

COUNCIL ON GOVERNMENTAL RELATIONS

Eleven Dupont Circle, Suite 480 Washington, D.C. 20036 (202) 861-2595

MR

May 22, 1987

TO: COGR Board
FROM: Milton Goldberg *mg*
SUBJECT: Coopers & Lybrand Review of Inspector General's
Report on Indirect Cost

Attached please find the Coopers & Lybrand review of the DHHS Inspector General's report on indirect cost at colleges and universities. Our transmittal letter to Mr. Kusserow and one to the President's Science Advisor is also attached, along with a recent Washington Post story on Mr. Kusserow.

Attachment

cc: Costing Policies Committee

COGR

an organization of research universities

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May 21, 1987

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Dr. William R. Graham
Director
Office of Science and Technology Policy
Old Executive Office Building
17th Street and Pennsylvania Avenue, N.W.
Room 358
Washington, D.C. 20506

Dear Dr. Graham:

On November 7, 1985, Jay Keyworth, then Science Advisor to the President, wrote to the Secretary of Health and Human Services and forwarded a recommendation to cap reimbursement of all administrative costs of research at colleges and universities. That recommendation was based principally on a report of the Inspector General at the Department of Health and Human Services. The purpose of this letter is to transmit to you a report of an independent accounting firm, which calls into question the objectivity of the findings and conclusions of the Office of the Inspector General (OIG) report. The independent audit shows that the OIG staff based its conclusions on formulas derived from subsamples which were arbitrarily chosen and not statistically valid. Essentially, the OIG staff selected universities with the lowest costs and asserted that these costs were appropriate for all universities. Therefore, the extrapolations made and the conclusions drawn were biased and not supported by fact.

I have enclosed a copy of the independent auditors report and a copy of my letter to the DHHS Inspector General. I want you to have this report both to set the record straight and because additional efforts may be forthcoming to reduce research reimbursement.

I will be happy to provide more detail or to discuss this report with you if you desire.

Sincerely,



Milton Goldberg

cc: University Participants

bcc: Robert Rosenzweig, AAU
Robert Clodius, NASULGC
Donald Phillips, GUIR Roundtable
Richard Ruttenberg, Columbia University
Board of Management

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KATHARINA PHILLIPS

Mr. Richard Kusserow
Inspector General
Department of Health and Human Services
330 Independence Avenue, S.W.
Room 5250
Washington, D.C. 20201

Dear Mr. Kusserow:

On behalf of the Council on Governmental Relations (COGR), I am forwarding the report of an independent auditing firm, which reviewed work of the Office of Inspector General (OIG) of the Department of Health and Human Services that resulted in the study of "The Impact of Indirect Costs on Research Sponsored by the Federal Government at Universities and Colleges." The Coopers & Lybrand review was requested by COGR because our members believed that the OIG study reached conclusions which were not consistent with their understanding of college and university finances and because the report did not reveal sufficient data or methodology to permit a review and discussion of the findings. We appreciate the cooperation of the OIG in making the supporting records available for this review.

The Coopers & Lybrand review shows that the OIG staff selected a representative group of universities for study, but based their conclusions on formulas derived from subsamples of these universities, which were arbitrarily chosen and not statistically valid. The review shows that the conclusions were reached by selecting universities with the lowest costs and asserting that these lowest costs were appropriate for all universities. This was true for the subcomponents of Departmental Administration which includes the salaries of faculty members, wages of clerical and technical staff and operating expenses. The formulas developed by the OIG to reach its conclusions were not consistent with OMB Circular A-21, with other applicable federal regulations nor with the expressed intent of the Congress.

The results of the OIG study were cited by OMB and others in efforts last year to arbitrarily cap overhead recovery of administrative costs. The conclusions of the study implied that universities' overhead rates had become seriously inflated and out of control. As such, the report damaged the credibility of the university community with OMB and with the Congress and jeopardized its reputation for responsible stewardship.

Subsequent reports by the General Accounting Office, "University Finances: Research Revenues and Expenditures", July 1986, and by DHHS, Public Health Service, "Trends in Indirect Costs", March 4, 1987 show that indirect cost recovery of universities has not increased at the rate implied by the OIG. The Coopers & Lybrand report gives a number of reasons why the OIG study is misleading.

The failure of the published report to reveal the nature of the subsamples from which invalid formulas were derived, and then used for its conclusions, and the consistent bias for using the lowest observed costs to reach these conclusions are viewed by COGR as not consistent with the responsibilities of the OIG to provide objective, unbiased information. We hope that future OIG studies will be conducted differently.

Sincerely,


Milton Goldberg

cc: Joseph Wright, Office of Management and Budget
David Kleinberg, Office of Management and Budget
University Participants

Players

Richard P. Kusserow

Tracking Waste and Abuse At the Top-Spending Agency

Two years ago, a little-known government agency shocked the medical world with a study calculating that the nation's hospitals made profits of 14 percent on the treatment of Medicare patients in 1984.

The report turned on its ear the conventional wisdom that hospitals were losing money on Medicare but making it up on private patients. The study suggested the reverse. Should the numbers hold up over time, they could induce Congress to reduce Medicare payments to hospitals by billions annually.

In another report, the agency asserted that an error had been made in calculating Medicare payments to hospitals to help defray the cost of training interns and residents. The payments were reduced sharply by Congress, saving Medicare \$1.7 billion over two years.

These studies illustrate the work of a relatively obscure but actually powerful and much-feared agency—the Office of Inspector General of the Department of Health and Human Services, headed by Richard P. Kusserow.

