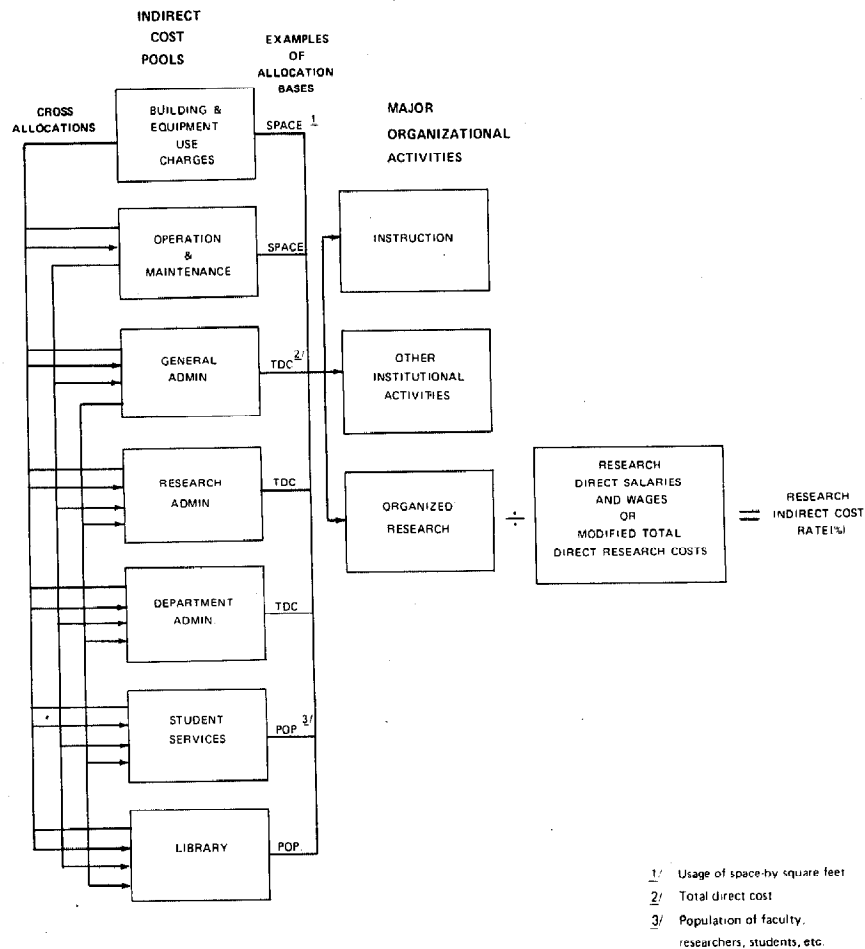
- general administration,
- departmental administration,
- research administration,
- operation and maintenance,
- student services,
- library costs, and
- use charges for buildings and equipment.

These costs are not readily and directly identifiable with each activity of the institution, or with each research project. For this reason, accountants have devised methods, based on estimates, to distribute these common costs. They

are collected in "cost pools" and distributed, first to the activities of the institution, and then to the individual projects within each activity. The distributions to the activities are to be made in a reasonable and equitable manner based on formulas that are consistent with the benefits received. A measure--such as square feet of office space, or hours of operation--is selected to allocate the common cost. Depending on the circumstances, one organization could charge an item of cost directly to projects, whereas another may choose to charge the same item indirectly.

In contrast to direct costs which are specifically identifiable to a project, indirect costs are charged on the basis of a negotiated rate, applied to total direct cost or to a portion thereof, such as salaries and wages. Thus, the indirect cost rate is the ratio of research indirect costs to a specified base, expressed as a percentage.

The following illustration shows how indirect costs at an educational institution may be calculated.



Since costs from the cost pools' activities cannot be assigned directly to research projects, they are classified as indirect costs. For example, a portion of building and equipment use costs is assigned to each of the other cost pools and to each of the major organizational activities using space as the basis for assigning costs. Thus, organized research might be assigned 10 percent of all building and equipment use costs. In a similar manner, a portion of the costs from each of the other cost pools is assigned to organized research. All of these costs are added together and then divided by a basis selected by the institution (usually either the cost of researchers' salaries and wages or total direct research costs). The result expressed in a percent is the indirect cost rate which can be used to help determine the cost of each research project.

SCOPE OF REVIEW

Our study included an analysis of legislation, regulations, and implementing agency instructions pertaining to the development, negotiation, and audit of indirect cost rates for health research grants. Major focus was placed on HEW since the vast majority of health research is sponsored under HEW grants and contracts. Audit work was performed in Washington, D.C., and in four HEW regional offices: Boston, New York, Philadelphia, and San Francisco.

Discussions were held with key agency officials in both headquarters and field locations of HEW and DOD. Also, in Washington, D.C., we met with officials from the Office of Management and Budget (OMB), NSF, and the National Association of College and University Business Officers.

Detailed audit work was performed at 14 institutions. (See app. X.) The institutions selected were picked to give us a cross section of entity types (i.e., educational, nonprofit, hospital, and State and local governments). We selected institutions with a relatively high indirect dollar grant activity (\$1 million or more in indirect costs per year). Limited work was also performed at four institutions which had low indirect cost rates. As agreed with the Chairman, Subcommittee on Health and the Environment, House Committee on Interstate and Foreign Commerce, we did not evaluate the legitimacy of claims made for indirect costs because it would duplicate work being done by other Federal auditors.

Additional information was obtained through a questionnaire which was sent to all 1977 NIH grantees to elicit

information on cost trends, the negotiation and audit of indirect costs, and the adequacy of indirect cost reimbursement principles. We received responses from 444 of the 600 grantees who were sent questionnaires.

CHAPTER 2

CONCERN OVER INDIRECT COSTS AND

CAUSES OF THEIR RAPID INCREASE

The indirect costs of institutions conducting research have greatly increased over the last decade and, proportionately, have been taking a greater share of each research dollar. General inflation has caused the cost of all goods and services, including research, to increase substantially over the last 10 years. Questionnaire responses from 444 NIH grantees indicated that 58 percent felt that, even after adjusting for the general rate of inflation, their indirect costs had increased. They attributed the increase primarily to utilities, and compliance with Government mandated programs and administrative requirements. Other factors have also contributed to the rapid increase of indirect costs.

Congressional concern about the increases in health research indirect costs has been recorded numerous times. A recurring topic is what can or should be done about limiting payment of indirect costs. Some Federal grant programs and most non-Federal health research programs do limit indirect cost reimbursement. Grantees have expressed the opinion that any further limits on Federal reimbursement for health research should be placed on total costs, not just the indirect cost portion.

FACTORS CAUSING INDIRECT COST INCREASES

Both personnel and nonpersonnel costs have risen. The Higher Education Price Index, which is most often used to measure average price changes at research institutions, shows that, during the 5-year period 1973-77, there has been an overall increase of 31.9 percent. Personnel costs such as salaries, wages, and fringe benefits have gone up 28.1 percent, while nonpersonnel costs such as utilities, equipment, supplies, and books have increased 48.2 percent. The greatest increases have been recorded by utilities (up 100 percent), supplies and materials (up 55 percent), and books and periodicals (up 51 percent). Since nonpersonnel costs comprise a much larger portion of indirect costs than direct costs, indirect costs have risen more sharply than direct costs.

Percentage Increases in Selected Subindexes
of the Higher Education Price Index

	Percent increase from <u>1973 to 1977</u>
Personnel costs:	
Professional salaries	22.3
Nonprofessional salaries and wages	32.2
Fringe benefits	49.2
Total	28.1
 Nonpersonnel costs:	
Services	26.4
Supplies and materials	55.3
Equipment	29.6
Books and periodicals	51.2
Utilities	100.0
Total	48.2
Higher Education Price Index	31.9

Our analysis of questionnaire responses regarding indirect cost reimbursements during the 5-year period 1973-77 showed that these costs increased about 48 percent. On the other hand, the increase for direct salary reimbursements of professional and technical staff was only 29 percent. These data parallel the Higher Education Price Index, in that indirect costs have increased at a faster rate than direct personnel costs. Further, the operations and maintenance cost pool classification showed the largest increase, in part attributable to the higher utilities costs which are normally included in this pool.

At the 14 institutions reviewed, utility cost was the item most frequently cited as contributing to increases in indirect costs. Two northeastern institutions experienced unusually high increases even though there was no major facility expansion. For example, at one institution--a university--the utility costs rose from \$2.3 million in 1970 to about \$10 million in 1977 (335 percent). Oil, at \$1.92 per barrel in 1970, had risen to \$13.79 per barrel by 1978.

Electricity costing 1.11 cents per kilowatt hour in 1970 rose to 3.6 cents in 1977. At the other institution--a hospital--total utility costs almost tripled between 1973 and 1976.

FEDERALLY MANDATED PROGRAMS AND ADMINISTRATIVE REQUIREMENTS

A total of 210 of the 444 questionnaire respondents reported that the cost of compliance with federally imposed programs was an important factor causing their indirect costs to increase. A total of 150 cited the cost of compliance with Federal Government administrative requirements, but we were not able to determine the extent of the increase in indirect costs caused by these requirements at the 14 institutions visited. Officials told us that, since accounting records are not organized in such a way to specifically identify the cost of these programs, they cannot readily compile such information.

Examples of federally imposed requirements cited by institutional officials include equal employment opportunity, equal pay, affirmative action, age discrimination, fair labor standards, unemployment compensation, Social Security, health and pension benefits, wage and salary controls, occupational safety and health, and environmental protection. We were told that the costs associated with these programs involve increased administrative and legal expenses, increased wages and benefits to employees, additional taxes, and physical plant investments.

In addition to the costs associated with federally mandated programs, institutional officials stated that the Government has added contract and grant provisions which become a part of the indirect costs applicable to research. Incorporated in grant manuals and contract clauses, the requirements relate, for instance, to animal-care requirements and the use of labor surplus area concerns, small business concerns, and minority business enterprises.

CONGRESSIONAL CONCERNS ABOUT INDIRECT COSTS

Over the years, concern has been expressed in the Congress over the proportion of health research funds used to pay indirect costs. In 1968, the Chairman of the House Committee on Appropriations requested us to do a study on indirect costs. In 1969, our report, "Study of Indirect Cost of Federally Sponsored Research Primarily by Educational Institutions," said that using a uniform percentage rate

would not result in a realistic determination of indirect costs. Also, we stated that using a fixed method or procedure for determining indirect costs was not feasible because of the differences in research institutions.

Congressional interest in indirect costs has continued, and in the last 5 years numerous questions have been raised about indirect costs of health research. Both the House and Senate Labor-HEW Appropriations Subcommittees have shown a continuous interest in indirect costs. The following are some specific concerns that have been discussed:

- What can be done to control indirect costs and get more research for the money?
- Why do grants from private organizations and foundations pay a lower indirect cost rate than grants from the Federal Government?
- Would it be desirable to reinstate a limit on indirect costs?
- What is being done to control the upward spiral in the rate of indirect costs?
- Why are there so many bases for determining indirect cost rates?

All of the above issues indicate that there is some dissatisfaction with the present system for computing indirect cost rates, and that some thought is being given to whether indirect cost reimbursement should be limited. No action has been taken by the Congress since 1966 when a percentage limit on indirect cost reimbursement was abolished.

CERTAIN FEDERAL AND PRIVATE GRANTORS LIMIT INDIRECT COST RECOVERY

Some Federal agencies have administrative regulations that limit recovery of indirect costs of federally sponsored research. For example, depending upon the nature of the research, agencies will place ceilings on the amount of indirect costs they will reimburse institutions. Questionnaire responses from NIH grantee institutions showed that one-third of the institutions were reimbursed by Federal agencies at indirect cost rates lower than negotiated. The most cited instance related to HEW's present policy of limiting indirect costs for research training grants to 8 percent of total direct costs.

At the National Science Foundation, the reimbursement policy generally followed can result in a grantee not fully recovering indirect costs. For example, assume that NSF awards a 1-year grant to an educational institution which, at the time of the award, has a fixed indirect cost rate of 33-1/3 percent of direct costs. The grant for \$100,000 is to cover \$75,000 of direct costs and \$25,000 of indirect costs. Six months into the grant period a new fiscal year begins for the grantee and the indirect cost rate is re-negotiated to 50 percent. NSF will recognize the new rate and allow the grantee to seek reimbursement at the new rate as long as total reimbursement does not exceed \$100,000. Thus, if the grantee spent \$75,000 on direct costs in monthly increments of \$6,250, only \$25,000 in indirect costs would be reimbursed instead of the \$31,250 which would represent full reimbursement of indirect costs. If this same grant was awarded by NIH, the grantee would be reimbursed a total of \$106,250 (\$75,000 for direct costs and \$31,250 for indirect costs).

In addition to federally imposed limitations, most non-Federal sponsors of research (private foundations, health associations, and private business concerns) will pay only a very limited amount of indirect costs. At the institutions reviewed, we noted examples where private commercial firms did not pay for any indirect costs. It is a common practice of national health associations, a major source for non-Federal research funds, to pay for only a portion of indirect costs. For example, the Muscular Dystrophy Association pays 8 percent of total direct costs, and the National Foundation--March of Dimes and the American Heart Association pay 10 percent of total direct costs. Questionnaire responses show that 84 percent of the respondents were not fully reimbursed by non-Federal grantors for their indirect costs. The primary reasons cited for accepting these non-Federal grants were:

- Accepted the private grantor's terms rather than not do the research.
- Wanted to develop research and staff capabilities.
- Considered the amount not reimbursed insignificant in relation to total research activity.
- Anticipated receiving additional grants, gifts, and donations.

INSTITUTIONAL VIEWS ON INDIRECT COST LIMITATIONS

At the 14 institutions included in our review, we asked officials for their views on limiting indirect cost reimbursement. Many of them expressed concern that, since different accounting practices affect the classifications of costs as either direct or indirect, the limitation of indirect cost reimbursement could result in inequities. Also, they believed that many institutions might be forced into making costly accounting changes to move more costs to the direct cost category, so that reimbursement of costs incurred under Federal grants could be maximized.

