

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: University of California Date: October, 13, 1977
 Indirect Cost Rate
 Docket No. 76-6
 Decision No.40

DECISION

This case involves an appeal by the Regents of the University of California (the "Grantee") from a decision of the Regional Director, Region IX (the "Regional Director"), of the Department of Health, Education, and Welfare ("DHEW") upholding a determination by the Assistant Regional Director for Financial Management, Region IX (the "ARD/FM") of indirect cost rates applicable to the Grantee for the fiscal years ending June 30, 1976, and June 30, 1977.

After submission by the Grantee and by DHEW of their initial documentation relating to this appeal, the Board, making an initial determination that no material issue of fact appeared to be in dispute, ordered on its own motion that an informal conference be held with the parties to assist in the clarification of the complex and difficult questions presented. That informal conference was held on March 22 and 23, 1977, attended by the full panel of the Board, representatives of the parties and representatives of the National Association of College and University Business Officers ("NACUBO"), as an amicus curiae. Subsequent to that informal hearing, the parties and NACUBO submitted additional briefs.

1. The Subject of the Appeal. The Grantee receives numerous Federal grants and contracts providing financial assistance for its activities, one major category of which is for basic or "organized" research. Eligible for reimbursement under those grants and contracts are not only costs directly associated with the organized research activity, such as salaries of research staff, but also a share of certain of the "indirect" costs of supporting the Grantee's operations generally. In other contexts, these indirect costs are often characterized as "overhead." Rather than computing reimburseable indirect costs on a grant-by-grant basis, the Federal government has established

procedures for determining overall indirect cost rates for each multiple-grant grantee applicable to defined categories of grants, relying principally on negotiations between the grantee and the designated lead Federal agency for that purpose. For educational institutions, that agency is DHEW.

The single indirect cost rate involved in this appeal is the Grantee's "on campus organized research" rate. The Grantee commenced the negotiation process with DHEW for fiscal years 1976 and 1977 by submitting a formal detailed proposal on August 15, 1974, based on fiscal year 1973 data. Among the proposed indirect cost rates was a 35.25% rate for on campus organized research. That is, the grantee proposed that for each \$100 of total direct costs (modified in a manner not here relevant) of Federally-supported organized research, the Grantee would be entitled to receive an additional \$35.25 as an indirect cost reimbursement.

The indirect cost rate for any given cost objective, such as "on campus organized research," is itself comprised of numerous component parts, such as maintenance and operations allowances, building and equipment use allowances, general and administrative expenses and the like. Each component part is the product of a complex analysis of expense categories, cost pools, allocation procedures and cost objectives in accordance with general cost accounting principles. In this case, the Grantee's initial calculations resulted in the 35.25% rate for the on campus organized research cost objective.

This appeal involves disputes as to certain of the component parts of this proposed rate, as discussed in detail below.

After the Grantee's original proposal was submitted to DHEW, the ARD/FM requested the DHEW Audit Agency to review and report on certain aspects of that proposal, and informal negotiations commenced. Four reports of the Audit Agency resulted: No. 57025-09 dated April 15, 1975, No. 67032-09 dated July 1, 1975, No. 67045-09 dated August 21, 1975, and No. 67042-09 dated October 9, 1975. Negotiations between the Grantee and the ARD/FM produced agreement as to some but not all of the issues then remaining in dispute. On December 23, 1975, the ARD/FM made a "determination" that the applicable on campus organized research indirect cost rate for fiscal years 1976 and 1977 would be 28.22%. Pursuant to the informal appeal procedures of 45 C.F.R., Part 75, the Grantee appealed this determination

to the Regional Director, then proposing a revised rate of 34.56%. After an informal hearing before the Regional Director, on April 7, 1976, the Regional Director sustained the ARD/FM on all material points, but adjusted the rate to 29.02%. This appeal followed. Further adjustments proposed by the Grantee have modified its currently proposed rate to 33.8%. The DHEW determined rate remains 29.02%.

2. The Scope and Nature of Review by the Board.

During the informal conference on this matter, the Board requested that the parties and the amicus address themselves to a preliminary question: What is the proper scope and nature of the review by the Board of a DHEW indirect cost rate determination? The issue has been the subject of a variety of formulations by the parties and the amicus, sometimes cast in terms of which action the Board is reviewing (i.e., the Grantee's final proposal or the DHEW determination) and what is the standard for such review, and at other times cast in terms of whether there is any "presumption" of validity to the Regional Director's decision or in terms of who has the "burden of proof."

