Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

COST ALLOCATION SERVICES NEEDS TO UPDATE ITS INDIRECT COST RATE-SETTING GUIDANCE

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Office of Inspector General

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The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

Report in Brief
Date: June 2022
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U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL

Cost Allocation Services Needs To Update Its Indirect Cost Rate-Setting Guidance

Why OIG Did This Audit

Nonprofit organizations use negotiated cost rates to ensure that Federal awards receive proper allocations of indirect costs, which are costs that benefit more than one activity. Within the HHS Program Support Center (PSC), Cost Allocation Services (CAS) is responsible for negotiating and approving indirect cost rates.

Previous Government Accountability Office and OIG reports identified deficiencies related to internal controls for setting indirect cost rates, concerns about CAS's approval of incorrect indirect cost rates, and inclusion of unallowable salaries in indirect cost proposals.

Our objective was to assess CAS's rate-setting process and determine whether it complied with Federal regulations when negotiating and approving indirect cost rates for nonprofit organizations.

How OIG Did This Audit

CAS officials provided us with a list of 1,455 indirect cost rates negotiated or renegotiated from January 1 through December 31, 2019. We removed 242 indirect cost rates for hospitals because they have different Federal criteria for determining their indirect cost rates. From the remaining 1,213 indirect cost rates, we selected a judgmental sample of 19 indirect cost rates to assess CAS's indirect cost rate-setting process and determine compliance with Federal regulations.

What OIG Found

We found that CAS's indirect cost rate-setting process for nonprofit organizations did not always comply with Federal regulations and its own policies. Specifically: (1) CAS did not ensure compliance with Federal regulations when negotiating indirect cost rates, (2) CAS did not always follow its Review Guide, (3) CAS did not always follow its internal guidance or negotiate rates in a timely manner, and (4) indirect cost rate proposals included potentially unallowable compensation costs. These errors occurred because CAS had not updated the Review Guide since 2003 to ensure that it reflected Federal requirements and its internal guidance. According to CAS officials, CAS also faced issues with the heavy workload associated with negotiating indirect cost rates and has been unable to fill positions for negotiators and branch chiefs lost through attrition.

What OIG Recommends and CAS Comments

We recommend that CAS update its Review Guide to include applicable Federal regulations and CAS internal policies and procedures and provide training to its branch chiefs and negotiators to ensure its indirect cost rate-setting process conforms with Federal regulations. Additionally, CAS should review its staffing levels and determine whether they are sufficient to meet the agency's objectives and seek clarification on whether the executive compensation policy complies with Federal law and governmentwide policy. See the report for more detailed recommendations.

In written comments on our draft report, CAS concurred with four recommendations and did not concur with two recommendations. In response to our recommendations, CAS stated that it has formed a work group and has started the process of updating the Review Guide to conform with applicable Federal regulations and its internal policies and procedures, that it will update checklists to include all federally required documents, and that it plans to implement a process for ensuring all required forms and signatures are included in the proposal submission. CAS stated that our characterization of the Non-Profit Review Guide is a factual error. Additionally, CAS disagreed with recommendations regarding CAS reviewing its staffing levels and seeking clarification on the policy of including executive compensation above the Level II statutory cap in the indirect cost pool. We maintain that our findings and recommendations are valid and our responses are detailed in the report.

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INTRODUCTION

WHY WE DID THIS AUDIT

Nonprofit organizations use negotiated cost rates to ensure that Federal awards receive proper allocations of indirect costs, which are costs that benefit more than one activity. Within the Department of Health and Human Services (HHS) Program Support Center (PSC), Cost Allocation Services (CAS) is responsible for negotiating and approving indirect cost rates.

In September of 2016, the Government Accountability Office (GAO) identified deficiencies related to internal controls established by CAS for setting indirect cost rates.[1] Specifically, GAO found that CAS's internal guidance (1) was not updated to reflect current Office of Management and Budget (OMB) guidance or changes in agency requirements and (2) lacked detailed instructions to supervisors on their review responsibilities in the indirect cost rate process. Additionally, a previous Office of Inspector General (OIG) audit of a nonprofit organization identified problems related to the inclusion of unallowable costs in an indirect cost rate proposal approved by CAS.[2]

OBJECTIVE

Our objective was to assess CAS's rate-setting process and determine whether CAS complied with Federal regulations when negotiating and approving indirect cost rates for nonprofit organizations. As a part of this audit, we determined whether CAS complied with its policies and procedures for reviewing, negotiating, and setting indirect cost rates.

BACKGROUND

Indirect Costs

Indirect costs represent costs that are not readily identifiable to specific contracts, grants, or other activities (cost objectives) of an organization. Examples of indirect costs for nonprofit organizations include depreciation on buildings and equipment, the cost of operating and maintaining facilities, and overhead expenses, such as the salaries of executive officers, personnel administration, and accounting.

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[1] *Agencies Involved in the Indirect Cost Rate-Setting Process Need to Improve Controls*. Available online at https://www.gao.gov/assets/gao-16-616.pdf.

[2] *Southwest Key Programs Failed To Protect Federal Funds Intended for the Care and Placement of Unaccompanied Alien Children*. Available online at https://oig.hhs.gov/oas/reports/region6/61707004.pdf.

An organization with several major functions that benefit from its indirect costs may accumulate those costs into cost groupings (indirect cost pools). The allocated indirect costs are then distributed to individual Federal grant awards and other activities by means of an indirect cost rate(s).[3] Organizations that do not have a previously established indirect cost rate with a Federal agency must submit an initial indirect cost rate proposal to the cognizant agency[4] immediately after being advised that a Federal award will be made or no later than 3 months after the effective date of the Federal award.[5] Unless granted an extension,[6] organizations that have a previously established indirect cost rate must submit a new indirect cost rate proposal within 6 months after the close of each fiscal year.[7] The indirect cost rates calculated by the organizations are subject to review and approval by CAS through a negotiation process known as rate-setting.

Federal awarding agencies use negotiated indirect cost rates that are applied to appropriate direct cost bases to reimburse indirect costs under Federal financial assistance awards, i.e., grants and cooperative agreements. There are four general types of negotiated indirect cost rates:

- Predetermined indirect cost rates are applicable to a specified current or future period based on an estimate of costs to be incurred during the period and are not subject to adjustment.[8]

- Final indirect cost rates are applicable to a specified past period, are based on the actual costs of the period, and are not subject to adjustment.[9]

- Fixed indirect cost rates have the same characteristics as predetermined rates, except that the difference between the estimated costs and actual costs for the period are

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[3] 45 CFR part 75, Appendix IV, § B.1.b.

