REVIEW GUIDE

FOR

LONG-FORM UNIVERSITY

FACILITIES & ADMINISTRATIVE COST PROPOSALS

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
PROGRAM SUPPORT CENTER
DIVISION OF COST ALLOCATION
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LONG FORM UNIVERSITY

F&A COST RATE PROPOSALS

I. INTRODUCTION

This review guide was developed to assist Division of Cost Allocation (DCA) staff in reviewing and negotiating Facilities and Administrative (F&A) cost proposals for universities and colleges. The guide presents a number of ideas, facts and concerns that should be considered during the review of F&A cost proposals. Alternative approaches and allocation methods, including their strong and weak points are presented and discussed in detail. The guide also presents a description of special cost studies, which vary from the standard cost distribution methods prescribed in the applicable Federal Cost Principles. While this guide is reasonably detailed and comprehensive, it is not intended to be a substitute for professional experience and judgment.

The Office of Management and Budget (OMB) issues cost principles for all Federal agencies that sponsor research, training and other work at institutions of higher education. OMB Circular A-21 establishes principles for determining costs applicable to grants and contracts with educational institutions. In general, the Circular identifies or defines the major functions of a university, the F&A cost pools, the allowability of selected items of cost and standard allocation methods. There have been several revisions to the Circular since its inception in 1958. Prior to 1979, the Circular permitted considerable flexibility in the allocation of costs. That flexibility sometimes allowed manipulation for purposes not originally intended. On March 6, 1979, OMB revised Circular A-21 with many significant and broad changes, although the general concept that the Federal government bear its fair share of total costs, determined in accordance with generally accepted accounting principles, was not changed. On December 11, 1979, the Department's Office of Grant and Contract Financial Management issued interpretations (Questions and Answers) of the revised Circular. These interpretations were widely disseminated to the university community and are considered Department policy, to the extent that they have not been superseded. DCA staff should therefore be familiar with the interpretations. The Circular was again revised on August 3, 1982, to modify the procedures for allocating salary costs and allow interest costs on buildings and equipment acquired or completed on or after July 1, 1982. On December 2, 1986, OMB again revised Circular A-21 to establish a fixed allowance on the reimbursement of costs associated with the administrative activities of academic department heads, faculty and other professional research and instructional staff. This fixed allowance was a departure from the Circular's normal cost reimbursement concepts.

The 1991 Congressional hearings on university F&A costs resulted in a major revision to OMB A-21 in October 1991. Additional unallowable costs were specified and provision was made for refunds to the Federal Government for unallowable costs which were included in prior F&A cost rates. Also, a cap on administrative costs (General Administration, Departmental Administration and Sponsored Projects Administration) was imposed. These costs were limited to 26 percent of MTDC for all grantee fiscal years after October 1, 1991. Further, grantees could not change their accounting or cost allocation methods, which were in use at May 1, 1991, if such a change would shift costs from capped pools to uncapped pools or from F&A to direct costs. Provisions were made for grantees to petition their cognizant agencies for exceptions to this requirement. Also, the revisions specified that costs assignable to activities sponsored by industry, foreign governments or other sponsors shall not be shifted to Federally sponsored agreements. A requirement was made that the largest 99 grantees in terms of Federal research dollars would have to expend currently or reserve for expenditure within five years the portion of F&A cost payments made for depreciation or use allowances under sponsored research agreements to acquire or improve research facilities. Finally, grantees were required to provide a certification with each proposal that the proposal has been reviewed and is in compliance with OMB A-21.

Another major revision to OMB A-21 was made in July 1993. This resulted, in part, from the recommendations of an HHS F&A cost study which was conducted by personnel from the OGCFM, the OIG and the NIH. Two major F&A cost categories were defined; Administration (General Administration, Departmental Administration, Sponsored Projects Administration, Student Services, and any other categories not defined as Facilities costs) and Facilities (Depreciation and Use Allowances, Operations and Maintenance, Interest and Libraries). The administrative cap of 26 percent was now inclusive of Student Services costs. The definition of University Research was modified so that University Research has to be combined with Sponsored Research under Organized Research, eliminating potential mismatching of pool and base costs. The predominant use methodology for allocating space related costs was eliminated and a new method for allocating joint use space was implemented. An alternative method for administrative costs was provided. Under this method, a grantee may elect to take a rate which is the lesser of 24 percent or 95 percent of the total rate for their Administrative components, with only minimal documentation in support of the Administrative components. The threshold for use of the simplified "short-form" methodology was raised from $3 million to $10 million. Also, the MTDC distribution base was defined, the use of multiple year predetermined rates was stated as the preferred methodology and additional language was incorporated to better define General Administration, Departmental Administration and Operations and Maintenance. Finally, there was new language with regard to allocation and documentation standards, consistency, medical liability insurance and tuition remission.

Educational institutions were made subject to four Cost Accounting Standards, effective January 1995, per a Final Rule published in the Federal Register in November 1994. The four Cost Accounting Standards are (1) consistency in estimating, accumulating and reporting costs, (2) consistency in allocating costs incurred for the same purposes, (3) accounting for unallowable costs and (4) consistency in the selection and use of a cost accounting period.

In May 1996, OMB A-21 was revised again. The four Cost Accounting Standards were incorporated in the Circular along with the associated administrative requirements promulgated by the Cost Accounting Standards Board. In addition, major institutions (those that receive aggregate sponsored agreements totaling $25 million or more subject to OMB Circular A-21 during the most recently completed fiscal year) were required to file a Disclosure Statement (DS-2) explaining their cost accounting practices. The term “indirect costs” was replaced by the term “Facilities and Administrative (F&A) costs”. Special cost analysis studies for libraries, student services and utility costs were eliminated effective July 1, 1998, although special cost analysis studies for libraries were subsequently reinstated. A new requirement was made for funding agencies to use F&A rates in effect at the time of an initial award throughout the life (competitive segment) of the sponsored agreement. OMB Circular A-88 was rescinded and cognizance for negotiations / audits was established through Circular A-21. Dependent tuition benefits were eliminated as allowable expenses. The HHS interpretation for conversion from use allowance to depreciation was incorporated in the Circular. The definition of capital equipment was amended by increasing the capitalization threshold to the lesser of the amount used for financial statement purposes or $5,000. Also, useful life for capital equipment was defined as one year or more. Finally, new provisions were incorporated related to interest expenses. A lease / purchase analysis was required for facilities costing over $500,000 and a cash flow analysis was required for debt arrangements over $1 million, unless the institution used at least 25 percent equity financing.

Another major revision to OMB A-21 was made in June 1998. A provision for the review of the reasonableness of the costs of large research facilities was incorporated. A Utility Cost Adjustment (UCA) of 1.3 percent was provided in lieu of the special utility cost studies for institutions that had used such studies in negotiating their most recent F&A rates. Criteria was specified to provide guidelines under which the salaries of administrative and clerical staff may be treated as direct costs. Also, a new option was provided for the computation of F&A rates under the simplified (“short-form”) method using a modified total direct cost base. The language on depreciation was modified to require that the depreciation methods used to calculate the depreciation amounts for F&A rate purposes shall be the same methods used by the institution for its financial statements. Also, additional requirements were made for institutions choosing to use the building componentization methodology for depreciating buildings. The language on use allowance was changed to limit the recovery of costs to the acquisition costs of the assets. Also, a provision was added to recognize the gains / losses on the final disposition of depreciable property. Finally, travel and subsistence costs of trustees were made allowable.

OMB approved a standard format for submission of long-form F&A proposals in August 2000. This is incorporated in OMB A-21 as Appendix C.

F&A costs are those expenses that benefit common activities and therefore cannot be readily assigned to a specific cost objective or project. At educational institutions such costs are classified in the following categories: (1) Building and Equipment Depreciation/Use Allowances; (2) Operation and Maintenance expenses (including utility expenses); (3) Interest expenses; (4) General Administration and General expenses; (5) Departmental Administration expenses; (6) Sponsored Projects Administration expenses; (7) Library expenses, and; (8) Student Administration and Services. F&A costs are apportioned between research and the other major functions of a university, such as Instruction, Other Sponsored Activities and Other Institutional Activities, based on various allocation procedures prescribed in A-21. That portion of F&A costs identified with research is then further distributed to individual research projects by an F&A cost rate(s). Where necessary, an F&A cost rate is also established for the instruction function and for "Other Sponsored Programs". The preparation of an F&A cost proposal and the maintenance of its subsystems is a significant undertaking, and at many large institutions requires the efforts of a full-time staff for the entire year and in some instances involves the assistance of specialized consultants. The importance placed upon the development of a comprehensive F&A cost proposal, including the development of special costing studies and the use of specialized consultants, affects the time and degree of sophistication required by DCA staff to effectively evaluate the cost proposal and related documentation.

The decision that a cost proposal needs a more in-depth review and analysis by the DCA (including the need for team reviews) will be influenced by (a) deviation from the standard allocation methods prescribed in A-21, (b) use of specialized costing studies, (c) use of specialized consultants, (d) excessive costs assigned to research compared to the regional or national norm, (e) inadequate university documentation of the cost proposal, (f) overall level of the proposed rate, (g) total dollars at risk and (h) rate trends.

II. PRELIMINARY REVIEW

A. GENERAL REVIEW

STEPS	COMMENTS
1. Determine whether the proposal package is complete, in sufficient detail to permit an adequate review, and is in a format that can be readily followed by the DCA.	The proposal package should include: ! The proposal itself, submitted in the Standard Format prescribed in A-21 Appendix C, including detailed schedules on the composition and allocation of each F&A cost pool, and subpools as applicable. ! Audited financial statements. ! A detailed and understandable reconciliation between the proposal and financial statements, showing and explaining each reclassification and adjustment to the financial statement accounts. ! An explanation of any significant increases in individual rate components (e.g., a proposed rate component that is more than 10 percent higher than the level negotiated for the prior year and the component is at least 10 points on the rate). ! Any information specifically requested by the DCA in prior agreements.

STEPS	COMMENTS
	! A certificate of F&A costs, in accordance with A-21 Section K.2., certifying that the proposal has been reviewed and that the costs are allowable and allocable.
	! An assurance statement that the grantee has complied with A-21 Section J.12.f which requires that an amount equal to the Federal reimbursement for depreciation and use allowances has been expended or reserved for expenditures to acquire or improve research facilities. (This assurance statement is only required for the institutions listed in A-21 Exhibit A).
	! A-133 audit report for the base year of the proposal. If not available, the most recent A-133 audit report should be requested. The A-133 audit report may have findings with regard to internal controls, systems deficiencies, etc.
	! Methodologies and results for deviations from standard methods prescribed in A-21.
	! The methodology and results of any review for unallowable/unallocable costs.
2. Review the prior negotiation workpapers and determine the following:	
a. When was the last on-site review conducted?	

STEPS	COMMENTS
b. When was the last time the institution's F&A cost proposal was audited and what were the results of the audit?	If a recent proposal was audited, were there any findings not fully sustained? If so, review the negotiator's rationale and determine if the same situation still exists.
c. What problems were found and adjustments made in prior negotiations? Were corrections made in the current proposal?	If the corrections were not made, appropriate adjustments should be made to the current proposal.
d. Were fringe benefit, off-campus or other special rates negotiated?	
e. Disclosure Statements required by Cost Accounting Standards Board, if applicable.	
f. Has the University complied with all conditions of any advance agreements?	
g. If fixed rates were negotiated, does the carry-forward amount in the current proposal agree with the prior written carry-forward agreement?	
3. Identify any aspects of the proposal which appear out-of-line and are not fully explained or discussed in the proposal package or the prior years' workpaper files.	
4. Determine the areas of the proposal that appear to require an in-depth review and/or an on-site review.	On-site reviews are usually needed to evaluate F&A cost proposals from major institutions.

STEPS	COMMENTS
5. Determine whether an audit of the proposal is needed.	As a general rule, an audit of an F&A cost proposal should be requested only where there are very large amounts involved and there appear to be serious problems with the proposal. If an audit is requested, the request should indicate the specific area(s) of the proposal the audit should cover. Also, to the extent possible, the negotiator should work closely with the auditors in planning and conducting the audit.
6. Determine whether the institution is proposing any rate increases beyond the rate based on historical costs of the base year.	Proposals which include rate components based on projected costs usually demand significantly more detailed review. The most common situation where this may occur would be where the University is in the process of new facility construction or major renovations, or plans such construction or renovations in the near future. Guidelines for evaluating the interest expense associated with these facilities are in Section IV. Some institutions may also propose general "inflation" adjustments to the rates. These types of adjustments should not be accepted since inflation affects both the F&A costs pools and the direct cost bases, and should, therefore, not cause an increase in the rates. Rate increases based on projected costs should be scrutinized very carefully, and should be accepted only where there is clear documented evidence that a specific event will occur (such as the construction of a major new facility) that will increase the rate. Also, when evaluating these proposed increases, any offsetting factors that may cause rate decreases also

STEPS	COMMENTS
	need to be carefully evaluated (e.g., base increases, lower utility or maintenance costs related to new buildings, etc.). Additionally, any proposed increases must be submitted as part of the institution's proposal, or at least well in advance of the negotiation. They should not be considered if they are raised for the first time at the negotiation conference.
7. Determine whether off-campus or other special indirect cost rates are needed.	If these rates were established in the past, they will likely also be needed in the future. Also, information provided by agency grant or contract offices may indicate a need for a special rate.
8. Determine the treatment of fringe benefits.	See Section XII.A.
9. In accordance with A-21, G.8.a., the administrative costs charged to sponsored agreements shall be limited to 26% of MTDC for the total of GA, DA, SPA, and SSA. Determine whether the institution has properly implemented the administrative cap.	
10. Section G.9. of A-21 provides an alternative method for administrative costs whereby the institution may claim a fixed allowance for the "Administration" portion of F&A costs provided there have not been certain accounting or cost allocation changes. The allowance claimed could be either 24% of MTDC, or a percentage equal to 95% of the most recently negotiated fixed or predetermined rate for the administrative cost pools, whichever is less.	

B. RECONCILIATION OF COST PROPOSAL TO FINANCIAL STATEMENTS

It cannot be emphasized too strongly how important it is for the negotiator to review the university's reconciliation of the F&A cost proposal to the audited financial statements. This process is essential to the negotiation and must be completed on each proposal. The reconciliation process will provide insight into the university's organizational structure, accounting system and costing methodologies that is essential to the proposal review process. The reconciliation should be completed by the university and submitted with its proposal as required by the A-21 Standard Format. If the university has not completed the reconciliation, it should be notified immediately to do so. It may be necessary to defer the processing of the proposal until the reconciliation has been completed by the university.