We do not believe that formulations cast in terms of "presumptions" or "burdens" are particularly helpful, since such terms merely serve as labels for results. Rather the answer must be found in the general framework of the function of the Board within DHEW, the general responsibilities of DHEW with respect to indirect cost rate determinations, the nature of the problem involved and the procedural posture in which the case reaches us.

(a) Function of the Board. The Board was established in 1973 (38 F.R. 9906) for the purpose of reviewing designated classes of post-award disputes arising in the administration of grants by constituent agencies of DHEW. It was designed as a vehicle for the administrative resolution of grantee disputes by persons having a considerable measure of independence (see 45 C.F.R. §16.11) from the agencies directly involved in those disputes, and thus as adding an additional element of due process to DHEW grant administration.

(b) DHEW Responsibilities with Respect to Indirect Cost Determinations. DHEW has been

delegated responsibility by the Congress for the administration of many of the myriad categorical grant programs here involved. Within the Federal government, and whether by reason of the terms of Reorganization Plan No. 1 of 1953 creating DHEW or by the terms of the statutes authorizing its various grant programs, no one disputes the general responsibility of DHEW for the efficient administration of those programs, a responsibility which clearly includes the duty to assure that appropriated Federal funds are spent only for authorized purposes and in an authorized manner. DHEW's own regulations make clear that it "will apply" the cost principles of Appendix D to 45 C.F.R., Part 74, Subpart Q¹ "in determining" the costs incurred "under any type of research and development agreement." Appendix D, paragraph A.3. Its procedural regulations are consistent with the concept of departmental "determinations". See 45 C.F.R. §16.5(a)(5) and 45 C.F.R. §75.4 and §75.6(c). See also the DHEW publication OASC-1, "A Guide for Colleges and Universities" (September 1974), p.5 (hereinafter cited simply as "Guide"), the provisions of which were known to the Grantee. In addition, the Office of Management and Budget has specifically delegated to DHEW the responsibility to negotiate and audit indirect cost rates for educational institution grantees in respect of all Federal programs, whether or not administered by DHEW. Thus the regulatory framework requires DHEW to make a "determination" of indirect cost rates if the negotiation process reaches an impasse.

.. We note that although technical questions can be raised as to which regulatory formulations of the applicable Federal cost principles is here governing, no issue in this case appears affected by any variation in such formulations. For convenience we will refer only to the provisions of 45 C.F.R., Part 74, Subpart Q, and Appendix D thereto. The text of Appendix D (hereinafter cited simply as "Appendix D") is derived from OMB (then BOB) Circular A-21, redesignated as FMC 73-8 and published as 34 C.F.R., Part 254, by the General Services Administration and subsequently withdrawn from 34 C.F.R. by the Office of Management and Budget. See also 45 C.F.R. Part 100, Subpart G (Office of Education grantees).

(c) The Nature of the Problem.

(i) The Issue of Judgment. For this purpose we accept DHEW's position that the application of cost accounting principles to particular situations requires the exercise of judgment. The provisions of Appendix D are replete to such terms as "reasonable", "allocable", "consistent", "equitable relationship", "relative benefits" and the like. Indeed, it is general knowledge that the application of "generally accepted accounting principles" to particular sets of facts, whether those principles involve the accrual or the cash method of accounting for financial presentation purposes or involve cost accounting for reimbursement purposes, requires the exercise of professional judgment as to which reasonable persons may differ. Even where, as in this case, no material underlying fact is in dispute, the notions of what is "reasonable" or "equitable" or "consistent" in particular situations may be reasonably disputed. As noted infra, part of the problem in this case is that standards set forth in the applicable Federal regulatory structure designed for the guidance of the parties during their negotiations may not be adequate for a reasoned and consistent resolution of disputes once those negotiations have reached an impasse.

(ii) The Issue of Autonomy. Another variable in the review process, working at times contrary to other variables, is the express degree of individual institutional autonomy granted by Appendix D. As paragraphs A.2 and C.3 of Appendix D make clear, it is DHEW policy not to disregard the academic philosophies, institutional objectives and otherwise applicable accounting practices of individual grantees. Put another way, Appendix D appears to contemplate the minimum degree of Federal interference with grantee operations and practices consistent with the general notions of equity and consistency which are the overriding guides to standards of Federal indirect cost reimbursement.