[4] A cognizant agency for indirect costs is the Federal agency responsible for negotiating and approving indirect cost rates for a nonprofit organization on behalf of all Federal agencies (45 CFR part 75, Appendix IV, § C.1.a). Generally, the cognizant agency is the Federal agency with the largest dollar value of Federal awards with an organization (45 CFR part 75, Appendix IV, § C.2.a).

[5] 45 CFR part 75, Appendix IV, § C.2.b.

[6] 45 CFR § 75.414(g).

[7] 45 CFR part 75, Appendix IV, § C.2.c.

[8] 45 CFR part 75, Appendix IV, § C.1.b.

[9] 45 CFR part 75, Appendix IV, § C.1.d.

carried forward as an adjustment to the indirect rate computation of a subsequent period.[10]

- Provisional indirect cost rates are temporary rates applicable to a specific period and are used pending the establishment of a final rate for the period.[11]

Table 1 is a hypothetical example of how organizations calculate indirect cost rates.

Table 1: Hypothetical Example of How Indirect Cost Rates Are Calculated

The indirect cost rate is calculated by dividing the total allowable indirect costs by total allowable direct costs.[12] For example, from the tables below:

Indirect Costs		$1,340,000
Direct Costs	÷	$3,350,000
Indirect Cost Rate		40%

Indirect Costs	Total Costs		Adjustments for Unallowable Costs		Total Allowable Indirect Costs
Data Processing/Software License Fees	$500,000	-	$185,000	=	$315,000
Accounting/Auditing	1,000,000	-	400,000	=	600,000
Office Supplies	100,000	-	75,000	=	25,000
Other Indirect Costs	600,000	-	200,000	=	400,000
Total Indirect Costs	**$2,200,000**	**-**	**$860,000**	**=**	**$1,340,000**

[10] 45 CFR part 75, Appendix IV, § C.1.c.

[11] 45 CFR part 75, Appendix IV, § C.1.e.

[12] To simplify, we used "total direct costs" as the direct cost base for this example; the direct cost base does not have to be total direct costs in all cases. Organizations must use a proposed cost base that results in an equitable distribution of indirect costs. For example, organizations may need to remove capital expenditures from the cost base to arrive at an equitable distribution of indirect costs.

Direct Costs	First Federal Award		Second Federal Award		Other Activities		Total
Salaries	$250,000	+	$750,000	+	$1,000,000	=	$2,000,000
Leave/Fringe	62,500	+	187,500	+	150,000	=	400,000
Other Direct Costs	187,500	+	262,500	+	500,000	=	950,000
Total Direct Costs	**$500,000**	**+**	**$1,200,000**	**+**	**$1,650,000**	**=**	**$3,350,000**

Once an indirect cost rate is calculated, it is used to allocate the organization's indirect costs to the Federal grant awards and other activities. Table 2 is an example of how indirect costs are allocated by a hypothetical organization.

Table 2: Example of How Indirect Costs Are Allocated by a Hypothetical Organization

Total Costs	Direct Costs		Indirect Cost Allocation (40% of Direct Costs)		Total Costs
First Federal Award	$500,000	+	$200,000	=	$700,000
Second Federal Award	1,200,000	+	480,000	=	1,680,000
Other Activities	1,650,000	+	660,000	=	2,310,000
Total	**$3,350,000**	**+**	**$1,340,000**	**=**	**$4,690,000**

Indirect Cost Rate-Setting Process

CAS must negotiate indirect cost rates with nonprofit organizations in accordance with 45 CFR part 75, Uniform Administrative Requirements, the Cost Principles and Audit Requirements for HHS Awards, Appendix IV to part 75 – Indirect (F&A) Costs Identification and Assignment, and internal guidance from the CAS *Review Guide For Non Profit Organization's Indirect Cost Proposals* (Review Guide).

To begin the indirect cost rate-setting process, a nonprofit organization submits its indirect cost rate proposal and supporting documents to the CAS regional office supporting the State where the organization is located. The four CAS regional offices are located in Bethesda, Maryland; New York, New York; Dallas, Texas; and San Francisco, California.

Indirect cost rate proposals submitted to CAS should contain certifications and documentation required by Federal regulations and CAS internal policy. The certifications should be signed by an official who is authorized to legally bind the organization.[13] These federally required documents are:

[13] 45 CFR § 75.415(a).

- Certificate of Indirect Facility and Administrative (F&A) Costs[14] (Certificate of Indirect Costs) and

- Lobbying Cost Certificate.[15]

CAS internal procedures require the following items:

- audited financial statements,

- indirect cost rate proposal,

- trend analysis[16] (required for indirect cost rate renegotiations),

- Schedule of Management and General Salaries (required for indirect cost rate renegotiations),

- organizational chart (required for initial indirect cost rate negotiations),

- Notice of Federal Award (required for initial indirect cost rate negotiations), and

- an Indirect Cost Proposal Checklist[17] (ICP Checklist) completed by the grantee.

The CAS Branch Chief reviews the indirect cost rate proposal to determine whether all required documentation was included before assigning it to a negotiator for a thorough review. Once a negotiator is assigned an indirect cost rate proposal, the negotiator performs the steps described in Figure 1 (next page):

