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ROUTING AND RECORD SHEET

SUBJECT: (Optional)

Office of Management and Budget Circular No. A-21

FROM:

Office of the Comptroller/BMG
7C36 Hqs.

EXTENSION

NO.

DATE

18 June 1986

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TO: (Officer designation, room number, and building)

DATE

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OFFICER'S INITIALS

COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Executive Registry

86-2814X

JUN 04 1986

CIRCULAR NO. A-21, Revised
Transmittal Memorandum No. 2

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost Principles for Educational Institutions

This transmittal memorandum revises OMB Circular No. A-21, "Cost Principles for Educational Institutions," to establish a 3 percent allowance to cover the administrative work of department heads and faculty.

Effective on grants and contracts awarded on or after July 1, 1987, Circular A-21 is revised as follows:

Departmental administration expenses.

Revise F.4.a.(2)(a):

(2) Academic departments

- (a) Salaries and fringe benefits attributable to the administrative work of department heads, directors of divisions and organized research units, faculty and professional staff shall be allowed at a rate of 3 percent of modified total direct costs. This allowance shall be added to the computation of the indirect cost rate for major functions in section G.; the expenses covered by the allowance shall be excluded from the development and allocation of the departmental administration cost pool. No documentation is required to support this allowance.

General Administration and General Expenses

Add the following sentence to F.3.a.:

General administration and general expenses shall not include expenses incurred within dean's offices, academic departments, organized research units, or similar organizational units (see section F.4., departmental administration expenses).

Sponsored Projects Administration

Revise F.5.a. as follows:

- (a) The expenses under this heading 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. This category also includes an allocable share of fringe benefit costs, general administration and general expenses, operation and maintenance expenses, and depreciation/use allowances. Appropriate adjustments will be made for services provided to other functions or organizations.

Federal agencies may authorize reimbursement of additional costs for department heads and faculty only in exceptional cases where an institution can demonstrate undue hardship or detriment to project performance.

Federal agencies are authorized to implement these changes earlier if they choose.


James P. Miller III
Director



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF MANAGEMENT AND BUDGET

Revision of OMB Circular A-21, "Cost Principles for Educational Institutions"

AGENCY: OFFICE OF MANAGEMENT AND BUDGET

ACTION: Notice of revision to OMB Circular A-21, "Cost Principles for Educational Institutions"

Summary:

This notice revises OMB Circular A-21, "Cost Principles for Educational Institutions." This revision is based on the numerous thoughtful comments received in response to the proposed revision published for comment in the February 12, 1986 Federal Register.

Effective July 1, 1987, Circular A-21 is revised to set a fixed overhead allowance for the administration of federally sponsored grants and contracts by department heads and faculty. The fixed allowance will equal 3 percent of modified total direct costs. No faculty reporting will be required to support the allowance. University indirect cost rates will be the sum of the rate negotiated for departmental administration, the negotiated rates for the remaining six cost pools, plus the 3 percent fixed allowance. The revision takes effect on July 1, 1987. Individual Federal agencies may elect to utilize the fixed allowance prior to July 1, 1987.

We agree with many of the comments received during the 3 month consultation with the university and scientific community begun with the February 12, 1986 Federal Register notice. We have refined the February 12th proposal accordingly. The final revision focuses on the narrow area of departmental administration. This area is costly to document and subject to considerable audit controversy.

A fixed allowance for the salaries of faculty and department heads engaged in administrative activities which support federally-funded research will eliminate any Federal requirement for faculty reporting to document overhead allocations. The elimination of this requirement will greatly reduce the controversy among individual researchers, their institutions, and the Federal funding and audit agencies. In addition, the allowance will restore a more appropriate balance between direct Federal research support and overhead payments.

When additional data become available, we will consider an adjustment to the 3 percent fixed rate for departmental administration by department heads and faculty. We are also willing to consult further with universities on ways to improve the conduct of research.

Background

Prior to 1966, the Federal Government used a fixed, national rate to establish the amount of Federal payments for overhead allocated to federally sponsored research. After the Federal

Government adopted the current policy of negotiating individual cost-based reimbursement rates with individual universities, Federal overhead payments increased from 22 percent of total Federal research support to universities in 1970 to 24 percent in 1974 and 31 percent in 1985.

The disproportionate growth of overhead payments has been recognized as a threat to maintaining appropriate levels of research support. This growing share of overhead payments has provoked tensions within universities, between scientists and administrators, and between universities and Federal funding and audit agencies.