(d) Procedural Posture. It is clear that the Board's jurisdiction under 45 C.F.R., Part 16, derives, in the context of this case, from an appeal by the Grantee from the adverse determination by the Regional Director on April 7, 1976, as to the Grantee's on campus organized research indirect cost rate. In that limited procedural sense, we are reviewing only the Regional Director's decision, not the propriety of any proposal for indirect cost rates submitted by the Grantee.

From the above considerations, we conclude that the Board should review DHEW indirect cost determinations appealed to it on the following basis:²

(i) The Board, as a component part of DHEW, must implement such Federal law and policy as may have been definitively promulgated by the Congress and the cognizant Federal agencies;

(ii) The Board will not provide a de novo review of the DHEW cognizant agency official's decision. The Board is not an adequate forum for making independent ad hoc determinations as to the application of cost accounting principles without regard to prior DHEW determinations in the particular case.

(iii) On the other hand, the Board will not regard any DHEW determination appealed to the Board as the beneficiary of an abstract presumption of validity, or dispose of its cases in terms of failures to meet preassigned burdens of proof.

(iv) The standard of review will be one of reasonableness of the previous DHEW determination, viewed in the context of entire record and the provisions of Appendix D, including

² We note that this case involves no disputed material underlying fact and no hearing in respect thereto. No conclusion herein necessarily applies to any case involving such a dispute.

those provisions of Appendix D according to individual grantees wide latitude in adhering to their own institutional objectives and accounting practices. See Oregon Statewide Cost Allocation, Docket No. 75-7, Decision No. 22, June 25, 1976, at p.5.

(v) In reviewing the reasonableness of any particular DHEW decision as to indirect cost rates, the Board will take into account, among other things, (A) the history of prior DHEW determinations or agreements with respect to the particular grantee involved, (B) the extent of changes in past practice involved in the current DHEW position, (C) the apparent reasonableness and evenhandedness of the grantee's own proposals and (D) the consistency and uniformity of the current DHEW position in respect of the particular grantee when viewed in the context of DHEW positions vis-a-vis other grantees similarly situated and the practical availability of rule-making procedures for the articulation of such positions.

(vi) If the Board reverses a prior DHEW determination, it will remand the matter to the appropriate official for further proceedings consistent with the Board's decision.

3. The Specific Issues.

(a) Operation and Maintenance Allowances; Building Use Allowance; Equipment Use Allowance. Paragraphs E.1. and E.2. of Appendix D provide general guidance for the establishment of appropriate "cost groupings" and for the distribution of those cost groupings among cost objectives, a process necessary for indirect costs "incurred for common or joint objectives" which "cannot be identified specifically with a particular research project, an instructional activity or any other institutional activity." Subparagraph 2.d.(3) provides:

"The essential consideration in selection of the distribution base in each instance is that it be the one best suited for assigning the pool of costs to appertaining cost objectives in accord with the relative benefits derived; the traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable."

The provisions of paragraph C.(2), clause (c) of Appendix D require that costs, to be allowable, "must be accorded consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances."

For operation and maintenance expenses and building and equipment use allowances, paragraph F.3. of Appendix D provides for an allocation to the various cost objectives on a basis "that gives primary emphasis to space utilization." Where actual space and related cost records are available, they should be used, but if those records are not adequate for these purposes, "a reasonable estimate of the proportion of total space assigned to the various cost objectives normally will suffice"

The Grantee's information systems provide detailed data on space by room type (e.g., laboratory, library, etc.) and on equipment cost by functional custodian, but do not provide data fully identifying the various classes of possible users of the space and equipment. The absence of that data resulted in a series of proposals and counterproposals by the Grantee and DHEW which continued until submission of the Grantee's appeal to the Board. Each of those proposals and counterproposals was believed by its proponent better to carry out the general guidance of Appendix D referred to above than the proposal to which it responded. In essence, DHEW representatives objected to the Grantee's various proposals either on the ground that they treated certain like types of costs inconsistently or that they ignored the use for instructional or other purposes of certain space associated with units classified by the Grantee's room-type analysis as "organized research units." Without repeating here

the somewhat tortured history of all of these proposals, the ARD/FM and the Regional Director concluded that the most equitable allocation of these cost pools would be derived from applying the room-type relationships developed for the FY1970 indirect cost rates of the Grantee (which relationships DHEW believed were consistently developed) to the actual FY1973 expense and allowance figures supplied by the Grantee.