STEPS	COMMENTS
1. Evaluate the adequacy of the institution's reconciliation of the proposal to the audited financial statements.	The first step is to reconcile total costs, both allowable and unallowable, to the total costs shown on the audited financial statement. This includes both restricted and unrestricted accounts and should provide a reconciliation of individual cost pools and direct cost bases, such as General Administration and General Expenses (G&A), Operations and Maintenance (O&M), Instruction, Organized Research, etc., to the financial statements. In some cases, costs shown on the audited financial statement may include organizations that are not subject to the F&A cost rate computation. For example, many universities have affiliated hospitals. In these cases it may be necessary to exclude all costs not pertaining to the particular organization under review. However, if the affiliated organization is receiving a service or benefit from the university, the associated costs must be assigned to that organization.

STEPS	COMMENTS
2. Analyze other supporting schedules used in the reconciliation process other than the audited financial statement.	There are many subsidiary schedules included as part of the reconciliation process. Frequently, a State university is part of a larger State system. In these cases the negotiator must review the applicable central administration cost distribution schedules for reconciliation purposes.
3. Once the negotiator is assured that the total costs, direct and F&A, included in the F&A cost proposal agree with the audited financial statements, analyze the adjustments for unallowable and extraneous costs that should be excluded from the proposal, and those that should be allocated their share of F&A costs.	This step takes place prior to the step-down schedule. The negotiator must be careful that only costs that should not be burdened with F&A costs are deleted from the rate computation. Frequently, the university will eliminate functions that should receive an allocation of G&A, O&M or other F&A costs (e.g., fund raising, services to outside organizations, etc.). Another frequent error is to delete all subcontract costs, rather than amounts over $25,000 or to delete costs associated with a medical practice plan (see Section XII.C. for further discussion of medical practice plans). In any case, the negotiator must be very careful to assure that these eliminations are appropriate.
4. Analyze and verify the accuracy and necessity for adjustments and reclassifications.	The negotiator must understand every substantial reclassification and why it is taking place. Understanding this process is an important part of the review of the cost proposal. Unallowable and unallocable costs (e.g., bad debts, scholarships, etc.) should always be eliminated from the F&A cost pools before the pools are allocated. However, unallowable activities should be reclassified to "other institutional activities" and receive their proper allocation of F&A costs based on benefits received (e.g., fund raising, public relations, alumni activities, etc.).

C. REVIEW OF DIRECT COST BASE

STEPS	COMMENTS
1. Analyze and verify the accuracy of the costs assigned to each functional direct cost base.	The primary schedule used in the review of the university's base is the summary of reclassifications and adjustments. Once costs in the financial statements have been reconciled to the cost categories of the proposal the analysis of the base is usually the next step.
2. Verify that all costs for each function have been included in the rate computation.	The following is a list of activities which normally benefit from F&A costs: Unrestricted funds, such as Instruction and University-funded research (commonly called Departmental Research). See DA Section. Restricted funds, such as Sponsored Research, and activities supported by private grants, gifts, endowments, etc. Voluntary services (e.g., voluntary faculty at medical schools). Cost sharing and matching. Unallowable activities, such as fund raising, public relations, alumni activities, etc.

STEPS	COMMENTS
	Other Institutional Activities (Auxiliary Operations) such as dormitories, athletic stadiums, bookstores, dairy farms, food services, etc. Projects performed by other organizations but performed on the university's premises and utilizing university services. Outside users of the institution's services.
3. Analyze all functional base adjustments and determine the appropriateness of each adjustment. Does the final distribution base conform to the MTDC base in Circular A-21? Does the proposal clearly state and define the exclusions from the base?	A-21 Section G.2. states that modified total direct costs consist of all salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant and subcontract (regardless of the period covered by the subgrant or subcontract). Equipment, capital expenditures, charges for patient care and tuition remission, rental costs, scholarships, and fellowships as well as the portion of each subgrant and subcontract in excess of $25,000 shall be excluded from modified total direct costs. Other items may only be excluded where necessary to avoid a serious inequity in the distribution of F&A costs. The exclusion for rental costs relates to building rental costs, not equipment rental costs.

STEPS

4. Determine that the university has accurately identified and included all cost sharing in the organized research direct cost base. (See XII.f.)

COMMENTS

Although most mandatory cost sharing requirements have been eliminated, there still is a widespread belief among faculty members that a high degree of committed cost sharing insures favorable review of research project proposals by Federal awarding agencies. The negotiator must examine and ensure that all cost sharing, both mandatory and voluntary committed, has been included in the direct cost base. The negotiator should obtain copies of institution's cost sharing policies. The university may try to argue that cost sharing is negligible or has significantly decreased now that records documenting cost sharing are not required. This is not likely to be the case. The negotiator may need to interview faculty members to determine a reasonable amount of cost sharing to be included in the base. During this interview process, the negotiator should review the budget documents of all awards on which the faculty member is working. This should include all submitted contract proposals and grant applications and supporting backup. This information tells the negotiator how much cost sharing the faculty member committed to, when applying for the award. The negotiator should determine if the committed cost sharing amount is higher or lower than the reported amount. If the reported amount is significantly lower, this may be indicative of an understatement of the base.

If cost shared research effort is not included in the Organized Research base, then the space costs associated with this effort should not be allocated to

STEPS	COMMENTS
	Organized Research. It is essential that there is consistency between the classification of space and the classification of the users of the space.
5. Verify that research training is consistently treated.	Research Training is an external funded award, almost always Federal, that can be classified as either Research or Instruction. Even though Research Training cost can be classified as Research or Instruction, it is necessary that consistency exist between the base and the assigned F&A costs. It would not be appropriate, for example, for Research Training to be classified as Instruction, but the space where the training takes place to be classified as Research space. An F&A cost rate can easily be inflated if Research Training is not consistently treated.
6. Identify other areas of inconsistency.	There are other areas of inconsistency, but the impact on the research F&A cost rate is usually not as significant. The primary areas are fringe benefits and subcontract costs and the differences between on-campus and off-campus charges. For example, a university may apply the negotiated rate to subcontracts when subcontract costs, even the first $25,000, are not included in the base. Usually these errors are infrequent but they do occur and should be reviewed.
	University Research refers to all research and development activities that are separately budgeted and accounted for by the institution under an internal application of institutional funds. University Research must be combined with Sponsored Research under

STEPS	COMMENTS
	Organized Research for allocation of F&A costs. This should eliminate a potential inconsistency in matching pool and base costs.

D. TREND ANALYSIS

A trend analysis of the university's F&A cost rates, rate components, cost pools, direct cost bases and other factors should be performed during the preliminary review of each long form university cost proposal. A trend analysis can be completed in a short period of time and frequently provides the negotiator with an insight into the direction the university's F&A cost rates are headed and areas where a detailed review is necessary.

STEPS	COMMENTS
1. Complete a detailed trend analysis of the university's F&A cost rates, rate components, cost pools and cost bases.	There are at least two types of trend analyses. The negotiator should use at least three base years of costs in developing a trend analysis. The first type of trend analysis is simply plotting the raw rate value of each F&A cost pool along with the applicable base involved. This provides the negotiator not only with an indication of where the rate is changing (increasing), but should also indicate where the negotiator should spend time reviewing the cost proposal. In the second type of trend analysis, the negotiator compares the ratio of research participation of each cost pool with that of other years, and with the ratios for other cost pools. This analysis is used in conjunction with the rate analysis. A comparison with base changes can now be easily made and the consistency between space and assigned costs can be quickly ascertained. For example, if the ratio of G&A to the research base is substantially different than the O&M ratio the negotiator should review the rationale.

STEPS	COMMENTS
	Often costs may appear to be rising at an excessive rate; however, the change in the base must be similarly analyzed and compared. Secondly, because of changes in accounting classifications in recent years (especially in administrative areas) the negotiator must be assured that the comparison of costs between years is consistent. For example, a contracts office or research accounting office might have been included in G&A in one year and in DA, or more frequently SPA, the next.
2. Evaluate the university's justification for any significant changes.	

E. COST ACCOUNTING STANDARDS

The cost accounting standards (CAS) which apply to educational institutions are (1) consistency in estimating, accumulating and reporting costs, (2) consistency in allocating costs incurred for the same purposes, (3) accounting for unallowable costs and (4) consistency in the selection and use of a cost accounting period. (See A-21 Appendix A)

Educational institutions that receive aggregate sponsored agreements totaling $25 million or more subject to OMB Circular A-21 during their most recently completed fiscal year shall disclose their cost accounting practices by filing a Disclosure Statement (DS-2), which is reproduced in A-21, Appendix B. With the approval of the cognizant agency, an educational institution may meet the DS-2 submission by submitting the DS-2 for each business unit that received $25 million or more in sponsored agreements. Educational institutions must file amendments to the DS-2 when disclosed practices are changed to comply with a new or modified standard, or when practices are changed for other reasons. Amendments to the DS-2 may be submitted at any time. If the change is expected to have a material impact on the educational institution's negotiated F&A cost rates, the revision shall be approved by the cognizant agency before it is implemented.

The negotiator will need to compare the cost accounting policies delineated in the DS-2 to the F&A cost and fringe benefit proposals in order to ensure that the proposals are consistent with the DS-2. Discrepancies will have to be accounted for by the institutions.

F. FILE DOCUMENTATION

The negotiation workpaper files should contain sufficient documentation (e.g., file notes, schedules, interview notes, etc.) to clearly show:

- What aspects of the proposal were reviewed.
- What significant aspects of the proposal were not reviewed and why.
- What adjustments were made to the proposal and the reasons for the adjustments.
- How the approved rates (by component where possible) were computed and negotiated.
- How the cost savings were computed.
- Required certifications and disclosure statements.

III. DEPRECIATION & USE ALLOWANCES

Depreciation and Use Allowances are the methodologies which are used to compensate institutions for the use of their buildings, capital improvements and equipment, provided they are used, needed in the institution’s activities and properly allocable to sponsored agreements. The computation of Depreciation or Use Allowances is based on the acquisition cost of the asset exclusive of (1) the cost of land, (2) any portion of the cost of buildings and equipment borne or donated by the Federal Government, irrespective of where title was originally vested or where it is presently located, (3) any portion of the cost of buildings and equipment contributed by or for the institution where law or agreement prohibit recovery. For an asset donated to the institution by a third party, its fair market value at the time of the donation should be considered as the acquisition cost. The expenses for Depreciation and Use Allowances are allocated based on the method detailed in Section F.2. of OMB Circular A-21.

The 1998 revision to OMB Circular A-21 requires that the same methodology be used for computing Depreciation for financial statement purposes and Facilities and Administrative cost rate purposes. Private institutions currently use depreciation methodologies for financial statement purposes. Governmental Accounting Standards Board Statement No. 35 requires that public institutions use depreciation accounting for financial statement purposes no later than the Fiscal Year beginning after June 15, 2003 (sooner for large institutions). Consequently, all colleges and universities will use depreciation accounting for financial statement purposes, and will, therefore, be required to use depreciation accounting for Facilities and Administrative cost rate purposes.

STEPS	COMMENTS
1. Determine if depreciation expense is recognized on the audited financial statements.	Federal negotiator should address concerns (about reasonableness of the disclosed depreciation expense) to the institution's external auditors who are responsible for certifying the adequacy of the institution's financial statements.
2. Reconcile costs of assets from audited financial statements to proposal.	

STEPS	COMMENTS
3. Determine that costs of assets were properly established.	For a purchased asset, the cost is its acquisition cost which is the amount paid and posted in the institution's accounting records. For assets donated by a third independent party, the value is the estimated market value at the time of donation. If cost records do not exist, estimated acquisition cost should be based on an independent and professional appraisal. When appraisals are used, care should be exercised to ensure that this valuation reflects estimated cost at the time of purchase and not replacement cost at the time of the appraisal.
4. Determine that land and Federally funded assets (or portion of assets that were Federally funded) have been eliminated from the computation.	The elimination of Federally funded assets should be identified to each specific major function (Organized Research, Instruction, and Other Sponsored Activities) and not an elimination from the gross (total) asset account of the university.
5. Determine that assets acquired on non-Federally sponsored awards have been excluded from the Depreciation/Use Allowance pools.	The elimination of non-Federally funded assets should be identified to each specific major function (Organized Research, Instruction, and Other Sponsored Activities) and not an elimination from the gross (total) asset account of the university.
6. Determine that a combination of the Use Allowance and Depreciation methods has not been used for a single class of fixed assets.	Circular A-21 provides that <u>all</u> buildings are a single class of assets. Therefore, an institution may not use Depreciation on some buildings and Use Allowances on others. If an institution elects to establish various useful lives for building components, the Circular provides for three general component groupings:

STEPS	COMMENTS

- Building shell (including construction and design costs).

- Building Services Systems (e.g., elevators, HVAC, plumbing, heating and air-conditioning systems)

- Fixed Equipment (e.g., sterilizers, casework, fumehoods, cold rooms, glassware/washers)

Institutions may group their equipment into the following classes for purposes of applying the restriction:

- Office equipment (e.g., desks, files, typewriters)

- Scientific equipment (e.g., microscopes, spectrometers, dental chairs/treatment units, laboratory benches, x-ray machines)

- Automatic data processing equipment (e.g., central processing units, tape drives, disc drives)

- Transportation equipment (e.g., automobiles, trucks, trailers, motorcycles, airplanes)

- Educational/other academic support equipment (e.g., classroom furniture, audio visual equipment, shop machinery and tools, musical instruments, athletic equipment)

	STEPS	**COMMENTS**
7.	Verify that the cumulative amount of Use Allowances does not exceed the acquisition cost of an asset.	Use Allowance on equipment assets over 15 years old should be eliminated from the proposal (6 2/3% per year x 15 years = 100% of acquisition cost).
8.	Determine that Depreciation or Use Allowance charges associated with idle facilities have been properly handled. Also, verify that Depreciation and Use Allowance charges associated with lost or replaced assets have been eliminated from the proposal.	Idle facilities are unused or underutilized facilities that are excess to the organization's current needs. Costs associated with idle facilities are unallowable with the following exceptions: If they are necessary to meet fluctuations in workload, and; the facilities were necessary when acquired and are now idle because of programmatic requirements (e.g., efforts to achieve more economical operations, reorganizations, terminations or other causes which could not have been reasonably foreseen). Normally in these instances costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities.
9.	Determine that the depreciation method used results in an equitable allocation of costs to the time periods in which the assets are used.	With very rare exceptions, Circular A-21 requires the use of the straight-line method.
10.	Verify treatment of gains or losses on disposition of plant equipment and other capital assets.	Gains and losses on the sale, retirement or other disposition of depreciable property shall be recognized in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. A gain or loss is the difference between the amount realized and the undepreciated basis of that

STEPS | **COMMENTS**

asset.