The 46-year-old Kusserow, an energetic and blunt former career FBI man, is charged with saving money and battling fraud and waste in HHS programs. But he doesn't confine himself to big-ticket economic studies.

In one example of the smaller fry he chases, the Paracelsus hospital chain last year agreed to pay the government \$4.45 million to settle accusations that it billed Medicare for expenses unrelated to health care.

In other cases, his office found that scores of doctors and other health personnel who were delinquent in repaying government educational loans were employees of HHS, or, as private practitioners, were receiving payments from

Medicare and Medicaid as high as \$350,000 a year. His office took action to compel payment.

In still others, the agency helped recover \$300,000 from a man who used birth certificates of long-dead people to apply for welfare benefits; helped convict a Social Security employee in a scheme to use other people's Social Security numbers to claim fraudulent income-tax refunds and helped crack a ring seeking to bribe HHS employees to issue Social Security cards to illegal aliens.

The Office of Inspector General, said Kusserow in an interview, is a unique institution. "The first one, in HHS, was started in 1976 under Public Law 94-505. Now there are 19. All departments and some agencies like the National Aeronautics and Space Administration have them except Justice and Treasury."

The idea, Kusserow said, was to implant in each department tough waste-fighting units shielded from political pressure. The "IGs," as they are widely known, are nominated by the president, and confirmed by the Senate, not appointed by the secretaries of the departments.

"The IG serves at the pleasure of the president," Kusserow said, and can be fired only by the president, who must give prior notice to Congress so that "it can decide if it was politically motivated."

"We make our reports to the president, the secretary and Congress. I don't need the approval of the secretary or president to issue reports, and I don't have to change anything in the report. The same thing with congressional testimony."

"I have my own statutory staff—1,232 full-time" slots. Although his budget request is handled by the Office of Management and Budget, Kusserow said, if he doesn't like OMB proposals, he has the right—unlike other executive branch officials—to ask Congress for more. He has never found it necessary to do so, however.

For fiscal 1988, Kusserow said, his office is seeking a total of \$79 million—consisting of an appropriation of \$38.4 million from Congress plus transfer of \$40 million from department trust funds such as Medicare.

These arrangements give him independence, Kusserow said—and he needs it, with his mandate to watch a department whose budget—\$361 billion a year—exceeds even the Pentagon's. "I have a lot of different hats,"

said Kusserow. Under one, he audits all the programs and operations of the department and of outside institutions and individuals who receive department money—examining the books, seeing that money is being used as intended and initiating corrective action when needed. About 670 of his 1,232 slots are in his auditing division.

"We audit state programs like Medicaid and Aid to Families with Dependent Children. We audit 2,800 colleges and universities that get HHS money and money from other federal agencies. Most people don't realize this, but 96 percent of the colleges and universities that get federal money get more of it from HHS than from any other agency. Under the government's system, instead of having each department go in and audit its own grants separately, the department

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that has the largest amount of payments to the college gets the job of doing all the federal auditing for all the federal money."

In addition, Kusserow has a 130-person analysis and inspections office that performs policy analysis and reviews department regulations. This division recently "did a study for the surgeon general on who is using smokeless tobacco. We found the average user is a person who started at 10 years old."

Another study, on medical licensing, showed that state boards are disciplining few doctors for misconduct. Kusserow calls the report a "catalyst" for recent improvements. "The following year there was a 40 percent increase in disciplinary actions," he said.

Finally, Kusserow said, he wears the hat of an investigator of criminal and civil wrongdoing. That division of his office has 400 people. In addition to the kinds of cases he described earlier, Kusserow, acting on a tip, initiated an investigation of former Medicare administrator and department chief of staff C. McClain Haddow, who has subsequently been charged with fraud-

ulently obtaining \$30,000 from a charitable foundation.

Kusserow is well suited for the investigative function. After receiving his MA from California State University and spending one year at Southern Methodist University law school, he taught at California State for a year then enlisted for four years in the Marines. For a year on each end of his military tour he worked as a case officer for the Central Intelligence Agency.

In 1969 he joined the FBI, where he remained almost 13 years, eventually heading its organized-crime program in Chicago before taking the IG job in 1981.

Kusserow's name is often floated within the administration as a possibility for other key jobs, including that of FBI director or associate director of OMB overseeing the government's spending on social programs. He said he has been sounded out about his interest in the latter job, but so far, "I'm not convinced that would be a better job than I have now."

As for the FBI post vacated by William H. Webster's nomination to head the CIA, it goes without saying that the former FBI agent would be interested. But he laughed and said, "I have not received any calls leading me to believe I'm on the short list."

Kusserow says he's had a lot of disagreements with HHS officials over policy positions he's recommended, and over some of his auditing plans. For example, several years ago "I testified for mandatory second surgical opinions on elective surgery in Medicare," when "Carolynne Davis, head of Medicare, opposed it. Congress has since required second opinions for elective surgery."

But while there were disagreements, he said, there have never been any attempts to force him to suppress material or suspend an investigation. "No one has tried to leverage me, or threaten me or tell me I couldn't do something."

Once in a while he gets a call from a member of Congress who thinks the IG office is a service agency for Congress, or who seems to be placing pressure on him, but when he explains the legal status of the IG office, "they back off."

Kusserow is an avid reader, particularly of history, but also of fiction. "But I never read any detective stories," he laughed. "It's too close to home."

