

**Memorandum**

Date APR 23 1993

From Bryan B. Mitchell *Bryan Mitchell*
Principal Deputy Inspector General

Subject Internal Indirect Cost Reviews Performed by Colleges and
Universities (A-01-91-04016)

To Elizabeth M. James
Acting Assistant Secretary
for Management and Budget

Attached are two copies of the Department of Health and Human Services (HHS), Office of Inspector General's (OIG) management advisory report entitled, "Internal Indirect Cost Reviews Performed by Colleges and Universities." The primary objective of our review was to ensure that colleges and universities (schools) adhere to the Office of Management and Budget Circular A-21, Cost Principles for Educational Institutions. As part of our continuing joint effort, OIG and the Assistant Secretary for Management and Budget requested that major schools under HHS' cognizance conduct internal reviews of their current procedures (self scrubs) to ensure that only allowable costs are included in the indirect costs allocated to Federal research.

We found that 193 of the 261 major schools under HHS' cognizance have completed self scrubs as of January 31, 1993, and have identified unallowable costs totaling \$62.9 million. Of the remaining 68 schools, 10 self scrubs were in process and we determined that self scrubs were not required at this time for 58 schools. The unallowable costs of \$62.9 million does not include \$20.4 million identified by HHS OIG during audits at 14 schools. Based on past experience, approximately 10 percent of the total unallowable cost was allocated to Federal research. The withdrawal of these costs from allocations to Federal research reduces indirect cost rates at various schools from one-tenth of 1 percent to as much as 4 percent. We are requesting that you inform us of any significant reductions in Federal dollars attributable to the self scrubs once HHS Division of Cost Allocation (DCA) has finalized new indirect cost rates at the schools so affected.

The schools' self scrubs are only one in a series of our continuing efforts to ensure that the Federal Government pay only its fair share of total research costs, both direct and indirect. Through numerous audits, special initiatives and audit assistance to DCA, the OIG has disclosed millions of

Page 2 - Elizabeth M. James

dollars of unallowable costs included in schools' indirect cost proposals. Currently, we have several audits and surveys underway with reports in process recommending changes in regulations or targeting areas of potential risk. During Fiscal Year 1993 and beyond, we will focus our limited resources on significant issues as we continue our commitment to ensuring that scarce research funds are efficiently utilized.

If you have any questions, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301)443-3582.

To facilitate identification, please refer to Common Identification Number A-01-91-04016 in all correspondence relating to this report.

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**INTERNAL INDIRECT COST REVIEWS
PERFORMED BY COLLEGES AND
UNIVERSITIES**



APRIL 1993 A-01-91-04016

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Principal Deputy Inspector General

Subject Internal Indirect Cost Reviews Performed by Colleges and
Universities (A-01-91-04016)

To Elizabeth M. James
Acting Assistant Secretary
for Management and Budget

The purpose of this management advisory report is to inform you of the results of our joint efforts to have colleges and universities (schools) conduct internal indirect cost reviews. As you know, the Office of Inspector General (OIG) and the Assistant Secretary for Management and Budget (ASMB) are engaged in a continuing effort to ensure that schools adhere to the Office of Management and Budget (OMB) Circular A-21 (A-21), Cost Principles for Educational Institutions. As part of that continuing effort, the OIG and ASMB requested that the largest 119 schools under the Department of Health and Human Services' (HHS) cognizance initiate a process with their own in-house and contracted audit and accounting staff to conduct reviews of their internal procedures (self scrubs) to ensure that only allowable costs are included in the indirect costs allocated to Federal research. The HHS OIG requested that an additional 142 schools under HHS' cognizance perform similar reviews. This report summarizes the results of the self scrubs performed by these schools.

We found that 193 of the 261 major schools under HHS' cognizance have completed self scrubs as of January 31, 1993, and have identified unallowable costs totaling \$62.9 million. Based on past experience, approximately 10 percent of the total unallowable cost would have been allocated to Federal research. The withdrawal of these costs from allocations to Federal research reduces indirect cost rates at various schools from one-tenth of 1 percent to as much as 4 percent. We are requesting that you inform us of any significant reductions in Federal dollars attributable to the self scrubs once HHS' Division of Cost Allocation (DCA) has finalized new indirect cost rates.