The Executive Director of the National Association of College and University Business Officers believed that, if Federal participation in research costs was to be further limited, it should be as a percentage or dollar reduction of total research costs, rather than a limit on the indirect cost component.

CONCLUSION

Indirect costs have increased sharply over the last decade and proportionately are taking a greater share of each research dollar. Higher utility costs along with general inflation have been key reasons for the increase. Although many institutional officials believe that federally mandated programs and administrative requirements have caused indirect costs to increase significantly, we could not determine the extent of the effect of these matters on indirect costs at the institutions studied since accounting records do not segregate this information.

The increase in indirect costs has been discussed by Members of Congress, and questions have been raised about whether limits should be reimposed on indirect costs. Officials at grantee institutions believe such a limitation would result in accounting methods being changed so that more costs would be classified as direct costs.

For many years Federal reimbursement of grantees' indirect costs was limited to a specified percentage. Since 1966, appropriation act language has provided that the Federal Government will not reimburse a grantee the entire cost of a research project. Cost sharing continues to be required on research grants and no limits have been reimposed on indirect cost reimbursement.

RECOMMENDATION TO THE CONGRESS

If the Congress should desire to further limit Federal participation in research project expenditures beyond the present legislative restriction, GAO recommends that this be achieved through some formal ceiling on Federal reimbursement, such as by requiring minimum mandatory grantee participation in total costs, rather than by limiting reimbursement on just the indirect cost portion of research. A reimbursement limitation imposed in this way would be more equitable among different institutions, since indirect cost rate comparisons are not meaningful and reflect a variety of accounting practices and other differences. Further, limiting Federal reimbursement in this manner would avoid the possibility of costly accounting system changes to increase direct cost classifications which might result if limits were imposed on the indirect cost portion of total research expenditures.

AGENCY COMMENTS

OMB, HEW, and NSF officials agreed with our recommendation. This recommendation was also endorsed by the Committee on Governmental Relations, National Association of College and University Business Officers.

CHAPTER 3

COMPARING INDIRECT COST RATES

AMONG INSTITUTIONS IS NOT MEANINGFUL

Audit work at 14 institutions and data developed from questionnaire responses of 444 NIH grantees show that it is not meaningful to compare indirect cost rates among institutions for measuring the relative efficiency of research activities. This work reaffirmed earlier findings presented in our 1969 report.

A variety of factors, such as the age and type of facilities used, geographic location, accounting system differences, and the type of research performed, cause wide variations in the indirect cost rate. For these reasons, a high indirect cost rate by itself does not mean that an institution is inefficient or that total costs assigned to research are excessive.

Data obtained from questionnaire responses showed that the indirect cost rates in 1977 varied from under 30 percent to close to 130 percent. As mentioned, variations in rates are caused by the effect of a variety of contributing factors. For ease of presentation, we categorized these factors affecting comparability into three broad areas:

- Accounting system differences.
- Differences in institutional characteristics.
- Specific types of rates negotiated by the institutions.

ACCOUNTING SYSTEM DIFFERENCES

As illustrated in chapter 1, the indirect cost rate is the ratio of indirect costs to a direct cost base. An accounting change which affects either the numerator or denominator of the formula will change the rate. For instance, at a given level of indirect cost, there is an inverse relationship between the base and the rate--the larger the base the lower the rate and vice versa. The following accounting decisions can affect the ratio, and therefore the comparability of indirect cost rates among institutions:

--The base selected to distribute indirect costs.

--The methods of classifying costs as either direct or indirect.

Base selected

The base selected to distribute indirect costs has a major effect on the indirect cost rate, or percentage. Institutions use two basic forms of distribution bases--salaries and wages or modified total direct costs. Some institutions use direct salaries and wages without fringe benefits; others use salaries and wages with various combinations of, or all, fringe benefits; and still others use some type of modified total direct cost base, such as total direct costs less capital expenditures.

A total of 63 different bases were used by the NIH 1977 grantees--86 percent of the grantees used 5 of the more common bases. From information furnished by NIH, we found that a breakdown of the two basic forms of bases used by the NIH 1977 grantees showed:

	<u>Salaries and wages</u>		<u>Modified total direct costs</u>	
	<u>Number</u>	<u>Percentage</u>	<u>Number</u>	<u>Percentage</u>
Educational institutions	281	85	48	15
Nonprofit research	103	67	50	33
Hospitals	61	51	59	49
State and local government agencies	<u>8</u>	100	<u>-</u>	-
Total	<u>453</u>	74	<u>157</u>	26

The following example used in our 1969 report shows that, without changing any cost elements, the base selected can result in an expression of different rates. Given that the cost elements were:

Direct salaries and wages	\$ 4,000,000
Fringe benefits	1,000,000
Other direct costs	3,000,000
Capital expenditures	<u>2,000,000</u>
Total direct cost	10,000,000
Total indirect cost	<u>2,000,000</u>
Total cost	<u>\$12,000,000</u>

Under the above identical set of costs, the indirect cost rate will vary as the base is changed:

<u>Base</u>	<u>Base amount</u>	<u>Indirect cost</u>	<u>Indirect cost rate</u>
Salaries and wages	\$ 4,000,000	\$ 2,000,000	50%
Salaries and wages plus fringe benefits	5,000,000	2,000,000	40%
Total direct costs less capital expenditures (modified total direct costs)	8,000,000	2,000,000	25%
Total direct costs	10,000,000	2,000,000	20%

As can be seen in the example above, the smaller the base used, the higher the rate. The negotiated indirect cost rates at the 14 institutions included in our review bear out this relationship. The 1977 indirect cost rates of these institutions were segregated by type of base used, and the average rate for each category was computed. The average rates were progressively smaller as the bases became greater, as shown below:

<u>Base</u>	<u>Number of institutions</u>	<u>Average indirect cost rate</u>
Direct salaries and wages plus sick and holiday leave and vacation pay	6	79%
Direct salaries and wages with all fringe benefits	3	62%
Modified total direct costs	<u>5</u>	45%
Total number of institutions we visited	<u><u>14</u></u>	64%

Classification of costs as direct or indirect

The methods used in classifying costs as either direct or indirect will affect the indirect cost rate. As more items are classified as direct costs, the indirect cost pools decrease, the base increases, and the rate becomes smaller.

The decision to classify costs as either direct or indirect is based on a variety of considerations. For example, one institution may assign secretaries to specific research projects and charge their salaries as direct costs. Conversely, in another institution the research projects may draw upon the services of the departmental secretarial pool, in which case secretarial costs would be recovered through indirect cost rates. To illustrate another condition which could result in similar costs being treated differently, let us analyze utility costs. In one organization where a research project is conducted in a separate building or location, utility costs would normally be accounted for separately and thus easily charged on a direct basis. On the other hand, where research activities are combined with other functions, the utility costs will be pooled and treated as an indirect cost.

DIFFERENCES IN INSTITUTIONAL CHARACTERISTICS

Whereas the previous section describes differences in accounting for indirect costs, there are other characteristics which are unique to an institution. These conditions make meaningful comparisons among institutions difficult.

Location of research facilities

The indirect cost rate for research is affected by the location of research facilities. Research performed at headquarters or on-campus facilities will influence research costs differently than if performed at auxiliary or off-campus facilities. Generally, more of the costs incurred in performing research in auxiliary facilities, or in buildings used solely for research, are charged directly. Under these circumstances the costs are more readily identified as direct costs. Available statistics show that indirect cost rates at the off-campus facilities are lower than those at the on-campus facilities. For example, at one institution reviewed, the on-campus indirect cost rate was 31 percent and the off-campus rate was 20 percent. However, certain costs, such as operations and maintenance and depreciation of facilities and equipment, were charged directly to research at the off-campus location since these costs could easily be identified separately.

The geographical locations also may be a factor affecting indirect cost rates. Some institutions are located in low-cost areas. The costs of utilities and labor, for example, could differ among the various regions of the country.

Difference in climatic conditions could result in varying consumption of utilities for heating and air-conditioning.

Our analysis of questionnaire responses from NIH grantees showed that climatic conditions can affect certain indirect costs. We compared the operations and maintenance cost pools (this includes utilities) in HEW's Region I (New England States) with Region IX (primarily Southwestern States). The operations and maintenance percentage of total indirect costs was 26 percent in Region I and 15 percent in Region IX.

Variations in research facilities

Indirect cost rates are also affected by variations in the age, operations and maintenance, and the method of financing research facilities and structures. For example, in accordance with the cost principles, building depreciation and use charges are computed from acquisition costs of the buildings. The depreciation or use charge would be greater for a new structure than for an older structure. Furthermore, operating costs more than likely increase as utility use requirements increase to accommodate more sophisticated equipment and current safety regulations. Also, the growth of an institution's research capabilities from adding new facilities will increase depreciation or use charges and operations and maintenance expenditures.

In one hospital, the actual indirect cost rate increased 38 percent from 1975 through 1977. Hospital officials stated that the increase in indirect costs was primarily due to a new building acquisition. During that 3-year period, building depreciation and plant operations allocated to research increased 311 percent and 144 percent, respectively.

The quality and the degree of maintenance performed by institutions could further affect indirect costs. Maintenance costs generally are greater for older structures. Also, some institutions have all their buildings in a relatively compact area, and others are located in a relatively spacious setting which may require more costs in landscaping and ground maintenance.

Methods by which the construction of research facilities were financed differ greatly and influence the degree of building use charges made to research. For example, if research is conducted solely in buildings constructed by the institution, depreciation costs are charged. If research is conducted in Government facilities, no depreciation is charged.

Nature of institution

The nature of the institution in terms of the mixture of various disciplines and the extent of research involvement may affect the amount of indirect costs. Our analysis of nonprofit research institutions, educational institutions, and hospitals awarded NIH grants during a 3-year period, 1975 through 1977, showed that the average percentage of total grant awards used to reimburse indirect costs was consistently higher for nonprofit research institutions than educational institutions and hospitals. State and local government agencies were not included in this analysis since only eight were NIH grantees. Although the percent differences among the institutions did not vary significantly, the following table shows a consistent ranking among the three types of institutions during the 3-year period.

<u>Type of institution</u>	Average percentage of total NIH grant awards used to reimburse indirect costs		
	<u>1975</u>	<u>1976</u>	<u>1977</u>
Nonprofit research	27.5	28.6	29.3
Educational institutions	25.9	27.0	27.2
Hospitals	23.1	24.4	25.1

Type of research

The nature of research itself affects the amount of indirect costs generated by the services needed for support. A research project in health may require extensive facilities, sensitive equipment, and precise environmental control which could be charged as direct or indirect costs. These charges are more costly than those for other types of research projects requiring little space and support services. Institutions with the capabilities to do research in many disciplines will have different total research requirements from institutions specializing in one research area.

TYPES OF RATES NEGOTIATED

Another factor which makes comparing rates not meaningful is the type of indirect cost rate negotiated for reimbursement purposes. There are three types of indirect cost rates which can be negotiated:

--Provisional/final rate--Temporary rate used for reimbursement during an agreed-to period. The provisional rate is retroactively adjusted to a final rate when the actual indirect costs for the agreed-to period have been audited and negotiated. If the finally negotiated rate is determined to be lower than the provisional rate, then a refund is paid to the Government. If the negotiated rate is higher than the provisional rate, the Government pays the difference to the institution.

--Predetermined fixed rate--Negotiated rate established to cover one or several years if both the Government and the institution agree that this will probably be equitable to both parties. The rate is used for the life of the research grant and cannot subsequently be adjusted.

--Fixed rate with carry-forward--Negotiated rate for which over- or under-recovery in the year or years to which it applies will be included as an adjustment to a subsequent indirect cost rate negotiated.

The use of the different rate applications varies significantly, thus preventing comparability. A breakdown of the type of rates used by the 1977 NIH grantees showed:

	<u>Provisional</u>	<u>Fixed with carry-forward</u>	<u>Predetermined</u>
Educational institutions	116	111	102
Nonprofit research organizations	124	21	8
Hospitals	98	12	10
State and local government agencies	<u>4</u>	<u>3</u>	<u>1</u>
Total	<u>342</u>	<u>147</u>	<u>121</u>

When rates are compared, there may be confusion as to what the rate actually represents. The rate may be a temporary rate which will later be adjusted or it may be a final rate.

For example, at one of the hospitals included in our review a provisional rate of 60 percent was established for the 1976 award period. This rate was based upon the final

actual rate experienced the prior year. After all actual cost information was complete for 1976, the provisional rate was finalized at 68 percent. Thus, if one were to compare the 60-percent provisional rate with some other institution it would have been misleading since it was understated.

Generally, under a "fixed rate with carry-forward" arrangement, the rate is based on the most recent year's costs for which information is available. Therefore, a rate may be negotiated in 1978 for use in 1979 and 1980 based on 1977 cost experience. The effect of this rate application is to defer recognition of changing levels of cost for approximately 2 years after their incurrence. Thus, in times of rising costs, the rates are temporarily understated, in times of falling costs, the rates are temporarily overstated.

To illustrate, at one hospital studied which used the "fixed rate with carry-forward" method, the 1977 negotiated rate of 49 percent included a 13-percent carry-forward from prior periods. Thus, if one were to compare the negotiated rate with that of some other institution it would have been misleading because the rate was adjusted upward by 13 percent to reflect the prior period carry-forward.

CONCLUSION

Various factors which affect indirect cost rates preclude meaningful comparisons of rates among institutions. Some of these factors such as the accounting decisions used to compute rates can be controlled, but other factors such as geographic location which affects utility costs cannot be controlled. Therefore, it is not meaningful to compare indirect cost rates for measuring the relative efficiency of research activities at one institution versus another.

AGENCY COMMENTS

OMB, HEW, and NSF all agreed with our conclusion that indirect cost rates cannot be meaningfully compared among grantees. The Committee on Governmental Relations, National Association of College and University Business Officers, stated that it was particularly important that our study reconfirmed what was stated in our 1969 report.