The Grantee refused to agree to this allocation formula, arguing that its own proposals were reasonable and within the latitude allowed under Appendix D, that the FY1970 relationships did not reflect current utilization relationships and ignored the more sophisticated FY1973 data. A considerable portion of the informal conference on March 22, 1977, was devoted to this issue. See Transcript, pp. 45-115.

In the meantime, the Grantee had refined its own proposal to take account of several of the criticisms made by DHEW representatives, but none of these refinements was ultimately acceptable to those representatives. At the informal conference, DHEW maintained that the Grantee's proposal still suffered from a basic inconsistency, i.e., the allocation of all portions of the organized research space "units" identified by the Grantee's data system, including so-called "service" or "support" or "common" areas associated with basic research laboratories, to the organized research objective, while not treating the other academic space in an equivalent manner. In other words, the Grantee's data system and methodology allocated none of the general category of "other academic space," which included "service" or "support" or "common" areas of the same type (in DHEW's opinion) as that associated with organized research space solely to the instructional cost objective, while it allocated all of these areas associated with the organized research objective solely to that objective.

The Grantee attempted in its final proposals to respond to the DHEW comment that "departmental research," not "Federally-sponsored," was or could be performed in the space identified by the Grantee's room codes as research-type space, by proposing a 30-70 allocation, based on an academic personnel survey of effort, for a portion of that space. That is, the Grantee proposed to take a portion of the space previously identified as organized research space and allocate 70% of that space to Federally-sponsored organized research and 30% to departmental

research allocable to the instructional cost objective, because the effort survey found that 70% of the relevant staff time was spent on organized research projects.

DHEW in effect responded that that allocation may be helpful as far as it goes, but that that allocation ought to be applied to the whole of the space identified as research type space (including the space identified as organized research space), on the ground that Federally-sponsored research is not the sole activity carried on in the space identified by the Grantee as organized research space. Put another way, DHEW argued that if some of the organized research space was to be allocated solely to organized research, some of the "other academic space" must be allocated solely to the instructional cost objective.

The parties agreed that given the inadequacies of the Grantee's FY1973 data base, any allocation of these cost pools, giving "primary emphasis to space utilization" would lack precision. What DHEW termed an "inconsistency", the Grantee called an "ambiguity", and pointed to the enormous problems of achieving precise allocation bases in a university as large and complex as the Grantee. The Grantee also noted that it had experienced difficulty in responding to DHEW's request for new cost studies and analyses, in effect that DHEW's position in negotiations was a constantly moving target.

While we have considerable sympathy with the Grantee's data collection and analysis problems, we are inclined to agree with the ARD/FM and Regional Director that the Grantee's proposals in this area appear to suffer from a basic inconsistency in approach. If the 30-70 split is valid, based on the Grantee's effort study, it would seem equally applicable to all research space (determined by room-type codes), not merely a portion thereof. Alternatively, some of the "service" or "support" or "common" space included within "other academic space" should have been allocated solely to the instructional cost objective.

— In a sense, the parties appeared to avoid coming to agreement as to the precise issue in this area to be resolved by the Board. Each argued that its own final proposal was reasonable and for this reason alone ought to be accepted. In addition, the Grantee argued that Appendix D provides broad latitude to educational institutions in the indirect cost area and that DHEW could not substitute its own judgment

for that of the institution, so long as the institution stayed within the bounds of reasonableness.

The broad guidance provided by Appendix D is inadequate for the purposes of a precise redetermination of this component part of the Grantee's indirect cost rate, on this record, by the Board. In this context, and recognizing that for later fiscal years the parties seem likely to resolve this issue on a different factual and conceptual basis, we are not inclined to substitute our judgment for that of the Regional Director, where, as here, that judgment appears to be reasonable and addressed to the issue of comparability or consistency of cost groupings, and the Grantee's own claim of reasonableness is impaired by its apparent inconsistency of approach. Therefore, as to the components in the on-campus organized research indirect cost rate represented by operations and maintenance expenses and building and equipment use allowances, we sustain the Regional Director's decision.

(b) Departmental Administrative Staff Expenses; The Use of a "Non-Federal Direct Charge Equivalent". Consistent with the accounting guidelines established by the American Council of Education, according to the Grantee, the Grantee's data collection system identifies with Federally-sponsored research projects most of the salary costs of departmental administrative personnel directly supporting those projects (permitting a direct charge to those projects) but does not similarly identify as direct costs the salaries of personnel providing direct departmental administrative support for non-Federally-sponsored projects.