BACKGROUND

During Calendar Year (CY) 1991, the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, held hearings which were highly critical of the way major research schools were charging overhead to Federal grants and

contracts. Numerous examples of excessive and unallowable items were presented during the hearings. The General Accounting Office (GAO), Defense Contract Audit Agency, and HHS' OIG and ASMB all testified during the hearings. The GAO had looked at indirect cost charges at 4 major research schools while HHS OIG visited 14 schools.

Our review at 14 schools showed that problems were widespread and systemic in nature. This was the subject of our report entitled, "National Audit of General and Administrative Indirect Costs at Selected Colleges and Universities" (A-01-91-04008). In order to address this problem at the remaining research schools under our cognizance, and to do so quickly and in the most efficient manner, we contacted the Chief Executive Officer at each school by letter and urged that they perform self scrubs. The first letter, issued on April 10, 1991, was signed by both the ASMB and the Inspector General and was sent to the 119 largest schools receiving Federal research funds. That letter urged each school to perform reviews of their internal procedures to ensure that only allowable costs are included in the indirect costs allocated to Federal research. In May 1991, HHS OIG issued a similar letter to an additional 142 schools which received \$300,000 or more in research funds.

The schools' self scrubs are only one in a series of our continuing efforts to ensure that the Federal Government pay only its fair share of total research costs, both direct and indirect. Through numerous audits and special initiatives, we have disclosed millions of dollars of unallowable costs included in schools' indirect cost proposals. For instance, during CY 1991, OIG audits at 14 of the schools receiving letters disclosed unallowable general and administrative costs totaling \$20.4 million, about 10 percent of which was allocated to Federal research programs. We also increased our audit assistance to DCA throughout Fiscal Year (FY) 1991, as we provided audit support during the negotiation process. Through these efforts, we continue to provide timely information to DCA negotiators who in turn negotiate the indirect cost rates proposed by the schools.

The OIG currently has several other audits, special initiatives and surveys underway with reports in process recommending potential changes in regulations or targeting areas of potential risk. During the next several years, we will continue our commitment to ensuring that scarce research funds are efficiently utilized. For instance, during FY 1993, we will focus our resources on significant issues such as: (1) cost containment of rising research costs; (2) the indirect cost reimbursement process; and (3) further revisions to strengthen A-21.

In order to maximize our limited resources most effectively, we will place heavy reliance on nonfederal audits provided through OMB Circular A-133 (A-133), Audits of Institutions of Higher Learning and Other Non-Profit Institutions. Nonfederal audits made in accordance with A-133 provide primary audit coverage and oversight at schools and provide Federal agencies with the information and assurances they require to execute their overall responsibilities.

METHODOLOGY

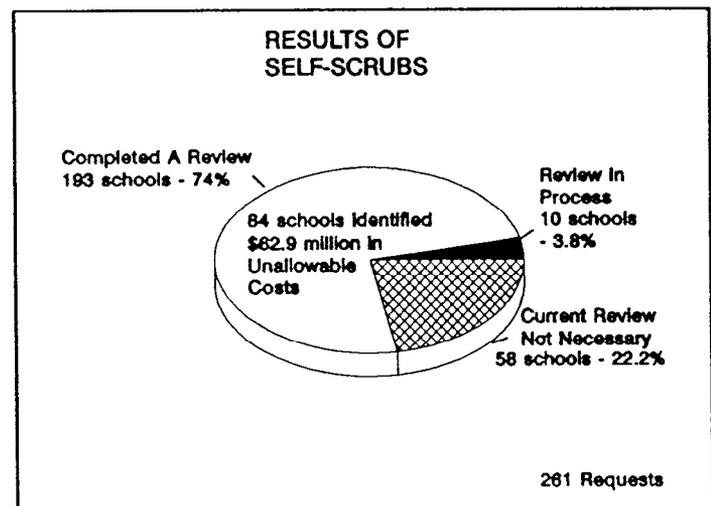
The primary objective of this review was to ensure that schools adhere to A-21, which provides the principles for determining the costs applicable to research and other work performed under federally sponsored agreements. These principles are intended to ensure that the Federal Government pay only its fair share of total costs.

To accomplish this objective, OIG and ASMB, in a joint effort, requested that the largest 119 schools under HHS' cognizance initiate a process with their own in-house and contracted audit and accounting staff to conduct self scrubs to ensure that only allowable costs are included in the indirect costs allocated to Federal research. The HHS OIG requested that an additional 142 schools under HHS' cognizance perform similar reviews.