CHAPTER 4

INDIRECT COST PRINCIPLES IN FEDERAL

GUIDELINES ARE NOT ALWAYS CONSISTENT

Various Federal guidelines have been promulgated which establish the cost principles to be used for reporting and recovering research indirect costs under Federal grants and contracts. These cost principles are not always consistently stated in the various guidelines. For example, the basis that can or must be used for determining the indirect cost rate varies in the guidelines currently in effect. Also, there are instances where the principles are ambiguous and can lead to differing interpretations of the allowability of certain indirect costs. OMB has recently revised some cost principles in the guideline for educational institutions, which should remove some ambiguities. We believe the revision is a significant improvement over the previous cost principles, but some inconsistencies with principles in other Federal guidelines still exist.

FEDERAL GUIDELINES

Guidelines containing cost principles have been issued for educational institutions (OMB-A-21) and for State and local government agencies (FMC 74-4). These guidelines are applicable to all Federal research grants awarded to those institutions. The circulars explain how direct costs should be charged. They define allowable and unallowable cost. Also, they show the type of indirect cost pools that should be established and the bases for distribution to research projects. There are no OMB guidelines for hospitals or nonprofit research institutions, although OMB is developing a guideline for nonprofit research organizations. HEW issued its own guidelines (OASC-3 and -5, respectively). These HEW guidelines are not binding for other Federal agencies, but may be used by them. DOD included the OMB principles for educational institutions and State and local government agencies into the Defense Acquisition Regulation (DAR), but did not include HEW's guidelines for dealing with nonprofit research organizations and hospitals.

The four different guidelines contain a few unique procedures and accounting methods which relate to the specific type of institution--i.e., accounting for patient care costs in hospitals. However, our comparison showed that the

majority of the cost principles covered similar items. We noted that in certain cases the similar items were treated differently. There were inconsistencies, substantive editorial differences, and omissions.

Questionnaire responses from 157 institutions with \$1 million or more of indirect cost reimbursements showed that 41 percent believe the cost principles in Federal guidelines to be either marginal or inadequate. A reason often cited was that the principles are too ambiguous, leading to differing interpretations between the institution and the Federal agency.

Further, for the 14 locations visited, both institution officials and Government representatives cited instances where cost disputes stemmed from ambiguities in the principles. The allowability of indirect costs associated with student services, depreciation, and departmental administration were reported to be particularly troublesome.

Inconsistent principles for indirect costs

Our analysis showed specific cases of inconsistencies among the cost principles for indirect costs contained in Federal guidelines. One of the most significant inconsistencies pertains to the base used to determine indirect cost rates. Educational institutions are instructed to use modified total direct costs as the basis to allocate indirect costs. Nonprofit institutions and State and local governments can choose direct salaries and wages, total direct costs, or any other equitable basis. Hospitals are advised that direct salaries and wages is the preferable basis, but others can be used. Other inconsistencies regarding indirect costs were observed as follows:

Examples of Inconsistent Principles

<u>Type of cost</u>	<u>Educational institutions</u> (OMB Cir. A-21)	<u>Hospitals</u> (OASC-3)	<u>Nonprofit institutions</u> (OASC-5)	<u>State and local government agencies</u> (FMC 74-4)
Organization costs	Not included in cost principles.	Legal, accounting, consulting, and related costs unallowable.	Legal, accounting, consulting, and related costs allowable if specified in grant or contract.	Not applicable.
Publication and printing costs	Not included in cost principles.	Not included in cost principles.	Unallowable as a direct cost of grants and contracts unless formally approved by the awarding agency.	Printing and reproduction service costs are allowable. Publication costs allowable when specified in grant agreement.
Proposal costs	Current accounting period proposal costs allowable. Past accounting period proposal costs unallowable.	Current accounting period proposal costs allowable. Past accounting period proposal costs unallowable.	Current accounting period proposal costs allowable. Past accounting period proposal costs unallowable.	No distinction made as to accounting period. Proposal costs allowable when specified in grant agreement.
Public information service costs	News release costs pertaining to specific research or scientific accomplishment are allowable when resulting from sponsored agreements.	News release costs pertaining to specific research or scientific accomplishment unallowable, unless specifically authorized by sponsoring agency.	To the extent costs are identifiable with a particular cost objective, they should be charged to the related objective. If not identifiable, they should be allocated as indirect costs to all major activities.	Not included in cost principles.
Reconversion costs	Restoration or rehabilitation costs of facilities to approximately the same condition existing immediately prior to commencement of Government research agreement work allowable.	Restoration or rehabilitation costs of facilities to approximately the same condition existing immediately prior to commencement of Government research agreement work allowable.	Unallowable, except for costs of removing Government property and the restoration or rehabilitation costs caused by such removal. In special circumstances where equity so dictates, additional costs may be allowed if agreed upon in writing before the costs are incurred.	Not included in cost principles.

Inconsistent inclusion of certain cost items

Our comparison of the four Federal guidelines showed numerous instances where certain cost items were specifically discussed in one or more of the guidelines and omitted from the others. These items can be classified as either direct or indirect costs. The table which follows illustrates a few of the more significant inconsistencies we noted.

Comparison of Selected Cost Items
not Included in All Four Guidelines
 (items with "X" are included)

<u>Cost item</u>	<u>Educa- tional institu- tions</u>	<u>Non- profit institu- tions</u>	<u>Hos- pitals</u>	<u>State and local govern- ment agencies</u>
Communication costs	X		X	X
Depreciation/use allowance:				
Idle (excess) facilities		X	X	X
Equipment and other facilities	X		X	
Copyright costs		X		
Printing and re-production costs		X		X
Relocation costs		X		
Specialized service facilities	X		X	X
Training and education costs		X		X

DAR provisions do not cover nonprofit research institutions and hospitals

The DAR provisions used by DOD incorporate cost principles from the guidelines for educational institutions and State and local governments. They do not include the principles promulgated by HEW guidelines for nonprofit research institutions and hospitals.

Although most indirect cost proposals audited by the Defense Contract Audit Agency (DCAA) are from educational institutions, there are a few instances where a nonprofit research institution or hospital is involved. During our review, we noted one instance involving a nonprofit research institution where the DCAA auditors were using the educational institution cost principles as contained in DAR, as criteria to determine allowable costs.

During discussions with DCAA headquarters officials, we found that they were unsure about what principles should be used for nonprofit research institutions and hospitals, since DAR is silent on these types of organizations.

RECENT OMB CHANGES SHOULD
RESOLVE SOME AMBIGUITIES AT
EDUCATIONAL INSTITUTIONS

Our analysis of the 14 institutions showed that there were often disagreements, between the institution officials and the Government, related to indirect cost principles. Often disagreements centered around the distribution base which was to be used for individual cost pools. In other instances, there were questions on the allowability of certain cost items because the principles lacked precise definitions.

The library cost pool category is one area where we found several disagreements between the Government and the institutions on the distribution base used. The principles previously specified that library expense should be allocated on the basis of an unweighted population unless it can be shown that another base would result in a more accurate and equitable distribution of costs. The principles did not require advance Government approval if a base other than unweighted was used. When the institutions used some other base, the audit agency in certain cases would subsequently question the allocation.

For example, at one educational institution, the HEW Audit Agency questioned library costs allocated to organized research because it believed that the cost study used to weigh library user population was not accurate. The HEW Audit Agency therefore recommended that library costs be allocated on the basis of unweighted population data. The university took the position that it was necessary to give weight to various users to achieve equity. The Federal negotiator, however, concurred with the auditor and required that library costs be based on unweighted population data.

OMB's recent revision to cost principles in its guideline for educational institutions provides more specific information on distribution methods, identification and assignment of indirect costs, and standards for selected items of costs. For instance, in the example described above, the principles require that library costs now be allocated on the basis of primary categories of users. An exception would be made only if the university could clearly demonstrate that a different base would result in a more equitable allocation of costs.

CONCLUSIONS

We believe that the cost principles contained in Federal guidelines are not always consistent. Further, there are ambiguities which lead to different interpretations between grantees and Federal agencies. Recent OMB revisions to the guideline for educational institutions are a significant improvement over what was being used. We believe that the OMB revisions are a major step toward establishing a more definitive basis for cost determination in connection with Federal work done at educational institutions. However, even with the recent revisions there are still inconsistencies with some cost principles in other Federal guidelines. DOD has not included guidance for nonprofit research institutions and hospitals in DAR which has resulted in the use of inappropriate guidelines at the local level. Since DOD does have these types of grantees, proper guidelines should be established.

RECOMMENDATIONS

We recommend that the Director of the Office of Management and Budget require that there be a consistent presentation of principles in the guidelines for educational institutions (Circular A-21), the guideline for State and local governments (FMC 74-4), and the proposed guideline for nonprofit research institutions. We further recommend that the Director, OMB encourage HEW to bring its guideline for hospitals into conformity with OMB guidelines.

We recommend that the Secretary of Defense require that the cost principles in HEW's guidelines for nonprofit research institutions and hospitals be included in DAR. Since HEW has issued guidelines for these organizational types, DOD should adopt them until OMB establishes Government-wide guidelines.

AGENCY COMMENTS

OMB agreed that there should be general consistency among the cost principle circulars except when there may be elements of cost where deliberate differences are appropriate. OMB stated that, with regard to the proposed guideline for non-profit institutions, it will see that consistency with the guideline for educational institutions is provided to the maximum extent. Also, OMB will strive for the same degree of consistency in the next revision of the guideline for State and local governments.

DOD agreed that DAR does not contain specific cost principles for nonprofit research institutions and hospitals. The Office of the Under Secretary of Defense for Research and Engineering therefore asked the DAR Council to review the matter and determine what actions may be needed.

CHAPTER 5

AUDIT COVERAGE FREQUENCY AND NEGOTIATION

PRACTICES VARY

Audits of indirect cost proposals and actions taken to negotiate indirect cost rates are carried out inconsistently. For various reasons (such as the lack of negotiation records) we could not determine the extent of any detrimental effect of this situation. We believe, however, it is important to present information on audit and negotiation practices, since such information is not routinely available and since it should add to the understanding of how indirect cost rates are determined. Further, we have a recommendation to offer which could result in better use of audit resources and aid negotiators with carrying out their assignments.

WHO IS RESPONSIBLE FOR AUDITING AND NEGOTIATING INDIRECT COST RATES?

For educational institutions, FMC 73-6 specifically assigns audit and indirect cost rate negotiation responsibilities to several Federal agencies. HEW is the responsible, or cognizant, agency for more than 90 percent of the educational institutions listed in an appendix to the circular.

Federal negotiation and audit responsibilities at State and local government locations are assigned by HEW, in consultation with other Federal agencies. Generally, the Federal agency having the greatest interest in grant work at the State and local government department level will be responsible for negotiation and audit of indirect cost proposals.

No Federal guidelines have been established for negotiation and audit of indirect cost proposals prepared by non-profit organizations or hospitals. According to HEW Audit Agency officials, this responsibility is usually assumed by the Federal agency having the greatest need for negotiation and audit work at these grantees. Generally, the agency needing to have work done will check with other Federal agency officials before commencing any negotiation or audit work. HEW again is the cognizant Federal agency for most nonprofit and hospital grantees since it is usually the primary Federal grantor.

DCAA MAKES INDIRECT COST AUDITS
MORE FREQUENTLY THAN HEW

At 8 of the 14 institutions we reviewed, audits of indirect cost proposals were made at least once during the 5-year period 1973-77, but no audits were made at the other 6. DCAA, which was responsible for auditing three institutions, performed an annual audit at two and made three audits in 5 years at the other. HEW, which was responsible for auditing 11 institutions, performed no audits at 6 institutions, one audit at 2, and two audits at the other 3.

Even though our review showed that negotiators consider the auditors' determinations of indirect cost when negotiating rates, information is not available to show how much use was made of audit results or the benefits derived from such audits.

HEW Audit Agency is not fully
satisfying negotiators' requests
for audit assistance

Generally, Federal audits of indirect cost proposals are initiated by negotiators' requests. The HEW Audit Agency is not satisfying all of the audit requests made to it by negotiators. HEW Audit Agency officials advised us that they cannot always satisfy these requests because of higher priority work, such as Medicare and Medicaid audits and specially assigned work, and because of limited staff availability. Overall, at the four HEW regional offices studied, about 5 percent of the total audit staff time available was spent in the indirect cost area. The following schedule shows the total staff days spent on audit work and that portion relating to indirect cost proposal audits by the four regions in 1977.

Percentage of HEW Audit Agency
Effort Expended on Indirect Cost
Proposal Audits in 1977

<u>Region</u>	<u>Total staff days</u>	<u>Staff days on indirect cost proposal audits</u>	<u>Percentage</u>
I	15,154	452	3.0
II	12,132	345	2.8
III	15,177	1,113	7.3
IX	<u>16,254</u>	<u>893</u>	5.5
	<u>58,717</u>	<u>2,803</u>	4.8

Each of the four HEW regional negotiating offices had different policies regarding the use of audit assistance:

- In region I, the negotiating office established a 3-year audit plan so that the indirect cost proposals of major grantees (those with \$1 million or more of indirect costs) would be regularly audited. The plan called for 23 audits from 1975 through 1977; 8 audits were actually performed.
- In region II, indirect cost proposal audits were requested based on the negotiator's judgment, no specific selection criteria were established. Although 11 audits were requested during 1977, only 1 was performed by the HEW Audit Agency.
- In region III, the negotiator's policy was to request audits at major educational institutions and for all State and local governments. In 1977 he requested 86 audits; however, the Audit Agency performed only 7. The negotiator realized that all requested audits would not be performed because the Audit Agency workload would not allow it.
- In region IX, officials of the negotiation and audit agencies collectively planned which institutions would be audited. Subjective criteria were used, but no dollar values or percentage factors were specified. However, we were informed that usually all major institutions submitting indirect cost proposals were scheduled for audit. In 1977, each of the seven institutions scheduled were audited.

Negotiation officials recognized that the HEW Audit Agency could not perform all the audits requested. To provide some assurance of the adequacy of indirect cost proposals, the negotiators used several other review procedures, such as onsite reviews, desk reviews, or audits by outside accounting firms.