—Spencer Rich



BACKGROUND: Inspector general, Health and Human Services Department, 46 years old. Formerly an FBI agent (1969-81); headed organized-crime program in Chicago. Former intelligence officer with CIA, received BA in political science and African studies from University of California at Los Angeles, MA in government and African studies from California State University at Los Angeles, studied law one year at Southern Methodist University Law School.

BY TIMOTHY MALCOLM FOR THE WASHINGTON POST

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Council on Governmental Relations



Report on the Study of the
Office of the Inspector General
on the Impact of
Indirect Costs on Research



May, 1987

Report on the Study of
the Office of the Inspector General (OIG)

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May 20, 1987

Mr. Robert Harrison
Chairman, Costing Policies Committee
Council on Governmental Relations
Office of the Treasurer
University of Delaware
Newark, DE 19716

Dear Mr. Harrison:

At your request, we have read and performed other procedures regarding the report of the Office of the Inspector General (OIG) of the United States Department of Health and Human Services (HHS) on his study of "The Impact of Indirect Costs on Research Sponsored by the Federal Government at Universities and Colleges." In general, we performed the procedures proposed in our letter to you of October 30, 1986.

Summary

We found that the Inspector General's staff did not perform an audit, nor did they evaluate all indirect cost components. The data they studied generally was provided by the universities themselves, or through regional representatives of the Inspector General. The OIG did not attempt to analyze components beside departmental administration (DA). Rather, HHS documents state that the study was an evaluation of various ways to "reduce the growth" in this administrative component of indirect cost reimbursement. Only the most promising alternatives were reported upon.

There was reasonable accuracy in the manner the data was taken from the workpapers and in the mathematical calculations utilized. In drawing conclusions from this data, however, the OIG selected criteria which appear to represent "least common denominators." The faculty effort component, for example, for which OIG recommended no reimbursement, was in fact zero at one of the sample institutions. (In December 1986, OMB amended Circular A-21 to limit faculty salaries and benefits included in departmental administration to 3.6% of modified total direct costs.) Operating expenses averaged less than one percent at three universities; and, at one, a higher proportion of clerical and technical salaries were allocated to instruction than to research. The related OIG recommendations were not adopted for clerical and technical salaries and operating expenses. In selecting each of these "least cost" criteria to formulate a "standard" DA rate, the OIG staff did not accommodate the diversity of accounting practices which are evident from the data.

The OIG proposed to study reasons for the growth in indirect components over time and to suggest ways to reduce the costs. The study of DA subcomponents, however, covered only one year, and the OIG recommendations dealt only with reimbursement, and not with the costs themselves. Finally, although an incremental versus full cost approach was dropped as an alternative, a number of the Inspector General's comments and recommendations reflect a favoring of the incremental cost approach rather than the full cost approach applied by the federal government to grants and contracts in general.

Our Procedures

We read the study, COGR's response of February 20, 1986 and a number of binders of background material at the Office of the Inspector General, Region I, in Hartford, Connecticut. We met with the study director a number of times and held an exit conference with the Regional Inspector General for Audit in Boston. We read the workpapers contained in about 50 binders, which were made available to us freely and openly by the study director. We compared the subcomponents of departmental administration shown in the report with those provided by the universities or by the regional offices of the Inspector General. We found that the subcomponents had generally been taken from indirect cost proposals for 1982 and 1983; for consistency, however, the Inspector General transformed these components, pro rata, to the departmental administrative component of negotiated rates for 1983 maintained on a data base by the Office of Procurement and Logistics (OPAL) of the Department of Health and Human Services in Washington. We requested confirmation of OPAL components for the years 1982 through 1985 with the individual institutions. A graphic presentation of OPAL data for its 118 major cognizant institutions appears as Exhibit 1 to this report. We reviewed the calculations in the report, including the weighted average of all schools in the survey, and the formula the Inspector General applied to reach his recommended rates. Finally, we prepared a briefing outline and discussed the data outline with the members of the Costing Policies Committee on February 5, 1987.

Our report includes comments on the purpose and conduct of the Inspector General's study, a summary of findings reported by the Inspector General, as well as those not reported; an evaluation of the study; and a discussion of problems with the study.

Purpose of the OIG Study

Various reports of the General Accounting Office, as well as the House and Senate Appropriations Committees had identified rising reimbursement for indirect costs as a problem within the budget of the National Institute of Health. Administrative components, including departmental administration, were found to be rising most rapidly. Among the stated purposes of the OIG study were (a) to discover the reasons for the increase in indirect costs and (b) to propose ways to control and reduce the costs. The HHS workpapers also set forth a purpose "to highlight the problem of growth in such costs, to generate interest in it, and to study alternative ways of limiting the rise in indirect costs in order to help the National Institutes of Health reconcile their budget with the needs of research."

Conduct of the Study

Region I (headquartered in Boston) was in charge of the study; other regions of the OIG participated, though roughly half the institutions in the study were based in New England. The study director met with government and college representatives, including COGR, to discuss plans for the study. Meetings within the government identified 15 potential ways to reduce indirect costs reimbursed under grants and contracts. The Inspector General studied a number of these in some detail, but placed the highest priority on departmental administration (DA). OIG representatives selected 13 institutions for review. They spoke to 12 (six public and six private universities). One did not participate. Detailed procedures used in the study are shown in the memo which appears as Appendix 1. They included interviews of administrators and professors about departmental administration, analysis of components of departmental administration under various alternatives, and an evaluation of the benefit of each component at each university. From the qualitative and quantitative findings of the study, the Inspector General developed a recommended rate for departmental administration. This rate was refined as the report made its way through the Department of Health and Human Services.