Throughout this review, we were in constant contact with appropriate school and ASMB officials. Our effort was conducted at all HHS regional offices during the period April 1991 through January 1993. We discussed the status of the schools' self scrubs throughout the course of this review with officials from DCA and ASMB's Office of Grants and Acquisition Management, Division of Cost Policy and Oversight.

RESULTS OF SELF SCRUBS

The great majority of the schools have acknowledged and promptly responded to our requests to review whether there were unallowable costs included in their indirect costs allocated to Federal research programs. We found that 193, or 74 percent, of the schools have completed self scrubs as of January 31, 1993, and



another 10 schools are in the process of completing self scrubs. For those schools which have conducted a self scrub, 84 schools identified and reported \$62.9 million of inappropriate or unallowable costs originally included in their indirect cost allocations to Federal research. (See EXHIBIT I for results of completed scrubs and scrubs in progress.) The withdrawal of these unallowable costs from allocations to Federal research reduces indirect cost rates at various schools from one-tenth of 1 percent to as much as 4 percent. Based on past experience at 14 schools, approximately 10 percent of the total unallowable cost would have been allocated to Federal research.

As of January 31, 1993, there were 10 schools which had reviews in process. Also, there are 58 schools which are not presently performing self scrubs for various reasons such as they receive minimum Federal research support, they have recently been audited or they plan reviews as part of their next indirect cost proposal process. Based on our review of each school's condition and correspondence with appropriate school and ASMB officials, we accept the reasons offered by these schools for not currently performing self scrubs. (See EXHIBIT II for schools which will not conduct a review at this time.)

On March 12, 1993, DCA informed us of some 30 universities which have issued cash refunds to DCA totaling over \$4 million for unallowable costs which these schools identified through their self scrubs. Generally, we are encouraged by the level of the schools' efforts. Although every school which identified unallowable costs did not provide us with specifics, some schools did provide details of unallowable costs disclosed through their scrubs. For example:

- o ENTERTAINMENT RELATED COSTS - Numerous schools identified unallowable costs pertaining to entertainment related activities, including charges for alcoholic beverages, meals, catering services, football "brunches" and tickets to sporting events.
- o MISCELLANEOUS EXPENSES - Several schools disclosed unallowable miscellaneous costs such as prizes and awards, parking fines, the purchase of rare books and greeting cards.
- o HOUSING AND PERSONAL LIVING EXPENSES - A number of schools reported unallowable housing and personal living expenses, including the costs of maintaining and furnishing the homes of schools' presidents.

- o STUDENT ACTIVITIES - Certain schools identified unallowable costs relating to student activities, such as costs associated with student busing, graduation exercises, and student administration.

The schools routinely identified other categories of unallowable costs without providing specifics, including costs pertaining to advertising and public relations, fund raising and investment management, dues and memberships, trustees and alumni activities, lobbying, and unallowable travel.

The above examples are similar in nature to the examples provided as a result of OIG audits conducted at 14 schools as discussed in our January 28, 1992 report entitled, "National Audit of General and Administrative Indirect Costs at Selected Colleges and Universities" (A-01-91-04008). The self scrubs provide additional evidence as to the systemic problems we identified and the necessity of implementing our recommendations in the National report. These recommendations are set forth again as an APPENDIX to this report.

CONCLUSION

We believe that the collaborative oversight efforts of Federal representatives and the academic community are necessary to reduce ambiguities, arbitrary interpretations, and misconceptions and to enhance the future acceptance and support of the indirect cost system. School officials' awareness of issues surrounding the identification, charging, and recovery of indirect costs in support of federally sponsored research has already been advanced through increased Federal oversight and through recent changes in A-21. The prospective success of the indirect cost system, however, is contingent on the full implementation of A-133, and diligent Federal and internal monitoring of school procedures for claiming indirect cost reimbursement. Accordingly, we will continue to maintain an audit presence at schools to supplement the A-133 audits performed by nonfederal auditors. Where indicated in the results of such work, we may also require that schools perform additional self scrubs in the future.

We are requesting that you inform us of any significant Federal dollars attributable to the self scrubs once DCA has finalized new indirect cost rates at those schools where reductions are necessary.

If you have any questions, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301)443-3582.