To illustrate, in one region the negotiators would not establish a final indirect cost rate at one major university until the indirect cost proposal was audited. Since the HEW Audit Agency was unable to provide timely audit coverage, the university hired an independent accounting firm. The negotiator requested the HEW Audit Agency to review the acceptability of the outside accounting firm's work prior to the finalization of the rate. The work was reviewed and approved by the HEW Audit Agency.

More frequent DCAA audit coverage

DCAA audits of indirect cost proposals are more frequent than those performed by the HEW Audit Agency. Questionnaire results included 394 institutions which had indirect cost rates negotiated with HEW, and 32 which had rates negotiated with DOD. Fifty-four of 426 institutions had an indirect cost audit for the year 1977. The following table shows the number of audits performed by the cognizant agency. As can be seen, DCAA coverage is proportionately much greater:

	<u>Number of institutions</u>	<u>Number audited in 1977</u>	<u>Percent audited</u>
DOD	32	13	41
HEW	394	41	10

Negotiators use indirect cost audits

Although Federal audit agency reports on indirect cost proposals are advisory only, we found that negotiators generally rely on the auditors' determinations. However, information is not compiled to identify the overall benefits derived from indirect cost audits.

The value of audits can be illustrated by the results achieved at two of the institutions included in our review. At one university, the negotiator relied on the HEW audit report to reduce indirect costs approximately \$1.1 million in 1974. At another major institution the negotiator's reliance on the HEW Audit Agency's audit reduced indirect costs approximately \$26.0 million for the 3-year period 1975-77. An official from this institution agreed that the negotiator's use of audit assistance resulted in lower indirect cost rates.

After making special inquiries of field offices, a DCAA headquarters official stated that for fiscal year 1977 DCAA audited approximately \$295 million of indirect cost proposals at 33 educational institutions; DCAA questioned a total of \$16 million. As a result of negotiations, \$10 million of proposed indirect costs was disallowed and \$2 million was allowed. Presently, \$4 million remains open for negotiation. Officials from both DCAA and the HEW Audit Agency stated that, although information on the dollar benefits derived from indirect cost audits have not been compiled, such data can be obtained.

In commenting on our report, DCAA advised us that its procedure is to audit overhead (indirect costs) on a timely basis after receiving a contractor's proposal which often results in an annual audit. DCAA believes that prompt audits facilitate early disclosure of unacceptable accounting practices or unsupported costs, and act as a fraud deterrent. HEW officials also said that indirect cost audits produce unquantifiable benefits.

NEGOTIATION PRACTICES ARE NOT CONSISTENT

Significant differences were noted in the methods used to negotiate indirect cost rates. Some negotiators relied on their own desk reviews of an institution's proposal, others performed their own onsite audits, and still others relied on Federal audit agency reviews. Some institutional officials believe that negotiators limit indirect cost rates arbitrarily in certain instances. Since we did not evaluate the quality of the indirect cost proposal data received by negotiators from grantee institutions, we did not attempt to assess the adequacy of the negotiation actions. The purpose of this section of the report is to provide information on how negotiation practices are being handled.

Methods of negotiation vary

HEW negotiated indirect cost rates with a majority of the institutions receiving Federal health research funds. Of the institutions responding to our questionnaire, 394 had rates negotiated with HEW; 32 had rates negotiated with DOD; and 15 had rates negotiated with other Federal departments.

HEW negotiates rates with institutions through personnel in each of its 10 regional offices. Other Federal agencies have centralized their negotiations in Washington. We reviewed the negotiation procedures in four HEW regions which negotiated the rates of 13 of the 14 institutions selected for review. In addition, we made inquiries regarding the negotiation procedures of the one institution under DOD cognizance.

The HEW Division of Financial Management Standards and Procedures has the overall Department-wide responsibility for establishment of negotiation policy on indirect cost. This Division provides coordination to the HEW regions and has

issued a publication entitled "Staff Handbook on Cost Negotiations." The handbook details the policies and procedures designed to provide guidance to negotiators when negotiating rates. We were advised that DOD does not have policy and procedure guidelines to assist its negotiators.

The HEW handbook allows negotiators to use their judgment about the scope and depth of their analysis of the rate proposal as well as when to request audit assistance. With regard to audit assistance, the handbook states that, to the maximum extent possible, proposals will be evaluated without the assistance of an audit. In determining the scope and depth of analysis, the negotiator must take into account a number of interrelated factors, including:

- The approximate dollar amount involved in the negotiation.
- Whether an audit of the proposal has been conducted and the findings of the audit.
- The percentage relationship of Federal funding to the total costs of the institution.
- Whether any significant increases in costs can be readily explained.
- Past problems in negotiations.
- Whether the proposal is adequately supported by accompanying documentation.
- Any information in the proposal to indicate a possible inequitable allocation of costs.
- Whether any significant changes have been made in the organization's accounting system or organizational structure which affect the proposal.

The handbook allows the head of the negotiation staff to establish, with the approval of the Regional Comptroller, dollar and rate thresholds for accepting proposals without review or with only a very cursory review.

Review results

HEW headquarters and regional officials said that indirect cost rates are generally negotiated annually. They stated that there are certain exceptions, such as when an indirect cost rate proposal is so complicated that more preparation and audit time is needed, thus necessitating that rates be negotiated for 2 or more years instead of annually. Our review of the 14 institutions showed that the current practice at 13 was to have indirect cost rates negotiated annually. For the other--an educational institution which was the largest NIH grantee--the rates were negotiated every other year because it took a year for the university to prepare its proposal and another year for Federal audit.

Our review at the 14 institutions showed variations in the methods used in negotiating indirect cost rates. Such methods included conducting negotiations over the telephone and face-to-face meetings. During the period 1973-77, a total of 35 negotiations were conducted at the institutions studied. Rates were negotiated by phone in 23 cases, or approximately two-thirds of the time, and during face-to-face meetings in 12 cases. We saw no particular pattern as to the method used based on the dollar size of the grantee.

At one educational institution with annual Federal research funding of over \$20 million, the indirect cost rate was negotiated over the telephone. Detailed cost pool information was not submitted to the negotiators but went directly to the audit agency. Although an audit was in process, it was not completed at the time the rate was negotiated. The negotiator stated that the rate he planned to negotiate would be lower than the rate the auditor would recommend. At a nonprofit research institution with a funding level of about \$10 million, the negotiator had the Federal auditor's report available to help him determine the rate. Also, face-to-face meetings took place each year. These meetings included discussion of the makeup of each individual cost pool as well as the allocation methods used.

Federal negotiators based their rate negotiations on one or a combination of desk reviews of indirect cost proposals, onsite reviews of supporting documentation, or audit agency reviews. As previously stated, the HEW regions can establish their own criteria regarding the dollar and rate thresholds which would be used to exclude certain institutions from detailed analysis. Of the four HEW regional offices reviewed, two had established criteria for which

negotiators may accept a proposal with only a cursory review. The thresholds established were not the same. The other two regions did not establish limits; instead, individual determinations were made as to the extent of review.

We were informed that negotiators have attempted to arbitrarily limit indirect cost rates. In one case, institution officials stated that the HEW negotiator tried to arbitrarily apply a 10-percent reduction on its 66-percent proposed rate. The officials stated that the negotiator felt that the 10-percent reduction was justified because an audit would probably find at least a 10-percent overstatement in the indirect cost rate proposal. The institution took exception to this and requested that the negotiator provide documentation of any questionable costs. A 64.3-percent rate was finally established after the negotiator was satisfied with the definitions of the different cost groupings used by the institution, and the various expenditures within these groupings.

At another institution, a ceiling rate of 93.5 percent was established before 1973, the period when the HEW regions started performing the indirect cost negotiations. Each year the institution proposed a rate higher than the ceiling; however, the ceiling rate continued to be negotiated at the insistence of the negotiator until 1977. For 1977, the institution requested an audit, at which time the negotiator performed an onsite review and a rate of 99.7 percent was negotiated.

USE OF DISCLOSURE STATEMENT

Under current Federal guidelines, grantee institutions submit indirect cost proposals, generally on an annual basis, which are rather voluminous and detailed. Even though the proposals may only slightly change from year to year, the negotiator is confronted with the entire proposal every time the rates are to be negotiated. Similarly the auditors must consider the entire proposal each time they are requested to make an audit.

There is a procedure that could be used that would save the grantee institutions, the negotiators, and the auditors a substantial amount of time and effort. This procedure involves the use of a disclosure statement. A disclosure statement would document an institution's accounting system and the methods used to develop indirect cost proposals. More specifically, it would identify

- each cost pool used,
- the types of costs included in each pool,
- the specific allocation base used for each pool and the rationale for the base, and
- whether financial data come from CPA audited records.

Complete disclosures would be made for the initial proposal, and subsequent disclosures would be made only when changes to any of the accounting factors were made by the institution. This would eliminate the need for an institution to annually prepare complete indirect cost proposals; the negotiator and the auditor would only have to review proposed changes after the initial proposal was accepted.

CONCLUSIONS

DCAA's indirect cost audit coverage at grantee institutions is more frequent than that performed by the HEW Audit Agency. Although negotiators consider the results of audit reports when negotiating indirect cost rates, the benefits of these audits are not compiled and their cost effectiveness is uncertain. Therefore, we are unable to conclude whether DCAA audits of indirect cost proposals are too frequent or HEW audits are not frequent enough from the standpoint of maximizing return on audit resources.

As observed during our review, significant variations in indirect cost negotiation practices exist. Since we did not evaluate the quality of proposal data reported by the institutions, we did not attempt to assess the adequacy of the negotiation actions.

We believe that the present indirect cost proposal system can be improved if a method, such as a disclosure statement approach, could be implemented which would allow both the negotiator and auditor to be more selective in choosing institutions for review.

RECOMMENDATIONS

We recommend that the Director, OMB, add a provision to its guidelines which would allow grantees to use a cost accounting system disclosure statement approach to identify changes in accounting methods. Once grantees have established specified accounting practices and auditors and negotiators have determined them to be acceptable, subsequent

reviews could be limited to system changes. We believe that this would allow already limited audit resources to be more effectively directed.

We also recommend that the Secretaries of Defense and HEW either jointly or separately analyze current auditing practices related to research grants and contracts to identify the benefits derived. The results of the analyses would provide a basis to establish dollar thresholds for an audit. When coupled with the "disclosure statement" approach recommended above, this could enhance the effectiveness of audit resources.

AGENCY COMMENTS AND OUR EVALUATION

Agency officials generally agreed with the use of a disclosure statement, as we recommended. OMB believed the recommendation may have merit and wanted to explore it further with the Federal agencies involved and with the universities. Its only concern was that additional paperwork might be generated if all institutions with Federal research grant activities were required to file disclosure statements. OMB suggested that some dollar limitation be established as a criterion for selecting institutions which must use this approach. The Committee on Governmental Relations of the National Association of College and University Business Officers endorsed the concept and offered to work with OMB to field test it.

We believe that a field test of the disclosure statement concept as suggested by the Association would be an effective approach. The test results could establish the specific disclosure statement details and procedures along with appropriate dollar thresholds.

DCAA stated that the disclosure statement will facilitate the audit process, but it should not be construed as a cure-all.

HEW agreed with our recommendation to analyze current auditing practices to identify the benefits derived. DOD's Defense Contract Audit Agency stated that its present frequency of auditing carefully considered the extent of risk and available resources and suggested that our recommendation for a joint HEW/DOD analysis of practices for auditing indirect cost proposals be deleted. However, we found that DCAA headquarters did not have information centrally compiled to show the cost/benefit of such audits. Accordingly, we believe that our recommendation to analyze current auditing practices to identify the benefits derived is appropriate as stated.

NINETY-FIFTH CONGRESS

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RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-4952

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Congress of the United States
House of Representatives
Subcommittee on Health and the Environment
of the
Committee on Interstate and Foreign Commerce
Washington, D.C. 20515
September 30, 1977

Honorable Elmer B. Staats
Comptroller General
of the United States
U. S. General Accounting Office
441 G Street
Washington, D. C. 20548

Re: Indirect Costs

Dear Mr. Staats:

The calculation, payment, and use of indirect costs attendant to Federal health research grants is a highly complex issue.

In reviewing the necessity and legitimacy of such costs, it would appear that the basis on which rates are determined, and the allowable costs in their calculation lack interinstitutional uniformity, making comparison of such rates among institutions a near impossibility.

Preliminary examination of the National Institutes of Health indirect cost payments for FY 76 shows that over \$316 million, representing an average of 42 percent of direct costs, was paid out to 611 institutions. Thirty eight institutions received indirect cost awards in excess of \$2,500,000.00 each, certainly significant dollar amounts.

While I fully appreciate the grantees' desire for flexibility from region to region, institution to institution, and category to category, I do have generic concerns about the indirect cost issue.

My Subcommittee staff has met with GAO staff to discuss the Subcommittee's concern over the large amount of health research funds being used to pay indirect costs, and the work GAO has been doing in this area. While we understand

that GAO has recently completed, or is now processing several reports which touch on the indirect cost issue, these reports do not address in sufficient detail several of the matters which are of interest to the Subcommittee. I would, therefore, request that the General Accounting Office review the following aspects of indirect costs associated with the health research programs in the Department of Health, Education and Welfare:

1. Who determines or negotiates indirect cost rates for colleges and universities, non-profit research organizations, hospitals, and State and local Government agencies?
2. What actions are taken to determine the validity of the information submitted to substantiate indirect cost rates?
3. How frequently are indirect cost rates re-determined or renegotiated?
4. What types of costs can be used as a basis for computing indirect cost rates?
5. If indirect cost rates cannot be compared from one organization to another, explain why such a comparison cannot be made?
6. Is there a maximum allowable percentage of direct costs that can be used to determine indirect costs?
7. Why are there such significant differences among indirect cost rates established for colleges and universities, non-profit research organizations, hospitals, and State and local Government agencies?; and
8. Over the last five years, have indirect costs been using a greater percentage of the health research dollar?

Any recommendations you may care to offer regarding

problems or inconsistencies discovered in this investigation will be most welcome.