Alternatives Pursued and Reported Upon

Of the 15 alternatives originally selected, the Inspector General pursued and reported upon four; two were pursued but not reported upon; and the rest were not pursued at any length. Those pursued and reported upon were:

1. To Establish a Fixed Allowance or Rate for Departmental Administration in Lieu of Cost Reimbursement. Since this was the fastest growing indirect cost area and the most controversial, the Inspector General sought resolution "once and for all". After constructing a formula for a rate, the Inspector General applied this to study data from the 12 universities, and recommended a 7% rate which he stated would save some \$315 million per year nationwide.
2. Predetermined Indirect Cost Rates for a Longer Period. In the course of this study, the Inspector General found that many universities were starting to extend their negotiations for multiple years. The Inspector General found that this would eliminate preparing a proposal every year, cut auditing costs, and reduce bickering. This alternative, too, was recommended, though the Inspector General did not estimate a firm dollar effect of doing so.
3. Eliminate Retrospective Adjustments. The Inspector General pursued the elimination of retrospective adjustments through the SROEAS system for NIH grants. Although there was no recommendation in the report, such adjustments were proposed to be eliminated by notice in the August 1986 Federal Register.
4. Awarding Research Grants on the Basis of Total Proposed Costs. At the time, this methodology was used by the National Science Foundation, not by NIH. NIH proposed the adoption the NSF procedure in the August 1986 Federal Register.

Alternatives Pursued But Not Reported

5. Awarding Block Grants for Indirect Costs. The Inspector General found that universities were generally not enthusiastic about block grants for indirect costs because full reimbursement would not be assured. The Inspector General resolved that such a step would be too much of an undertaking at the time of the report, and made no recommendations in this direction.
6. Extend the Short Form of Indirect Cost Proposal. Universities with less than \$3 million of direct costs use a "short form" which bases overhead reimbursement on numbers reported in the financial statements. An original alternative had been to extend this threshold from \$3 million to \$10 million. The Office of the Inspector General talked with five universities which

were in the \$3 million to \$10 million range. In general, they did not oppose raising the limit, if use of the short form was kept optional. If it were mandated, all would oppose raising the threshold because they would lose reimbursement.

Original Alternatives Not Pursued

7. Reducing reimbursements by a fixed percentage was found not palatable and unfair to universities.
8. Establishing a fixed indirect cost rate, such as 20%, for all universities was nonproductive, controversial and a step back to 1966.
9. Establishing a fixed indirect cost rate or allowance based on an institution's historical experience would penalize a number of universities which had not moved aggressively to increase rates.
10. Standardizing institutional accounting systems to categorize costs as either direct or indirect was considered to be an infringement on the universities.
11. Using an incremental concept for reimbursing indirect costs was judged to be unfair to universities if fully applied there and not to other organizations, such as contractors or research institutes.
12. Establishing fixed indirect cost rates with incentives built in were considered too time consuming for this particular project, although universities might find it acceptable in the future.
13. Introducing competition into the award process would provide additional research monies to universities that lowered their indirect costs. This was considered to be too time consuming as well, though universities could pursue it in the future.
14. Redefining reimbursable indirect costs in A-21 was limited to departmental administration; other costs were not pursued.
15. Changing the current mix of cost sharing between governments and the universities was also considered to be too time consuming an alternative for this particular study. It could also impact upon other contracting methods the Inspector General found.

OIG Formulas

The Inspector General's recommendations came from formulas applied to each of the subcomponents. OIG had no question with the effort of deans and department heads, but recommended an average rate. The entire benefit of faculty was questioned. For clerical and technical salaries, the Inspector General assumed that instruction should be burdened with a "direct charge equivalent" of such salaries equal to the amount charged directly to research, as a proportion of total direct costs charged to research. Six institutions were selected where such a calculation could be made. The Inspector General calculated an average amount for these six institutions which should, in his view, have been charged to instruction rather than departmental administration. He then questioned the amount allocated to departmental administration, and through departmental administration to research, above this "direct charge equivalent". A calculation for a sample university (University II on Schedule 2 of the Inspector General's study) appears as Appendix 2 to this report.

With regard to operating expenses, the Inspector General selected three public institutions (institutions X, XI and XII on OIG Schedule 1) which restricted the types of operating expenses charged to research through the departmental administrative pool to expenses "such as office supplies and certain types of telephone expenses". These institutions had a significantly lower component for operating expenses than the others; and the Inspector General questioned any costs above the weighted average of these three institutions. An analysis of other operating expenses, together with a computation of the recommended operating expense rate, appears as Appendix 3 to this report. The Inspector General then reduced the allocation from other pools to departmental administration in proportion to the reduction in the subcomponents above. This calculation is shown in Appendix 4.

The Inspector General proposed a rate of 7% for departmental administration. This is about 46% of the nationwide average of 15.4%. Annual reports for 1984 from the government showed that universities had been reimbursed \$570 million for departmental administration at negotiated rates. A reduction of the nationwide average from 15.4% to 7% would save the government \$315 million, or 55% of this amount, as follows:

<u>Category</u>	<u>Average*</u>	<u>OIG</u>	<u>\$ MM</u>
Deans, chairmen	1.64%	1.65%	0
Faculty	2.82%	-	\$85
Clerical/ Technical	5.81%	3.14%	80
Operating Costs	5.63%	.85%	140
Allocations	<u>3.19%</u>	<u>1.13%</u>	<u>60</u>
	<u>19.09%</u>	<u>6.77%</u>	<u>\$365</u>
Round to nationwide average	<u>15.4%</u>	<u>7.00%</u>	<u>\$315</u>