These gains or losses will not be recognized if the:

- Gain or loss is processed through a Depreciation account and is reflected as a component of allowable Depreciation;
- Property was part of a trade-in (or exchange) of a similar item and the gain or loss was recognized in determining the cost basis of the new asset;
- Loss results from failure to maintain permissible insurance; or
- Compensation for use of the asset was provided by Use Allowances in lieu of Depreciation.

11. If use charges are proposed, determine that a factor no greater than 6 2/3% percent is claimed for equipment assets and 2 percent for buildings.

When the Use Allowance method is used, the entire building must be treated as a single asset. The 2 percent Use Allowance factor must be applied to all parts of the building including (1) walls, partitions, floors, and ceilings, as well as any permanent coverings such as paneling or tiling; (2) windows and doors; (3) all components (whether in, on or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts; (4) plumbing and plumbing fixtures, such as sinks and bathtubs; (5) electric wiring and lighting fixtures; (6) chimneys; (7) stairs, escalators, and elevators including all components; (8) sprinkler systems; (9) fire escapes; and (10) other equipment

STEPS	COMMENTS
	which is permanently fixed to the building. The 6 2/3% percent Use Allowance may be applied to equipment that is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). As a general rule, such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment to make the space useable for other purposes.
12. If an institution converts from Use Allowances to Depreciation, determine that future Depreciation on each asset is computed as if the asset has been depreciated over its entire useful life (i.e., from the date the asset was acquired to the date it is expected to be disposed of or otherwise withdrawn from active use). The aggregate amount of Use Allowances and Depreciation applicable to the asset (including imputed Depreciation applicable to period(s) prior to charging of Use Allowances as well as Depreciation after the conversion) may not exceed total cost of the asset.	Example: Building Cost $1,000,000 Acquisition Date 1930 Conversion Date 1980 Estimated Remaining Useful Life 50 years Total Useful life 100 years Use Allowance Taken From 1960 to 1979 (20 years @ 2%) $400,000

STEPS	**COMMENTS**
	In this example, future Depreciation charges would be \$10,000 per year (\$1,000,000 divided by 100 years). However, no Depreciation would be allowed after the year 2009 since the aggregate amount of Use Allowance and Depreciation as of that date would equal the building's total acquisition cost as shown below:

Use Allowance	\$ 400,000
Depreciation 1930-1959 (30 years @ \$10,000)	300,000
Depreciation 1980-2009 (30 years @ \$10,000)	300,000
Total	\$ 1,000,000

13. Compare allocation of Building Use Allowances and Depreciation with those for Equipment and O&M. If there are significant differences, determine the reasons.

STEPS	COMMENTS
14. Confirm receipt of an Assurance Statement. This statement should be in writing and provide assurance that an amount equal to the Federal reimbursements has been expended or reserved to acquire or improve research facilities. The Assurance Statement applies only to those institutions on Exhibit A of Circular A-21.	Review the beginning and ending dates of the Assurance as they should be dates that have past as opposed to dates in the future. Future dates constitute a promise to comply and not assurance of compliance. Past dates should run consecutively. Those that are signing the assurance statement for the first time may have concern over the five-year rule in terms of when it begins. It is acceptable to add language which would begin the five year period at the time of signing. The assurance should be signed by an individual that has knowledge of the capital assets.
15. Obtain a schedule(s) to support the Assurance Statement, including a reconciliation of the schedule(s) to the financial statements. The schedule(s) may include the following: • Calculation of costs subject to expense and reserve • Definitions of awards subject to expense and reserve • Reconciliation of schedule(s) to financial statements • Cumulative effect of expense and reserve	Review the schedule(s) for compliance to A-21.J.12.f.

Note: See the Section VI. Space, for guidelines for review of allocation methods applicable to all space-related costs, including Depreciation and Use Allowances.

IV. INTEREST

The cost of interest paid to an external party is allowable where associated with (1) buildings acquired or completed on or after July 1, 1982, (2) major reconstruction and remodeling of existing buildings completed on or after July 1, 1982, and (3) acquisition or fabrication of capital equipment completed on or after July 1, 1982, costing $10,000 or more, if agreed to by the Federal Government. The assets must be used in support of sponsored agreements and the total cost (including Depreciation or Use Allowance, Operations and Maintenance costs and Interest) does not exceed the rental cost of comparable assets in the same locality. The Interest expenses are allocated in the same manner as the Depreciation or Use Allowances on the buildings, equipment and capital improvements to which the Interest relates.

When a proposal contains interest costs for construction or renovation of a building or major equipment over $10,000, documentation should be obtained from the organization so that an adequate and in-depth evaluation of these financing costs is made. The major factor affecting the scope of review would be the impact of Interest, O&M and Use Allowance/Depreciation for the new/renovated facility. DCA does not accept projected increases or inflationary factors for O&M and other rate components other than Depreciation and Interest.

STEPS	COMMENTS
1. Verify actual interest payments and reconcile to audited financial statements.	
a. Are there any proposed interest costs which are not included in the audited financial statements?	A public institution might be assessed interest costs under bonds issued by a State government (e.g., general obligation bonds). This interest expense may be recorded at the State government level and therefore, would not be included in the financial records of the college or university. If this occurs, verify (I) reasonableness of these interest costs charged to the college or university (e.g., amount included in an approved Statewide Cost Allocation Plan or in an approved cost allocation plan of a State Agency) and (ii) acceptability of procedures used to assign these costs to a specific building(s).

STEPS	COMMENTS
2. Obtain the financing agreement (e.g., prospectus, mortgage agreement).	This agreement should contain the amount and purpose of the loan; as well as the interest rate(s), term of loan, lender and maturity schedule. Does interest expense reconcile to maturity schedule? Does the agreement contain appropriate prepayment clauses, so that lower interest rates could be obtained (without penalty) in the future? Is the term of the loan consistent with the proposed life of the asset? (e.g., It would not be appropriate to pay for 20 years of interest on an item of equipment with a 10 year useful life, nor would it be appropriate to recognize as a useful life the financing term, if the true useful life is longer than the number of years of financing.) Is lender an external, independent party? Care should be exercised to assure that this current borrowing is not merely a method of retiring old debt (referred to as defeasement). Interest is allowable under Circular A-21 only if it is necessary for the acquisition or construction of buildings, renovations or equipment on or after June 30, 1982. Interest associated with refinancing or retiring older debts is not allowable. Interest associated with increasing the size of a loan on an asset originally constructed or acquired on or after June 30, 1982, is also not allowable. In both of these latter cases, the interest is not related to the acquisition or construction of the asset and is therefore unallowable.
3. Determine percent of financing for acquisition of a	For debt arrangements over $1 million, interest cost will

STEPS	COMMENTS
building or renovation of an existing facility.	be reduced by an amount equal to imputed interest earnings on excess cash unless an initial equity contribution is 25% or more.
4. Evaluate computation and impact of Interest expense.	Details should show total proposed interest cost for each building and impact to the F&A cost rate for each building. This schedule would also indicate the amount of capitalized interest included in the cost of each building; and the amount of annual interest expense (uncapitalized) for each building.
5. Verify proposed capitalized and interest cost of each building.	Evaluate clerical accuracy of proposed amounts. This includes reconciliation and verification to financing agreement/building contract. Reconcile differences between proposed cost of the facility with construction cost per construction contract.
a. Determine how much interest is included in the capitalized building cost.	
b. Determine how much proposed cost is associated with the building and how much is assigned to the cost of land. Verify that basis for making split is reasonable.	An appraisal may be the method used to establish land and building cost. What is the timing of this appraisal? How does it relate to the construction activity? For example, did the organization buy an old building for its location or availability, then destroy and refurbish the interior? In this case, nearly all old building costs and removal costs if applicable should be classified as land because the purchase price was, in effect, only for the land and a building shell.

STEPS		COMMENTS
6.	Verify that the lender is an independent, third party.	Interest costs must be associated with a loan from an independent, third party to be allowable.
7.	Review the lease vs. purchase analysis.	Analysis is required prior to acquisition of facility (not needed for equipment, renovations or alterations) costing over $500,000. Federal reimbursement is limited to the least costly alternative based on the total cost analysis.
8.	Determine if the space is to be solely used by the educational institution.	Are other tenants involved? Are these tenants considered independent or related organizations?

V. OPERATION AND MAINTENANCE (O&M) EXPENSES

The expenses under this heading are those that have been incurred for the administration, supervision, operation, maintenance, preservation, and protection of the institution's physical plant. They include expenses normally incurred for such items as janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; care of grounds; maintenance and operation of buildings and other plant facilities; security; earthquake and disaster preparedness; environmental safety; hazardous waste disposal; property, liability and all other insurance relating to property; space and capital leasing; facility planning and management; and central receiving. The operations and maintenance category should also include its allocable share of fringe benefit costs, depreciation and use allowances and interest costs. Operations and maintenance costs are allocated in the same manner as Depreciation and Use Allowances.

STEPS	COMMENTS
1. Obtain the following documents: a. Detailed breakout of O&M expenses by subpool if applicable, including a summary of any direct charging (recharging) of O&M expenses. b. Allocation statistics for each O&M (sub)pool. c. Map or list of utility meters at the institution. d. University capitalization policies. e. University telephone directory.	The negotiator should be aware that many universities will expense costly capital construction projects, such as new roofs, completely new heating, ventilation, and air-conditioning (HVAC) systems, road construction, etc. Capital construction, renovation, alteration, equipment, and similar accounts should be analyzed and appropriate adjustments should be made for those assets that were expensed and should have been capitalized.
2. Analyze the O&M pool. a. Analyze the reconciliation of the proposed O&M pool to the audited financial statements.	

STEPS	**COMMENTS**
b. Ensure that applicable credits have been made to the pool.	Institutions sometimes receive insurance recoveries related to the physical plant. These recoveries should be credited against the O&M pool (these revenues may be reported in the miscellaneous income account).
c. Changes in costing practices.	The negotiator should review the O&M pool to ensure compliance with the A-21 definition of O&M costs. Should the institution change their costing practices, from the previous proposal, to conform to the A-21 definition of O&M costs, a further justification of the change is not necessary. Changes in costing practices that are not specifically addressed in A-21 require the approval of the DCA prior to the change.
d. Determine if the university is eligible for the Utility Cost Adjustment (UCA).	Exhibit B of A-21 identifies the institutions eligible to receive the 1.3 percent UCA. The negotiator should determine if the University is potentially violating the intent of the UCA allowance by having more than one utility meter per building. With multiple meters per building, there is the potential of research receiving an excessive allocation of utility costs. Related to this issue, review the buildings to determine if the University has broken a building into multiple units so as to increase the metering and therefore the costs allocated to research.
e. Review Departmental, or Department Paid O&M, if applicable.	Some institutions include departmental repairs and maintenance expenses in the O&M costs. We have noted instances where such costs are directly charged to Federal projects but left in departmental

STEPS	**COMMENTS**
	costs for non-Federal projects. This results in non-compliance with CAS 502 requirements for consistency of treatment of costs.
f. Examine any recharging of O&M costs.	Certain functions of the institution such as auxiliary enterprises, hospitals, bookstores, etc. may be direct charged for O&M costs through a recharge mechanism. These charges and the recharge mechanism should be reviewed to ensure that the charges are consistent and equitable. It is particularly important that these functions pay for the full amount of O&M costs (including administrative costs) that they use, so that they are not subsidized by other functions, including research. Furthermore, O&M recharge centers for maintenance and repairs (e.g., carpenters, plumbers, electricians, etc.) may also be directly charged to organized research. When direct charging to organized research occurs, issues of duplicative charging and inconsistent charging arise. To correct these issues an adjustment(s) to the O&M pool or allocation bases should be made to avoid duplicative or inconsistent costing.
g. If there is more than one O&M pool, determine if the allocation base for each pool is reasonable.	The O&M pool may contain the costs of the campus environmental health and safety unit and the campus police force. The negotiator should ensure that an equitable allocation base is used for such functions. For instance, the campus police may provide significant effort at athletic events, night-time safety for students, etc. Consequently, it may be better to allocate the costs of the campus police on some basis that reflects effort, such as FTEs, rather than using the normal O&M

STEPS	**COMMENTS**
	square footage allocation of these costs.
h. Determine if O&M costs were allocated based on overall square footage of university buildings. If so, is there a more precise base for certain O&M components and is the data necessary to calculate this base available?	

VI. SPACE

The allocation of space among the various functions (Organized Research, Instruction, Other Sponsored Activities, and Other Institutional Activities) is important because Facilities costs (Building and Equipment Depreciation, Operation & Maintenance costs, and Interest) are allocated in proportion to the amount of space allocated to each function. One method for allocating space is to conduct a space survey where the surveyor goes into each room and determines what type of activities are being conducted in the room. Under this method, the percentage of salaries & wages incurred for each function in a department may not correlate with the space allocated to each function. Consequently, space surveys need to be reviewed thoroughly to determine their accuracy.

Another method is to allocate space based on the same percentage as the salaries & wages incurred for each function included in the department. This is the same methodology that OMB A-21 prescribes to allocate joint use space.

STEPS	COMMENTS
1. Obtain the following documents: a. Space inventory instructions, forms, and definitions. b. Detailed results of the space survey by room summarized by building and department. c. Space inventory floor plans as necessary. Campus map.	
2. Analyze the space survey.	