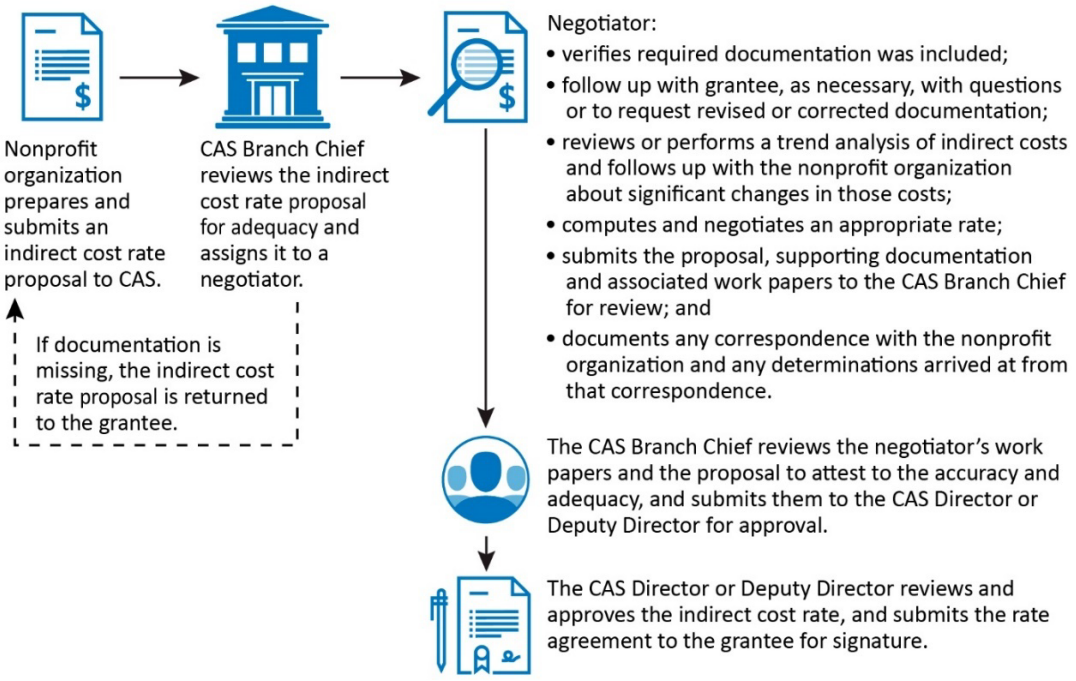
[14] 45 CFR part 75, Appendix IV, § D.1.

[15] 45 CFR § 75.450(c)(2)(vi).

[16] A trend analysis is a review of the nonprofit organization's indirect costs, rates, and allocation base for the last 3 years, including the proposal year.

[17] ICP Checklist. Available online at icpchecklist2.pdf (psc.gov). Accessed on July 14, 2020.

Figure 1: The CAS Indirect Cost Rate-Setting Process for Our Audit Period*



* The indirect cost rate-setting process depicted in this figure assumes the general rate-setting process for nonprofit organizations from January 1, 2019, through December 31, 2019 (CY 2019), our audit period. We understand that some negotiations may not follow the process depicted.

CAS implemented two standardized checklists for its staff to use in its indirect cost rate-setting process. The standardized checklists are the Negotiator Standard Review Checklist (negotiator checklist) and the Supervisor Review Checklist (supervisor checklist).

The negotiator checklist outlines procedures that should be performed by the negotiator in the indirect cost rate-setting process. The negotiator checklist requires the negotiator to (1) conduct a risk assessment to determine whether the proposal qualifies for a standard or limited review;[18] (2) based on the risk assessment results, complete a standard or limited review procedures checklist that outlines the steps the negotiator should complete; (3) complete a rate computation, including adjustments to the proposed rate; (4) complete a trend analysis, if applicable; (5) document notes on the indirect cost rate-setting process in the Summary of Review as well as items that were not reviewed; and (6) complete the cost avoidance sheet.[19]

[18] The risk assessment is used to determine whether the indirect cost rate proposal qualifies for a standard or limited review process. A standard review is more common and is a more extensive review than the limited review.

[19] The cost avoidance sheet is used to calculate the Federal cost savings when a negotiated rate is lower than the proposed rate.

The supervisor checklist outlines procedures performed by the branch chiefs[20] to verify the accuracy and adequacy of the negotiator's workpapers and add explanations if needed. The supervisor checklist includes a review of the Summary of Review, the negotiator's checklist, the trend analysis, adjustments to the proposed rate, any cost avoidance, and any correspondence or followups between the negotiator and the grantee. Additionally, by completing the supervisor checklist, the branch chief is confirming that the negotiator's review and negotiation was performed in compliance with the governing Federal regulations and CAS policies.

In the final step in the indirect cost rate-setting process, an individual authorized to bind the nonprofit organization signs the indirect cost rate agreement received from CAS. The rate agreement establishes the effective period of the indirect cost rate. The nonprofit organization is required to submit an indirect cost rate proposal for renegotiation within 6 months after the close of each fiscal year (FY).[21]

HOW WE CONDUCTED THIS AUDIT

CAS officials provided us with a list of 1,455 indirect cost rates negotiated or renegotiated during our audit period, CY 2019. We removed 242 indirect cost rates associated with organizations we identified as hospitals because they have different Federal criteria for determining their indirect cost rates. From the remaining 1,213 indirect cost rates, we selected a judgmental sample of 19 indirect cost rates to assess CAS's indirect cost rate-setting process and determine compliance with Federal regulations. For each CAS region, we selected one of each entity type[22] that had a negotiated or renegotiated indirect cost rate in CY 2019:

- 4 nonprofits with direct Federal awards of more than $6 million,
- 4 nonprofits with direct Federal awards from $2 million to $6 million,
- 4 nonprofits with direct Federal awards of less than $2 million,
- 3 Native American Tribal-affiliated nonprofit organizations,[23] and

[20] In this report, the term "branch chief" refers to supervisors.

[21] 45 CFR part 75, Appendix IV, § C.2.c.

[22] The entity type is a category of nonprofit that submits an indirect cost rate proposal. The entity types are N1 (entities with direct Federal awards of more than $6 million), N2 (entities with direct Federal awards from $2 million to $6 million), N3 (entities with direct Federal awards of less than $2 million), N4 (Native American Tribal-affiliated entities), and N5 (Community Action Agencies).

[23] In the list of indirect cost rates provided by CAS, there was one region with no Native American Tribal-affiliated nonprofit organizations.

- 4 Community Action Agencies.

We held discussions with CAS officials and negotiators to gain an understanding of the indirect cost rate-setting process and related requirements. For each sampled rate agreement, we reviewed the CAS case file containing the indirect cost rate proposal, supporting documentation, and CAS workpapers; interviewed negotiators and supervisors assigned to the proposals; and determined the extent to which CAS complied with Federal requirements and its internal guidance for reviewing, negotiating, and setting indirect cost rates. The scope of the audit did not include independently verifying the allowability of any proposed costs. Accordingly, we could not determine whether negotiated indirect cost rates were reasonable or appropriate.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains the details of our audit scope and methodology, Appendix B contains Federal requirements, Appendix C is a summary of sample items in our review that had one or more instances of noncompliance, and Appendix D is a table of the sample items in our review that were not completed in a timely manner.

FINDINGS

CAS did not always negotiate and approve indirect cost rates for nonprofit organizations in accordance with Federal regulations or its own policies during our audit period. Specifically, 16 of the 19 indirect cost rates we audited had 35 instances of noncompliance with Federal regulations or with CAS's policies and procedures (Table 3, next page).