* of 12 institutions in the study

Problems with the Study

Problems with Data

The Inspector General analyzed the subcomponents of departmental administration which were drawn from indirect cost proposals; then, for consistency, he transformed each subcomponent, pro rata, to the components of negotiated rates. Negotiation may have eliminated components found excessive by OIG or altered the mix of those components. With the following exceptions, the individual components could be confirmed with the universities in the sample: a) for three of 12 institutions, the MTDC base for 1983 at OPAL was out of date; b) two of 12 institutions disagreed with the departmental administrative component, though not with the total negotiated rate, and c) one institution provided a workpaper to OIG which showed a preliminary DA rate which differed from the final one contained in its proposal. A comparison of proposal rates from which the subcomponents were taken with the negotiated rates to which they were projected appears in Appendix 5. In the aggregate, these differences are not material to the OIG's conclusions.

Finally, there were problems with the calculations of the weighted average subcomponents for the 12 sample institutions. While many of the OIG calculations were computerized, the final calculation of weighted averages was not. Use of appropriate MTDC bases and DA components from the OIG workpapers and those were confirmed with the institutions yielded small differences in the weighted averages reported by OIG. Potential adjustments to the weighted average from confirmed bases and rates are also not material; they appear as Appendix 6.

Problems with the Formulas

The most significant problem with the formulas was the OIG's choice of the lowest rate in the sample for the DA's subcomponents for faculty effort, operating expenses, and clerical and technical support. The range in the faculty subcomponent of the sample institution was zero to over 5%; the Inspector General recommended zero. The "direct charge equivalent" for clerical and technical salaries is intended, according to the Inspector General, to deal with inconsistent costing policies within research universities. Generally, there are no separate accounts for instruction, as opposed to departmental administration, the OIG found. These costs are allocated on the basis of effort reports prepared by university personnel. Instead, the Inspector General proposed an equivalent charge for such salaries to instruction. The direct charge equivalent ("DCE") assumes that research and instruction require the same level of clerical and technical support. The OIG performed no procedures to verify this premise. The "resulting DCE" is not a substitute for a good cost accounting system; and it is not a method recommended by A-21. Finally, the Inspector General's recommended "DCE" percentage is based on a subsample of only six universities. Adoption of the average rate for deans and department heads would penalize institutions whose rates were above the average and reward those below. The OIG report offers no arguments for favoring an average rate over an actual one.

The formula for other operating expenses is also intended to deal with inconsistent cost accounting policies. Operating costs are charged directly to sponsored activities, according to OIG; but when they are not, they are allocated among instruction and other activities on the one hand, and departmental administration on the other through A-21 effort reports, and sponsored activities pick up a portion in DA as well. The Inspector General's formula limits operating expenses to the amount charged by three public universities which exclude many items from the allocation discussed above. The Inspector General assumes that all universities charge these costs consistently as direct costs;

he also assumes that sponsored projects require very little support from these operating expenses. In addition, he has limited the allowed cost to the average of the three lowest universities, while at least one other university (with a higher percentage of operating costs in departmental administration) also limited the types of costs charged through the pool, though not as severely as the three chosen by the Inspector General.

Finally, as discussed above, the OIG reduced the allocation from other pools to departmental administration in proportion to the reduction in sub-components which results from applying the various formulas. The OIG did not review in detail the nature of these expenses, which consist principally of space costs such as utilities and depreciation. They are now allocated to departmental administration on the basis of square footage; and the OIG report does not question their allocability, but reduces them in proportion to the other components in the pool. It is not immediately apparent why formula-based "caps," were they adopted, should apply automatically to other costs which have not been questioned.

Evaluation of the OIG Study

The OIG staff did not broadbrush the subcomponent data for departmental administration, but studied it in some detail. They did not pick a specific monetary target for savings and make their data fit the target. They proceeded with thought and careful discussions with all the parties. The report does reflect a certain frustration of the OIG with the variations of cost allocation procedures within the universities, as well as prior concerns with departmental administration from the General Accounting Office and from others. (A more recent report by the General Accounting Office, University Finances, Research Revenues and Expenditures showed that indirect costs as a percentage of the federal research dollar had risen from 22% in 1975 to 26% in 1984 -- less than 1/2% per year.)

As discussed above, the Inspector General proposed to discover the reasons for the growth in indirect cost rates and to ascertain ways to control the costs. We found, however, that the OIG did not study in detail the reasons for growth in the departmental administrative subcomponents over time, but focused on their composition at one point in time. And, while the report contains specific recommendations for limiting reimbursement of indirect costs, there are no suggestions for containing the costs themselves.

Given the complexity of the data, it is not surprising that there were minor errors, but misunderstanding would have been limited if final weighted-average and formula calculations had been double checked by OIG, and final figures had been reconfirmed with the institutions. For example, the OIG's transformation of proposal data to negotiated rates may not recognize any reduction of components which took place in those negotiations. The report could have benefited, moreover, from a further examination of the inter-relationships of components (the costing nuances) within particular schools, and among institutions.

As discussed above, the OIG's conclusions were based on certain formulas which applied only to certain institutions in the sample. The formulas that support the recommendations were not spelled out directly in the report; they were supported by the data only in the fact that costs at certain institutions -- by no means all -- fell within them; and they were not discussed extensively with the universities. The OIG has made a significant, "hard" recommendation of a 7% rate on the basis of these formulas. The sample as a whole excluded parts of certain sample universities (such as the University of Massachusetts Medical Center and the Harvard Medical School) because the timing of the OIG's review was not convenient for them. One sample university, as reported above, did not choose to participate.