Departmental administration salary costs are recognized as an element in reimburseable indirect costs by Appendix D, paragraph F.5., to the extent they "cannot be directly identified with a specific research project, with an instructional activity or with any other institutional activity." Since some of those costs were identified with organized research projects, but with no other cost objective, the Grantee recognized the need to reduce this indirect cost pool (i.e., all relevant staff salaries less those directly charged to Federal projects) in some manner, in order to achieve comparability and consistency. See Appendix D, paragraph E.2.(c)(2). Beginning in FY1966, the Grantee did this by use of a "non-Federal direct charge equivalent" ("NFDCE"), based on twin assumptions that grant expenditures net of equipment costs is a proper base for measuring necessary administrative staff

support and that the administrative staff support necessary for a given level of grant expenditures is roughly the same for organized research as for the Grantee's other cost objectives.

The Grantee developed its NFDCE by applying to non-Federally supported expenditures net of equipment and administrative support costs a percentage figure equal to the percentage of total Federally-supported expenditures, similarly net of equipment and administrative support costs, represented by support staff expenses directly charged to the Federal projects. The dollar figure represented by this calculation was then deducted from the total of the uncharged staff salary costs. The remainder of that indirect cost pool was then allocated as an indirect cost among the Grantee's various cost objectives.

Prior to the Grantee's proposal for FY1976 and FY1977, it had "averaged" these departmental administrative costs by using a single expense pool for the entire University for this purpose and making an aggregate NFDCE calculation. In 1971, DHEW representatives asked the Grantee to undertake an analysis of these indirect costs on a department-by-department basis. The Grantee agreed to do so and secured the approval of representatives of the DHEW Audit Agency for its proposed computational methodology. The DHEW representatives did not challenge the basic concept of using a NFDCE at that time.

Based on FY1973 data, the Grantee incurred, on a University-wide basis, approximately \$38.5 million in administrative staff salaries, of which approximately \$8.6 million were charged directly to Federal projects. The Grantee's calculations showed that after applying its NFDCE technique to the remaining staff salary expense pool for each relevant department (with adjustments not here relevant), a total of approximately \$13.3 million would be deemed the NFDCE deduction from all of the indirect cost pools. That \$13.3 million figure represents the aggregate of the separate NFDCE calculations for the various individual departments.

The Grantee did not, however, propose a NFDCE deduction of \$13.3 million, but rather one of approximately \$7.7 million. The \$5.6 million difference resulted from two limitations applied by the University. First, if the total of the staff salaries not directly charged to Federal projects for any department (i.e., the remainder of the pool to be allocated) was less

than the NFDCE figure for that Department, the lesser amount was used. Second, in departments with Federal projects which had no staff salaries directly charged thereto (usually departments with a relatively small degree of Federally-supported activity) no NFDCE figure was used and all staff salaries went into the indirect cost pool.

The results of these limitations prompted DHEW representatives to challenge the Grantee's application of the NFDCE in two respects, both of which attacked the assumptions on which the NFDCE was based. For those departments with uncharged staff salaries less than the NFDCE for that department, DHEW argued that the basic comparability assumption underlying the NFDCE appeared invalid. For those departments with no NFDCE, they argued that the effect of the obviously relatively high non-Federal activity rate would be understated. While the DHEW Audit Agency recommended disallowance of the entire staff salary pools on the basis of total unreliability, the ARD/FM and Regional Director concluded that such disallowance would be inequitable to the Grantee. As a practical compromise, they in effect averaged the application of the separately-calculated departmental NFDCE's on a University-wide basis and allowed the staff salary indirect cost pools, after deduction of an aggregate \$13.3 million NFDCE.

The Grantee has argued that the determinations by the ARD/FM and the Regional Director were self-contradictory and inconsistent in applying an NFDCE developed on a department-by-department basis to the University as a whole as though the departmental structure on which the computations were based were irrelevant. The Grantee concluded that the only logical basis for those DHEW determinations was the naked result, i.e., a lower Federal reimbursement rate. As to the limitations used by the Grantee to reduce the NFDCE offset from \$13.3 million to \$7.7 million, the Grantee contended that each is perfectly logical. It makes no sense to charge to non-Federal projects "equivalent" salaries in excess of those actually expended and, if there is no direct charge of Federal salaries to Federal projects in a given department, then by definition there ought not be an equivalent charge to non-Federal projects. Finally, the Grantee has complained that it has been using the NFDCE concept since FY1966 and that it developed the department-by-department approach at DHEW's request, only to

have DHEW reject the results of that approach. If it returned to the exact basis it used in prior years, wherein a single University-wide cost pool was used (instead of separate departmental cost pools), the Grantee contends that the resulting NFDCE deduction from indirect costs would have been slightly smaller than the \$7.7 figure it used in its proposal.