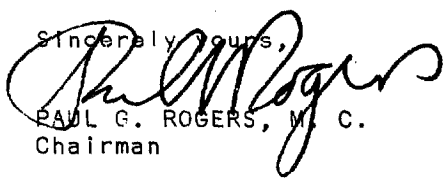
An additional area of concern which needs be addressed is the broader question of the propriety of indirect cost claims. Therefore, I would appreciate a review of the purpose of paying indirect costs, as originally conceived. I would also suggest an audit to determine the legitimacy of actual claims made for indirect costs at two or three of the institutions receiving the largest dollar awards in this area (Harvard, John Hopkins, Stanford, and Yale). Such an audit should assure, among other things:

1. that Government equipment and facilities constructed with Federal funds are not being included in calculating institutional indirect cost rates;
2. that salaries and fringe benefits of individuals on research projects are not being included on several grants which might total in excess of one-hundred percent of such costs to the institution;
3. that salaries and fringe benefits of individuals involved with a given research project are not included at a percentage of time in excess of the actual percent of their time devoted to the project; and
4. that the salaries and fringe benefits of individuals not associated with the specific project are not included with project costs.

I would appreciate your comments on this request and would certainly be available for discussion if you think it helpful.

Kindest personal regards and all good wishes.

Sincerely yours,


PAUL G. ROGERS, M. C.
Chairman

PGR:lsr

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

MAY 7 1979

Honorable Elmer B. Staats
Comptroller General of the
United States
General Accounting Office
Washington, D.C. 20548

Dear  ~~Mr. Staats:~~

This is in reply to a request for comments on the draft report, "Toward A Better Understanding Of Health Research Indirect Costs And How They Are Computed."

We agree with the findings of the report that indirect cost rates cannot be meaningfully compared among grantees. We agree that, if Federal participation in health research grants is to be limited, it should be done through mandatory grantee participation in total costs, rather than a limit on indirect costs.

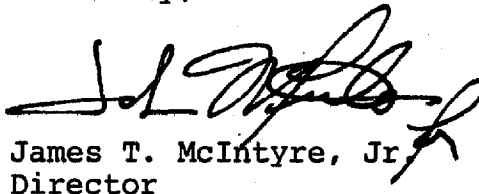
The report recommends that OMB provide consistent presentation of cost principles in the guidelines for educational institutions (Circular A-21), the guidelines for State and local governments (Circular 74-4), and the proposed circular for nonprofit organizations. We agree that there should be general consistency among these circulars, although there may be elements of cost where deliberate differences are appropriate. As the report points out, the recent revision of Circular A-21, "Cost principles for educational institutions," is a significant improvement over the previous cost principles, and should clear up many of the ambiguities. As far as the proposed circular for nonprofit organizations is concerned, we will see that consistency with Circular A-21 is provided to the maximum extent. In the next revision of Circular 74-4, we will also strive for the same degree of consistency.

The report also recommends that OMB should add a provision to its cost principles to require grantees to submit a cost accounting disclosure statement, with periodic updating to reflect subsequent changes to their systems. The recommendation may have merit, and we will explore it further with the Federal agencies involved, and with the universities. We are

somewhat concerned, however, with the amount of paperwork that might be involved. The proposal appears to be along the lines of the disclosure statement requirements promulgated by the Cost Accounting Standards Board for defense contractors. In that case, the Board, in recognition of the paperwork involved, limited its requirements to those defense contractors whose government business exceeds \$10 million a year. Any initiative along these lines for universities might have to be similarly limited.

We appreciate the opportunity to review the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read "J. T. McIntyre, Jr.", written in a cursive style.

James T. McIntyre, Jr.
Director



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

MAY 09 1979

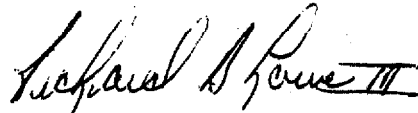
Mr. Gregory J. Ahart
Director, Human Resources
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

The Secretary asked that I respond to your request for our comments on your draft report "Toward A Better Understanding of Health Research Indirect Costs and How They are Computed." We are in general agreement with the report and its recommendations.

Thanks for the opportunity to review this report before its final publication.

Sincerely yours,

for 

Thomas D. Morris
Inspector General



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

HEALTH AFFAIRS

22 MAY 1979

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General
Accounting Office
Washington, D. C. 20548

Dear Mr. Ahart:

This is in reply to your letter of April 10, 1979 to the Secretary of Defense regarding your draft report, "Toward A Better Understanding of Health Research Indirect Costs and How They are Computed (OSD Case #5142) (Code 103910).

The draft report includes basically two recommendations which affect the Department of Defense. One, that the Department adopt the cost principles incorporated in the Department of Health, Education, and Welfare's guidelines for nonprofit research institutions and hospitals pending the establishment of Government-wide guidelines by the Office of Management and Budget. We agree that the Defense Acquisition Regulation (DAR) (formerly ASPR) does not contain specific cost principles for research institutions and hospitals. Therefore, the Office of the Under Secretary of Defense for Research and Engineering has asked the DAR Council to review the matter and determine what action may be needed.

The second recommendation relating to the frequency of audit has been addressed by the Defense Contract Audit Agency. A copy of its comments on this recommendation and other aspects of the report is attached.

We appreciate the opportunity to provide comments on the report.

Sincerely,

A handwritten signature in dark ink, appearing to read "Vernon McKenzie".
Vernon McKenzie
Principal Deputy Assistant Secretary

Principal Deputy Assistant Secretary

Enclosure



DEFENSE CONTRACT AUDIT AGENCY

CAMERON STATION
ALEXANDRIA, VIRGINIA 22314

4 MAY 1979

PP

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (HA)

ATTENTION: Mr. John Dexter, Room 3E183

SUBJECT: GAO Draft Report Dated 10 April 1979, "Toward a Better Understanding of Health Research Indirect Costs and How They Are Computed" (OSD Case #5142) (Code 10391)

In response to your request, we are submitting the following comments on the subject GAO draft report.

1. DCAA or HEW Is Auditing too Frequently

GAO states that DCAA has a significantly higher frequency of indirect cost proposal audit coverage at grantee institutions than does the HEW Audit Agency. GAO indicates that for 1977 DCAA audited 41 percent (13 of 32) of the installations in their survey, while HEW audited 10 percent (41 of 394). But GAO is unable to conclude if DCAA audits are too frequent or HEW audits are not frequent enough.

GAO further states that the HEW Audit Agency is not satisfying all of the audit requests made by negotiators because of higher priority work and limited staff availability.

We believe our audit coverage is necessary to the proper performance of our contract audit mission, and we carefully consider the extent of risk and available resources in scheduling the frequency of our audits.

The DCAA procedure is to perform the overhead audit on a timely basis after receipt of contractors' proposals. This often results in an annual audit. Generally, DCAA has cognizance of institutions in which the preponderance of work is with DoD. As such, indirect costs are reviewed on an annual basis to aid in the establishment of final rates for DoD costing purposes and to avoid creating cash flow problems for contractors and grantees. Since the audit of indirect costs is ordinarily performed across-the-board, i.e., including both DoD and non-DoD operations, rates applicable to any HEW grants and contracts can also be determined at the same time.

In addition, the usual audit objectives of any DCAA review of nonprofit institutions are to ascertain that costs included in claims or proposals are reasonable, fairly presented, appropriately charged or allocated, and determined in accordance with the terms of the agreement with the Government agency and applicable regulations. Prompt audits also facilitate early disclosure of unacceptable contractor/grantee

PP

SUBJECT: GAO Draft Report Dated 10 April 1979, "Toward a Better Understanding of Health Research Indirect Costs and How They Are Computed" (OSD Case #5142) (Code 10391)

accounting practices or unsupportable costs so that timely corrective action can be taken. They also act as a deterrent for fraud and other forms of wrongdoing.

GAO recommends that the Secretaries of Defense and HEW either jointly or separately analyze current auditing practices related to research grants and contracts in order to identify the benefits derived. (GAO representatives stated "auditing practices" means "frequency of audits." We informed them that this should be clarified and they agreed to do so.)

We can only address the adequacy of our practices, and as stated above, we believe the present frequency of our audits is necessary to adequately protect the interest of the Government without wasting valuable resources. Nevertheless, we will continue our present practice of reevaluating the use of these resources in relation to the risks involved.

We believe that GAO and/or HEW should establish any problem of frequency at HEW. Therefore, we suggest that the joint review concept be deleted from the report.

2. Disclosure of Accounting Practices

Under current Federal guidelines, grantee institutions submit indirect cost proposals, generally annually, which are voluminous and detailed. Even though the proposals may change only slightly from year to year, the negotiator and auditors are confronted with the entire proposal every time the rates are to be negotiated. Therefore, GAO recommends that OMB should add guidelines to allow grantees to use a cost accounting system disclosure statement approach to identify accounting methods and changes. Once grantees have established specified accounting practices and auditors and negotiators have determined them to be acceptable, subsequent reviews could be limited to system changes. GAO asserts that substantial time and effort could be saved in the preparation of indirect cost proposals and in the attendant Government review by using disclosure statements.

We do not agree that once disclosed practices are agreed upon, no audit review would be needed unless a system change occurs. Disclosure will certainly facilitate the audit process and provide an internal control over arbitrary and inadvertent accounting practice changes. Still, it should be recognized that the disclosure statement should not be construed as a "cure-all." Our experience with contractors who have submitted disclosure statements in accordance with the cost accounting

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SUBJECT: GAO Draft Report Dated 10 April 1979, "Toward a Better Understanding of Health Research Indirect Costs and How They Are Computed" (OSD Case #5142) (Code 10391)

standards has shown that more than minimal audit effort is required for their initial and subsequent compliance reviews. Further, continuing audit is needed to assure that disclosed practices are being followed and to evaluate the reasonableness of costs incurred or projected.

3. Uncertainty of Applicable Cost Principles

GAO states: "During our discussions with DCAA headquarters officials, we found that they were unsure as to what principles should be used for nonprofit research institutions and hospitals since the ASPR is silent on these types of organizations." Therefore, GAO recommends that DAR incorporate the cost principles in HEW's guidelines for nonprofit research institutions and hospitals, until such time as the OMB establishes Government-wide guidelines.


The statement that DCAA was unsure of the applicable cost principles is misleading and should be deleted. During our discussion, we indicated that the applicable cost principles are contained in the specific contracts and grants, but we stated that these are not maintained at the Headquarters level. However, they are available at the cognizant field audit offices. Generally, organizations referred to as "nonprofits" consist of educational institutions that perform DoD research under contracts and grants incorporating DAR XV, Part 3, cost principles with no fee provisions. Those classified as "not-for-profits" perform DoD research under contracts which incorporate DAR XV, Part 2, cost principles and are provided fees.

4. Use of Improper Cost Principles

GAO noted one instance involving a nonprofit research institution where DCAA auditors were using the educational institution cost principles in DAR as a criterion to determine allowable cost. The cognizant DCAA Branch Manager stated that the contractor had NIH and DoD cost-reimbursement-type contracts with no fees. Based on a verbal agreement between the Navy and Army contracting officers and the contractor, it was decided that predetermined rates would be used for these contracts, i.e., Part 3 of DAR Section XV. In accordance with this agreement the auditors used the agreed-upon cost principles. Therefore, we believe that the GAO report should either delete this sentence or clarify it to show the circumstances.

We would appreciate reviewing your final draft reply before issuance to the GAO.

FOR THE DIRECTOR:


IRVING J. SANDLER
Assistant Director
Policy and Plans

NATIONAL SCIENCE FOUNDATION

WASHINGTON, D.C. 20550

OFFICE OF AUDIT
AND OVERSIGHT

April 16, 1979

Mr. Harry S. Havens
Director
Program Analysis Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Havens:

This is in response to your request for comments on the proposed GAO report "Forward to Better Understanding of Health Related Indirect Costs and How They are Computed." We feel that it is a good report which will prove very useful. The recommendations are soundly based and we concur in them.

At a meeting on April 12, 1979, involving NSF staff, Mr. Weinstein and Mr. Ell of your Los Angeles office, and Mr. Cavanaugh of the GAO/NSF site team, we suggested a minor rewrite of the paragraph concerning NSF policy (pages 18-19) which we believe will further clarify the description of NSF methods. We also made a few other small suggestions, none substantive, which might be helpful in aiding the reader to understand a complex situation.

We appreciate the opportunity to comment on the proposed report and recognize the necessity for the unusually short period of time allowed for comment. Since there were no substantive differences, the short time was not a problem, but we hope that normally more time would be available to us to formulate a response.

Sincerely yours,

Jerome H. Fregeau
Director
Office of Audit
and Oversight

cc: Mr. Paul J. O'Neill, GAO

COMMITTEE ON GOVERNMENTAL RELATIONS

National Association of College & University Business Officers

ONE DUPONT CIRCLE, N.W. • SUITE 510 • WASHINGTON, D.C. 20036 • (202) 296-2346

April 27, 1979

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MILTON GOLDBERG

Mr. Gregory J. Ahart
United States General Accounting Office
Director, Human Resources Division
Washington, D.C. 20548

Dear Mr. Ahart:

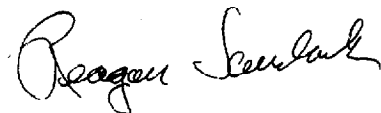
Thank you for the opportunity of reviewing the draft report entitled "Toward a Better Understanding of Health Research Indirect Costs and How They are Computed."

The report is an objective document which clearly describes the nature of a difficult subject. It will undoubtedly serve as a valuable reference document in future years. An item of particular importance is that the study reconfirms the findings of the 1969 GAO study of indirect costs, which reports that it is not feasible to compare indirect cost rates among grantees.

The Committee on Governmental Relations endorses the concept of a disclosure statement to describe an institution's indirect cost practices with the goal of reducing audit effort. We would welcome the opportunity to work with OMB in developing the concept. If OMB should desire a field test, we would be pleased to seek volunteers from among our member institutions for this purpose.

