

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: Oregon Department of Higher Education
Indirect Cost Rate Proposal
Audit Control No. 50012-10
Docket No. 75-9
Decision No. 27

DATE: September 27, 1976

DECISION

This appeal by the Oregon Department of Higher Education ("Grantee") by letter dated June 4, 1975 ("Appeal"), asks the Departmental Grant Appeals Board ("Board") of the Department of Health, Education, and Welfare ("DHEW") to review an adverse determination made by DHEW's Regional Director, Region X, on May 7, 1975, as to Grantee's dissatisfaction with a proposed indirect cost rate "Negotiation Agreement" proposed by DHEW for the University of Oregon Medical School (the "School").

Pursuant to DHEW policy, the Grantee, on February 25, 1974, submitted to the Regional Director an indirect cost rate proposal for the School for FY1973. The DHEW Audit Agency reviewed the proposal and, on September 6, 1974, issued an audit report thereon (Control No. 50012-10) proposing certain adjustments and disallowances, and indicating that the same adjustments and disallowances should be made for the FY1971 and FY1972 indirect cost rate proposals for the School. After preliminary negotiations with representatives of the Grantee, DHEW delivered to the Grantee a proposed indirect cost rate "Negotiation Agreement" for FY1976 which included provisional rates for later periods and carry-forward adjustments based on the Audit Agency's conclusions with respect to prior years. The Grantee objected to certain of the proposed adjustments.

By the conclusion of an informal appeal proceeding before the Regional Director, all outstanding issues relating to the indirect cost rate proposal were resolved to the satisfaction of the parties, except one: whether so-called "non-mandatory cost-shared salaries and wages" should be included in the allocation base for the School's "Organized Research" cost objective for indirect cost rate purposes.

Pursuant to DHEW policy, DHEW and the School in 1972 reached an agreement setting 5% as the minimum level of "cost-sharing" for all of the School's research projects sponsored by DHEW. In other words, the School was to provide from non-Federal sources 5% of the cost of all DHEW-funded research projects. This computation was to be made periodically on an aggregate basis, in lieu of a project-by-project basis. For this purpose, the School established a series of separately budgeted accounts, which it has funded from grant and gift sources other than Federal or State appropriations. An amount equal to the wages and salaries included in this so-called "mandatory" cost-sharing was included by the School in the wages and salaries base used to allocate indirect costs related to its Organized Research cost objective between DHEW and the School.

During its review of the Grantee's indirect cost rate proposal, the DHEW Audit Agency determined that the School did not require staff members to identify and report time spent on specific projects or activities. Thus the School was unable to identify, for cost-sharing purposes, any specific amount of staff activity expended on the aggregate of Federally-sponsored projects grouped under the Organized Research cost objective. Rather, it relied entirely on the mandatory cost-sharing amount to measure its contribution to its DHEW-sponsored research efforts. The DHEW Audit Agency reviewed all active DHEW grants and contracts for FY1973 and determined, based on data in the relevant applications, that the sum of \$225,287 should be added to the mandatory amount of cost-shared salaries and wages in the allocation base under Organized Research for indirect cost rate purposes. The Audit Agency's conclusion was, therefore, that the amount of cost-shared wages and salaries of staff actually expended in DHEW-sponsored research exceeded the mandatory level by the amount of \$225,287. The addition of this amount to the Organized Research allocation base used for indirect cost purposes could significantly affect the allocation of indirect costs in fact apportioned between the School and DHEW. Since some indirect costs may be allocated on a basis other than wages and salaries (e.g., a building use allowance allocated on a square footage basis), an under-reporting of the total amount of wages and salaries

spent on Federally-supported projects (here, Organized Research) could result in an over-allocation of indirect costs to those projects and therefore to DHEW. The School has estimated the adverse financial impact on it of this inclusion at \$94,000 for FY1973. The propriety of including this additional amount in the Organized Research allocation base is the subject of the Appeal.