STEPS	COMMENTS
a. Determine if the space survey is current and complete.	The space survey should relate to the base year of the proposal and be of sufficient scope to accurately assign space-related costs. Also, determine if the space survey has been updated to reflect changes, moves and renovations. The negotiator's review involves the verification of the accuracy of the university's space usage inventory and space surveys. The survey definitions must agree with the functional categories included in the cost proposal.
b. Determine if the written instructions to the space survey are adequate.	The instructions to the space survey should be clear, complete, and unbiased. The definitions used in the space survey instructions should be in compliance with A-21 definitions. This is particularly important for the definition of Organized Research. It is critical that the definition of Organized Research be limited to Organized Research projects, and not include departmental research, thesis research performed by students (unless part of an Organized Research project), etc.
c. Determine if functionalized space and its related base costs are treated consistently.	The negotiator must be assured that the university's space inventory system accurately assigns space to the actual functional user and is consistent with the base costs assigned to each function. In developing the MTDC rate base for research, the institution may have reclassified some costs from Organized Research to Instruction and Departmental Research (I&DR). In such an instance, the university should have made an appropriate reclassification of space from Organized Research to I&DR. If an adjustment was not made, an adjustment should be made to the research base. As

STEPS	COMMENTS
	discussed in the Section II. c., Step #5, Research Training can be classified as either Research or Instruction; however, the university must ensure that the related space is consistently assigned. Also, as indicated in Step #4 of that Section, cost shared research effort and the space where the effort is performed must be treated consistently. The accuracy of salary and wage or FTE figures used to allocate space should be verified. It may be necessary to impute a salary and wage figure for clinical, institutional faculty, postdoctoral fellows, visiting professors, graduate students, etc. who use space or provide services at the institution but who receive no salaries from the institution. Such imputed salaries should normally be assigned to I&DR.
d. Review the treatment of space assigned to a single function.	Single function space must be assigned to that function. Assignment of space based on predominant use is no longer acceptable.
e. Review the treatment of Joint Use Space.	The negotiator should verify that all activities which use joint space receive an allocation of space costs. Activities which may have been excluded could include Patient Care, Student Services and Other Institutional Activities.

STEPS	COMMENTS
	Joint space should be allocated to the benefiting functions on the basis of: a. the employee FTEs or salaries and wages of those individual functions benefiting from the use of that space; or b. institution-wide employee FTEs or salaries and wages applicable to the benefiting Major Functions of the institution. Any use of multiple distribution bases for joint space should be carefully evaluated for conformance to the A-21 criteria. Lack of conformance to the A-21 criteria could result in inconsistent costing and overcharges to research.
f. Conduct an evaluation of space.	It may be necessary to review a sample of rooms included in the space study in order to evaluate the reasonableness of the study. In order to select the space to be reviewed, an analysis which compares departmental S&W costs to departmental space usage may be useful. This analysis may reveal discrepancies, such as a situation where a department has a relatively small percentage of salary & wage costs charged to research, but a high percentage of space charged to research. Such discrepancies should be investigated. Also, it is useful to compute the ratio of research assignable square feet to research salaries in a department. A high ratio (e.g., a high amount of space per salary dollar) may indicate a

STEPS	COMMENTS
	misclassification of space. When evaluating the space to be sampled, the current user of the space or a person knowledgeable about the use of the space and the direct cost functions should be interviewed to verify the accuracy of the space usage per the survey. It may also be useful to compare the usage per the survey to the payroll records or PAR forms of the persons using the space in order to determine if these are consistent. Significant inconsistencies could lead to questioning the validity of the space survey. Space under construction should not be reported as usable space and included in the space survey and space inventory until the construction is completed and the space is actually used.

VII. GENERAL ADMINISTRATION AND GENERAL (G&A) EXPENSES

G&A expenses are those that have been incurred for the general executive and administrative offices of the university and those expenses of a general nature which do not relate solely to any major function of the institution. The G&A expense category includes allocated amounts of fringe benefits, Depreciation or Use Allowance, Operation and Maintenance expense, System's or State Board of Regents's allocation of central administrative support costs. General administration and general expenses shall not include expenses incurred within non-university-wide deans' offices, academic departments, organized research units, or similar organizational units. The G&A expenses should be grouped first according to common major functions of the institution to which they render services or provide benefits. The aggregate expenses of each group should then be allocated to serviced or benefited functions on a modified total cost base. Modified total costs consist of salaries and wages, fringes benefits, materials and supplies, services, travel and the first $25,000 of each subgrant and subcontract. Equipment, capital expenditures, charges for patient care and tuition remission, rental costs, scholarships, and fellowships as well as the portion of each subgrant and subcontract in excess of $25,000 shall be excluded from the Modified Total Cost (MTC) base. General Administration and General Expenses, combined with Departmental Administration Expenses, Sponsored Projects Administration Expenses, and Student Administration and Services Expenses, are limited to 26 % of modified total direct costs.

STEPS	COMMENTS
1. Evaluate the adequacy of the institution's reconciliation of the total G&A expense to the Institutional Support account in the audited financial statements.	
2. Obtain a list of the accounts by title and by amount that were included in the proposed G&A cost category.	
3. Obtain additional information from the university on accounts which have titles that are vague or questionable.	

STEPS	COMMENTS
4. Review the proposed G&A cost pool for capital expenditures and costs which are unallowable for sponsored agreements under Circular A-21.	The following expenses are some examples of unallowable costs or activities according to Circular A-21: a. advertising b. bad debts c. entertainment d. contributions e. losses which could have been covered by permissible insurance f. fund raising g. investment counsel for purposes of enhancing income from investments h. public relations i. alumni activities j. news releases other than those pertaining to scientific accomplishments under sponsored agreements. k. alcoholic beverages. l. personal use portion of institution furnished automobiles. m. contingencies. n. defense against Government claims or appeals or the prosecution of claims or appeals against the Government. o. patent infringement litigation. p. insurance to correct defects in materials or workmanship. q. fines and penalties. r. goods or services for personal use. s. lobbying.

STEPS	COMMENTS
	t. membership in civic or community organizations. u. memberships in country clubs, social and dining clubs. v. selling and marketing costs. w. malpractice insurance. x. housing and personal living expenses of current and past officers. The above activities should be reviewed to determine if they should be included in the base. Costs that receive benefit from the functions in the G&A pool must be included in the modified total direct cost base.
6. Review the proposed G&A expenses for costs which should be reclassified to the Student Administration and Services cost category.	The following and similar costs should be reclassified to Student Administration and Services: a. commencement b. convocation c. student activities d. student publications e. student clubs f. vice president of student services g. admissions and registrar h. counseling and placement services i. student accounting and billings.

STEPS	COMMENTS
7. Review cost transfers out of G&A which may represent a change in accounting or cost allocation methods.	At the time the 26% cap was placed on administrative costs, the regulations indicated institutions should not change their accounting or cost allocation methods which were in effect 5/1/91 if the effect was to: (1) change the charging of a type of cost from indirect to direct. (2) reclassify costs from indirect pools covered by the cap to other indirect pools. Changes may be permitted when an institution's charging practices are at variance with acceptable practices followed by a substantial majority of other institutions.
8. Reconcile the proposed allocation base for G&A to the total expenditures for the year. Determine what costs were excluded from the MTC base.	The MTC base should include all unrestricted and restricted expenses less operations and maintenance expenses, G&A expenses, tuition remissions, student support costs (such as student aid, stipends, scholarships, fellowships), patient care costs, capital expenditures, rental costs, alterations and renovations, and that portion of each subaward in excess of $25,000.
9. Determine if the institution has elected to use the alternative method for claiming administrative costs.	Institutions may elect to claim a fixed allowance for the Administration portion of indirect costs. The allowance could be either 24% of MTDC or a percentage equal to 95% of the most recently negotiated fixed or predetermined rate for the cost pools included under "Administration", whichever is less. Refer to A-21

STEPS	COMMENTS
	Section G-8 for details of the calculation.
10. Determine that the G&A type functions which were excluded from the G&A cost category because they were unallowable in accordance with Federal regulations are included in the Other Institutional Activities modified total direct cost base.	Unallowable functions such as fund raising, alumni activities, etc. should be treated as part of Other Institutional Activities and allocated their share of G&A, O&M and any other indirect costs that benefit these functions.
11. Determine that cross allocations are not included in the MTC allocation base.	The standard allocation methods for departmental administration and general expenses use the term Modified Total Cost (MTC). The MTC base includes the cross allocation of the other cost pools to which the G&A expenses are allocated (e.g., Libraries, Student Administration and Services, etc.) However, the indirect costs previously allocated to those functions (such as; Depreciation and Operation and Maintenance expenses) should be excluded.
12. Determine if G&A expenses should be assigned to university or non-university activities that are not included in the university's financial statements (e.g., medical practice plans, hospitals, insurance companies, utility companies, printing companies, real estate companies, etc.).	
13. Determine the accuracy and appropriateness of allocations or billings of G&A services provided to affiliated organizations, such as hospitals. Be sure that the distribution method is a reasonable measure of services rendered.	If the allocations or billings to these organizations are understated, the allocations of G&A to university functions (including Organized Research) will be overstated.

STEPS	**COMMENTS**
14. Ensure that G&A expenses are grouped first according to common major functions of the institution to which they render services or provide benefit.	Review G&A expenses for those costs which do not benefit all functions of the university. Make appropriate adjustments to the allocation process.
15. Review costs included in G&A but not recorded on the institution's financial statements.	Certain costs may be attributable to an institution but not necessarily paid by the institution. This is especially true at state institutions. Examples include allocated, billed and non-billed costs from the Statewide Cost Allocation Plans, State University System-wide costs**,** or Board of Regents.
16. If applicable, review the System or State Board of Regent's central administrative support costs.	The System or Board of Regent's allocates its central administrative and support cost, possibly including interest costs from bonds issued by the System or Board of Regents, (see the review steps regarding interest), to its universities using a methodology which should have been submitted to the DCA office for review and approval in accordance with OMB Circular A-87. The negotiator should reconcile the costs in the G&A cost pool to the central administrative support costs in the approved State-Wide Costs Allocation Plan or System or Board of Regent's Plan. The negotiator should request and review all of the institution's support schedules for adequate documentation. If the allocation methodology has not been approved by the DCA office, this cost should be disallowed.

VIII. DEPARTMENTAL ADMINSTRATION

Departmental Administration (DA) expenses are those that have been incurred for administrative and supporting services that benefit common or joint departmental activities or objectives in academic deans' offices, academic departments and divisions, and organized research institutes.

The DA expense pool is not included as a line item expenditure on the institution's financial statements. This pool is developed during the preparation of the F&A cost rate proposal. Generally, the DA cost is reclassified from the Instruction and Academic Support expenditures shown on the financial statements.

Salaries and fringe benefits attributable to the administrative work of faculty, department heads and professional personnel conducting research and/or instruction should not be reclassified to the DA cost pool. This cost is covered by the 3.6 percent of modified total direct costs that is added to the F&A cost rate for major functions. No documentation is required to support this allowance.

DA expenses include salaries and operating expenses incurred in Academic deans' offices related to college/school administration functions, and administration and supporting expenses incurred within academic departments, provided they are treated consistently in like circumstances. These costs include salaries and benefits of secretarial, clerical, administrative officers and assistants, as well as the cost for travel, supplies, and stock rooms, etc.

The expenses in the DA pool should be allocated as follows:

1. The administrative expenses of the dean's office of each college should be allocated to the academic departments within that college on a MTC base.

2. The administrative expenses of each academic department, including that department's share of the dean's allocation, should be allocated to the appropriate functions of the department on a MTC base.

STEPS	COMMENTS
1. Obtain schedules detailing the composition of the DA pool. These schedules should reflect, by department, costs included in DA and the amounts of salaries and fringe benefits for each of the following employee groups: faculty, professional research (e.g., research associate), other administrative personnel, technical, and clerical. Also obtain schedules showing the amounts by college of the deans' administrative expenses.	
2. Review the expenses included in the deans' offices, including a listing of the personnel assigned to the deans' offices along with their job titles. If further support is needed, review the position descriptions of the personnel involved and follow up with interviews of the individuals.	It is not uncommon to find employees assigned to the deans' offices who are performing student administration duties rather than general college or school administration duties. Such employees have job titles such as academic advisor, college advisor, director of student affairs, academic coordinator, and admissions analyst. Other employees whose primary duties might not be the general administration of the college or school are occasionally assigned to a dean's office. Examples would be a media specialist or a special events coordinator whose effort is mostly in the area of public relations. Frequently, there are personnel in the deans office account that are heavily involved in fund raising and other activities that do not benefit sponsored research. This includes direct activities, such as, Instruction and Research and “seed” and “bridge” funding.

STEPS	COMMENTS
3. Make a comparative analysis to determine if the salaries of individuals in years prior to the 3.6 percent faculty allowance were included in academic departments, but are now included in the deans' offices.	Such reclassifications would possibly circumvent the 3.6 percent faculty allowance. It is the responsibility of the university to substantiate all such reclassifications.
4. Review the expenses other than labor costs charged to the deans' offices.	The deans' offices expenses may include costs that are not appropriate DA costs. This situation seems to be especially true at medical schools. Medical liability (malpractice) insurance should not appear as an F&A cost of the dean's office or in any other F&A cost pool. Such costs may only be claimed as a direct cost.
5. Obtain a listing of personnel by department whose salaries and fringe benefits are included in the DA pool because the university believes that their administrative efforts are not covered by the 3.6 percent allowance. Review the job titles and position descriptions of these employees. If necessary, interview selected employees to determine their major duties.	The administrative salaries and fringe benefits of business officers and administrative assistants are not covered by the 3.6 percent allowance. These costs may be included in the DA pool. Some examples of these administrative positions are: business officers, administrators, administrative assistants, budget officers, accountants, statisticians, and systems analysts. Employees such as research associates, research scientists, lecturers, social workers, and health specialists may be fully or partially charged to DA. Since these people qualify as "other professional personnel conducting research and/or instruction", their administrative effort is covered by the 3.6 percent allowance. Their salaries should not be included in DA.