Table 3: Instances of Noncompliance[24]

Finding	Total
Noncompliance With Federal Regulations	5
Did Not Follow Its Review Guide	10
Did Not Follow Its Standard Operating Procedures	14
Potentially Unallowable Compensation Costs	6
Total	**35**

These errors occurred because CAS had not updated the Review Guide since 2003 to ensure that it reflected Federal requirements and its current internal procedures. According to CAS officials, CAS also faced issues with the heavy workload associated with negotiating indirect cost rates[25] and has been unable to fill positions for negotiators and branch chiefs lost through attrition. In addition, CAS:

- branch chiefs were not able to effectively monitor the work of negotiators;
- negotiators relied on their professional judgment rather than adhering to internal policies;
- did not ensure that its negotiators and branch chiefs followed the procedures in the Review Guide that were applicable; and
- relied on a 1990 policy regarding inclusion of executive compensation in excess of the statutorily mandated cap in the indirect cost rate base, which may require clarification.

As a result, CAS may have established indirect cost rates during the audit period that did not always fairly distribute indirect costs to benefit cost objectives associated with Federal awards. If the indirect cost rates that CAS established were understated, an organizations' non-federally funded activities may have incurred more than their fair share of indirect costs, and the financial interests of the organizations may have been harmed. Alternatively, if the indirect

[24] We consider the number of errors as the instances in which we found noncompliance with Federal regulations or CAS internal policy.

[25] CAS reported that they receive around 6,900 rate agreements and complete about 2,800 rate agreements annually.

cost rates that CAS established were overstated, an organizations' federally funded activities may have been allocated more than their fair share of indirect costs, and the financial interests of the Federal Government may have been harmed. In addition, when CAS did not promptly establish indirect cost rates, it may have affected Federal agencies' and organizations' ability to meet mission or project goals.

COST ALLOCATION SERVICES DID NOT ALWAYS COMPLY WITH FEDERAL REGULATIONS WHEN NEGOTIATING INDIRECT COST RATES

Federal Regulations

Federal regulations state that an indirect cost rate proposal to establish an indirect cost rate should not be accepted unless the costs have been certified by the non-profit using the Certificate of Indirect Costs. The certificate must be signed on behalf of the organization by an individual no lower than vice president or chief financial officer of the organization.[26] Additionally, according to Federal regulations, final rates are established as an indirect cost rate for a specified past period based on actual costs for the period.[27]

CAS Did Not Always Comply With Certificate of Indirect Cost Requirements

Four of the nineteen indirect cost rate proposals we reviewed did not meet Federal regulations related to the Certificate of Indirect Costs. Specifically, CAS was unable to locate the required Certificate of Indirect Costs for three indirect cost rate proposals. For another indirect cost rate proposal, the Certificate of Indirect Costs was present but lacked the signature of an individual authorized to bind the organization.

The Certificate of Indirect Costs was not listed on the ICP Checklist for nonprofits submitting an initial proposal; therefore, grantees submitting an initial cost rate proposal may not be aware of the requirement to submit a signed certificate.

However, the Certificate of Indirect Costs is listed on the ICP Checklist for nonprofits submitting an indirect cost rate renegotiation proposal. As CAS officials pointed out, the negotiator checklist and the supervisor checklist did not include a step to review the Certificate of Indirect Costs to verify that the certificate was submitted with the proposal and was signed. Additionally, the Review Guide does not include a step to review the Certificate of Indirect Costs. CAS officials noted that the negotiators' heavy workload contributed to negotiators not ensuring that the required certificate was included in the case file.

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[26] 45 CFR part 75, Appendix IV, § D.1.

[27] 45 CFR part 75, Appendix IV, § C.1.d.

Without a Certificate of Indirect Costs signed by an official authorized to bind the organization, CAS does not have assurance that all costs included in the proposal to establish the rate are allocable and allowable. Additionally, CAS may have difficulty taking subsequent action on the rate agreement with the grantee given that an incomplete indirect cost rate proposal was used to negotiate the indirect cost rate.

CAS Did Not Negotiate a Final Rate Based on Actual Costs

For one of the indirect cost rates that we sampled, CAS negotiated a final rate that was not based on the actual costs from the previous year. Specifically, the nonprofit organization submitted a proposal for a final rate of 18.69 percent. The nonprofit organization based this rate on its FY 2018 actual costs. However, the negotiator agreed to a final rate of 19.00 percent rather than establishing a final rate based on the actual allowable costs incurred for FY 2018.

CAS was unable to provide an explanation for why the final negotiated rate for 2018 was not based on actual costs. The negotiator stated in the workpapers that he or she did not identify any materially questionable items in the indirect cost rate proposal that required further review or adjustments. Additionally, the branch chief reviewed the negotiator's work and indicated that the review was thorough and thus did not question the agreed final rate of 19.00 percent. Negotiating a final rate higher than the actual costs incurred could allow an organization to draw down more funds than to which it is entitled.

These errors occurred because CAS did not ensure that its negotiators complied with Federal regulations pertaining to the Certificate of Indirect Costs and negotiating indirect cost rates on actual costs. The Federal requirements pertaining to the Certificate of Indirect Costs is not included in the Review Guide. Additionally, the Review Guide does not provide guidance specific to final rates. However, under the provisional rate guidance, the Review Guide states that when a provisional rate is established, a final rate must be negotiated when the actual costs for the period become known. Therefore, CAS negotiators and branch chiefs do not have a resource for guidance on the consistent application of Federal regulations. This could cause CAS to establish indirect cost rates that are not in compliance with Federal regulations.

COST ALLOCATION SERVICES DID NOT ALWAYS FOLLOW ITS REVIEW GUIDE

CAS Review Guide Requirements

According to the Review Guide, last updated by CAS in 2003, one of the first steps in the indirect cost rate-setting process is to reconcile the costs included in the proposal with the

organization's financial statements. As part of the reconciliation process, negotiators should analyze and verify the accuracy and necessity for adjustments and reclassifications.[28]

The Review Guide also states that the negotiator's workpapers should contain sufficient documentation to clearly show what adjustments were made to the proposal and the reasons for the adjustments, as well as what aspects of the proposal were not reviewed and why.[29] As for the negotiator's workpapers containing sufficient documentation, the CAS Review Guide states that the negotiator would be prudent to inquire about large increases to cost categories on the trend analysis.