The discussion of increasing overhead payments resulted in a consensus among Congress, the General Accounting Office, the Inspector General of the Department of Health and Human Services (HHS), the Office of Science and Technology Policy, and the White House Science Council on the need for a government-wide policy to address the share of Federal university research spending expended on allocated overhead.

— Congressional directives The FY82 Senate Labor/HHS Appropriation report stated, "Should indirect costs continue to increase as a percentage of total costs, the amount of money appropriated by the Congress will finance less and less actual

research." (Report 97-268, p. 48) The House Appropriations subcommittee on Labor/HHS, expressing itself in its FY85 report (House Report 98-911, p. 31), held that allocated overhead should be addressed through a government-wide plan. In the conference report for the FY86 Labor/HHS appropriation bill (House Report 99-402, p. 28), Congress stated that containing research costs and payments for allocated overhead should be a high priority of all executive branch agencies.

— General Accounting Office In the 1984 report, "Assuring Reasonableness of Rising Indirect Costs on NIH Research Grants -- A Difficult Problem," (GAO/HRD-84-3) the General Accounting Office found that university allocations of departmental administration overhead to federally sponsored research are subjective and difficult to verify. The General Accounting Office also found that: first, current A-21 allocation criteria give universities broad discretion in allocation of overhead to Federal research grants and, second, universities' overhead allocations are rarely audited by HHS, which sets overhead payment rates for 98 percent of the universities receiving Federal research grants.

The General Accounting Office recommended that OMB revise A-21 to limit overhead allocations to a fixed percentage of departmental administration expenses, thus ensuring reasonable reimbursement for overhead and a reduction of universities' accounting and reporting burden.

-- HHS Inspector General In December, 1985, the HHS Inspector General published the report, "The Impact of Indirect Costs on Research Sponsored by the Federal Government at Universities and Colleges." The report recommended a 7 percent fixed allowance for all departmental administration overhead allocated to federally sponsored research. The 7 percent fixed allowance applied to the entire departmental administration pool -- deans, department heads, faculty, clerical support, and miscellaneous overhead.

In a sample of 13 research universities, the HHS Inspector General found that faculty administration (and the associated salaries) tends primarily to benefit instruction and not federally sponsored research -- and recommended that no allowance be made for such salaries. The HHS Inspector General also found that clerical support which ought properly to be allocated to instruction and other institutional activities is being charged to federally sponsored research -- and recommended that a fixed allowance be established for such support activities. In the view of the HHS Inspector General, OMB Circular A-21 lacks clear criteria for allocation of departmental administration overhead to federally sponsored research, particularly with respect to the allocation guidelines for faculty salaries.

-- Office of Science and Technology Policy The Office of Science and Technology recommended last fall that a single fixed rate for all allocated administrative overhead, based on a five year average, be phased in over two years. In addition to restoring the balance between direct Federal research support and overhead payments, the Office of Science and Technology Policy argued that the plan would eliminate the need for faculty activity reporting to document university allocations of faculty and department heads salaries to federally sponsored research.

-- Packard-Bromley Panel On May 13, 1986, the White House Science Council released the report of the Panel on the Health of U.S. Colleges and Universities. Among its numerous recommendations, the Panel recommended a fixed, national rate for allocated administrative overhead. The Panel proposed to phase-in the national rates over two years. The Panel also proposed: 1) elimination of faculty reporting to document overhead allocations, 2) peer review of allocated overhead as well as direct costs, 3) increases in use allowances for facilities and equipment, and 4) reductions of Federal administrative burdens.

Proposed Revision of February 12, 1986

On February 12, 1986, OMB proposed to phase-in a fixed rate for administrative allocated overhead to: first, reduce the controversy among researchers, their institutions, and Federal funding and auditing agencies and, second, restore an

appropriate balance between direct Federal research support and overhead payments. This proposal followed up on Congress' directive to address the growth of overhead payments, and was based on recommendations of the General Accounting Office, the HHS Inspector General, and the Office of Science and Technology Policy to set a fixed rate for a subset of the overhead categories. The proposal also adopted the HHS Inspector General's specific recommendation to reduce administrative overhead rates from the current national average.

Comments on the February 12th Proposal

Over 300 comments were received in response to the February 12th publication. The major comments were:

Comment: Due to organizational differences, some universities charge clerical support as allocated overhead while others charge it as a direct cost. The February 12th proposed revision would impact more heavily on universities which charge clerical support as allocated overhead.

Response: We agree. In light of these legitimate organizational differences, a more selective approach is preferable to the February 12th proposal. We have accordingly focused the fixed allowance on salaries of faculty and department heads. This will avoid disruption to the organizational arrangements of universities and will not restrict the allocation of clerical support costs.