COGR also endorses your recommendation to the Congress that the Government should not attempt to limit its support of research by limiting the indirect portion of such costs.

Sincerely,



Reagan Scurlock

SUMMARY OF QUESTIONNAIRE
RESULTS - ALL NIH RESPONDENTS

INSTRUCTIONS: As mentioned in our letter the U.S. General Accounting Office, the agency of the Congress responsible for the oversight of Federal expenditures, is currently reviewing the indirect costs of health research. The purpose of this questionnaire is to gather historical and current data on indirect costing, negotiation and audit practices, and to obtain your professional opinions and observations about certain issues that affect this area. The study was prompted by the fact that it has been several years since this area was last surveyed and conditions appear to have changed since then. We will not use this data to make audits or judgements about individual institutions.

We are asking financial officers and administrators from institutions like yours to help us by completing this questionnaire. The form could take from 1 to 3 hours to fill out depending on the accounting procedures and the availability of records at your institution. The majority of the questions can be answered in a few seconds by checking boxes or filling in blanks. Most of the time will be taken up by several items which will require you to go to your financial records. Therefore, we suggest that you read the entire form, or at least the first 15 questions, first so that you will have a general idea of what is to be asked of you and what types of information you may need from your files.

As you read the questionnaire you will note certain numbers within shaded parentheses to the right of the question. Please disregard these numbers. Their only purpose is to assist our key-punch operators in tabulating responses.

We realize that some of you may consider the requested accounting information private or the issue of indirect cost to be of a sensitive nature. You can be assured that your response will be treated with the strictest of confidence. We have asked for identifying information only to help us in making comparisons between various types of institutions and, should the need arise, in following up on those who fail to respond. Again, we do not intend to make determinations about specific organizations. Your name is not important to this study, but what you have to say is.

Please give us your most frank and honest assessments. We are most grateful for your cooperation because we can not make a meaningful report to the U.S. Congress without your assistance and participation. If you have any questions, please call me or my assistant, Harold Weinstein, at (FTS) 798-4066 or commercial at (213) 688-4066 We will be very glad to help.

Thank you for your consideration.

RESPONDENT INFORMATION

I. _____
(Name & phone no. of person completing this form)

II. _____
(Title of person completing form)

(Start Card No. 1) (1)
(24) (2-4)

BACKGROUND

1. What type of institution are you primarily considered to be? (Check one.) (3)

- 1. 1239 Educational (College/University)
- 2. 189 Hospital or medical services
- 3. 105 Nonprofit research
- 4. 3 State or local governmental agency
- 5. 8 Other (specify) _____

2. For your last fiscal year, approximately what percentage of the institution's total expenditures went for research (i.e., all direct and indirect costs of all research grants and contracts)? (Your best guess is good enough.) (3)

29.0 % of total expenditures going for research

3. Again for your last fiscal year, approximately what percent of your research (all grants and contracts) was supported by the Federal government? (Again, your best guess.) (3)

65.9 % of total research supported by Federal government

4. Which Federal department or agency provided the largest dollar amount of reimbursement for research conducted by your institution during your last fiscal year? (Check one.)

1. 1294 National Institutes of Health (NIH) (60)
2. 1447 HEW - Other than NIH
3. 1267 Department of Defense (DOD)
4. 1427 National Science Foundation (NSF)
5. 1387 Other (specify) _____

REIMBURSED COSTS

(For both Federal and all other grantors.)

5. Please provide the total amount in thousands of dollars of all of your reimbursed research cost (both direct and indirect) for each of the five fiscal years from 1973 through 1977.

NOTE: For this and following questions asking for 5-year data, if it is impractical to go back five years, please provide the totals for the last 3 years.

(Dollars in thousands)					
	1973	1974	1975	1976	1977
TOTAL COST	\$7,159	\$8,691	\$9,017	\$9,566	\$10,062
	(31-35)	(36-40)	(41-45)	(46-50)	(51-55)

6. Again for the last five years, provide the total amount of the reimbursed or recorded indirect costs for research. As in question 5 provide all totals in thousands of dollars.

	1973	1974	1975	1976	1977
\$ AMOUNT OF INDIRECT COST	\$1,410	\$1,668	\$1,751	\$1,979	\$2,081
	(36-40)	(41-45)	(46-50)	(51-55)	(56-60)

7. Provided below is a listing of commonly used direct cost categories. Please check each category considered by your institution to be a direct cost. If other direct cost categories are used, or if clarification is needed on the items already listed, please make the additions or clarifications in the spaces following the list. Your response will help us assess the possible variations among institutions.

- 1- salaries and wages of all principal investigators, co-investigators, professional associates, research staff, technicians, computer science and administrative support, and secretaries who work on and who directly affect the scope of the research project 4377 (61)
- 2- project services and supplies 4377 (62)
- 3- all scientific equipment over a specific amount; Specify amount: 364 (63)
- 4- travel 438 (64)
- 5- fringe benefits 409 (65)
- 6- publications 415 (66)
- 7- consultant costs 424 (67)
- 8- scientific equipment maintenance 377 (68)
- Additional items or clarification - 195 (69)

Start Card No. 2 (1)
(CN) (2-4)

8. For each of the previous five years, provide the total reimbursed direct cost of the wages and salaries of the professional research and technical staff—that is, principal investigators, co-investigators, professional associates, research staff, technicians, and others who are directly involved with specific research projects. Exclude all fringe benefits.

Do not include secretaries, administrators and support staff, clerks, guards and shop support who do not charge direct time and labor to specific projects and whose effort does not directly affect the scope of effort of specific research projects. We recognize that your accounting records may not allow you to easily provide this information. If this is the case give us your best estimate.

(Dollars in Thousands)

	1973	1974	1975	1976	1977
\$ Amount of wages and salaries of professional and technical research staff	\$3,280	\$3,409	\$3,654	\$3,938	\$4,236

(8-9) (10-14) (15-19) (20-24) (25-29)

9. INDIRECT COST POOLS

Please provide a breakout of the negotiated dollar amounts (if not available use the proposed dollar amounts) of each of your indirect cost pools or cost categories. Show all dollar amounts in thousands. We realize, of course, that your indirect cost pools or cost categories may be different from the ones we have presented below. So please cross out the categories that you do not use and write in any additional categories that you may use.

Start Card No. 3 (1)
(CN) (2-4)

(Dollars in thousands)

Indirect Cost Pool Categories	1973	1974	1975	1976	1977
1. Use Allowance (or Depreciation)- Building	\$ 198 (5-8)	\$ 211 (9-12)	\$ 206 (13-16)	\$ 227 (17-20)	\$ 226 (21-24)
2. Use Allowance (or Depreciation)- Equipment	\$ 168 (25-28)	\$ 211 (29-32)	\$ 210 (33-36)	\$ 233 (37-40)	\$ 234 (41-44)
3. Operations and Maintenance	\$ 797 (45-48)	\$ 901 (49-52)	\$ 972 (53-56)	\$ 1,046 (57-60)	\$ 1,138 (61-64)
				(Start Card No. 4) (1)	(CN) (2-4)
4. General and Administrative	\$ 687 (5-8)	\$ 721 (9-12)	\$ 765 (13-16)	\$ 831 (17-20)	\$ 879 (21-24)
5. Library	\$ 308 (25-28)	\$ 328 (29-32)	\$ 329 (33-36)	\$ 344 (37-40)	\$ 340 (41-44)
6. Structural Administration	\$ 1,111 (45-48)	\$ 1,111 (49-52)	\$ 1,111 (53-56)	\$ 1,111 (57-60)	\$ 1,111 (61-64)
				(Start Card No. 5) (1)	(CN) (2-4)
7. Research Administration	\$ 325 (5-8)	\$ 340 (9-12)	\$ 368 (13-16)	\$ 421 (17-20)	\$ 436 (21-24)
8. Student Services	\$ 243 (25-28)	\$ 256 (29-32)	\$ 254 (33-36)	\$ 255 (37-40)	\$ 236 (41-44)
9. Other (identify)	\$ (45-48)	\$ (49-52)	\$ (53-56)	\$ (57-60)	\$ (61-64)
				(Start Card No. 6) (1)	(CN) (2-4)
10. Other (identify)	\$ (5-8)	\$ (9-12)	\$ (13-16)	\$ (17-20)	\$ (21-24)
11. Other (identify)	\$ (25-28)	\$ (29-32)	\$ (33-36)	\$ (37-40)	\$ (41-44)
12. Other (identify)	\$ (45-48)	\$ (49-52)	\$ (53-56)	\$ (57-60)	\$ (61-64)

INDIRECT COST CHANGES

10. Consider your indirect costs. After adjusting for the increase in the general inflation rate and for changes in your volume of research, to what extent, if any, have your indirect costs changed in the last five years? (Check one.) (85)

- 1. 10 A substantial or great decrease (in indirect costs)
 - 2. 28 A moderate decrease
 - 3. 14 Some decrease
 - 4. 31 Little or no change
- If you checked a decrease or no change, go to Question 12.

- 5. 03 Some increase
 - 6. 08 Moderate increase
 - 7. 38 Substantial or great increase
- If you checked an increase, continue.

11. Answer, if after adjusting for inflation and changes in your volume of research, your indirect costs still increased over the last five years. How important or not were each of the following possible causes for this increase? (Check one column for each row.)

	1 Of little or no importance	2 Somewhat important	3 Moderately important	4 Of substantial or great importance	5 Of very great importance	
1-Increase in utility costs	18	28	50	101	53	(86)
2-Increase in administrative costs due to new Government programs (e.g., affirmative action, health and safety etc.)	32	61	82	53	14	(87)
3-More sophisticated accounting system due to new Government grant accounting requirements	86	49	69	24	8	(88)
4-Changes in methods of allocating indirect costs to research and non-research activities	122	43	38	21	9	(89)
5-Increase in insurance costs	92	53	59	25	8	(90)
6-Increases in administrative costs due to reorganization	158	38	23	7	6	(91)
7-Changes in operations or scope of work	147	37	21	8	8	(92)
8-Other (Specify)	2	3	13	19	16	(93)
_____						(94)
_____						(95)
_____						(96)
_____						(97)

Start Card No. 7 (1)
(C) (2-4)

INDIRECT COST RATES

12. What were the proposed and negotiated (Federal) indirect cost rates for each of the previous years? (NOTE: In the event that negotiated rates for certain years are still undetermined, write undetermined in the space provided for the specific year(s) in question. Also, if more than one rate is negotiated, use the main or "on campus" rate of the largest government research activity.)

	FEDERAL INDIRECT COST RATES				
	1973	1974	1975	1976	1977
Proposed rate %	57.2	58.8	58.0	58.3	59.2
	(3-7)	(8-10)	(11-13)	(14-16)	(17-19)
Negotiated rate %	52.2	53.3	52.9	54.4	53.9
	(20-22)	(23-25)	(26-28)	(29-31)	(32-34)

13. Did you receive any non-Federal research grants or contracts in your last fiscal year? (e.g., Ford Foundation, American Cancer Society, etc.)

1-855 Yes (CONTINUE)

2-83 No (GO TO QUESTION 17)

14. If yes, list the allowable indirect cost rates and, if you care to, the name(s) of the organization(s). (If you had support from more than three organizations, list the three that provided the largest dollar support.)

	Allowable indirect cost rates %	Name of organization (optional)
1-	32.1	
	(34-36)	(39-40)
2-	34.2	
	(41-43)	(44-45)
3-	30.4	
	(46-48)	(49-50)

15. In the above listing, did all of the non-Federal organizations allow cost rates that fully reimbursed you for all of the indirect costs actually incurred for doing the research?

1-55 Yes (GO TO QUESTION 17)

2-95 No (CONTINUE)

16. If no, which of the following reasons were a major influence on your decision to accept cost rates that did not fully reimburse you? (Check one or more.)

1-57 Anticipated gifts and donations from non-Federal grantor(s).

2-83 Anticipated receiving additional grants.

3-58 The grantor made other compensating concessions.

4-40 Non-Federal research study objectives more fully met the institution's objectives than other studies.

5-103 The amount not reimbursed was insignificant in relation to total research activity.

6-223 Chose to accept these terms rather than not do the research.

7-62 Believed that the institution could absorb the costs.

8-5 Underestimated the indirect costs.

9-139 To develop research and staff capabilities.

10-69 Occasionally accept some of these grants for use in other cost sharing arrangements.

11-6 Original documentation was not sufficiently complete to sustain the rate and/or it was not worth the effort to develop this documentation.

12-57 Other (Specify) _____

17. What was the cost base method used in calculating the indirect Federal government cost rates for each of the previous five years? (Indicate your answer by checking one of the two broad categories listed below for each year.)

Indirect Cost Base Calculation Method	Year				
	1973	1974	1975	1976	1977
1-Wages & Salaries	312	314	333	333	324
	(63)	(64)	(65)	(66)	(67)
2-Modified Total Direct Cost	63	76	88	95	108
	(68)	(69)	(70)	(71)	(72)

18. If your indirect cost base changed during the last five years, what was your primary reason(s) for this change? (If not, skip to Question 21) (Check one or more.)

- 1-44 To more equitably distribute indirect costs. (33)
- 2-5 To provide more management flexibility for considering other alternatives (e.g. make, buy or lease. Do in house or subcontract.) (34)
- 3-9 To show a lower rate. (35)
- 4-5 To satisfy principal investigator(s) requests to control costs of their projects. (75)
- 5-9 To simplify the distribution of indirect costs. (77)
- 6-24 Other (Please specify) _____ (78)

State Code No. (13)
(ON) (2-4)

INDIRECT COST NEGOTIATION AND AUDIT

19. Again if your indirect cost base changed, did the Federal negotiator or auditor require that the indirect cost base change be justified in writing?

- 1-51 Yes (3)
- 2-19 No

20. Regardless of the Federal negotiator's or auditor's requirements, did you submit a written justification to either party for this indirect cost base change?

- 1-60 Yes (6)
- 2-12 No

21. Consider the indirect cost proposal package for the most recent year. Which, if any, of the following items of documentation were included in the proposal package: (Check all that apply.)