Additionally, the Review Guide states that rental costs are allowable subject to several conditions. Specifically, rental costs should be reasonable and comparable with the property's fair market value, rental costs under sale leaseback arrangement are allowable up to the amount that would be allowable had the organization continued to own the property, and rental costs under less-than-arm's length conditions are allowable only up to the amount that would be allowed had title to the property vested in the organization.[30]

CAS Did Not Always Follow Its Review Guide Procedural Steps

In the 19 indirect cost rates that we reviewed, we found 10 instances in which CAS negotiators did not follow its Review Guide procedural steps. Specifically, we found the following:

- For one indirect cost rate proposal, we could not determine whether the negotiator reconciled both the direct and indirect cost amounts included in the indirect cost rate proposal with the audited financial statements. For that instance, the Standard Review Procedures in the negotiator's checklist indicated that the financial statements reconciled; however, we were unable to reconcile these amounts, and in interviews with the negotiator, he was unable to provide documentation or explain the steps taken to reconcile the proposed costs with the audited financial statements.

- For another indirect cost rate proposal, we found that the CAS negotiator determined that a nonprofit organization needed to adjust the indirect cost rate pool and base amounts. The negotiator discussed those adjustments with the nonprofit organization. After those discussions, the nonprofit organization submitted a revised indirect cost rate

[28] *Review Guide For Non Profit Organization's Indirect Cost Proposals*, p.10 – 11. Available online at https://rates.psc.gov/fms/dca/negrev4.pdf. Accessed on July 14, 2020.

[29] *Review Guide For Non Profit Organization's Indirect Cost Proposals*, p.21. Available online at https://rates.psc.gov/fms/dca/negrev4.pdf. Accessed on July 14, 2020.

[30] *Review Guide For Non Profit Organization's Indirect Cost Proposals*, p. 40. Available online at https://rates.psc.gov/fms/dca/negrev4.pdf. Accessed on July 14, 2020.

proposal to CAS. We found that the total costs in the revised indirect cost rate proposal were higher than the total costs in the audited financial statements. This indicated to us that the negotiator did not verify that the agreed-upon adjustments were applied correctly.

- For seven indirect cost rate proposals, we found trend analyses that included cost categories with large increases from the previous year. The negotiators did not follow up with the grantee for an explanation on the large increases. Also, the negotiators did not include sufficient documentation in their workpapers (as required by the Review Guide) to explain why they decided to not investigate the cost increases. Additionally, the ICP Checklist states that the grantee submitting the proposal should explain any increases or decreases of 10 percent or more in cost categories. CAS officials stated that its negotiators may look at the level of risk related to the increase or decrease to the indirect cost rate and then exercise their professional judgment to determine whether followup is necessary.

- Lastly, for one indirect cost rate proposal, we found a cost element in the proposal that referenced a sublease from a "strategic biotechnology partner." In this instance, the negotiator failed to verify the relationship between the lessee and lessor to determine whether the rental costs for the sublease could be considered as less-than-arm's length. For this lease agreement, the negotiator's focus was on the fact that it was a sublease for a facility of more than 3,000 square feet, and the rental cost seemed reasonable for the area. CAS officials added that high employee turnover, a heavy workload of indirect cost rate proposals, a new grantee with limited documentation, and the negotiator's perceived level of risk and reliance on professional judgment all contributed to this condition.

These errors occurred because CAS did not ensure that its negotiators followed the policies and procedures in its Review Guide. Specifically, CAS negotiators did not follow CAS's Review Guide regarding following up on cost categories and lessee/lessor arrangements and documenting sufficient information in the case file to support decisions made in the indirect cost rate-setting process. These steps were all documented in the Review Guide as tasks to be performed in the indirect cost rate-setting process. These errors could cause CAS to establish an inappropriate indirect cost rate and lead to the grantees' indirect costs not being fairly distributed to the Federal grant.

COST ALLOCATION SERVICES DID NOT ALWAYS FOLLOW ITS STANDARD OPERATING PRODECURES

CAS Standard Operating Procedures

In the indirect cost rate-setting process, CAS has established policies and procedures that are not incorporated into its Review Guide. The most recent version of the Review Guide was

issued in 2003. Some of the changes to policy since 2003 include completing the negotiator checklist and the supervisor checklist, and reviewing the ICP Checklist.

The CAS negotiator checklist and supervisor checklist outline steps the negotiator performs in the indirect cost rate-setting process and steps for the branch chief to follow when reviewing the negotiation workpaper files. As a part of the indirect cost rate-setting process, CAS negotiators can enter notes for the Summary of Review into the negotiator checklist. These notes help to provide explanations or context for actions taken by the negotiator in the indirect cost rate-setting process. The branch chiefs can enter notes on the supervisor checklist to explain why some items were not reviewed. In addition to entering notes on the supervisor checklist, the branch chiefs also verify the accuracy and adequacy of the negotiator's workpapers.

Additionally, CAS's website instructs grantees to submit an ICP Checklist[31] as part of their indirect cost rate proposal.[32] The ICP Checklist includes assertions made by the grantee and a list of items that must be submitted. One of the items listed on the ICP Checklist is a management and general salaries schedule that details the percentage of employee salaries included in the indirect cost pool. Additionally, the ICP Checklist should be signed by an official of the organization.

CAS Did Not Always Follow Through With Performing Its Procedural Steps

In the 19 indirect cost rates we reviewed, we found 14 instances in which CAS's branch chiefs and negotiators did not follow its standard operating procedures. Specifically, we found:

- For one indirect cost rate proposal, the negotiator's Summary of Review workpaper included information that pertained to a grantee other than the one under review. CAS officials stated that the branch chief did not identify the issue during his or her review. As part of CAS's internal guidance, the branch chief is required to annotate the supervisor checklist, which verifies the adequacy and accuracy of the negotiator's Summary of Review.

- For two indirect cost rate proposals, the proposals included a trend analysis, but the branch chief did not follow CAS's internal guidance to document on the supervisor checklist that he or she reviewed the trend analysis. CAS officials stated that branch chiefs were not all aware that if the trend analysis is not present or reviewed, they should include a note indicating this on the supervisor checklist.

[31] ICP Checklist. Available online at icpchecklist2.pdf (psc.gov). Accessed on July 14, 2020.

[32] CAS link for indirect cost rate proposal examples and documents required to be submitted by Non-Profit Organizations: HHS | Program Support Center (psc.gov).

- For another indirect cost rate proposal, the ICP Checklist was missing. The negotiator did not follow CAS's internal guidance, which requires that the ICP Checklist be provided as part of the indirect cost rate proposal. For this proposal, the negotiator realized that the ICP Checklist was missing and requested it from the grantee telephonically but failed to follow up to ensure that the grantee submitted the document.