STEPS	COMMENTS
	Also, the efforts of faculty and other professional research/instructional staff associated with the development of contract proposals, grant applications, etc., whether funded by Federal sponsoring agencies, private foundations, departmental funds, "seed" money, or another source, are covered by the 3.6 percent allowance and should not be included in the DA pool.
	Directors of research units are not mentioned specifically in Circular A-21 with regards to the 3.6 percent allowance. Since a director of a research unit's duties are similar to a department head, his or her salary and fringe benefits would be covered by the 3.6 percent allowance.
6. Review the treatment of other administrative personnel, technical, and clerical salaries for inconsistent costing practices. Scan available records of labor charges to determine whether any secretarial, technical, or administrative effort is charged directly to sponsored projects.	Inconsistent costing exists when a university's accounting system charges support costs directly to sponsored activities but charges similar support costs attributable to non-sponsored activities to the DA indirect cost pool. If the university maintains inconsistent costing in this area, corrective action can be accomplished through a "Direct Charge Equivalent" (DCE). See the following Section for guidelines on the use of DCEs. Section F.6.b. of the May 8, 1996 revision of circular A-21 states that the salaries of administrative and clerical staff should normally be treated as F&A costs**.** Direct charging of these costs may be appropriate where a major project or activity explicitly budgets for administrative or clerical services and the individuals involved can be specifically identified with the project or activity.

STEPS

COMMENTS

This provision is intended to establish the principle that the salaries of administrative and clerical staff should usually be treated as F&A costs, but that direct charging of these costs may be appropriate where the nature of the work performed under a particular project requires an extensive amount of administrative or clerical support which is significantly greater than the routine level of such services provided by academic departments. The costs would need to meet the general criteria for direct charging in section D.1.-- i.e, "be identified specifically with a particular sponsored project... relatively easily with a high degree of accuracy," and the special circumstances requiring direct charging of the services would need to be justified to the satisfaction of the awarding agency in the grant application or contract proposal.

The following examples are illustrative of circumstances where direct charging the salaries of administrative or clerical staff may be appropriate.

- Large, complex programs, such as General Clinical Research Centers, Primate Centers, Program Projects, Engineering Research Centers, and other grants and contracts that entail assembling and managing teams of investigators from a number of institutions.

- Projects which involve extensive data accumulation, analysis and entry, surveying, tabulation, cataloging, searching literature, and reporting, such as epidemiological studies, clinical trials, and

STEPS	COMMENTS

retrospective clinical records studies.

- Projects that require making travel and meeting arrangements for large numbers of participants, such as conferences and seminars.

- Projects whose principal focus is the preparation and production of manuals and large reports, books and monographs (excluding routine progress and technical reports).

- Projects that are geographically inaccessible to normal departmental administrative services, such as seagoing research vessels, radio astronomy projects, and other research field sites that are remote from the campus.

- Individual projects requiring project-specific database management; individualized graphics or manuscript preparation; human or animal protocol, IRB preparations and/or other project-specific regulatory protocols; and multiple project-related investigator coordination and communications.

Major projects or activities that have a material effect on F&A costs may have need for a separate F&A cost rate calculation. A separate rate may also be necessary for all "major projects", as that base receives a lesser allocation of Departmental administration costs.

The above examples are not exhaustive nor are they

STEPS	**COMMENTS**
	intended to imply that direct charging of administrative or clerical salaries would always be appropriate for the situations illustrated in the examples. Where direct charges for administrative and clerical salaries are made, care must be exercised to assure that costs incurred for the same purpose in like circumstances are consistently treated as direct costs for all activities. The Circular does provide for direct charging of administrative and clerical salaries; however, it is intended that such charging may be appropriate only where there is a demonstrated need for such support on major projects. Where direct charges for administrative and clerical salaries are made to Federal projects that is inconsistent with the intent of the regulations, similar proposed indirect costs would be considered unallowable.
7. Determine whether the supplies and other non-labor expenses included in DA for any departments are unusually high. Review those departments' supplies and expense accounts to detect whether any of the accounts are strictly instructional accounts.	The departmental supplies and expenses may include unusually large accounts which are strictly instructional in nature, such as lab or chemical supplies, glassware, or computer costs in some circumstances. These expenditures are usually direct costs and are frequently large enough to cause distortions in the amount assigned to DA.
8. Obtain schedules showing the allocation of the deans' offices' expenses to all departments under the deans.	

STEPS	COMMENTS
9. Also obtain schedules detailing the allocation of DA by department. These schedules should show the total amount of DA for each department, the allocation bases for each department, and the DA allocated to each function by department.	
10. Calculate a departmental DA rate for each department.	This step can help locate departments with unusually high DA rates and might, therefore, pinpoint departments with inequities in the DA cost category.
11. Reconcile the total Research bases of all departments and the total Instruction bases of all departments to the Research, Instruction, Other Institutional Activities, and other major bases used to allocate G&A.	
12. When dealing with a medical school, determine whether the DA cost category is allocated to the physicians' medical practice plan. If not, review the practice plan agreement for evidence of the medical school staff's roles in the administration of the private practices of the physicians on the faculty.	The medical school dean or other officials may be responsible for the quality of patient care provided by the physicians in the medical practice plan. Also they may be involved in determining the amount of time devoted by each physician to teaching and to patient care and in determining the amount to be paid to individual physicians from the practice plan pool. Other DA services may also be provided to the practice plan. See Section XI.C. for a further discussion of medical practice plan issues.

STEPS	COMMENTS
13. Also, if reviewing a proposal for a medical school, ascertain whether there are any service contracts between the medical school and any local hospitals. If so, review the contracts to learn what roles are played by the deans, department chairperson or other officials in the administration of the contract.	If appropriate, an allocation of some DA costs should be made to these contracts.
14. If a medical school owns or operates a hospital, determine how the hospital is treated in the allocation of DA.	The medical school dean as well as other staff of the dean's office or academic departments may be involved in the administration of the hospital. If this is the case, then the hospital should receive an allocation of DA. Particular attention should also be paid to the Intern and Residence Supervision transfer (sometimes referred to as the Medical Education transfer) which has been reported on the Medicare step-down. This transfer must be added back to the instruction base of affected departments prior to allocations.

DIRECT CHARGE EQUIVALENT

Universities generally do not treat academic department support costs (e.g., the salaries of secretaries and clerks, travel, office supplies, etc.) consistently. For example, clerical salaries often are charged directly to sponsored agreements and there are either nominal or no similar direct charges to instruction. The balance of clerical salaries is included in DA. This is not a consistent method for the treatment of these costs and is not in compliance with A-21. Therefore, there is a serious question as to the amount of these costs that should be included in the DA pool, if any. One method to give recognition that a portion of these costs could be allowed as DA is the use of a Direct Charge Equivalent (DCE). The DCE is designed to compensate for this inconsistent costing. The DCE makes a correction for the inconsistency by calculating a reduction to the DA pool which represents the imputed value of departmental support costs related directly to non-sponsored activities. (Note: The DCE methodology should only be used to correct for inconsistent costing in the DA pool. It should not be used to correct for inconsistent costing in other pools, such as O&M.)

STEPS	**COMMENTS**
1. Determine if development of a DCE is warranted by: a. Examining university accounting policies and documents. b. Interviewing university accounting and departmental support personnel.	The university's charging methodologies can be determined through a review of accounting documents (including approved budgets and expense summaries for sponsored projects) and interviews with accounting personnel. A DCE is not needed if: (a) all departmental support costs for <u>all</u> activities, including sponsored activities, are included in DA, or (b) the institution's accounting system <u>accurately</u> assigns departmental support costs to all direct activities (sponsored and non-sponsored). <u>In practice, both of these situations are rare.</u>

STEPS	COMMENTS
	Computation of a DCE is warranted if: (a) the review of the institution's accounting policies or practices demonstrates the kind of inconsistency described above, or (b) the institution's effort reporting system assigns departmental support salary costs to all activities, but due to deficiencies in the system, an insufficient amount of these costs are assigned to non-sponsored activities such as Instruction and Departmental Research. This can be determined by interviewing a sample of departmental support personnel charged to DA to see if their actual effort should have been charged to I&DR or some other non-sponsored activity rather than DA. These interviews may also reveal that the system is not working in practice in the way it was intended in theory, and it is not properly classifying employee activity. If the effort reporting system is inadequate, a DCE is an alternative method that may be accepted by the negotiator to assign the appropriate amount of additional departmental support costs to non-sponsored activities.
2. Obtain available accounting information to compute the DCE, including:	
a. MTDC and S&W figures for Organized Research, Instruction and Other Institutional Activities for each department.	The university may be able to generate the required data from its database.
b. A summary of departmental support costs charged to sponsored projects for each department.	

STEPS		COMMENTS
	c. Departmental support costs charged to DA, broken down into S&W and non-labor costs, for each department.	
	d. Other data as required. The method used to compute the DCE may depend on the accounting data available.	
3.	Request the institution to compute the DCE.	The negotiator should provide guidance to the institution on how the DCE should be computed as well as the rationale for the use of the DCE and the specific DCE method preferred. If the institution refuses to make the computations, they should be made by the negotiator. All DCE methods are based on assumptions and are, therefore, approximations. While there may be various DCEs, a good DCE methodology should be based on readily available data, be relatively simple to compute, and directly compensate for the costing inconsistency in the university's accounting system. An example of a preferred DCE method is included in Exhibit A. It will usually be necessary to compute separate DCEs by different cost categories (e.g., support salaries and non-labor costs).

STEPS | **COMMENTS**

Because DA is required to be generated department-by-department, the DCE's should be computed on the same basis. This will take into account variations in departmental treatment of support costs and produce more equitable DCE adjustments than would be achieved by computing a campus-wide DCE adjustment.

The pool of departmental support costs in each department should be reviewed to determine if there are any support costs related to patient care plans or any recharge activity type costs (e.g., electronics shops, etc.) included. These costs are not DA and should be eliminated from the departmental support costs before computing the DCE figure for each department.

Due to the numerous departments and calculations involved, it is recommended that a computer be used to compute the DCE.

4. Recompute the DA component after making adjustments for the DCE.

The DA component should be recomputed for each department.

In addition to reducing the DA pool for the DCE amount, a pro-rata portion of cross-allocations to DA for G&A, O&M and use-allowances which relates to the DCE amount should also be removed from the DA pool.

STEPS	COMMENTS
	The revised departmental DA amounts should be added together to arrive at the DCE adjusted DA pool for the entire institution. In addition to adjusting the DA pool, the Instruction MTDC base should also be increased by the DCE amount, which will affect the allocation of G&A and DA.

<u>Preferred DCE Methodology</u> **<u>Exhibit A</u>**

1. The preferred DCE methodology is based on the following assumption: that within a department, the ratio of support costs to salaries and wages (S&W) for non-sponsored activities should be the same as the ratio of support costs to S&W charged directly to sponsored activities.

$$\text{DCE Ratio} = \frac{\text{Support Costs Charged Directly to Sponsored Activities}}{\text{S\&W of Sponsored Activities (Net of support S\&W)}}$$

2. Assume the following information is known about a particular department in the University:

- Sponsored Research S&W ($S\&W_{SR}$) = \$1,100,000
- Instruction & Dept'l. Research S&W ($S\&W_{I\&DR}$) = \$2,000,000
- Departmental Support S&W in DA pool ($DS_{S\&W}$) = \$500,000
- Departmental Support Non-Labor Costs in DA pool ($DS_{N\text{-}L}$) = \$250,000
- Dept'l. Support S&W charged directly to SR (DS_{SR}) = \$100,000
- The University has not allocated any Dept'l. Support to I&DR.

3. The DCE is computed as follows:

$$\text{DCE Ratio} = \frac{DS_{SR}}{S\&W_{SR} - DS_{SR}} = \frac{\$100{,}000}{\$1{,}100{,}000 - \$100{,}000} = .10$$

The .10 DCE ratio is then applied to the $S\&W_{I\&DR}$ of $2,000,000 to arrive at the DCE adjustment for S&W of $200,000. Consequently, the $DS_{S\&W}$ of $500,000 is reduced by $200,000 to arrive at the $DS_{S\&W}$ allowable as DA of $300,000.

A separate DCE computation should be made for departmental non-labor costs. The DCE for non-labor costs should be computed in the same manner as the prior example for salaries and wages, except non-labor costs should be used in the calculations instead of support S&W. For the purposes of this illustration, it is assumed that the adjustment for non-labor costs is $100,000.

The total DCE adjustment then is $300,000 ($200,000 & $100,000) and the departmental support costs which remain as DA are ($500,000 + $250,000) - $300,000 = $450,000. A pro-rata portion of cross-allocations to DA for G&A, O&M and Use Allowances should also be adjusted.

If this department had other direct activities (e.g., public service), then the DCE ratio developed would also applied to the S&W of these direct activities.

The DCE adjustments should be made for each department for which the university is claiming DA.

It is possible that after computing a DCE adjustment the residual departmental support costs are a <u>negative</u> number. Under these circumstances, the departmental support costs available as DA should be considered to be zero. A negative number should not be used because costs cannot be disallowed that have not been incurred.

This particular methodology can be applied on a campus-wide basis if the appropriate data is only available campus-wide, rather than department-by-department. If applied on a campus-wide basis a single ratio would be developed and the DCE would be calculated on the entire DA pool. However, more precise results will be obtained if the methodology can be applied on a department-by-department basis.

IX. SPONSORED PROJECTS ADMINISTRATION

Sponsored Projects Administration (SPA) expenses are limited to those incurred by a separate organization(s) established primarily to administer sponsored projects, including such functions as grant and contract administration (Federal and non-Federal), special security, purchasing, personnel administration, and editing and publishing of research and other reports. They include the salaries and expenses of the head of such organization, assistants, and immediate staff, together with the salaries and expenses of personnel engaged in supporting activities maintained by the organization, such as stock rooms, stenographic pools and the like. Among others, SPA activities normally include proposal tracking, proposal review, (e.g., salary rates), award budget monitoring and final expenditure report preparation. This category also includes an allocable share of fringe benefit costs, Use Allowance/Depreciation, Operations and Maintenance expense, and G&A expense. Appropriate credits to SPA should be made for services provided to other functions or organizations. The expenses in the SPA category should be allocated to the major functions of the institution under which the sponsored projects are conducted on the basis of the modified total costs of sponsored projects (Federal and non-Federal). The extent of the DCA review of expenses in the SPA category should be determined by the materiality of the amount allocated to research. Sponsored Projects Administration Expenses, combined with General Administration and General Expenses, Departmental Administration Expenses, and Student Administration and Services Expenses, are limited to 26 % of modified total direct costs.

STEPS	**COMMENTS**
1. Assure that SPA includes <u>only</u> costs incurred by separate units established primarily to administer sponsored projects.	
2. Obtain a list of the organizational units in the SPA cost category. Review the discrete units to determine their functions and activities.	