EXHIBITS

SUMMARY OF SCHOOLS HAVING COMPLETED OR WILL
COMPLETE INTERNAL INDIRECT COST REVIEWS

<u>SCHOOLS</u>	<u>UNALLOWABLE COSTS REPORTED (A)</u>	<u>REPORTED REDUCTION OF INDIRECT COST RATE</u>
<u>Region I</u>		
University of Vermont	\$ 555,653	2.1%
Harvard University (Medical School)	\$ 240,000	1.3%
University of Massachusetts	\$ 177,790	-
Tufts University	\$ 650,062	-
Boston University	\$ 4,771,584	0.6%
University of Maine	\$ 26,940	0.1%
University of Connecticut	\$ 27,000	-
Boston College	-	-
Worcester Poly Technology	\$ 7,391	-
Clark University	\$ 44,364	4.0%
University of New Hampshire	\$ 0	-
University of Lowell	-	-
Brandeis University	\$ 469,314	0.75%
Northeastern University	\$ 85,760	-
Dartmouth College	\$ 98,881(B)	-
<u>Region II</u>		
Rensselaer Polytechnic Institute	\$ 154,045	0.14%
State University of New York (includes 6 schools)	\$ 5,763,282	-
New Jersey University of Medicine and Dentistry	\$ 4,100,000	-
Rutgers University	\$ 5,551,000(B)	1.41%
Rockefeller University	\$ 1,260,000	2.01%
New York University	\$ 394,208	-
New York University Medical Center	\$ 164,089	-
New York Medical College	\$ 134,528	-
Mount Sinai School of Medicine	\$ 2,646	-
Yeshiva University (in process)	-	-
University of Puerto Rico (5 in process)	-	-
<u>Region III</u>		
Hampton University	\$ 0	-
Gallaudet University	\$ 0	-
Bryn Mawr College	-	-
University of Maryland, University College	\$ 0	-
University of Maryland Eastern Shore	\$ 0	-
Franklin and Marshall College	\$ 267,003	0.3%
Medical College of Hampton Road	\$ 0	-
Slippery Rock University	-	-
West Virginia School of Osteopathic Medicine	\$ 0	-
George Washington University	\$ 20,000	-
University of Delaware	\$ 37,012	0.25%
University of Maryland	-	-

SUMMARY OF SCHOOLS HAVING COMPLETED OR WILL COMPLETE INTERNAL INDIRECT COST REVIEWS

SCHOOLS	UNALLOWABLE COSTS REPORTED (A)	REPORTED REDUCTION OF INDIRECT COST RATE
<u>Region III (Continued)</u>		
Virginia Commonwealth University	\$ 29,635	-
Thomas Jefferson University	-	2.0%
Lehigh University	0	-
Howard University	-	-
George Mason University	0	-
James Madison University	0	-
West Chester University	0	-
Bucknell University	0	-
Morgan State University	0	-
Towson State University	0	-
Allegheny College	0	-
Pennsylvania College of Optometry	0	-
Haverford College	0	-
Virginia Polytechnic Institute	\$ 224,100	0.45%
University of Virginia	\$ 260,584	0.16%
Temple University	-	-
Medical College of Pennsylvania	-	-
Hahnemann University	0	-
West Virginia University	0	-
University of Richmond	0	-
Washington School of Psychiatry	0	-
Eastern Virginia Medical School	0	-
Virginia State University	0	-
Marshall University	0	-
Korfolk State University	0	-
Old Dominion University	0	-
Pennsylvania College of Podiatric Medicine	0	-
University of Scranton	\$ 4,398,672	-
Georgetown University	\$ 558,417	2.25%
University of Maryland, Baltimore County	-	-
Delaware State University (in process)	-	-
<u>Region IV</u>		
North Carolina State	\$ 270,573	-
University of North Carolina	\$ 18,014	-
University of Alabama, Birmingham	\$ 0	-
Vanderbilt University	\$ 2,739,992	2.9%
Medical University of South Carolina	\$ 0	-
University of Georgia	\$ 0	-
University of Kentucky	-	-
Medical College of Georgia	\$ 0	-
University of South Carolina	-	-