- Lastly, for two indirect cost rate proposals, the proposals were missing the management and general salaries schedule required by the ICP Checklist.[33] The negotiator did not follow CAS's internal guidance, which requires verification of applicable items listed on the ICP Checklist. For these indirect cost rate proposals, the nonprofit organizations had indirect cost rates originally established by the Centers for Medicare & Medicaid Services (CMS).[34] These rates were subsequently transferred to CAS. Because those nonprofit organizations were new to CAS, they were not aware of CAS's indirect cost rate proposal documentation requirements.

These errors occurred because CAS had not updated the Review Guide to include internal guidance. Specifically, the process of using the negotiator checklist and supervisor checklist were not incorporated into the Review Guide. CAS has been aware of the outdated Review Guide and internal guidance on conducting the indirect cost rate-setting process since GAO identified in its 2016 report that CAS's internal guidance was not updated to reflect its current procedures and that the agency's internal guidance lacked detailed instructions for supervisors on the indirect cost rate process.[35] Until CAS updates the Review Guide, CAS negotiators and branch chiefs may continue to have errors when conducting the indirect cost rate-setting process.

COST ALLOCATION SERVICES DID NOT ALWAYS NEGOTIATE INDIRECT COST RATES IN A TIMELY MANNER

CAS has established an internal Key Performance Indicator (KPI) metric that set a goal that 95 percent of initial nonprofit indirect cost rate proposal reviews be completed within 90 days and

[33] The ICP Checklist states that the amount in the management and general salaries schedule must reconcile to the total salary amounts in the proposal. Available online at icpchecklist2.pdf (psc.gov), item 12.

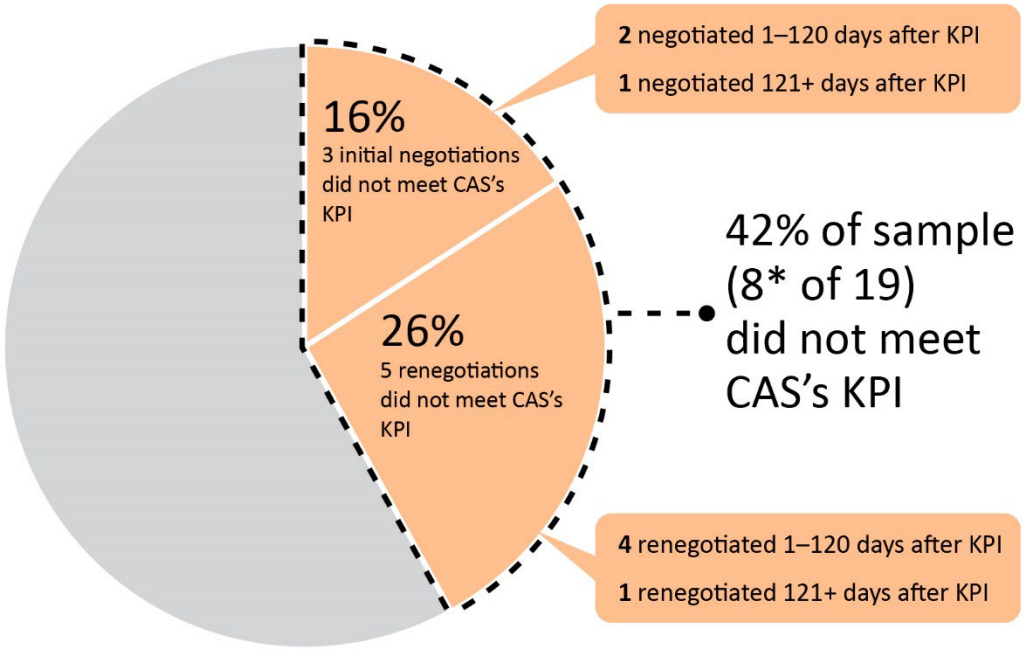
[34] CMS's authority to establish indirect cost rates is unclear, and how this occurred is beyond the scope of our review.

[35] *Agencies Involved in the Indirect Cost Rate-Setting Process Need to Improve Controls*. Available online at https://www.gao.gov/assets/gao-16-616.pdf.

that 85 percent of renegotiated indirect cost rate proposal reviews be completed within 180 days.[36]

As shown in Figure 2 on the next page, we found that 8 of the 19, or 42 percent, of the indirect cost rate negotiations in our sample were not completed in a timely manner, using the KPI metrics as a guideline for determining timeliness. Specifically, 3 of the 19, or 16 percent, of the initial indirect cost rate negotiations in our sample were not completed within 90 days, and 5 of the 19, or 26 percent, of indirect cost rate renegotiations in our sample were not completed within 180 days.[37]

Figure 2: Indirect Cost Rate Negotiations That Were Not Completed in a Timely Manner



* The number of days that these 8 sample items were overdue are reported in Appendix D.

CAS officials stated that the KPI metrics are a guide for the completion of indirect cost rate negotiations, not CAS policy. Although OIG agrees that the KPI metrics are not CAS policy, we are using the KPIs as a measure to assess CAS's goal of the timely completion of indirect cost rate negotiations.

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[36] KPIs are not CAS policy but rather serve as a goal. We are using the KPIs as a measure to determine timeliness. Failure to complete indirect cost rate negotiations in a timely manner is not necessarily a violation of law or internal policies or procedures, but still is a concern for the reasons noted in the report.

[37] The percentages in this section of the report result from our judgmental sample of indirect cost rate proposals. Because of the nonstatistical nature of our sample, the results reflect only the percentages relative to our sample and have no relationship to the universe of indirect cost rate proposals processed during the audit period.

The officials also stated that the KPI metrics are an internal measure implemented by the previous PSC and CAS leadership. Additionally, when the KPI metrics were implemented, CAS negotiator staffing was higher than the staffing level during the audit period, and the reduction in CAS staffing contributed to negotiators managing a heavier workload of indirect cost rate proposals. These factors contributed to indirect cost rate negotiations taking longer than allowed under the KPI metrics.

By not establishing indirect cost rates in a timely manner, Federal agencies and nonprofit organizations may not be able to meet mission or project goals. Delays in establishing indirect cost rates can affect a grantee's ability to charge indirect costs above the 10-percent de minimis rate to the grant.[38] Additionally, delays in establishing a final indirect cost rate may require Federal agencies to reopen awards for adjustments.