STEPS		COMMENTS
3.	Obtain a list of the employees assigned to each discrete unit along with the percentage of each employee's effort charged to the unit.	Each employee whose salary is included in SPA should be assigned 100 percent to a separate organization that exclusively or primarily benefits sponsored agreements. Any work performed for other than sponsored projects should be charged to the benefiting functions. However, any such work should not constitute a significant portion of any employee's effort. In addition, since the units included in SPA should be separate organizations, the units should not be under academic departments or report to a department head.
4.	Review job titles and position descriptions of employees assigned to the SPA organizational units to determine what type of effort is being charged to SPA.	Effort associated with the preparation of contract proposals, grant applications, cost sharing, etc., are inappropriate charges to SPA. According to Circular A-21, proposal costs should be allocated to all activities of the institution, and should preferably be included in G&A. However, it is acceptable to include proposal costs in departmental administration since proposal costs bear little relationship to auxiliary enterprises, which are not in the DA base. The negotiator should insure that the allowable proposal costs excluded proposal costs covered by the 3.6 percent allowance for administrative activities of department heads, faculty and other professional employees. Also, universities should not charge direct effort which is currently unfunded to SPA. Unfunded direct effort is considered cost sharing or university funded research and must be treated as part of the appropriate direct function. It may be necessary to interview employees assigned to SPA if position descriptions are inadequate or not available.

STEPS	COMMENTS
5. Determine that SPA costs do not include consultant fees for the development of special cost studies and indirect cost proposals. Also, SPA should not include patent costs and environmental health costs.	These costs should be in the G&A cost pool. Normally these costs benefit the institution at large and therefore should be charged as G&A costs rather than SPA.
6. Review the SPA pool for costs that were previously classified as DA or G&A.	These reclassifications may have been made to circumvent the 3.6 percent faculty allowance or a DCE adjustment. As a general rule, to be an allowable SPA cost there must be a direct line-reporting to the SPA Director or other SPA manager.
7. Determine that the base used to distribute SPA costs included modified total direct costs of all projects, both Federal and non-Federal, and that base items are consistent between Federal and non-Federal projects.	

X. LIBRARY EXPENSES

OMB Circular A-21 indicates that library expenses shall be allocated to institutional functions on the basis of primary users of library services, including students, professional employees and other users. Each user category shall be calculated on a full-time equivalent basis. The costs allocated to the student category shall be assigned to the Instruction function. The costs allocated to the professional employee category shall be assigned to the major functions of the institution in proportion to the salaries and wages of faculty and professional employees. The costs allocated to other users shall be assigned to the "Other Institutional Activities" function.

The library environment has changed considerably in recent years due to the increasing use of computer-based library functions, such as the internet. In some institutions the library function has been commingled with the data processing functions of the institution. Consequently, the negotiator must be careful to note any organizational changes that may have affected the library function since the prior negotiation. Also, increasing use of the internet to access the libraries resources by users outside of the institution may require additional analysis in estimating the portion of the library expenditures which are allocable to Other Institutional Activities.

STANDARD ALLOCATION METHOD

STEPS	COMMENTS
1. Reconcile claimed expenses to the financial statements.	Certain items should be directly assigned to Instruction, for example, audio-visual learning center and computer assisted instruction. In some cases, audio-visual services should be treated as a recharge function, and direct charged through a rate mechanism. Rare book purchases and museums should be excluded.

STEPS	COMMENTS
	Appropriate adjustments should be made for the Research Library Resources Program and for income from library sales, such as, copy center services, FAX services, etc.
2. Determine whether there are specialty libraries which should be allocated separately if material amounts are involved.	Most university centers have separate medical/dental schools with a medical library, which services owned/affiliated hospitals. Affiliation agreements should be reviewed to determine if there is a reimbursement for library usage and how it is determined.
3. Request the university to provide schedules used to support the full-time equivalents (FTE). Also, if not self-explanatory, a brief explanation of the methodology used to compute the FTE should be provided. Assure that all FTE's are included in the computation of FTE percentages. This information should be obtained from the registrar's office, which maintains census reports.	When separate allocations are made to specialty libraries, be sure the main library does not include the same FTE's. The clinical faculty FTE methodology count should be reviewed (e.g., if a faculty member works at the university part-time, review how the university computed the FTE). Be sure that voluntary faculty are included in the FTE count and salaries and wages are imputed for inclusion in the S&W allocation base. Health science complexes (Hospital/Medical School) have voluntary faculty that teach courses in return for admitting privileges at owned or related hospitals. Many universities now offer continuing education classes (non-credit classes, etc.) to the general public and students. These individuals must be included in the FTE count. Also, all other outside users of the library and library services must be identified and included in the FTE count.

STEPS	COMMENTS
4. Costs should be assigned to the following categories:	
a. Professional employees include faculty members and other professional employees, such as professional researchers. Administrative employees are excluded. This category is then reallocated to all functions of the university based on the salary and wage ratio of the benefiting functions. The salary and wage amounts should be traced to the appropriate records.	
b. Students includes all individuals enrolled as students regardless of whether they do or do not earn credit toward a degree or certificate. The amount allocated to this category is assigned to Instruction.	Students can be counted as students and employees. The employee FTE should be based on the ratio of employment hours to a full-time schedule. Student FTE should be based on FTE status as a student. If there are a significant number of volunteer faculty, an imputed salary amount should be developed for this group, based on their FTE count, as explained above.
c. Other users includes the general public. This category is assigned entirely to "Other Institutional Activities".	The other user category includes all employees not included in the professional employees and students categories, such as teachers, high school students, students and faculty from other colleges, alumni, medical professionals, and the general public. Assistance should be requested from the institution and their librarian in developing an FTE for outside users. Perhaps a formula approach should be considered. This category should be developed on a case by case basis.

SPECIAL LIBRARY COST STUDIES

As discussed under the standard allocation method, Circular A-21 requires that library expenses be allocated to functions based on primary users of the library services, including students, professional employees and other users. A number of institutions have developed survey techniques, usually based on statistical sampling methods, to attempt to determine the actual users of the various library services (e.g., book and periodical circulation, on-line computer searches, inter-library loan services, etc.). The surveying methods utilized are based on various sampling techniques and approaches claimed to be statistically valid by institutions. Section E.2.d.(3) of the Circular allows cost analysis studies to measure the use of institutional services, if the studies are unbiased and statistically valid. Library cost studies which use intended usage or cause for purchase as an allocation methodology for technical services costs, including book acquisitions, are unacceptable. These costs must be allocated based on actual usage, as reflected in a library user survey.

STEPS	COMMENTS
1. Obtain a copy of the library cost study, including the study methodology, survey forms, statistical sampling plan, statistical projections and supporting workpapers.	
2. Analyze and determine the appropriateness of the library study methodology for at least the following areas: a. Organization and cost centers b. Functional definitions c. Length of study d. Non-responses e. Audit trail f. Non-library service users g. Surrogate users	Library organizational charts should be used as the primary method to determine library functions and cost centers. If the major functions do not correspond to the organizational chart, then interviews with appropriate library officials, or staff surveys, could be used as a method to determine the cost of each major library function. Usually separate cost centers, if costs are material, should be established for at least five major functions of a library: reference, circulation, audio visual, inter-library loan and on-line computer searches.

STEPS	**COMMENTS**
	The cost of each of these functions should be allocated based on the results of the library user survey. The study methodology should adequately substantiate and define major library functions. Be sure that library service centers (e.g., copy centers, etc.) are identified and assigned appropriate indirect costs. Some individuals use the library facility (building) to study, meet other individuals, rest, etc. These individuals do not use library services. They only utilize library space. It may be equitable to only allocate O&M and other indirect costs assigned to the library to the individuals identified in this category by the survey.
3. Review the survey forms used during the survey process. Determine that the form is clear and concise, that all library functions and activities are identified on the form and that the functional definitions are presented in "plain English" with examples of each function.	A-21 definitions and terminology should be fully explained, especially the definitions of Organized Research and Departmental Research. This is critical since the individuals completing the survey forms generally do not know the difference between "Organized Research" and "Research" related to course assignments, thesis requirements, etc. Inadequate or unclear definitions of these terms can seriously jeopardize the validity of the study. The definition of the "Instruction and Departmental Research" category should always be shown first on the survey form.

STEPS		COMMENTS
4.	Determine that alternative survey forms used will allow for rotating the positions of the various functions to be selected.	If the survey form allows the same function to always be in the first position on the form to be selected, this may skew the results of the survey.
5.	Determine that the survey forms include a space for an identification number and a question asking if the user is in the library for his/her own benefit or for someone else (surrogate users).	The survey should allow for subsequent review and analysis and therefore, a means for an audit trail. The survey form must identify the individual surveyed by a unique identification number such as social security number, university payroll number, etc. The survey methodology should also address how surrogate users will be counted compared to non-surrogate users.
6.	Evaluate the statistical sampling methodology developed by the university to select survey periods and project the results of users based on the results of the surveys conducted. Determine if the sampling methodology is statistically valid.	Assistance may be obtained from the OIG to help determine the statistical validity of the sample. Outside consultants may also be retained by the Department to assist negotiators in a limited number of cases. Library user surveys should be conducted over a full year-long period. Survey forms must be distributed to all persons entering the library during the randomly scheduled survey periods. The survey methodology should establish acceptable response levels.
7.	Determine the actual survey periods to be selected using computerized random generation.	
8.	Determine whether the statistical sampling plan considers weighing the usage of library services	The validity of linear weighting has never been accepted as part of a valid library costing study.

STEPS	COMMENTS
based on the number of books and periodicals used by each library user. For example, if linear weighing factors were used, an individual using two books would be assigned twice the amount of library costs as an individual using just one book.	
9. Obtain the following information for each library surveyed and analyze the results of the surveys and the projections based on the results: (1) mean usage, number of respondents associated with materials used in the library, materials checked out and reference services used; (2) mean usage, number of items used and number of respondents assigned to each major function for materials used in the library, materials checked out and reference services used; (3) mean usage, number of items used and number of respondents assigned to each major function broken-down by type of user category (e.g., faculty, staff, student, etc.) and (4) mean usage, number of items used and number of respondents by type assigned to each major function broken-down by materials used in the library, materials checked out and reference services used.	This information should be used to help evaluate the reliability of the sampling plan and to evaluate the statistical validity of the statistical sampling method.

STEPS	COMMENTS
10. Obtain a copy or listing of each library user survey form which indicated that the library was used for research purposes. Verify that the individuals were actually working on organized research projects during the time the survey was conducted.	Past experience has indicated that many individuals indicate on the survey form that they are working on organized research when they are in the library, while in fact, they are not associated with organized research in any way. In these cases, it is necessary to use the standard A-21 FTE base allocation method in lieu of the study.

XI. STUDENT ADMINISTRATION AND SERVICES

Student administration and services are expenses incurred for the administration of student affairs and for services to students, including expenses of such activities as deans of students, admissions, registrar, counseling and placement of students, student advisers, student health, catalogs, commencements and convocations. The expenses included in these categories and other student related services should generally be allocated entirely to the instruction function, and subsequently to any sponsored agreements in that function. An allocation of student service expenses to Organized Research should be accepted only where an institution can clearly show that a given service benefits Organized Research. These services would be those associated with students performing substantive work on Organized Research projects which are analogous to fringe benefits or services normally associated with employees (e.g., health services). Student Administration and Services Expenses, combined with General Administration and General Expenses, Departmental Administration Expenses, and Sponsored Projects Administration Expenses, are limited to 26 % of modified total direct costs. Indirect cost proposals for fiscal years beginning on or after January 1, 1994 are to include this cost category in the 26% ceiling for reimbursement of administrative costs. This category should include its allocable share of Depreciation/or Use Allowances, Interest costs, Operation and Maintenance expenses and fringe benefit costs.

XII. OTHER AREAS

A. FRINGE BENEFITS

Fringe benefits include all benefits paid by an organization to, or on behalf of, its employees. Examples include vacation, holiday, sick leave pay, and other paid absences; employee health, life, and disability insurance; postretirement benefits (including pensions); social security taxes; unemployment compensation; worker's compensation, sabbatical leave and tuition remission provided to individual employees. (Fringe benefits do not include tuition remission provided to an employee's family or to students. See Step 12. of this section and Section XI.E. for further discussion. Fringe benefits also does not include costs associated with the administration of fringe benefits unless those costs were included as fringe benefits prior to May 1, 1991, before the implementation of the 26% administrative cap.)

The nature of the review of fringe benefit costs will be governed by the organization's practices for budgeting and charging fringe benefit costs on Federal awards:

- If the organization uses a fringe benefit rate for both budgeting and charging purposes, the rate will be reviewed and negotiated concurrently with the negotiation of the organization's F&A cost rate (or more often if the F&A cost rate is a multi-year rate and the fringe benefit rate is annual). The review should include an evaluation of the development of the rate as well as an evaluation of major and sensitive cost elements (i.e., the implementation of FASB Statement 106, Employers Accounting for Postretirement Benefits Other Than Pensions). The negotiated rate should be included in the F&A cost Negotiation Agreement.

- If the organization budgets and charges fringe benefits based on specific identification of the costs of each benefit to individual employees, or uses estimated fringe benefit rates for budgeting purposes but uses specific identification system for determining their actual charges, the review should normally be limited to an evaluation of the organization's fringe benefit policies and its policies and procedures for determining and assigning the costs of the benefits to Federal awards. Primary emphasis should be given to major and sensitive cost elements.

- If the organization uses a "hybrid" system where certain benefit costs are charged based on a rate and other benefit costs are charged based on specific identification, the costs charged based on a rate will be subject to the review described in the first section above. The costs charged based on specific identification will be limited to the review in the second section above.

- Fringe benefit costs included in F&A costs will be reviewed as part of the normal review of F&A costs.

In order to avoid the necessity of making retroactive adjustments to the fringe benefit costs claimed on individual awards, the rates should be negotiated on a permanent (either predetermined or fixed) basis.

STEPS	**COMMENTS**
1. The following information should be requested:	
a. A listing of the fringe benefits paid by the organization	If the organization uses a fringe benefit rate for charging, the annual costs should be included in the listing. A break-out of the costs of paid absences should not be requested if they are included in gross salaries.
b. A copy of the current fringe benefit policies	After the initial submission of these policies, only changes to the policies should be requested in subsequent years.
c. The method used for budgeting and charging the cost of each benefit to Federal awards	This information will be included in the Negotiation Agreement.
d. Whether the organization anticipates any changes to its fringe benefit policies or budgeting/charging method(s) in the future.	