SUMMARY OF SCHOOLS HAVING COMPLETED OR WILL COMPLETE INTERNAL INDIRECT COST REVIEWS

SCHOOLS	UNALLOWABLE COSTS REPORTED (A)	REPORTED REDUCTION OF INDIRECT COST RATE
<u>Region IV (Continued)</u>		
University of Mississippi Medical Center	\$ 0	-
Florida State University	\$ 161,507	-
University of Tennessee, Knoxville	\$ 0	-
University of Louisville	\$ 231,931	-
University of North Carolina, Charlotte	\$ 0	-
University of Alabama, Tuscaloosa	\$ 165,150	-
Florida Atlantic University	\$ 0	-
East Carolina University	\$ 0	-
Memphis State University	\$ 30,873	-
Kentucky State University	\$ 0	-
North Carolina Agricultural & Technical State University	\$ 53,317	-
Middle Tennessee State University	\$ 0	-
University of Tennessee, Chattanooga	\$ 0	-
Florida International University	\$ 38,115	-
Albany State College	\$ 0	-
University of Florida	\$ 0	-
University of Alabama, Huntsville	\$ 36,653	-
University of South Alabama	\$ 0	-
Auburn University	\$ 0	-
University of North Carolina, Greensboro	\$ 16,650	-
Bowman Gray School of Medicine	\$ 407,100	-
Wake Forest University	\$ 161,904	0.7%
Florida Institute of Technology	\$ 15,714	-
Clark Atlanta University	\$ 0	-
Clemson University	\$ 0	-
University of Tennessee, Memphis	\$ 1,557	-
Mississippi State University	\$ 2,148,920	1.8%
Florida A&M University	\$ 0	-
East Tennessee State University	\$ 0	-
Alcorn State University	\$ 0	-
Jackson State University	\$ 0	-
Mississippi Valley State University	\$ 0	-
Fisk University	\$ 0	-
Central Florida University	\$ 0	-
Fort Valley State College	\$ 0	-
Morehouse School of Medicine (in process)	-	-
Morehouse College (in process)	-	-
<u>Region V</u>		
Northwestern University	\$ 0	-
Michigan State University	\$ 400,000	-
University of Chicago	\$ 479,659(B)	0.3%

SUMMARY OF SCHOOLS HAVING COMPLETED OR WILL COMPLETE INTERNAL INDIRECT COST REVIEWS

SCHOOLS	UNALLOWABLE COSTS REPORTED (A)	REPORTED REDUCTION OF INDIRECT COST RATE
<u>Region V (continued)</u>		
Wayne State University	-	-
Ohio State University	-	0.1%
Purdue University	-	0.3%
Medical College of Wisconsin	\$ 135,427	-
Indiana University	-	-
Oakland University	\$ 10,600,000(C)	1.6%
University of Wisconsin (2 schools)	\$ 672,546	-
University of Minnesota	\$ 2,270,172	-
Case Western Reserve University	\$ 481,332	-
University of Cincinnati	\$ 0	-
Michigan Technological University	\$ 0	-
Loyola University	\$ 0	-
Illinois Institute of Technology	\$ 0	-
University of Michigan	\$ 0	-
<u>Region VI</u>		
University of Arkansas	\$ 0	-
University of Arkansas for Medical Science	\$ 271,099	-
University of New Mexico	\$ 452,000	-
Rice University	\$ 0	-
Texas A&M University System	\$ 0	-
Southern Methodist University	\$ 0	-
University of Texas, Austin	\$ 344,179	-
Oklahoma State University	-	-
University of Oklahoma	\$ 0	-
Baylor College of Medicine	\$ 0	-
Texas Tech University	\$ 354,103	-
University of Houston	\$ 335,489	-
University of Texas System	\$ 701,183	-
University of Texas Medical Branch-Galveston	\$ 98,793	-
University of Texas - San Antonio Health Science Center	\$ 154,736	-
University of Texas - El Paso	\$ 35,210	-
University of Texas, Health Science Center Houston	\$ 68,265	-
<u>Region VII</u>		
Iowa State University	\$ 578,547	-
Kansas State University	\$ 29,852	-
University of Kansas	\$ 29,489	-
University of Kansas Medical Center	-	0.4%
University of Nebraska	-	0.3%
University of Nebraska Medical Center	\$ 15,603	-
University of North Dakota	\$ 0	-