- 1-370 A written request or statement of the proposed indirect cost rates. (7)
- 2-344 Certified financial statements. (9)
- 3-394 Summary schedules showing the make-up of indirect cost rates. (9)
- 4-156 Detailed worksheets showing the breakdowns and cost allocations of all elements that make up each of the indirect cost pools or cost categories and summary data on actual indirect cost pools for previous years with explanation notes for all cost pools that show substantial changes between the previous year to the most recent negotiated year. (10)
- 5-169 Notes or statements indicating that detailed work sheets as described above are available for audit. (11)
- 6-88 Other (Please specify) _____ (12)

22. Which Federal department has responsibility for your indirect cost rate negotiations? (Check one)

- 1-394 HEW
- 2-327 DOD
- 3-15 Other (Please specify) _____

23. Has the Federal negotiator ever performed an ON-SITE audit of your institution's indirect costs?

- 1-205 Yes (CONTINUE)
- 2-233 No (GO TO QUESTION 25)

24. If yes, for which year(s) was this audit last performed?

- 1-17 1978 (15-16)
- 2-63 1977
- 3-61 1976
- 4-66 1975
- 5-80 Prior to 1975

25. Has a Federal audit agency ever performed an audit of your indirect costs? (17)

- 1-286 Yes (CONTINUE)
- 2-150 No (GO TO QUESTION 29)

26. If yes, for what year(s) was this audit last performed? (18-19)

- 1-17 1978
- 2-59 1977
- 3-78 1976
- 4-67 1975
- 5-59 1974
- 6-63 1973
- 7-59 1972
- 8-119 Prior to 1972

27. Now, consider the most recent year for which your indirect costs were negotiated. Did a Federal audit agency perform an audit of your indirect costs before negotiations took place? (20)

- 1-120 Yes (CONTINUE)
- 2-185 No (GO TO QUESTION 29)

28. If yes, which Federal audit agency performed the audit. (Check one.) (21)

- 1-69 HEW Audit Agency
- 2-48 Defense Contract Audit Agency
- 3-7 Other (Please specify) _____

RATE DETERMINATION

29. Do you believe that your most recent indirect cost rate is a true reflection of the indirect costs actually incurred for the Federal government research? (22)

- 1-131 Yes (GO TO QUESTION 32)
- 2-159 For the most part yes
- 3-60 For the most part no (CONTINUE)
- 4-87 No

30. If you checked no, or for the most part no, what is the reason(s) for your position? (Check one or more.)

- 1-97 Federal cost principles did not allow for the inclusion of all indirect costs. (23)
- 2-53 Negotiator did not allow all indirect costs. (24)
- 3-0 Indirect cost pools or cost accounting entries contain direct cost expenditures. (25)
- 4-27 Indirect cost pools or cost accounting cost entries did not contain all indirect costs. (26)
- 5-30 Intentionally accepted a lower rate for very valid reasons. (27)
- 6-39 Full recovery was not worth the additional cost and effort necessary to get it. (28)
- 7-37 Other (Please specify) _____

31. If you indicated that the negotiator did not allow all indirect costs (Question 30, Item 2), in general, what types of costs were disallowed? If not, skip to Question 32. (30)

Disallowed Cost Items Or Cost Rate Factors

32. Consider the particular set of cost principles that are appropriate for your particular institution. (For the most part, educational institutions use FMC73-8 or A-21, state and local governmental agencies use FMC74-4, hospitals use OASC-3, and non-profit institutions use OASC-5; but some of these types of institutions may use Department of Defense Cost Principles-ASPR.) How adequate or inadequate is the particular set of cost principles that apply to your institution? (Check one.) (31)

- 1- / 28 / More than adequate (GO TO QUESTION 35)
- 2- / 25 / Generally adequate
- 3- / 79 / Marginal or borderline (CONTINUE)
- 4- / 26 / Generally inadequate
- 5- / 2 / Very inadequate
- 9- / 26 / No basis to judge (GO TO QUESTION 35)

33. If you indicated that the cost principles used for your particular institution were either marginal or inadequate, in general, what are your major criticisms? (Check one or more of the most appropriate reasons listed below.)

- 1- / 38 / Compliance requirements among Federal agencies differ. (32)
- 2- / 21 / Cost principles are too specific and are not consistent with the institution's accounting system. (33)
- 3- / 62 / Cost principles are too ambiguous, and this leads to varying interpretations among research institutions, Federal agencies and the individuals concerned. (34)
- 4- / 68 / Cost principals are inequitable because they exclude certain legitimate research expenditures. (35)
- 5- / 20 / Other (Please specify) _____

_____ (36)

34. If you checked any of the above items listed in question 33, it would be most helpful if you could site specific examples for additional clarification. (37)

INDIRECT COST REIMBURSEMENT

35. For the most recent period, did any Federal agencies reimburse you at indirect cost rates lower than those most recently negotiated?

- 1-148 Yes (CONTINUE) (38)
- 2-195 No (GO TO QUESTION 38.)

36. If yes to the question above, list the Federal agencies and the rates at which they reimbursed you.

<u>Federal Agency</u>	<u>Rate</u>
(39-40)	28.4 (41-43)
(44-45)	31.1 (46-48)
(49-50)	32.5 (51-53)
(54-55)	32.3 (56-58)
(59-60)	22.2 (61-63)

37. If you were not fully reimbursed at the negotiated indirect cost rates (yes on question 35), why did you accept them? (Check one or more of the most appropriate reasons.)

- 1-11 Anticipated gifts and donations from non-Federal grantor(s). (64)
- 2-17 Anticipated receiving additional grants. (65)
- 3-6 The Federal grantor made other compensating concessions. (66)
- 4-18 Federal research study objectives more fully meet the institution's objectives than other studies. (67)
- 5-23 The amount not reimbursed was insignificant in relation to total research activity. (68)
- 6-88 Chose to accept these terms rather than not do the research. (69)
- 7-20 Believed that the institution could absorb the costs. (70)
- 8-4 Underestimated the indirect costs. (71)
- 9-48 To develop research and staff capabilities. (72)
- 10-61 Other (Please specify) _____ (73)

ADDITIONAL COMMENTS

38. We realize that this questionnaire cannot provide information in the same depth as that obtained from a personal interview or through narrative responses. Therefore, if you feel that there are issues raised in this questionnaire which need further clarification or if you have any additional comments you believe would be of interest to the Congress on any of the items within the questionnaire or related topics not covered, please feel free to express them in the space below or on the back of this page. Any further information you can give us will be greatly appreciated.

Thank you. (74)

SUMMARY OF QUESTIONNAIRE
RESULTS - NIH RESPONDENTS
RECEIVING INDIRECT COST
REIMBURSEMENTS OF \$1 MILLION
OR MORE, IN 1977

INSTRUCTIONS: As mentioned in our letter the U.S. General Accounting Office, the agency of the Congress responsible for the oversight of Federal expenditures, is currently reviewing the indirect costs of health research. The purpose of this questionnaire is to gather historical and current data on indirect costing, negotiation and audit practices, and to obtain your professional opinions and observations about certain issues that affect this area. The study was prompted by the fact that it has been several years since this area was last surveyed and conditions appear to have changed since then. We will not use this data to make audits or judgments about individual institutions.

We are asking financial officers and administrators from institutions like yours to help us by completing this questionnaire. The form could take from 1 to 3 hours to fill out depending on the accounting procedures and the availability of records at your institution. The majority of the questions can be answered in a few seconds by checking boxes or filling in blanks. Most of the time will be taken up by several items which will require you to go to your financial records. Therefore, we suggest that you read the entire form, or at least the first 15 questions, first so that you will have a general idea of what is to be asked of you and what types of information you may need from your files.

As you read the questionnaire you will note certain numbers within shaded parentheses to the right of the question. Please disregard these numbers. Their only purpose is to assist our key-punch operators in tabulating responses.

We realize that some of you may consider the requested accounting information private or the issue of indirect cost to be of a sensitive nature. You can be assured that your response will be treated with the strictest of confidence. We have asked for identifying information only to help us in making comparisons between various types of institutions and, should the need arise, in following up on those who fail to respond. Again, we do not intend to make determinations about specific organizations. Your name is not important to this study, but what you have to say is.

Please give us your most frank and honest assessments. We are most grateful for your cooperation because we can not make a meaningful report to the U.S. Congress without your assistance and participation. If you have any questions, please call me or my assistant, Harold Weinstein, at (FTS) 798-4066 or commercial at (213) 688-4066. We will be very glad to help.

Thank you for your consideration.

RESPONDENT INFORMATION

- I. _____
(Name & phone no. of person completing this form)
- II. _____
(Title of person completing form)
-

(Start Card No. 1) (1)
(CW) (2-4)

BACKGROUND

1. What type of institution are you primarily considered to be? (Check one.) (5)
1. Educational (College/University)
 2. Hospital or medical services
 3. Nonprofit research
 4. State or local governmental agency
 5. Other (specify) _____
-
2. For your last fiscal year, approximately what percentage of the institution's total expenditures went for research (i.e., all direct and indirect costs of all research grants and contracts)? (Your best guess is good enough.) (6)
- _____ % of total expenditures going for research
3. Again for your last fiscal year, approximately what percent of your research (all grants and contracts) was supported by the Federal government? (Again, your best guess.) (8)
- _____ % of total research supported by Federal government

4. Which Federal department or agency provided the largest dollar amount of reimbursement for research conducted by your institution during your last fiscal year? (Check one.)
1. National Institutes of Health (NIH) (60)
 2. HEW - Other than NIH
 3. Department of Defense (DOD)
 4. National Science Foundation (NSF)
 5. Other (specify): _____

REIMBURSED COSTS

(For both Federal and all other grantors.)

5. Please provide the total amount in thousands of dollars of all of your reimbursed research cost (both direct and indirect) for each of the five fiscal years from 1973 through 1977.

NOTE: For this and following questions asking for 5-year data, if it is impractical to go back five years, please provide the totals for the last 3 years.

(Dollars in thousands)

	1973	1974	1975	1976	1977
TOTAL COST	\$	\$	\$	\$	\$
	(11-12)	(16-18)	(21-23)	(26-30)	(31-35)

6. Again for the last five years, provide the total amount of the reimbursed or recorded indirect costs for research. As in question 5 provide all totals in thousands of dollars.

	1973	1974	1975	1976	1977
\$ AMOUNT OF INDIRECT COST	\$	\$	\$	\$	\$
	(36-40)	(41-45)	(46-50)	(51-55)	(56-60)

7. Provided below is a listing of commonly used direct cost categories. Please check each category considered by your institution to be a direct cost. If other direct cost categories are used, or if clarification is needed on the items already listed, please make the additions or clarifications in the spaces following the list. Your response will help us assess the possible variations among institutions.

- 1- salaries and wages of all principal investigators, co-investigators, professional associates, research staff, technicians, computer science and administrative support, and secretaries who work on and who directly affect the scope of the research project (61)
- 2- project services and supplies (62)
- 3- all scientific equipment over a specific amount; Specify amount: (63)
- 4- travel (64)
- 5- fringe benefits (65)
- 6- publications (66)
- 7- consultant costs (67)
- 8- scientific equipment maintenance (68)
- Additional items or clarification (69)

Start Card No. 2 (1)
(CN) (2-4)

8. For each of the previous five years, provide the total reimbursed direct cost of the wages and salaries of the professional research and technical staff--that is, principal investigators, co-investigators, professional associates, research staff, technicians, and others who are directly involved with specific research projects. Exclude all fringe benefits.

Do not include secretaries, administrators and support staff, clerks, guards and shop support who do not charge direct time and labor to specific projects and whose effort does not directly affect the scope of effort of specific research projects. We recognize that your accounting records may not allow you to easily provide this information. If this is the case give us your best estimate.

(Dollars in Thousands)

	1973	1974	1975	1976	1977
\$ Amount of wages and salaries of professional and technical research staff	\$	\$	\$	\$	\$
	(5-8)	(9-12)	(13-16)	(17-20)	(21-24)

9. INDIRECT COST POOLS

Please provide a breakout of the negotiated dollar amounts (if not available use the proposed dollar amounts) of each of your indirect cost pools or cost categories. Show all dollar amounts in thousands. We realize, of course, that your indirect cost pools or cost categories may be different from the ones we have presented below. So please cross out the categories that you do not use and write in any additional categories that you may use.

(Dollars in thousands)

Indirect Cost Pool Categories	1973	1974	1975	1976	1977
1. Use Allowance (or Depreciation)- Building	\$	\$	\$	\$	\$
	(5-8)	(9-12)	(13-16)	(17-20)	(21-24)
2. Use Allowance (or Depreciation)- Equipment	\$	\$	\$	\$	\$
	(25-28)	(29-32)	(33-36)	(37-40)	(41-44)
3. Operations and Maintenance	\$	\$	\$	\$	\$
	(45-48)	(49-52)	(53-56)	(57-60)	(61-64)
4. General and Administrative	\$	\$	\$	\$	\$
	(5-8)	(9-12)	(13-16)	(17-20)	(21-24)
5. Library	\$	\$	\$	\$	\$
	(25-28)	(29-32)	(33-36)	(37-40)	(41-44)
6. Departmental Administration	\$	\$	\$	\$	\$
	(45-48)	(49-52)	(53-56)	(57-60)	(61-64)
7. Research Administration	\$	\$	\$	\$	\$
	(5-8)	(9-12)	(13-16)	(17-20)	(21-24)
8. Student Services	\$	\$	\$	\$	\$
	(25-28)	(29-32)	(33-36)	(37-40)	(41-44)
9. Other (identify)	\$	\$	\$	\$	\$
	(45-48)	(49-52)	(53-56)	(57-60)	(61-64)
10. Other (identify)	\$	\$	\$	\$	\$
	(5-8)	(9-12)	(13-16)	(17-20)	(21-24)
11. Other (identify)	\$	\$	\$	\$	\$
	(25-28)	(29-32)	(33-36)	(37-40)	(41-44)
12. Other (identify)	\$	\$	\$	\$	\$
	(45-48)	(49-52)	(53-56)	(57-60)	(61-64)

INDIRECT COST CHANGES

10. Consider your indirect costs. After adjusting for the increase in the general inflation rate and for changes in your volume of research, to what extent, if any, have your indirect costs changed in the last five years? (Check one.)