Finally, the nature of the task -- a study of opportunities for reduction in reimbursement for indirect costs, rather than a full survey or an audit -- should have been more clearly stated in the report. Observers outside the government may expect that the Inspector General would audit the data, or study each and every aspect of it.

The OIG should design a clearer format when asked to perform limited studies such as this one. Potential confusion over the nature of the study is most apparent in reading the "Executive Summary." Here OIG contended that "over \$300 million of [DA] payments did not benefit government research" in 1984. A casual reader could infer widespread misappropriation from this statement. The OIG went on to point out, however, that these calculations were more a matter of judgment: the costs under study were "difficult to identify, quantify and challenge under the current provisions, of OMB Circular A-21." These two statements are not reconciled: one is left to wonder whether OIG has challenged \$300 million under the current rules, or has suggested the rules be changed for the future. The OIG should design a clearer format when asked to perform limited studies such as this one.

* * * * *

-11-

We appreciate the assistance of the sample universities, the COGR representative who joined us at the Regional Office of the Inspector General in Hartford, and particularly the cooperation of the study director and other representatives of the OIG in the conduct of our review.

Sincerely,

Coopers & Lybrand



DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL
REGION I

Memorandum

Date : May 4, 1984

From : Robert K. Bergman
National Project Manager

Subject : Nationwide Project on Indirect Costs - Revised ~~Steps~~ Procedures

To : See Below

We have revised the ~~steps~~ steps relative to our original Alternative #1, "Establish a fixed allowance/rate for Departmental Administration". Specifically, we deleted original Step C.8., revised steps H and I (now re-lettered J and K) and inserted two new steps (lettered H and I). To avoid confusion, we suggest you use the complete package of revised ~~steps~~ steps included below. If you have any questions in completing this work, please call me or Ray Losnes at (FTS) 244-2127.

~~Steps~~ PROCEDURES

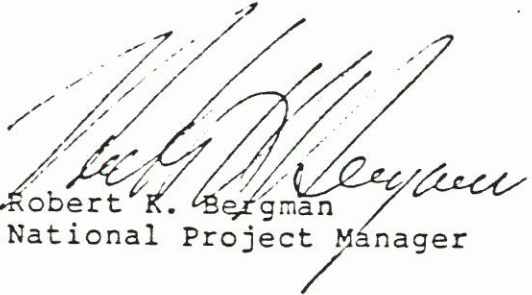
- A. Determine the nature of departmental administration costs. Specifically, what dollar amount and percentage of total departmental administration costs are represented by:
 1. Salaries, wages & fringe benefits of:
 - a. Faculty.
 - b. Deans & department heads.
 - c. Secretarial, administrative, business, and managerial personnel.
 2. Non-salary expenses such as supplies, travel, etc., allocated to departmental administration because of the salaries & wages in 1.a, b, and c above.
 3. Allocations of depreciation, use allowance and operations and maintenance expense.
 4. Allocations of general and administrative expenses.
 5. Other, i.e., residual amounts from service centers, etc.

- B. Obtain a copy of the Personnel Activity Report which the university uses to justify the inclusion of faculty salaries in departmental administration. Obtain a copy of instructions or a verbal description of the types of faculty activity which the university includes in departmental administration.
- C. Interview a small sample of professors (at least six) at each university. Choose the sample from a variety of departments having (1) a large percentage of Federal grant and contract activity, (2) a moderate amount of such activity, and (3) little or no Federal activity. If the university has a medical school as well as a liberal arts school, some of the six should be from each. Determine the following:
1. What duties does the faculty member consider a condition of his employment?
 - a. Teaching.
 - b. Research.
 - c. Community service.
 - d. Patient care.
 - e. Other.
 2. If the faculty member performs research for reasons other than as a condition of employment, is it because:
 - a. The university desires its faculty members to perform research?
 - b. Of other reasons?
 3. How does the university expect research by faculty members to be funded?
 - a. Federal grants and contracts.
 - b. Non-Federal grants and contracts from
 1. Private foundations.
 2. Private industry.
 - c. Internal university funds.
 4. If a faculty member were unable to obtain a Federal or non-Federal grant or contract, what kind of research would he/she do?
 5. What consequences does the faculty member face if he/she does not do research?
 6. Does a faculty member teach additional courses if he/she does not perform research?

7. How do faculty members perceive their salary to be affected by the number of courses they teach and the amount of research they do?
- D. Interview the Provost and/or other officials responsible for hiring faculty members and managing their payment policy. Ascertain the following:
1. What factors are considered in hiring faculty members:
 - a. Reputation as instructor.
 - b. Class standing while in school.
 - c. Publications.
 - d. Research accomplished.
 - e. Other.
 2. What duties and responsibilities are expected of a faculty member?
 - a. Teaching.
 - b. Research.
 - c. Community service.
 - d. Patient Care.
 - e. Other.
 3. Is the faculty member paid more if he/she performs research?
 4. Is a faculty member paid more if he/she serves on administrative committees or performs other activities which qualify part of the salary for inclusion in departmental administration?
 5. Is a faculty member paid more at this institution than at others which do not consider themselves research institutions?
 6. Does a faculty member who does research teach fewer courses than one who does no research?
 7. Does a faculty member who serves on administrative committees or performs other activities which qualify part of his/her salary for inclusion in departmental administration teach fewer courses than one who does no research?
- E. Obtain a copy of any written rules or guidance which set forth policy regarding the duties and responsibilities of faculty members relative to:

1. Teaching.
 2. Research.
 3. Community Service.
 4. Patient Care.
 5. Other.
- F. Obtain a copy of any written policy which sets forth rules for determining the salary of a faculty member.
- G. Compare the non-faculty administrative and technical staff of at least three departments relative to number and type of positions and the payroll. One of the three departments should have a high percentage of Federal grant and contract activity, one an average amount, and one should have little or no Federal activity. Include in this comparison all types of non-faculty positions which would be included in the departmental administration pool, i.e., secretarial, business managers, clerical, stockroom personnel, technical, etc. The objective of this comparison is to determine if research activity causes higher levels of these types of expenses.
- H. Choose a sample of personnel whose salaries are included in departmental administration. Our sample should be drawn from the faculty, from deans and department chairmen, and from non-faculty personnel. Determine through documentary evidence furnished by the University what activities that person performs to justify inclusion of part of his/her salary in departmental administration indirect cost. How do these activities benefit federally sponsored activities? Where documentary evidence cannot be furnished by the university, personnel may be interviewed to determine why they believe inclusion of their salary in departmental administration is appropriate.
- I. Determine how many people in the sample chosen in H. above have had part of their salary charged directly to a federally sponsored project and part of their salary charged indirectly. For those charged both directly and indirectly, determine why. This question relates to the Cost Accounting Standard Part 402 - Consistency in Allocating Costs Incurred for the Same Purpose. The point we want to consider is whether certain types of positions such as secretaries who are being charged both as direct and indirect should, in fact, be charged only one way.
- J. Interview several chairmen in departments with heavy Federal research levels.
1. What changes in Federal regulations would allow reduction in administrative staff? To what extent could it be reduced?

- *N. Talk to Division of Cost Allocation officials and obtain their opinion of the equity and acceptability of our proposed methods.
- *O. Determine what changes would be needed to Circular A-21 or other Federal regulations.
- *P. Talk to top level administration and Congressional officials and university organizations to determine the feasibility of any proposed changes being accepted.



Robert K. Bergman
National Project Manager

Addressees:

Director, GISAD (ATTN: Andy Tronolone)
Mr. Finegan, Project Coordinator, Region III
Mr. Grodzicki, Audit Manager, Region VII (Des Moines)
Mr. Frelot, Audit Manager, Region IX

*Steps to be done by Region I only.

"Direct Charge Equivalent"
for Clerical and Technical Salaries

<u>Sample University</u>	<u>\$ (000)</u>
1. Total research MTDC	\$42,888
2. Non-faculty salaries and wages charged directly to research	<u>9,700</u>
3. Remaining costs	33,188
4. Ratio of non-faculty salaries (2 ÷ 3)	29.2%
5. Instruction MTDC	79,291
6. Non-faculty salaries and wages	<u>13,100</u>
7. Remaining costs	66,191
8. Times ratio (4 above)	29.2%
9. Equals unexpected non-faculty salaries charged to instruction	19,348
10. Less amount charged	<u>13,100</u>
11. Understatement of instructional allocation - overstatement of DA	6,248
12. Times % of DA allocated to federal grants and contracts	<u>31.2%</u>
13. Non-faculty salaries and wages improperly allocated to research	<u>\$ 1,954</u> (in report \$1,900)

Analysis of Other Operating Expenses

1. Range from 0.59% to 9.38%. Simple mean about 4%, weighted average 5.6%.

2. High at institutions:

III and IV (9.38%) Any cost incurred that cannot be identified with a direct cost function may be allocated to DA, including supplies and materials, laundry, honoraria, printing, etc.

I (7.66%) Includes laboratory supplies and other costs, though institution I already direct charges many of these costs to research.

VI (5.83%) No limits on types of operating expenses.

VII (5.29%) included in DA.

3. Low at institutions:

X (0.75%), XI (0.59%), and XII (0.83%) Limited to office supplies, certain telephone charges.

Computation of Recommended
Operating Expense Rate

1. Weighted average of component for 12 schools	5.63%
2. Weighted average DA for these schools	19.09%
3. Operating expenses as a % of DA (1 - 2)	29.5%
4. Nationwide average DA	15.4%
5. Expected nationwide operating expenses (3 x 4)	4.5%
6. Weighted average of operating expenses for three "low" schools which restrict the type of operating expenses assigned to DA pool	0.7%
7. Recommended allowance for operating expenses (6 - 5)	15%
8. Recommended rate for 12 schools (7 x 1)	0.85%

Computation of Allocations
from other Pools

1.	Weighted average DA for 12 schools	19.09%
2.	Weighted average of other pools allocated to DA	3.19%
3.	Allocations as a % of remaining DA components ($2 \div [1-2]$)	20%
4.	Recommended rates	
	Deans and department heads	1.65%
	Clerical and technical	3.14
	Operating expenses	.85
		<u>5.64</u>
5.	Recommended rate for allocations (3 x 4)	1.13%

Comparison of Proposal with Negotiated Rates

<u>Institution</u>	<u>DA per Proposal (1)</u>	<u>Negotiated Rate (3)</u>	<u>Difference</u>
I	23.85%	24.80%	0.95%
II	24.51	23.61	(0.90)
III	26.51	22.50	(4.51)
IV	25.26	22.00	(2.76)
V	17.07	19.80	2.73
VI	18.30	19.20	0.90
VII	16.60	16.73 (5)	0.13
VIII	20.60 (3)	15.29 (4)	(5.31)
IX	15.32	14.30	(1.02)
X	11.55	11.55	-
XI	11.21	10.59	(0.62)
XII	6.2	9.0	2.80