Section G.2. of 45 C.F.R. Part 74, Appendix D (Federal Management Circular 73-8) provides in relevant part that indirect costs allocated to organized research at grantee educational institutions should be distributed on the basis of direct salaries and wages, which may for this purpose include that portion contributed to the research by the institution for cost-sharing purposes. Section D.1 of 45 C.F.R. Part 74, Appendix D, provides that "direct" costs are "those costs which can be identified specifically with a particular research project ... or any other institutional activity ...," and Section D.2 identifies typical direct costs applicable to research agreements as including "the compensation of employees for performance of work under the research agreement" "Organized research" is defined in Section B.1. of 45 C.F.R. Part 74, Appendix D, as "all research activities of an institution that are separately budgeted and accounted for."

Much of the debate on the issue involved in the Appeal has centered on the School's past budgeting and management practices. The parties appear to agree that some effort budgeted by the School to its "Instruction and Departmental Research" cost objective has been expended on the research projects classified by the School as part of its Organized Research effort. Despite this fact, the Grantee has vigorously and articulately defended its allocation of all non-mandatory cost-shared wages and salaries to the School's Instruction and Departmental Research objective. Its defense of this allocation has rested on a variety of grounds, but appears to be based primarily on the argument that the assignment of particular costs among various institutional objectives depends on a managerial judgment as to which objective that cost primarily benefits, and that the School has made a judgment that those salaries which are funded from State sources, despite the work performed by the staff receiving

those salaries on DHEW-sponsored research, benefit primarily the instructional efforts of the School and thus should be associated with that cost objective. The School has also argued that since the non-mandatory cost-shared wages and salaries are in fact not "separately budgeted and accounted for," they do not constitute part of the organized research effort.

Much of the Grantee's argument seems to have relentlessly assumed its conclusions. The definition of "organized research" in 45 C.F.R. Part 74, Appendix D, relates to a type or class of institutional activity, not the method used by an institution to allocate costs to that activity. Clearly the School does maintain an organized research effort which is separately budgeted and accounted for. The question is what costs ought to be allocated to that activity for indirect cost rate purposes. Nor can a management judgment by the School that work by individual staff members on Federally-sponsored research projects may benefit primarily the School's instructional, rather than research, efforts determine what costs should be included in an allocation base for Federal indirect cost rate purposes. For those purposes, 45 C.F.R., Part 74, Appendix D, clearly provides that wages and salaries which can be specifically identified with a particular research project are allowable direct costs of the project, which in turn form part of the indirect cost allocation base for the organized research cost objective. Where appropriate, particular salaries must be split among objectives, a process recognized as appropriate in general by the Grantee but for some unexplained reason believed by the Grantee to be inapplicable to those salaries funded from State sources. As noted earlier, the mandatory cost-sharing amount of wages and salaries which was included by the School in its allocation base is funded solely from grants and gifts.

For purposes of allocating costs for indirect cost-sharing purposes, the Board is unable to find any rational basis for differentiating between non-Federal sources derived on the one hand from State appropriations and on the other from grants and gifts, nor any basis of distinction based on the School's present accounting practices or on its institutional cost-sharing agreement with DHEW, which is designed to meet other requirements. All wages and salaries

which can be "identified specifically with a particular research project" included by the School within its Organized Research efforts must be included in any wages and salaries allocation base used for indirect cost purposes, whatever the funding source. No other result would carry out the purposes of 45 C.F.R., Part 74, in respect of an equitable and consistent sharing between DHEW and its grantees of indirect costs.

The Board thus denies Grantee's appeal and remands the case to the Regional Director, Region X, to resolve the dispute as to the actual amount of cost-shared wages and salaries which ought to be added to the mandatory amount for indirect cost rate allocation purposes.

/s/ Thomas Malone

/s/ Francis D. DeGeorge

/s/ Wilmot R. Hastings, Panel Chairman