- 1. 0 A substantial or great decrease (in indirect costs)
 - 2. 1 A moderate decrease
 - 3. 4 Some decrease
 - 4. 3 Little or no change
-
- 5. 4 Some increase
 - 6. 4 Moderate increase
 - 7. 1 Substantial or great increase

If you checked a decrease or no change, go to Question 12.

If you checked an increase, continue.

11. Answer, if after adjusting for inflation and changes in your volume of research, your indirect costs still increased over the last five years. How important or not were each of the following possible causes for this increase? (Check one column for each row.)

	1 Of little or no importance	2 Somewhat important	3 Moderately important	4 Of substantial or great importance	5 Of very great importance	
1-Increase in utility costs	4	8	18	45	30	(68)
2-Increase in administrative costs due to new Government programs (e.g., affirmative action, health and safety etc.)	8	17	34	37	7	(63)
3-More sophisticated accounting system due to new Government grant accounting requirements	27	21	34	13	4	(63)
4-Changes in methods of allocating indirect costs to research and non-research activities	52	16	20	8	1	(63)
5-Increase in insurance costs	37	19	30	8	3	(67)
6-Increases in administrative costs due to reorganization	67	21	4	1	2	(73)
7-Changes in operations or scope of work	71	12	5	0	4	(72)
8-Other (Specify)	0	1	8	7	7	(73)
_____						(73)

Stat: Cont No. 7 (2)
(CN) (1-4)

INDIRECT COST RATES

12. What were the proposed and negotiated (Federal) indirect cost rates for each of the previous years? (NOTE: In the event that negotiated rates for certain years are still undetermined, write undetermined in the space provided for the specific year(s) in question. Also, if more than one rate is negotiated, use the main or "on campus" rate of the largest government research activity.)

		FEDERAL INDIRECT COST RATES				
		1973	1974	1975	1976	1977
Proposed rate		(5-7)	(8-10)	(11-13)	(14-16)	(17-19)
Negotiated rate		(20-22)	(23-25)	(26-28)	(29-31)	(32-34)

13. Did you receive any non-Federal research grants or contracts in your last fiscal year? (e.g., Ford Foundation, American Cancer Society, etc.) (35)

- 1- Yes (CONTINUE)
- 2- No (GO TO QUESTION 17)

14. If yes, list the allowable indirect cost rates and, if you care to, the name(s) of the organization(s). (If you had support from more than three organizations, list the three that provided the largest dollar support.)

	Allowable indirect cost rates	Name of organization (optional)
1	(36-38)	(39-40)
2	(41-43)	(44-45)
3	(46-48)	(49-50)

15. In the above listing, did all of the non-Federal organizations allow cost rates that fully reimbursed you for all of the indirect costs actually incurred for doing the research?

- 1- Yes (GO TO QUESTION 17) (51)
- 2- No (CONTINUE)

16. If no, which of the following reasons were a major influence on your decision to accept cost rates that did not fully reimburse you? (Check one or more.)

- 1- Anticipated gifts and donations from non-Federal grantor(s). (52)
- 2- Anticipated receiving additional grants. (53)
- 3- The grantor made other compensating concessions. (54)
- 4- Non-Federal research study objectives more fully met the institution's objectives than other studies. (55)
- 5- The amount not reimbursed was insignificant in relation to total research activity. (56)
- 6- Chose to accept these terms rather than not do the research. (57)
- 7- Believed that the institution could absorb the costs. (58)
- 8- Underestimated the indirect costs. (59)
- 9- To develop research and staff capabilities. (60)
- 10- Occasionally accept some of these grants for use in other cost sharing arrangements. (61)
- 11- Original documentation was not sufficiently complete to sustain the rate and/or it was not worth the effort to develop this documentation. (62)
- 12- Other (Specify) _____

17. What was the cost base method used in calculating the indirect Federal government cost rates for each of the previous five years? (Indicate your answer by checking one of the two broad categories listed below for each year.)

Indirect Cost Base Calculation Method	Year				
	1973	1974	1975	1976	1977
1-Wages & Salaries	(63)	(64)	(65)	(66)	(67)
2-Modified Total Direct Cost	(68)	(69)	(70)	(71)	(72)

18. If your indirect cost base changed during the last five years, what was your primary reason(s) for this change? (If not, skip to Question 21) (Check one or more.)

- 1- To more equitably distribute indirect costs. (73)
- 2- To provide more management flexibility for considering other alternatives (e.g. make, buy or lease. Do in house or subcontract.) (74)
- 3- To show a lower rate. (75)
- 4- To satisfy principal investigator(s) requests to control costs of their projects. (76)
- 5- To simplify the distribution of indirect costs. (77)
- 6- Other (Please specify) _____ (78)

Start Card No. 8 (1)
(CM) (2-4)

INDIRECT COST NEGOTIATION AND AUDIT

19. Again if your indirect cost base changed, did the Federal negotiator or auditor require that the indirect cost base change be justified in writing? (8)

- 1- Yes
- 2- No

20. Regardless of the Federal negotiator's or auditor's requirements, did you submit a written justification to either party for this indirect cost base change? (6)

- 1- Yes
- 2- No

21. Consider the indirect cost proposal package for the most recent year. Which, if any, of the following items of documentation were included in the proposal package: (Check all that apply.)

- 1- A written request or statement of the proposed indirect cost rates. (7)
- 2- Certified financial statements. (8)
- 3- Summary schedules showing the make-up of indirect cost rates. (9)
- 4- Detailed worksheets showing the breakdowns and cost allocations of all elements that make up each of the indirect cost pools or cost categories and summary data on actual indirect cost pools for previous years with explanation notes for all cost pools that show substantial changes between the previous year to the most recent negotiated year. (10)
- 5- Notes or statements indicating that detailed work sheets as described above are available for audit. (11)
- 6- Other (Please specify) _____ (12)

22. Which Federal department has responsibility for your indirect cost rate negotiations? (Check one) (13)

- 1- HEW
- 2- DOD
- 3- Other (Please specify) _____

23. Has the Federal negotiator ever performed an ON-SITE audit of your institution's indirect costs? (14)

- 1- 95 Yes (CONTINUE)
- 2- 59 No (GO TO QUESTION 25)

24. If yes, for which year(s) was this audit last performed?

- 1- 9 1978 (15-16)
- 2- 40 1977
- 3- 34 1976
- 4- 34 1975
- 5- 36 Prior to 1975

25. Has a Federal audit agency ever performed an audit of your indirect costs? (17)

- 1- 139 Yes (CONTINUE)
- 2- 14 No (GO TO QUESTION 29)

26. If yes, for what year(s) was this audit last performed? (18-19)

- 1- 8 1978
- 2- 32 1977
- 3- 47 1976
- 4- 40 1975
- 5- 36 1974
- 6- 38 1973
- 7- 34 1972
- 8- 58 Prior to 1972

27. Now, consider the most recent year for which your indirect costs were negotiated. Did a Federal audit agency perform an audit of your indirect costs before negotiations took place? (20)

- 1- Yes (CONTINUE)
- 2- No (GO TO QUESTION 29)

28. If yes, which Federal audit agency performed the audit. (Check one.) (21)

- 1- HEW Audit Agency
- 2- Defense Contract Audit Agency
- 3- Other (Please specify) _____

RATE DETERMINATION

29. Do you believe that your most recent indirect cost rate is a true reflection of the indirect costs actually incurred for the Federal government research? (22)

- 1- 29 Yes (GO TO QUESTION 32)
- 2- 54 For the most part yes
- 3- 30 For the most part no (CONTINUE)
- 4- 42 No

30. If you checked no. or for the most part no, what is the reason(s) for your position? (Check one or more.)

- 1- 62 Federal cost principles did not allow for the inclusion of all indirect costs. (23)
- 2- 34 Negotiator did not allow all indirect costs. (24)
- 3- 0 Indirect cost pools or cost accounting entries contain direct cost expenditures. (25)
- 4- 11 Indirect cost pools or cost accounting cost entries did not contain all indirect costs. (26)
- 5- 15 Intentionally accepted a lower rate for very valid reasons. (27)
- 6- 16 Full recovery was not worth the additional cost and effort necessary to get it. (28)
- 7- 13 Other (Please specify) _____

_____ (29)

31. If you indicated that the negotiator did not allow all indirect costs (Question 30, Item 2), in general, what types of costs were disallowed? If not, skip to Question 32.

Disallowed Cost Items Or Cost Rate Factors

32. Consider the particular set of cost principles that are appropriate for your particular institution. (For the most part, educational institutions use FMC73-8 or A-21, state and local governmental agencies use FMC74-4, hospitals use QASC-3, and non-profit institutions use QASC-5; but some of these types of institutions may use Department of Defense Cost Principles-ASPR.) How adequate or inadequate is the particular set of cost principles that apply to your institution? (Check one.)

- 1-10/ More than adequate (GO TO QUESTION 35)
2-78/ Generally adequate
3-51/ Marginal or borderline (CONTINUE)
4-12/ Generally inadequate
5-1/ Very inadequate
9-3/ No basis to judge (GO TO QUESTION 35)

33. If you indicated that the cost principles used for your particular institution were either marginal or inadequate, in general, what are your major criticisms? (Check one or more of the most appropriate reasons listed below.)

- 1-23/ Compliance requirements among Federal agencies differ.
2-8/ Cost principles are too specific and are not consistent with the institution's accounting system.
3-34/ Cost principles are too ambiguous, and this leads to varying interpretations among research institutions, Federal agencies and the individuals concerned.
4-49/ Cost principals are inequitable because they exclude certain legitimate research expenditures.
5-13/ Other (Please specify)

34. If you checked any of the above items listed in question 33, it would be most helpful if you could site specific examples for additional clarification.

INDIRECT COST REIMBURSEMENT

35. For the most recent period, did any Federal agencies reimburse you at indirect cost rates lower than those most recently negotiated?

- 1- Yes (CONTINUE) (38)
- 2- No (GO TO QUESTION 38.)

36. If yes to the question above, list the Federal agencies and the rates at which they reimbursed you.

<u>Federal Agency</u>	<u>Rate</u>
_____ (39-40)	_____ (41-43)
_____ (44-45)	_____ (46-48)
_____ (49-50)	_____ (51-53)
_____ (54-55)	_____ (56-58)
_____ (59-60)	_____ (61-63)

37. If you were not fully reimbursed at the negotiated indirect cost rates (yes on question 35), why did you accept them? (Check one or more of the most appropriate reasons.)

- 1- Anticipated gifts and donations from non-Federal grantor(s). (64)
- 2- Anticipated receiving additional grants. (65)
- 3- The Federal grantor made other compensating concessions. (66)
- 4- Federal research study objectives more fully meet the institution's objectives than other studies. (67)
- 5- The amount not reimbursed was insignificant in relation to total research activity. (68)
- 6- Chose to accept these terms rather than not do the research. (69)
- 7- Believed that the institution could absorb the costs. (70)
- 8- Underestimated the indirect costs. (71)
- 9- To develop research and staff capabilities. (72)
- 10- Other (Please specify) _____ (73)

ADDITIONAL COMMENTS

38. We realize that this questionnaire cannot provide information in the same depth as that obtained from a personal interview or through narrative responses. Therefore, if you feel that there are issues raised in this questionnaire which need further clarification or if you have any additional comments you believe would be of interest to the Congress on any of the items within the questionnaire or related topics not covered, please feel free to express them in the space below or on the back of this page. Any further information you can give us will be greatly appreciated.

Thank you. (74)

LIST OF PRIOR STUDIESON INDIRECT COSTS

American Council on Education, the Association of American Medical Colleges, and the Rand Corporation, "A Report on the Indirect Costs of Academic Research." Prepared for the President's Biomedical Research Panel.

Comptroller General of the United States, "Study of Indirect Cost of Federally Sponsored Research Primarily by Educational Institutions." Report to the Congress (June 12, 1969 (B-117219)).

House Surveys and Investigations Staff, "A Report to the Committee on Appropriations, U.S. House of Representatives, on Overhead Reimbursement to Grantees and Contractors, Department of Health, Education, and Welfare," Mar. 1975.

Kidd, Charles V., Executive Secretary, Association of American Universities, "Why Are Indirect Cost Rates for Federal Research Grants and Contracts with Universities Increasing?" Report for the House Committee on Appropriations, Mar. 16, 1976.

Peat, Marwick, Mitchell & Co., "Study of Indirect Cost Rates of Organizations Performing Federally Sponsored Research." Report to Stanford University, Nov. 1977.

Peat, Marwick, Mitchell & Co., "Variations in Research Indirect Cost Rates--A Study of Six Universities." Report to American Council on Education, Feb. 14, 1969.

Van Alstyne, Carol, and Coldren, Sharon L., American Council on Education, "The Costs of Implementing Federally Mandated Social Programs at Colleges and Universities." Policy Analysis Service - special report, June 1976.

INSTITUTIONS WHERE GAODID DETAILED AUDIT WORKEducational institutions

Albert Einstein College of Medicine of Yeshiva University,
New York, New York.

California Institute of Technology, Pasadena, California

Johns Hopkins University, Baltimore, Maryland

Research Foundation of the State University of New York,
Albany, New York

University of California, Berkeley, California

Yale University, New Haven, Connecticut

Nonprofit institutions

Scripps Clinic and Research Foundation, La Jolla,
California

Sloan-Kettering Institute for Cancer Research, New York,
New York.

The Salk Institute, La Jolla, California

Wistar Institute of Anatomy and Biology, Philadelphia,
Pennsylvania

Hospitals

Children's Hospital Medical Center, Boston, Massachusetts

Sidney Farber Cancer Institute, Boston, Massachusetts

Massachusetts General Hospital, Boston, Massachusetts

State agency

Health Research Incorporated - Buffalo Division, New York

State Department of Health, Buffalo, New York

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