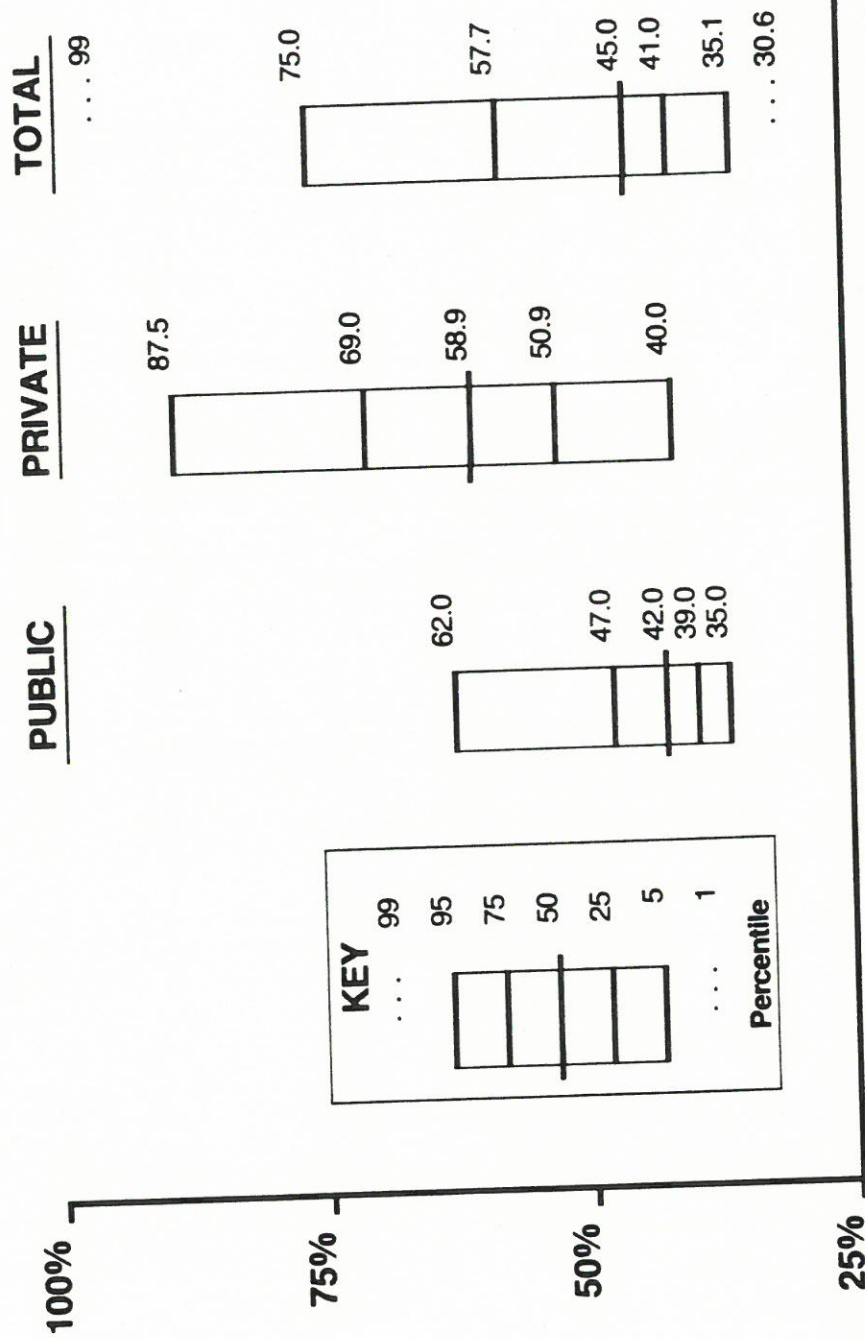
Notes

- (1) Actual results, generally for FY '82 or '83, provided to OIG by the institutions.
- (2) DA component of fixed or negotiated rate, maintained on HHS-DC data base, used in report.
- (3) Sum of components on worksheet prepared by institution and used by OIG.
- (4) DA component per HHS-DC. Institution confirmed a 17.7% rate.
- (5) DA component per HHS-DC. Institution confirmed an 18.5% rate.

Potential Adjustments from Confirmations

	<u>Per OIG</u>	<u>Per Univer- sities</u>
Deans, chairmen, etc.	1.64%	1.41%
Faculty	2.82	2.64
Clerical & technical	5.81	5.96
Operating expenses	5.63	5.95
Allocations	<u>3.19</u>	<u>3.18</u>
TOTAL DA	<u>19.09%</u>	19.14%
Adjustment for DA rates with confirm exceptions		<u>0.51</u>
TOTAL		<u>19.65%</u>

Indirect Cost Rate



Represents: Negotiated rate for fiscal 1985 at 118 major research universities for which Health and Human Services is cognizant

Source: U.S. Department of Health and Human Services

Base (Millions)

TOTAL
... 108

PRIVATE

PUBLIC

\$110

75

50

25

0

65

55

67

27

26

27

15

13

16

8

7

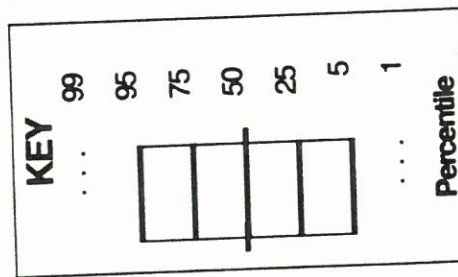
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5

5

5

2



Source: U.S. Department of Health and Human Services