STEPS	COMMENTS
e. A fringe benefit proposal	This is only required if the organization uses a fringe benefit rate for charging purposes. The proposal should be based on the organization's most recently completed fiscal year, and be reconciled and cross-referenced to the organization's audited financial statements.
2. Review previous negotiation file to determine whether adjustments or problems were found. If so, determine whether the problems have been corrected.	
3. Determine whether the organization treats the costs of the benefits consistently.	It is not necessary that all benefits be treated in the same manner. However, the costs of each benefit must be treated consistently as a direct charge via a fringe benefit rate, as a direct charge through specific identification to individual employees, or as an indirect charge.
4. Determine whether the organization's fringe benefit policies are applied on a non-discriminatory basis as between employees working on Federally supported projects and employees engaged in other activities of the organization.	
5. Determine whether the benefits are reasonable.	Examples of unreasonable fringe benefits include, discounts on athletic/civic activities, bookstore discounts, etc.

STEPS	COMMENTS
6. Determine whether rebates and other applicable credits are properly considered in determining the costs (e.g., rebates of unemployment compensation insurance, life insurance dividends, etc.).	These rebates and credits are often found in a breakdown of miscellaneous income from the audited financial statements.
7. For pension plan costs, determine:	
a. Whether the costs assigned to the fiscal year are determined in accordance with generally accepted accounting principles.	Organizations may elect to follow the "Cost Accounting Standard for Composition and Measurement of Pension Costs" (4CFR Part 412). For defined-benefit plans, emphasis should be given to ensuring that: a. The costs of the plan are assigned to each fiscal year based on an actuarial study. b. Past and prior service costs are amortized over not less than 10 years. c. The actuarial computations take into account unrealized as well as realized gains and losses on pension fund investments. d. The amount assigned to a given fiscal year is funded within six months after the close of that year. Increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

STEPS	COMMENTS
	For defined-contribution plans, determine that the contributions required under the plan are actually made (funded) and that the costs are reduced by dividends and other applicable credits.
b. Whether the plan complies with the Employee Retirement Income Security Act (ERISA).	ERISA (Public Law 93-06) establishes certain standards which private pension plans must meet and imposes penalties (e. g., excise taxes) for non-compliance with the standards. Excise taxes on accumulated funding deficiencies and prohibited transactions of pension plan fiduciaries imposed under ERISA are unallowable. Premiums paid for pension plan termination insurance are allowable; however, late payment charges on such premiums are unallowable.
c. Whether the organization credits the fringe benefit pool for unvested contributions made by the organization and included in the fringe benefit pool in prior years for employees no longer employed by the organization.	Consider the university's treatment of the unvested contributions.
8. For postretirement benefits other than pensions, determine:	
a. Whether the costs assigned to the fiscal year are determined in accordance with generally accepted accounting principles.	FASB Statement 106, <u>Employers' Accounting for Postretirement Benefits Other Than Pensions</u>, issued in December 1990 and effective for fiscal years beginning after December 15, 1994 (for nonpublic enterprises), establishes accounting standards for employers' accounting for postretirement benefits other

STEPS	COMMENTS
	than pensions. Its primary focus is postretirement health care benefits. It changed the typical practice of accounting for postretirement benefits on a pay-as-you-go (cash) basis by requiring accrual (during the years that the employee renders the necessary service) of the expected cost of providing those benefits to an employee and/or the employee's beneficiaries and dependents.
	Transition obligations for postretirement benefits are costs arising from the failure to accrue the accumulated postretirement benefit obligation in earlier periods. FASB Statement 106 measures transition obligations as the unfunded and unrecognized accumulated postretirement benefit obligation for all plan participants. The Statement provides two options for recognizing the transition obligation: 1) the transition obligation may be recognized immediately or 2) amortized over a period not to exceed twenty years with disclosure of the unrecognized amount. For budgeting and charging on Federal programs, the transition obligation will be allowable if funded and amortized over twenty years.
b. The amount funded.	Postretirement benefit costs will be based on the lesser of amounts funded or amounts accrued. In addition, the following cost principles will be applied: • Interest adjustments in current or future years, caused by delays in funding a reasonable estimate of the actuarial liability beyond thirty days after each quarter of the year to which such costs

STEPS	COMMENTS
	are assignable, are unallowable. • Earning of investment income on reserves must be credited to those reserves. If reserves are not invested, imputed earnings will be credited to the reserves at the governmental unit's investment rate.
9. If the organization charges all or some of the costs of paid absences (vacation, holiday, sick leave, etc.) on an accrual (when earned) basis, determine whether the amount accrued is properly determined.	Most grantees and contractors charge the costs of paid absences on a cash basis as part of gross salaries and wages (i.e., when the employee is on leave, the project(s) he is working on continues to be charged for his salary). However, some organizations set up accruals for these costs and charge them separately from salaries. When accruals are used, they should normally apply only to paid absences which represent a definite liability of the organization (i.e., the organization must compensate the employee for the amount earned if the employee terminates his employment with the organization). However, if the organization can demonstrate that the accruals are properly adjusted by experience factors to reflect actual absences taken, the accruals may be accepted even where they do not represent a definite liability.
10. If paid absences are charged separately from salaries, determine whether the amounts budgeted and charged for salaries exclude paid absences.	Verify that the published rate agreement states the treatment of paid absences, and is consistent with the organization's treatment in the proposal.
11. Review the organizations treatment of sabbatical leave.	If sabbatical leave is included in fringe benefits, determine that the aggregate charges to all work of the

STEPS	COMMENTS
	organization during the base period is reasonable in relation to the organization's actual experience under its sabbatical leave policy. The sabbatical leave policy must be uniform for persons engaged in instruction and persons engaged in research.
12. Determine whether tuition remission for an employee's family members or for students working on research projects are included in the organization's fringe benefit rate or F&A cost rate.	For fiscal years beginning after September 30, 1998, tuition support for dependents of employees is no longer an allowable fringe benefit or F&A expense. For tuition remission for students see Section XII.E. for further discussion.
13. Reconcile the rate computation to the organization's financial statements.	
14. Ensure that the compensation of all employees receiving the benefits is included in the distribution base.	The compensation includes salaries and wages and payments in addition to basic compensation (e.g., amounts reported on IRS Form 1099, bonus payments, and awards). This may include compensation of employees working for affiliated or related organizations.
15. Determine whether multiple rates for different classes of employees are needed.	If the organization provides substantially different benefits to different classes of employees and the cost of these benefits in relation to the salaries of the employees differs significantly, a rate for each class must be considered.
16. Determine whether there are any benefit costs which should be assigned directly to a given employee(s) rather than to all activities through a rate (e.g., a special benefit provided only to one	

STEPS	COMMENTS
employee or a small group of employees).	
17. Determine whether any changes are expected in the level of benefits or charging practices that would affect the rates in future years.	
18. If a fixed rate was established for a prior year, determine whether an appropriate adjustment (carryforward) to compensate for the difference between the costs used to compute the rate and actual costs has been made.	If carryforward amounts are calculated for multiple rates, verify that the carryforward amounts are determined on a discrete basis.

B. SPECIALIZED SERVICE FACILITIES (SSF)

When material, the costs of institutional services involving the use of highly complex or specialized facilities such as electronic computer centers, animal care facilities, wind tunnels, motor pools, reactors, bio-technical services (such as graphics, printing, and equipment rental) and many others should be charged directly to users. User billing rates should be calculated for each SSF that do not discriminate between Federally and non-Federally supported activities including university internal activities. Rates for SSF's should be designed to recover not more than the aggregate costs of the services over a long-term period. Therefore, billing rates must be reviewed periodically for consistency with the long-term plan and adjusted if necessary.

STEPS	COMMENTS
1. Review the university's policies identifying SSF from other services.	A university usually has several hundred service centers that could be treated as SSF. The university should have a policy describing the guidelines followed to identify a center as a full cost burdened and full cost recovered SSF. The negotiator should be aware that a university might treat service centers that are largely used by Federal projects as a SSF while the costs of service centers primarily used by non-research functions are included in the G&A or O&M pools. This is inconsistent and unacceptable. Request a listing of all service centers along with the total amount charged out during the fiscal year under review. SSFs can be identified through review of cost transfers.

STEPS	COMMENTS
2. Analyze a representative number of SSF (especially those used largely by Federal projects) and determine the following: ! When the SSF was first established; ! How the SSF was initially funded; ! Existence of financial statements; ! Method of annual reconciliation of billed charges to actual costs; ! Rates include all allowable costs (direct as well as F&A costs); ! All users (including outside users) are billed and are billed at the same rate for the same services; ! Utilization statistics are used to compute billing rates and charges; ! Treatment of over and under charges.	Normally under a billing rate system a formal schedule of user rates is published and used for charging purposes. Users are charged based on utilization, such as, CPU time, miles driven, animal per diem, etc. Variances between billed costs and actual costs should normally be handled as adjustments to future billing rates. For reconciliation purposes, revenue should include all revenue (including imputed revenue for unbilled services). The negotiator should determine that SSF operating costs and losses are not included in the F&A cost rate. Losses would frequently be located in the G&A or other administrative cost pools. Some reasons for losses in a SSF include: (a) establishing billing rates based on less than full cost; (b) not billing all users of the services provided; (c) using billing rates based on raw estimates or inadequate financial data, and; (d) deliberately under billing in order to maintain revenue sources (to be competitive). Fund balances should be reviewed to make sure they are considered in the development of future years rates. Also, all transfers from fund surpluses/deficits should be reviewed. Fund deficits should not be transferred to other F&A cost categories and surpluses should not be diverted to other uses.
3. Determine that F&A costs are properly allocated to all SSF.	The allocation of F&A costs to a SSF is necessary to assure that these costs are assigned to the users of the services rather than to general overhead. However, it may not be necessary to require these allocations if the effect on the F&A cost rate is nominal (e.g., one tenth of a percentage point). It should be noted that the 26% ceiling on the reimbursement of administrative costs is

STEPS

COMMENTS

not applicable to specialized service center charges. Institutions should not add new specialized service facilities in order to exclude administrative costs which would be subject to the 26% ceiling on administrative cost. Institutions should not change their accounting or cost allocation methods which were in effect on May 1, 1991.

SPECIAL REQUIREMENTS FOR ANIMAL RESEARCH FACILITIES (ARF)

In recent years, the sophistication of animal research has caused more research to be conducted within the confines of these facilities. Since most non-animal research takes place in office or laboratory space (which is included as part of the F&A cost), an inequity exists. Based on the changing nature of research conducted in these facilities, the methodology has been changed to include a certain portion of animal facility costs in the institution's F&A rates. This includes procedure rooms, operating and recovery rooms, isolation rooms and quarantine rooms directly related to research protocols, as well as rooms that house animals involved in research that are generally not removed from the facility for conducting research. An example of this would relate to an animal that is removed from the facility for a specialized procedure, such as Magnetic Resonance Imaging (MRI). This animal is removed for the MRI, which is part of the research protocol and returned to the facility. In addition, to avoid potential over-allocations of F&A costs on a case-by-case basis, animal care charges may be treated like patient care costs and excluded from the allocation base used to charge F&A costs to awards.

This guidance has also been incorporated in the revised Cost Analysis and Rate Setting Manual for Animal Research Facilities (CARS) - May 2000, which is available on the NIH National Center for Research Resources (NCRR) web site (www.ncrr.nih.gov/ncrrpubl.htm).

STEPS	COMMENTS
1. Request a copy of the space survey instructions for the ARF.	The ARF Director should have this information, since it is an integral part of the rate setting process, as delineated in the CARS manual.
2. Review the space to determine compliance with the revised guidance.	Compare space designated as research space with the animal facility rate setting supporting workpapers to confirm that there is no duplication. Space designated as research should be reviewed to confirm that it relates directly to a research protocol and that the animals are not generally removed from the facility.

STEPS	COMMENTS
3. Space used for joint service and research purposes.	In situations where space, i.e., animal rooms are utilized for joint purposes of service and research, request supporting data on how space was identified to service. Grantee should identify space to each function service/research based on the specific space within the joint area considering the days the activity took place in the space.
4. Summarize the results of the review.	Results of the review would generally impact the facilities component of the F&A cost rate.

C. MEDICAL PRACTICE PLANS (MPP)

Medical Practice Plans (MPP) have become the major means of organizing and managing the clinical practice activity of faculty at Medical/Dental colleges. These plans set forth rules and policies for participation, compensation and management of the plan as it relates to the college and other entities. MPP have become increasingly important over the last few years since they are a major revenue source for the institution, serve to attract faculty members, increase the funds available for faculty compensation, and fund other activities within the institution.

In conjunction with our review of a college/university F&A cost proposal, a review of the MPP or similar type entity or activity is necessary in order to verify the proper identification of expenses related to this function.

Selective reviews of MPP at various institutions revealed that there were deficiencies in allocation methodologies utilized to properly identify and allocate F&A costs to them. Accordingly, this section of the Guide was developed to assist in the review of MPP. The principal objective of this section of the Guide is to assure that MPPs are allocated their proper share of all appropriate F&A costs as dictated by the facts and circumstances involved.

STEPS	COMMENTS
1. Determine whether the institution permits the conduct of private practice by faculty members.	Most medical/dental colleges permit some type of private practice. This would include treating patients and billing for services. MPP normally function in clinical departments, such as Medicine, Obstetrics, Pediatrics, etc. Review of the institution's financial statements should indicate whether an MPP exists. Selected interviews with department administrators should reveal existence of a plan whose revenue and expenses do not flow through the institution.

STEPS	COMMENTS
2. Request copies of formalized agreements between the institution and practice plan participants. These agreements should include: a. Organizational structure of the plan; b. Operating policies and procedures; c. Leases for space and equipment; d. Non-capital items or services to be provided.	Many institutions have formal agreements with the plan members or the organization conducting the practice. Organizational structure will vary, with some institutions having different agreements with each department or possibly one agreement institution-wide. If formal agreements do not exist, it is recommended that the negotiator meet with a select group of clinical department administrators and the practice plan administrator to discuss all aspects of practice activities.
3. Request copies of MPP financial statements (certified, if available) and expense details for the fiscal year under review.	Many MPP are large and generate a significant amount of revenue, requiring certified financial statements. Internal financial statements should be available from the MPP administrator.
4. Request copies of brochures and directories describing private practice services available.	In recent years, MPP have been advertising their services to prospective patients. This information can be helpful in reviewing space costs and other aspects of the plan.
5. Determine whether faculty and support staff efforts associated with the MPP is addressed in the institution's activity reporting system.	Many plans are fully integrated into the institution's activities.
6. Determine MPP treatment in the F&A cost proposal.	The degree of autonomy and the amount of supporting services (e.g., space related expenses, administrative and general expenses) rendered to the MPP varies. Accordingly, a clear understanding of how and what services the institution considers allocable to MPP activity should be documented.