We agree with the ARD/FM and the Regional Director that the NFDCE, as applied to the Grantee, has been demonstrated to be seriously flawed as a comparability measure or technique. Both DHEW and the Grantee (at least if the limitations which it applied are accepted) appear to agree that a department-by-department analysis of these indirect cost pools tends to be a more accurate basic approach, since the costs involved are in fact incurred on a departmental level. On a departmental basis, however, the assumptions upon which the NFDCE concept are based do not appear to be valid. The resulting ratios in the Grantee's departments in fact appear to bear no consistent relation to the relative degree or level of Federal or non-Federal activity in those departments. While the limitations applied by the Grantee to reduce its \$13.3 million NFDCE to \$7.7 million appear to be perfectly logical and appropriate, considered separately, the result of those limitations is the undermining of the entire conceptual basis for use of the NFDCE by the Grantee. In this context, the DHEW representatives concluded that there was no real basis, given the Grantee's data system, for identifying reasonably accurate administrative staff salary pools for an indirect cost rate. We agree with that conclusion.

The resulting determinations of the ARD/FM and Regional Director, to aggregate the separate departmental NFDCE figures and then apply that aggregate to the University as a single unit was admittedly an ad hoc compromise. In the absence of more accurate data (i.e., the absence of a basis of reasonableness for the Grantee's own proposal), we conclude that such an ad hoc determination was reasonable, and sustain the Regional Director on this issue.

(c) Downweighting of Departmental Administration Expenses Charged to Organized Research. After determination of the appropriate and allowable indirect cost pools for departmental administration expenses, the Grantee allocated those expense pools to the various cost objectives for each department on the basis of unweighted expenditure relationships within that department (or in the case of deans' offices, within an entire school or college). In other words, comparable expenditure figures were established for each cost objective on the basis of modified total direct costs, and the departmental administration indirect costs were then allocated to those cost objectives in related percentages.

During the Audit Agency's review of these cost pools and their allocation to Federally-supported organized research, it noticed that some departments having relatively high levels of organized research activity appeared in general to have low departmental administration costs, according to the Grantee's data system. Paragraph G.l.b. of Appendix D, for example, recognizes that "different environmental factors" may require different indirect cost rates applicable to specific kinds of organized research activity. This observation prompted the auditors to wonder about the comparability of these indirect cost pools, i.e., whether costs accounted for as indirect costs in departments having relatively low levels of Federally-sponsored research would typically be accounted for as direct costs in those with relatively high levels of Federally-sponsored activity.

To test this hypothesis, the auditors conducted a statistical regression analysis for two variables at the departmental level: level of organized research and level of departmental administration expense, each as reflected by the Grantee's data. After receiving the Grantee's critique of the Audit Agency's initial analysis, the auditors conducted a second regression analysis including a factor of departmental size. Based on the resulting "coefficient of correlation" of .304, the auditors recommended and the ARD/FM and Regional Director determined that the allocation of the departmental administration cost pools to the organized research cost objective ought to be down-weighted by including only 85.58% of those costs as Federally reimburseable. Expressed differently, DHEW concluded that direct organized research costs typically

generated approximately 15% less in departmental administration costs than the direct costs associated with other cost objectives. In this context we should note that this conclusion did not imply that Federally-sponsored projects cost less to administer, but only that the costs classified by the Grantee's data system as indirect costs tended to be approximately 15% less as a factor of the level of organized research activity.

The Grantee challenged this down-weighting on a number of grounds. First, it argued that it is a universal impression, although not quantifiable, that the administrative burdens associated with Federally-supported activity are much higher than those for state or privately supported programs, citing such requirements as equal opportunity hiring, cost-sharing, audit and review programs and the like. As noted above, to the extent that such administrative burdens are direct charges to organized research programs, the argument is not entirely responsive to the DHEW analysis.

Second, the Grantee and NACUBO both challenged the basic validity of the regression analysis technique used by the Audit Agency, in that it failed to isolate other errant variables which would tend to force a correlation such as that found by the auditors.

We need not stray too far into statistical theory in this case, since we believe that in the context of accepted prior practice of the Grantee, questions raised about the validity of the analysis and the relevant provisions of Appendix D, the record before us does not support this down-weighting determination.