INDIRECT COST RATE PROPOSALS INCLUDED POTENTIALLY UNALLOWABLE COMPENSATION COSTS

The Department of Defense and Labor, Health and Human Services, and Education Appropriations Act of 2019, section 202,[39] states that none of the funds appropriated in this title[40] may be used to pay the salary of an individual, through a grant or other extramural mechanism, at a rate in excess of the Executive Level II.[41]

We found that 6 of the 19 indirect cost rate proposals we reviewed included salaries exceeding the Executive Level II limitations in the indirect cost rate pools. The salaries in those 6 instances were for 17 executives whose salaries exceeded the Executive Salary Level II threshold by between $9,321 and $405,392 annually. Salaries exceeding the limitations imposed by the Appropriations Act may be unallowable if paid for using Federal funds. Inclusion of salaries exceeding the statutory cap in the indirect cost rate pool resulted in the recipient receiving a higher indirect cost rate and additional benefit from indirect costs.

During our audit period, CAS relied on a 1990 Policy Memorandum that interpreted the HHS 1990 Appropriations Act general provision restriction on salary rates that stated that any

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[38] Any non-Federal entity that has never received a negotiated indirect cost rate, subject to some exceptions, may elect to charge a de minimis rate of 10 percent of modified total direct costs, which may be used indefinitely (45 CFR § 75.414(f)).

[39] P.L. No. 115-245.

[40] This Act provides funding for various agencies, i.e., the Department of Labor, Department of Health and Human Services, Department of Education, and various related agencies.

[41] Executive Level II salary cap for agencies with Federal awards. Available online at Salary Cap Summary (FY 1990 - Present) | grants.nih.gov. Accessed on March 22, 2021.

increment exceeding the limitations should be included in the appropriate indirect cost base. CAS officials stated that the issue of indirect salaries limits is unclear.[42]

The inclusion of potentially unallowable salaries exceeding the Appropriations Act limits creates a risk that CAS could establish an inflated indirect cost rate that could result in the grantee receiving excess funds.

RECOMMENDATIONS

We recommend that Cost Allocation Services:

- update the Review Guide to conform with applicable Federal regulations and CAS internal policies and procedures;

- take steps to ensure that branch chiefs and negotiators follow all Federal and internal CAS requirements;

- include all federally required documents on checklists provided to the nonprofit organizations and on checklists used by CAS officials;

- ensure that negotiated final indirect cost rates are calculated based on actual costs;

- review its staffing levels and determine whether resources are aligned efficiently, and adjust as needed, to ensure that the indirect cost rate-setting process is conducted in a timely manner; and

- seek clarification on whether the policy of including executive compensation higher than the Level II statutory cap in its indirect cost pool calculation complies with Federal law and governmentwide policy.

COST ALLOCATION SERVICES COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In its written comments on our draft report, CAS concurred with the first four of our six recommendations and described actions it has taken or plans to take to address three of them. Specifically, CAS stated that it:

- has formed a work group and has started the process of updating the Review Guide to conform with applicable Federal regulations and its internal policies and procedures,

[42] The HHS Departmental Appeals Board (DAB) recently issued an opinion holding that a recipient 'cannot avoid the consequences of paying executive compensation above the cap just because it paid the compensation…through its indirect or overhead accounts.' (*International Educational Services, Inc.*, DAB No. 3055 (2021)).

- will update checklists to include all federally required documents and will implement a process for ensuring that all required forms and signatures are included in the indirect cost rate proposal submission, and

- will include clear guidance in the updated Review Guide that indirect cost rates should not be finalized at a higher rate than the actual final calculated rate.

Although CAS concurred with our second recommendation, it disagreed with our characterization of the Non-Profit Review Guide, which it said is not intended to be a substitute for professional experience and judgment. CAS stated that negotiators and branch chiefs exercise professional judgment based on their experience, the materiality of the grantee's Federal awards, and the materiality of each indirect cost item to the rate calculation and that it would be impractical and a poor use of HHS resources to perform every possible review step for every single grantee proposal.

CAS did not concur with our final two recommendations. Below, we summarize CAS's comments regarding the final two recommendations and provide our responses.

CAS's comments are included in their entirety as Appendix E.

OIG Response

After reviewing CAS's comment on the Review Guide not intended to be a substitute for a negotiator's professional experience, judgment and materiality, we maintain that our finding is valid. OIG found that the Review Guide states that negotiation workpaper files should contain sufficient documentation regarding what significant aspects of a proposal are not reviewed and why. Not including sufficient documentation could lead to CAS approving an indirect cost rate that is unsupportable based on the information in the negotiation workpaper file.

COST ALLOCATION SERVICES DID NOT ALWAYS NEGOTIATE INDIRECT COST RATES IN A TIMELY MANNER

CAS Comments

CAS did not concur with our recommendation to review staffing levels and determine whether resources are aligned efficiently, and adjust as needed, to ensure that the indirect cost rate-setting process is conducted in a timely manner. CAS indicated that our finding that reviews were not completed in a timely manner was based on management tools (KPIs) for measuring employee productivity and not on Federal regulation or HHS policy. CAS requested that OIG not make an official recommendation related to staffing. CAS indicated that it was aware that its current staffing is below authorized levels but stated that it lacks direct hiring authority to fill positions. It also stated that it is "working with PSC to update and improve position

descriptions, in order to facilitate job announcements that more closely reflect CAS' responsibilities and duties."

OIG Response

After reviewing CAS's comment on the timeliness of its cost rate-setting process, we maintain that this finding and our related recommendation are valid. We recognize that the KPI's are not a Federal regulation or HHS policy; we used these measures only as a general guideline to assess whether CAS completed indirect cost rate negotiations in a timely manner. Completing these negotiations in a timely manner can help ensure that Federal agencies and nonprofit organizations are able to meet mission or project goals. CAS's current staffing levels are not sufficient to ensure these timeframes are met. In response to CAS's request to remove the recommendation related to staffing, we acknowledge CAS's viewpoint, but we note that a recommendation from OIG may support CAS's efforts to hire. Additionally, OIG is an independent and objective oversight agency that is statutorily required to recommend policies for promoting economy and efficiency in the administration of HHS programs and operations.[43] The recommendations made by the OIG are to assist management in initiating corrective action(s) and contribute to public accountability.

INDIRECT COST RATE PROPOSALS INCLUDED POTENTIALLY UNALLOWABLE COMPENSATION COSTS

CAS Comments

CAS did not concur with our recommendation to seek clarification on whether executive compensation above the Level II statutory cap may be included in the indirect cost pool. Specifically, CAS stated that it cannot make policy decisions to apply salary limitations contained in appropriations law to indirect cost calculations. CAS noted that it has previously informed HHS grants management policy officials in writing several times that it cannot unilaterally make a policy decision to apply salary limitations to indirect salaries. CAS requested that OIG not include this as a finding or recommendation.