STEPS	COMMENTS
7. Review plan agreement(s) and note the following:	
a. Treatment of compensation paid to participants.	Most plans fund a portion of the participants' basic compensation package and are part of the activity reporting system.
• Methodology utilized to pay bonuses above base payments.	Amounts paid above the basic compensation are normally considered bonus payments. Treatment of this item for F&A cost and fringe benefit allocation should be reviewed. Reasons for exclusions from the allocation base should be evaluated to determine whether they are appropriate.
• Compliance with HHS Salary Ceiling.	This could have a significant impact on the institution, since combined reimbursements (institution/base MPP payments) could easily exceed the annualized level of the HHS ceiling. In these instances any increment in excess of the limitation should be included in the appropriate F&A cost base (bonus payments should be evaluated on a case-by-case basis). Fringe benefit base treatment should also be reviewed.
b. Treatment of compensation paid to support staff.	Support staff are normally institution employees and charging patterns should be similar to other institution functions. Differences should be documented for subsequent review.
• Salary rate structure.	Compensation rates should be the same as those for other institutional employees performing similar functions. Differences should be evaluated.

STEPS	COMMENTS
c. Treatment of fringe benefits.	Fringe benefits treatment should be similar to other activities of the institution with any specifically identified items eliminated from the fringe benefit expense pool.
d. Treatment of support services (e.g., space related cost, telephone, medical records, postage, purchasing, personnel, etc.)	Compare to treatment noted in the proposal and determine differences (e.g., telephone and postage may be charged directly to the plan).
e. Treatment of malpractice insurance. Request copies of policies and coverage terms.	Treatment of malpractice insurance applicable to MPP activities varies. Copies of insurance policies and applicable coverage terms should be reviewed. Normally a portion of the "risk management" office would be allocable to this activity. Current regulations require that malpractice insurance shall be treated as a direct cost. (See Section XII.D. for further discussion of malpractice insurance.)
f. Methodology utilized to bill and collect patient accounts.	This function is similar to the restricted funds accounting function and should be charged directly to the MPP.
g. Treatment of expenses of MPP administrator(s) and support staff.	This item is directly charged to the plan at most institutions. It should be noted that plan employees may occupy space in departmental administrative offices.
8. Request summary analysis of plan expenditures by major expense classification and:	At some institutions, plans are established on a departmental basis and are not administered on an institution wide basis. If this is the case, select two or three departments with a significant amount of private practice activity for further review.

STEPS	COMMENTS
a. Reconcile to the institution's financial statements and/or MPP financial statements (if available) and review all significant differences.	
b. Selectively review effort reports of faculty and support staff.	Review should include verification that effort reporting is in compliance with activity reporting system and A-21 requirements.
c. Review major expense classifications, such as, support salaries (e.g., technicians, nurses, medical transcriptionists, supplies, special service facilities charges).	Normally expense listings are available detailing the type of expense charged to the MPP.
d. Review for charging patterns.	Determine whether expenses charged directly to the MPP are similar to those charged to other activities and that differences are documented (e.g., treatment of nurses, medical transcriptionists, etc., are normally direct charges).
9. Meet with MPP administrator(s).	Discuss operating policies and procedures and request additional information if considered necessary.
10. Determine reasonableness of treatment in the F&A cost proposal as follows:	
a. Equipment use allowance/depreciation.	
• Determine how equipment use/depreciation is identified.	At most institutions, equipment related to the MPP is specifically identified and charged to the MPP.
• Allocation to MPP made for jointly used equipment.	Many departments have common equipment rooms, which include jointly used equipment, which may be

STEPS	COMMENTS
	utilized by MPP. Selectively review usage logs and/or discuss with Department Administrator.
b. Space related costs.	At some institutions, the MPP facility is housed in department space. At others, the MPP is housed off campus or at an affiliated hospital. Space allocation to the MPP may vary on a department by department basis. For example, in some departments faculty may see patients in their offices.
• Included in space survey.	Treatment should be similar to other major functions of the institution.
• Treated as an offset to the operations and maintenance expense pool.	Compare the offset to the amount that would have been allocated to the MPP had it been handled as a major function in the space survey. The offset should at least equal the full allocable amount of use allowance/deprecation and O&M costs. Evaluate any differences.
• Selectively review clinical department space for unidentified MPP space.	At many institutions, MPP space is not properly identified. During the space survey, the negotiator should note space related to waiting rooms, patient file rooms, examining tables contained within faculty offices, etc. MPP brochures and telephone directories can be of assistance in identifying misclassified MPP space. In addition, MPP employees often occupy Departmental Administrative space requiring an adjustment.

STEPS	COMMENTS
c. General Administrative and General expenses.	
• G&A costs fully allocated to the MPP, similar to other major institutional functions.	Extent of G&A allocability to MPP can vary depending upon organizational setup and operating procedures. For example, MPP employees may not be hired by the institution; also the institution may not prepare the MPP payroll. In many instances, the MPP does not benefit from all G&A functions requiring the formulation of cost groupings. This is a sensitive area, since most institutions do not fully allocate to this activity. The negotiator should assure that the appropriate amount of G&A is allocated to the MPP.
• Treatment of billing and collection of patient accounts receivable.	This activity is similar to a sponsored projects administration unit and should be charged directly to the MPP. At some institutions, this activity is done by a service bureau under contract to the MPP.
• Scan major expense items such as legal accounting, consultants, insurance, etc.	Review items and identify those related specifically to the MPP. These items should be removed from the G&A expense pool.
d. Departmental Administration (DA)	
• Selectively interview Department Administrator(s) to determine relationship with the MPP.	The degree of autonomy and the extent of departmental administrative support varies. At some institutions the plan reimburses the department directly for administrative support. An MPP administrator, paid by the plan, may be physically located in DA offices requiring an adjustment for support services and cross allocations (Depreciation/Use Allowances and O&M).

STEPS	COMMENTS
• Review treatment of MPP activities in the allocation of DA.	At most institutions a portion of MPP revenues are used to fund DA type functions. A selective review of these functions is necessary to verify that they are DA and not specifically related to the MPP. In addition, at some institutions the MPP funds positions directly which are excluded by the institution without considering support costs (supplies and services, etc.), and cross allocations.
e. Allocation Base	
• Review treatment of MPP costs to determine that the allocation base is consistent with other functions of the institution.	Institutions have often excluded portions of the MPP allocation base. All significant exclusions should be reviewed and reasons for exclusion should be documented.
11. Summarize results of review.	Results of the review could impact the fringe benefit rate, as well as the F&A cost rate.
a. Clarify any misstatements of fact.	
b. Request additional information, if necessary.	
c. Incorporate adjustments, if any, into overall negotiation position.	

D. MEDICAL MALPRACTICE INSURANCE

Malpractice insurance is the professional liability insurance subscribed to by a medical practitioner to insure against a loss resulting from a judgment against the practitioner. Current regulations require that medical liability (malpractice) insurance is an allowable cost of research programs only to the extent that the research involves human subjects. Medical liability insurance costs shall be treated as a direct cost and shall be assigned to individual projects based on the manner in which the insurer allocates the risk to the population covered by the insurance.

E. <u>TUITION REMISSION EXPENSE</u>

Universities frequently employ graduate students on research projects and waive some or all of their tuition as compensation for their effort on the projects. Since the waivers (called tuition remissions) are considered part of the students' compensation for effort performed on the projects, they are allowable costs under Circular A-21. The Circular requires that the remissions be treated as direct costs to the projects the students work on, unless the student is working in an F&A function. Remission costs should not be included in a composite fringe benefit rate.

STEPS	**COMMENTS**
1. Determine whether tuition remission costs are treated as direct or F&A costs.	Circular A-21 requires that charges for tuition remission be treated as direct or F&A costs in accordance with the actual activity being performed. Thus if a student works directly on a research project the tuition remission costs should be directly charged to that project. The only remissions that would be allowed as F&A costs are those related to graduate students who work in an F&A function, such as accounting or administration, which is rare. Tuition remission for students working on research projects or other activities should be consistently treated as direct charges to those projects or activities, not as F&A costs or part of a general fringe benefit rate. It is also acceptable to treat the remission as a special "tuition remission" rate for graduate students, or as part of a <u>special</u> fringe benefit rate for graduate students.

STEPS	**COMMENTS**
2. If tuition remission costs are treated as F&A or included in a general fringe benefit rate, make the appropriate adjustment to the F&A and/or fringe benefit rates.	

F. CONTRIBUTED EFFORT

We cannot emphasize enough the need for the negotiator to properly identify all costs of a project and confirm that they are properly charged to that cost objective. Cost accounting consistency (in estimating, accumulating and reporting costs) is a primary tenet of OMB Circular A-21. This position has been further strengthened by the addition to OMB Circular A-21, of Appendix A-Part 99005 - Cost Accounting Standards for Educational Institutions. In particular, CASB standards 9905.501 - Consistency in Estimating, Accumulating and Reporting Costs and CASB 9905.502 - Consistency in Allocating Costs Incurred for the Same Purpose. The basic concept is the proper matching of "space and base," regardless of the funding source. The cost determination process is not affected by the various funding decisions made by the varied Federal or non-Federal awarding agencies. In sum, the cost accounting process for project costs will be the same regardless of the source of funds sponsoring that activity. The scope of the negotiator's review should be the determination that all contributed effort is properly identified. This has been problematic, since the university labor distribution system is fundamentally budget driven. This means that the system produces "actual costs," which almost always equals Federal reimbursement limitations, contained in individual grants and contracts. As a result of this budgetary system, actual labor costs associated with a specific award would not be formally recorded in the accounting system.

Contributed effort, which is a form of cost sharing, is that portion of the project costs not borne by the sponsor. Mandatory cost sharing is required by the sponsor as a condition of obtaining an award. When an award is received in which mandatory cost sharing was proposed, the cost sharing becomes a binding commitment, which the institution must provide and document as part of the performance of the sponsored agreement. Voluntary cost sharing represents resources offered by the institution, when not a specific sponsor requirement. When an award is received in which voluntary cost sharing was proposed, the cost sharing becomes a binding commitment (voluntary committed cost sharing), which the institution must provide and document, as part of the performance of the sponsored agreement. Voluntary uncommitted cost sharing (VUCS), related to contributed effort, is defined as the costs of university faculty including senior researchers effort donated to research projects over and above any formal commitment to a particular project. It excludes the unfunded effort that was committed by university faculty including senior researchers on research proposals. Thus, in our review, we are dealing with three types of cost sharing related to contributed effort: mandatory cost sharing, voluntary committed cost sharing and voluntary uncommitted cost sharing. Recent experience has indicated that grantees are attempting to do a better job capturing mandatory and voluntary committed cost sharing, while voluntary uncommitted cost sharing no longer needs to be included in the Organized Research base or be reflected in any allocation of F&A costs.

STEPS	COMMENTS
1. Request a copy of the institution's cost sharing policy and procedures.	With the submission of the DS-2 Disclosure Statement, most institutions developed/updated their cost sharing policies and procedures.
2. Review cost sharing policies and procedures.	This should include determining how much cost sharing is included in the organized research base and the type of cost sharing being identified, i.e., mandatory and voluntary committed.
3. Request a copy of and review activity reporting instructions and system.	Review instructions to determine if the issue of voluntary uncommitted cost sharing is addressed.
4. Select sample departments for review.	These departments should be selected on a judgmental basis and should have a significant amount of Federally funded research, i.e., Medical school, select two basic science and two clinical departments.
5. Request copies of grant awards, budgets, and applications and related supporting data including non-Federal awards.	Note that for most NIH awards, there is no formalized budget since most awards are made using the modular grant concept. Modular grant applications contain percentages of effort of personnel. Non-Federal awards may have significant cost sharing requirements.
6. Request activity reports for selected Principal Investigators and staff included on project awards.	It may be advisable to scan all activity reports for the departments selected to determine if any changes have been made. Experience indicates that there are very few changes on budget-driven systems.
7. Request variance reports, if any.	Some institutions prepare variance reports, so that changes are formally entered into the system.

STEPS	**COMMENTS**
8. Determine potential cost sharing adjustment(s).	As noted above some institutions have cost sharing systems that properly capture mandatory and voluntary committed cost sharing through the use of “shadow” accounts. These accounts are established when the award is received, to capture this type of cost sharing. These systems should be selectively tested by comparing amounts to grant award data (budget applications).
9. Develop negotiation position for mandatory and committed cost sharing, if required.	If a determination is made that mandatory and committed cost sharing is not being properly identified, an adjustment is required. This should be based upon the sampled departments, extrapolated to the entire organized research base. The basis of the adjustment will be the monetization of mandatory/committed amounts on award applications not captured on the activity reports. Applicable fringe benefits must be added to the cost shared salary amount.
10. Determine that voluntary uncommitted cost sharing is being treated in accordance with the OMB memorandum.	OMB recently issued a memorandum clarifying the treatment of this cost. As noted in the memorandum, the grantee should have procedures in place preventing the shifting of voluntary committed cost sharing to voluntary uncommitted cost sharing.
• Request a listing of significant workload shifts.	University faculty including senior researchers are required to maintain their base workload schedule as noted in their appointment letter or activity schedule. This information is normally controlled by the faculty member’s Dean or Department Chair. If they are not meeting this requirement, their effort related to their research activities may be understated and should be

STEPS	COMMENTS
	adjusted.
• Interview selected PIs, if necessary.	
11. Summarize the results of review.	Results of the review will impact the facilities component of the F&A cost rate.

Note: Cost sharing may be performed by visiting/guest investigators and graduate students that are not accounted for through the activity reporting system. These individuals should be identified, and an adjustment made, based upon imputing a salary amount for these individuals, which would be an addition to the MTDC base. Another approach would be to adjust the facilities component based upon Full Time Equivalents. This is required in order to properly match "space and base".