Paragraph E.2(d)(2) of Appendix D³, while permitting use of cost analysis studies in establishing

³ "(2) Results of cost analysis studies may be used when they result in more accurate and equitable distribution of costs. Such cost analysis studies may take into consideration weighting factors, population, or space occupied if they produce equitable results. Cost analysis studies, however, should (a) be appropriately documented in sufficient detail for subsequent review by the cognizant Federal agency, (b) distribute the indirect costs to the appertaining cost objectives in accord with the relative benefits derived, (c) be conducted to fairly reflect the true conditions of the activity and to cover representative transactions for a reasonable period of time, (d) be performed specifically at the institution at which the results are to be used, and (e) be updated periodically and used consistently. Any assumptions made in the study will be sufficiently supported. The use of cost analysis studies and periodic changes in the method of cost distribution must be fully justified.

distribution methods, places significant limitations on their acceptability. In general terms, we believe DHEW as well as grantees are subject to the same general restraints under Appendix D in proposing modifications of distribution bases supported by special analyses such as the one here involved. We are not ruling that the Audit Agency study was not a valid approach to this problem or could not be supported under the provisions of paragraph E.2.(d)(2). We hold only that DHEW has not demonstrated to our satisfaction, on this record, that its analysis was fully justified. On this issue, we reverse the decision of the Regional Director and direct that the Grantee's unweighted expenditure relationships be accepted for the purpose of this issue.

(d) Allocation of Administrative Stipends.

The Grantee pays to certain of its academic personnel "administrative stipends," as a supplement to salary, during the periods of time those personnel perform predominantly administrative functions, such as that of dean, departmental chairman or the like. The stipend is a particular reward for serving in the administrative position and lapses when and if that position is relinquished.

The Grantee has historically treated these administrative stipends as a cost sub-pool separate from the basic salary paid to the academic personnel serving in those administrative positions. The cost sub-pool of basic salaries is allocated, pursuant to the Grantee's survey of relative staff effort, to the various cost objectives benefited, including organized research, instruction and the like. The remaining unallocated portion then becomes part of the indirect departmental or college-level administration pool, allocated to all cost objectives. The administrative stipends, however, are initially allocated entirely to administration, in three parts: indirect administration, nondepartmental committee work and student administration.

The Audit Agency recommended, and the ARD/FM and Regional Director determined, that the stipends should be aggregated with basic salaries and then allocated to the benefiting functions at the appropriate level as a single cost pool.

The basis for DHEW's action was inconsistency of treatment (see Appendix D, paragraph C.2.(c)),

because the Grantee did not offset against the basic salary charge to departmental (or other level) administration, based on its survey of relative staff effort, any portion of the stipend. That is, if 50% of a given group of basic salaries was charged to departmental administration, because 50% of the effort of those personnel included in the study of relative staff effort was devoted to departmental administration, it was inconsistent, in DHEW's view, to charge the entire stipend pool to departmental administration in respect of that same effort, without an offset or netting calculation.

We believe the ARD/FM's and Regional Director's determinations on this issue were correct, in that the inconsistent treatment of these costs was clearly evident, and sustain the Regional Director's decision in respect thereto.

(e) "Total Student Hours". Paragraph J.41. of Appendix D provides as follows:

"Student services costs. Costs of the deans of students, administration of student affairs, registrar, placement offices, student advisers, student health and infirmary services, and such other activities as are identifiable with student services apply only to instruction and therefore are not allocable to research agreements, either as direct costs or indirect costs. However, in the case of students actually engaged in work under research agreements, a proportion of student services costs measured by the relationship between hours of work by students on such research work and total student hours including all research time may be allowed as a part of research administration expenses."

The Grantee has consistently interpreted the words "total student hours" to mean the sum of classroom hours and hours worked as a University employee.

During the 1971 negotiations for the previous indirect cost rate for the Grantee, DHEW representatives argued that "total student hours" should include student study hours and proposed to include two study hours for every hour of classroom time. In the interest of concluding those negotiations, DHEW and the Grantee agreed to include one study hour for each classroom hour, pending an authoritative interpretation of the

phrase "total student hours" from the Office of Management and Budget. Despite apparent efforts by the Grantee and NACUBO since 1971 for such an interpretation, none has been forthcoming.