Comment: Set payments for faculty administrative efforts at a fixed percentage of faculty salaries.

Response: We agree conceptually with this approach. The revision applies this concept against the base of modified total direct costs of federally sponsored research.

Comment: Focus the revision on departmental administration, excluding non-controversial administrative overhead from the fixed rate.

Response: We agree.

Comment: Allocated overhead as well as direct costs should be reviewed during scientific peer review of funding applications.

Response: We agree.

Comment: Universities should be permitted to charge more of allocated overhead as direct costs.

Response: We agree. Charging more of existing allocated overhead as direct costs would subject these charges to proper scientific peer review and improve the allocation and management of scarce research funds.

Comment: Federal administrative burdens, such as effort reporting, application requirements, and funding controls should be reduced to a minimum.

Response: We agree. The three percent fixed allowance for research administration by faculty and department heads will result in the elimination of Federal requirements for faculty reporting to document overhead allocations. OMB encourages the research community to identify areas where federally-imposed administrative burdens could be reduced. In addition, OMB will conduct a thorough review of all paperwork requirements associated with Circular A-21.

Comment: Universities would not have time to adjust to reduced payments for allocated overhead.

Response: We agree that the February 12th notice did not clearly indicate that the fixed rate would be phased-in gradually by being applied to only new grants. We have corrected this, and believe most universities are able to adjust to the revision. Those facing a severe hardship will, under the current notice, be able to apply for a waiver.

Comment: Freeze overhead payment rates at 90 percent of current rates for one year rather than changing A-21.

Response: An arbitrary reduction would affect all universities regardless of their current overhead payment rate, and would run counter to specific Congressional guidance. In addition, a rate

freeze would not permit the elimination of Federal requirements for faculty reporting to document overhead allocations.

Comment: OMB proposed the revision without consulting the affected parties.

Response: The February 12th proposal was published to initiate the consultation process. We believe that consultation is best achieved when all affected parties have a specific proposal to discuss and analyze, thus permitting the presentation of alternatives. We believe in fostering the university-government partnership by opening the debate on issues to all affected parties. Since the February 12th proposal, we have heard from and consulted with numerous affected parties.

Comment: The proposal departs from the White House Science Council report.

Response: The report, released in early May, is currently being reviewed by the Executive Branch. Based on a preliminary review, we believe that the report's recommendations regarding overhead deserve considerable attention. We believe the 3 percent fixed allowance is consistent with the report's recommendations. We

note that the formal requirement for cost sharing has already been eliminated. Further, we note that the Department of Health and Human Services (HHS) intends to adopt the National Science Foundation's practices for the award and payment of overhead allocated by universities to federally sponsored research. HHS also intends to institute peer review of allocated overhead associated with proposed grant budgets. Together, these initiatives will respond to a significant number of the report's recommendations.

Comment: Circular A-21 should be revised to change the use allowances for buildings and equipment.

Response: While use allowances are beyond the scope of the February 12, 1986 notice, we will consider any proposals advanced as part of future discussions on improving the administration of research. Until a further revision of Circular A-21, institutions may find it profitable to use the current A-21 provisions which allow depreciation of facilities.

Revision of Circular A-21

We continue to share Congress' concern that the growth of allocated overhead threatens the continued productivity of the Federal/university research partnership.

Consistent with the reports of the General Accounting Office, the HHS Inspector General, and the Office of Science and Technology Policy, we believe that Circular A-21 should be revised to reduce the controversy among scientists, their institutions, and the various Federal funding and auditing agencies. In addition, the revision should restore an appropriate balance between direct Federal research spending and overhead payments.

Responding to the numerous thoughtful insights of commenters, a fixed 3 percent allowance for the research administration efforts of faculty and department heads is established, effective July 1, 1987. The revision will greatly reduce the current friction among researchers, universities, and Federal funding and auditing agencies. The allowance focuses on the area of greatest concern, salaries of department heads and faculty in departmental administration, but adopts the thrust of numerous suggestions that the revision recognize the organizational diversity of educational institutions.

Overhead payments for salaries of faculty and department heads will be calculated as 3 percent of modified total direct costs. University indirect cost rates will be the sum of the rate negotiated for departmental administration, the negotiated rates for the remaining six pools, plus the 3 percent fixed allowance.

Faculty reporting will not be required to support the 3 percent allowance.

Implementation

The revision is effective July 1, 1987. Individual Federal agencies may implement the revision upon publication.

Billing code 3110-01-M