SUMMARY OF SCHOOLS HAVING COMPLETED OR WILL COMPLETE INTERNAL INDIRECT COST REVIEWS

SCHOOLS	UNALLOWABLE COSTS REPORTED (A)	REPORTED REDUCTION OF INDIRECT COST RATE
Region VII (Continued)		
University of Colorado, Boulder	\$ 570,222	-
University of Colorado Health Science Center	\$ 626,919	0.4%
Washington University	\$ 2,231,200(B)	-
St. Louis University	\$ 70,474	-
Creighton University	0	-
Colorado State University	\$ 288,000	-
North Dakota State University	\$ 0	-
University of Utah	\$ 6,222	-
Montana State University	\$ 0	-
University of Iowa	\$ 176,960	-
University of Wyoming (in process)	-	-
Region IX		
Arizona State University	-	-
University of Arizona	\$ 106,218	-
University of Washington	\$ 110,000	0.1%
University of Southern California	\$ 3,112,150(B)	0.6%
University of California, Oakland	-	-
University of California, Berkeley	-	-
University of California, Davis	-	-
University of California, Irvine	-	-
University of California, Los Angeles	-	-
University of California, Riverside	-	-
University of California, San Diego	-	-
University of California, San Francisco	-	-
University of California, Santa Barbara	-	-
University of California, Santa Cruz	-	-
California State University, Northridge	-	-
California State University, Long Beach	-	-
University of Nevada, Las Vegas	-	-
University of Idaho	-	-
Oregon State University System	\$ 0	-
California St. University, Chico	-	-
California St. University, Los Angeles	-	-
California St. University, Fresno	-	-
California St. University, Sacramento	\$ 100,000	0.1%
University of Nevada, Reno	-	-
Loma Linda University	\$ 0	-
Washington State University	\$ 56,897	-
TOTAL UNALLOWABLE COSTS IDENTIFIED BY SCHOOLS AUDITED BY OIG:	\$11,472,890(B)	
TOTAL UNALLOWABLE COSTS IDENTIFIED BY SCHOOLS NOT AUDITED BY OIG:	51,461,786	
TOTAL UNALLOWABLE COSTS IDENTIFIED:	\$62,934,676(D)	

Notes:

- (A) All unallowable costs and reduction of indirect cost rates identified are the representations of the schools.
- (B) Four schools conducted internal reviews and identified unallowable costs of \$11,374,009 prior to the start of the OIG's NATIONAL AUDIT OF GENERAL AND ADMINISTRATIVE INDIRECT COSTS AT SELECTED COLLEGES AND UNIVERSITIES (CIN: A-01-91-04008) and one school conducted an internal review during the OIG audit and identified unallowable costs of \$98,881.
- (C) Unallowable costs identified by Wisconsin Legislative Audit Bureau.
- (D) Not all unallowable costs were submitted in Indirect Cost Proposals as several schools identified unallowable costs through a screening and scrubbing process prior to preparing the Indirect Cost Proposal.

SUMMARY OF SCHOOLS WHICH WILL NOT PERFORM
INTERNAL INDIRECT COST REVIEWS

SCHOOLS

Mercer University
University of Tennessee System
Philadelphia College of Osteopathic Medicine
University of Arkansas, Little Rock
University of Houston, Clear Lake
Lincoln University
Loyola College of Maryland
Tuskegee Institute
University of Arkansas - Pine Bluff
University of Texas - Arlington
University of Texas - San Antonio
North Carolina Central University
South Carolina State College
University of Colorado

REASON FOR NOT PERFORMING A REVIEW

School certified that the most recent ICP was in compliance with A-21
School certified that the most recent ICP was in compliance with A-21
School uses short form to report indirect costs
Administrative office of Colorado System (See EXHIBIT 1 - Colorado, Boulder)

A TOTAL OF 58 SCHOOLS WILL NOT PERFORM A REVIEW

APPENDIX

APPENDIX

OIG RECOMMENDATIONS FROM
NATIONAL AUDIT OF GENERAL AND ADMINISTRATIVE INDIRECT COSTS AT
SELECTED COLLEGES AND UNIVERSITIES (A-01-91-04008)

- I. The ASMB work with OMB to further modernize A-21 by including provisions to: (1) make all trustee related expenses unallowable; (2) provide examples of unallowable miscellaneous expenses; (3) include the same definitions of allowable and allocable costs as the Federal Acquisition Regulation; and (4) clarify when costs are necessary for the overall operation of the institution and when they benefit organized research.
- II. The ASMB work with OMB to further modernize A-21 by including provisions to: (1) clarify when recreational activities become unallowable entertainment; (2) include a comprehensive list of other institutional activities and student activities which are considered to be unallowable; and (3) specify that unallowable fines and penalties include interest on such.
- III. The ASMB continue to work closely with the schools to provide assistance whenever possible regarding the clarification and the implementation of A-21.
- IV. The ASMB appropriately implement the 26 percent cap on administrative costs and adjust the previously negotiated indirect cost rates for the schools and calculate a refund as appropriate under A-21.