According to DHEW representatives, the Department's current policy is that "total student hours" does include study time. That policy, however, has never been reduced to writing internally, or quantified, or made the subject of any formal DHEW notice to grantees. Nonetheless, in the Guide, at page 61, DHEW has provided to the grantee community a sample format for use under paragraph J.41. of Appendix D, in which hours other than work and classroom hours are described as "[h]ours spent registering, hours spent in job placement interviews, and hours spent in all other related student activities."

If this description was intended to clarify the DHEW position as to the ambiguities inherent in the curious phrase "total student hours," it surely failed to do so. Indeed, it is somewhat difficult, in the context of that description in the Guide, to include study time as "related student activities." One would have supposed that studying was a primary student objective.

While we think that as a matter of logic and sound policy there is considerable justification for including study time in the student hours base for purposes of paragraph J.41., we believe that in the context of a well-known and publicized issue relating to an interpretation of Appendix D in general terms, and not as applied to a particular set of facts, DHEW cannot insist on its own position on that issue in the individual audit process. Elemental evenhandedness requires, in this context, a clarifying amendment to paragraph J.41. Where the issue is one of general interpretation of the governing Federal standards, it is inequitable for DHEW to rely on individual audits and varying regional applications of the Department's unarticulated policy position. For this reason, we reverse the decision of the Regional Director on this issue and rule that until paragraph J.41 is amended, study hours are not to be included in the base of "total student hours."

(f) Treatment of Student Application Fees.
Paragraph C.5.a. of Appendix D provides:

"The term applicable credits refers to

those receipt or negative expenditure types of transactions which operate to offset or reduce expense items that are allocable to research agreements as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; sales of scrap or incidental services; and adjustments of overpayments or erroneous charges."

In the course of audit, the DHEW Audit Agency noticed that there were expenses relating to the student admissions offices which were not congruent with the allocation base of "total student hours." These were the expenses of processing applications which were rejected, i.e., of those persons who contributed no student hours. In an attempt to compensate for this noncongruence, DHEW determined that it should credit the admissions office expense pool with the application fees paid by all applicants, based on paragraph C.5.a. quoted above. This was done on the basis of materials in the Grantee's catalogues indicating that the purpose of the fees was to defray the cost of processing applications.

As in the case of the immediately prior issue relating to "total student hours," the applicable provisions of Appendix D do not provide sure footing for a definitive resolution of this issue. Nor do the elusive concepts of generally accepted accounting principles as applied to cost accounting by universities.

For the reasons noted below, until and unless paragraph C.5.a. of Appendix D is appropriately clarified and whatever the validity of making some adjustment to the admissions office expense pool in respect of rejected applicants, we believe that the Grantee's treatment of these fees was reasonable, was within the range of accounting acceptability and was not intended to take inequitable advantage of existing Federal reimbursement guidelines.

Unlike parking lots, in which fees are credited to expenses, or computer or reproduction centers which are supported in part by user charges, it is not the admissions offices' own activities which are generating these fees. The student is not applying for admission to that office, but rather to the University, or to a specific school or college within it. Thus the unit generating those fees is not the admissions office

but rather the entire Grantee, or relevant component institution. This view of these fees is consistent with (although not controlled by) the Grantee's crediting of them to its general funds accounts.

In addition, the cost of processing applications has not been identified by the Grantee in any way which would make the credit meaningful. The aggregate of those fees may exceed or be less than those costs.

Finally, we think that reliance on the stated catalogue explanation for these fees may place too much weight on the alleged "purpose" for charging the fee. For it may be that, as the Grantee has argued, another, and perhaps dominant "purpose" of these fees is the simple discouragement of frivolous applications. The revenue, in this view, is simply a byproduct of that purpose.

For these reasons, the Regional Director's decision as to the credit of these fees under paragraph C.5.a. of Appendix D on this issue is reversed. This reversal, however, is not intended either (a) to preclude an equitable adjustment (if such can be established) to the admissions office expense pool in respect of fees paid by rejected applicants or (b) to indicate any view that an amendment to paragraph C.5.a. of Appendix D having the effect of treating the fees in question as credits would not be fair or appropriate. We hold only that the credit technique does not appear appropriate, on this record and in view of the present text of paragraph C.5.a.

4. Conclusion. This case is remanded to the Regional Director's successor for recalculation of the FY1976 and FY1977 indirect cost rates for the Grantee in a manner consistent with the decisions herein.

/s/ Wilmot R. Hastings, Chairman

/s/ Francis D. DeGeorge

/s/ Edwin Yourman