OIG Response

After reviewing CAS's comments on the indirect salaries exceeding Level II limitations, we maintain that our recommendation is valid. We acknowledge that the CAS director cannot authorize a policy decision to apply limitations on indirect salaries and are not recommending that CAS make such a decision. We commend CAS's ongoing efforts to seek clarification on the HHS 1990 Policy Memorandum with HHS grants management policy officials, which is

[43] Inspector General Act of 1978, as amended, § 4(a)(3)

consistent with the intent of our recommendation. We hope that this report will aid CAS in its efforts.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE:

CAS provided a list of 1,455 indirect cost rates negotiated or renegotiated during CY 2019, and we reviewed a judgmental sample of 19. For each CAS region, we selected one of each entity type that had a negotiated or renegotiated indirect cost rate in CY 2019. We limited our review to determining whether CAS's indirect cost rate-setting process complied with Federal regulations when negotiating and approving indirect cost rates for nonprofit organizations. We did not extend our review to any other organization types.

We did not review the overall internal control structure of CAS's document management system. Rather, we reviewed CAS's internal policies, procedures, and guidance related to the indirect cost rate-setting process.

We conducted our audit work from August 2020 through October 2021.

METHODOLOGY

To accomplish our objective, we:

- reviewed Federal regulations and guidance pertaining to indirect costs;
- reviewed CAS's organizational structure, including its organizational chart, position descriptions, staffing levels, and workload requirements;
- reviewed CAS's *Review Guide For Non Profit Organization's Indirect Cost Proposals*;
- held discussions with CAS officials to gain an overall understanding of the indirect cost rate-setting process;
- selected a judgmental sample of 19 indirect cost rates from nonprofit organizations to review (1 nonprofit per entity type from each of the 4 CAS regional offices);
- reviewed the judgmentally selected indirect cost rate proposals and supporting documents;
- interviewed CAS officials and negotiators to discuss issues found in specific sample items; and
- met with CAS officials to discuss our findings and recommendations.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: FEDERAL, GOVERNMENT ACCOUNTABILITY OFFICE, AND COST ALLOCATION SERVICES REQUIREMENTS

FEDERAL REQUIREMENTS

45 CFR Part 75, Uniform Administrative Requirements, Costs Principles, and Audit Requirements for HHS Awards

45 CFR § 75.361 Retention requirements for records

> Financial records, supporting documents, statistical records, and all other non-Federal entity records pertinent to a Federal award must be retained for a period of 3 years from the date of submission of the final expenditure report or, for Federal awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, respectively, as reported to the HHS awarding agency or pass-through entity.

45 CFR § 75.403 Factors affecting allowability of costs

Except where otherwise authorized by statute, costs must meet the following general criteria to be allowable under Federal awards:

> (a) Be necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles.
> (b) Conform to any limitations or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
> (c) Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
> (d) Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
> (e) Be determined in accordance with generally accepted accounting principles (GAAP), except, for state and local governments and Indian tribes only, as otherwise provided for in this part.
> (f) Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period. See also § 75.306(b).
> (g) Be adequately documented. See also §§ 75.300 through 75.309.

45 CFR § 75.412 Classification of costs

> There is no universal rule for classifying certain costs as either direct or indirect (F&A) under every accounting system. A cost may be direct with respect to

some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost incurred for the same purpose be treated consistently in like circumstances, either as a direct or an indirect (F&A) cost to avoid possible double-charging of Federal awards. Guidelines for determining direct and indirect (F&A) costs charged to Federal awards are provided in this subpart.

45 CFR § 75.413 Direct Costs

(a) *General.* Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Costs incurred for the same purpose in like circumstances must be treated consistently as either direct or indirect (F&A) costs. See also § 75.405.
(e) The costs of certain activities are not allowable as charges to Federal awards. However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect (F&A) cost rates and be allocated their equitable share of the non-Federal entity's indirect costs if they represent activities which:
(1) Include the salaries of personnel,
(2) Occupy space, and
(3) Benefit from the non-Federal entity's indirect (F&A) costs.

45 CFR § 75.415 Required Certifications

(b)(2), Unless the non-Federal entity has elected the option under § 75.414(f), the Federal Government may either disallow all indirect (F&A) costs or unilaterally establish such a plan or rate when the non-Federal entity fails to submit a certified proposal for establishing such a plan or rate in accordance with the requirements. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant agency for indirect costs and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because the non-Federal entity failed to submit a certified proposal, the plan or rate established will be set to ensure that potentially unallowable costs will not be reimbursed.

45 CFR § 75.450 Lobbying

(c)(2)(vi) The non-Federal entity must submit as part of its annual indirect (F&A) cost rate proposal a certification that the requirements and standards of this section have been complied with. (See also § 75.415.)

45 CFR § 75.465 Rental cost of real property and equipment

(b) Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the non-Federal entity continued to own the property. This amount would include expenses such as depreciation, maintenance, taxes, and insurance.
(c) Rental costs under "less-than-arms-length" leases are allowable only up to the amount as explained in paragraph (b) of this section. For this purpose, a less-than-arm's-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between:
(1) Divisions of the non-Federal entity;
(2) The non-Federal entity under common control through common officers, directors, or members; and
(3) The non-Federal entity and a director, trustee, officer, or key employee of the non-Federal entity or an immediate family member, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, the non-Federal entity may establish a separate corporation for the sole purpose of owning property and leasing it back to the non-Federal entity.
(5) Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in paragraph (b) of this section) that would be allowed had the non-Federal entity purchased the property on the date the lease agreement was executed. The provisions of GAAP must be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in § 75.449. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the non-Federal entity purchased the property.

Appendix IV to Part 75 – Indirect (F&A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations

B., 2., b. – Both the direct costs and the indirect costs must exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in § 75.413(e).

C., 2., f. – Provisional and final rates must be negotiated where neither predetermined nor fixed rates are appropriate. Predetermined or fixed rates may replace provisional rates at any time prior to the close of the organization's fiscal year. If that event does not occur, a final rate will be established and upward or downward adjustments will be made based on the actual allowable costs incurred for the period involved.
D. Certification of Indirect (F&A) Costs
1. Required Certification. No proposal to establish indirect (F&A) cost rates must be acceptable unless such costs have been certified by the nonprofit organization using the Certificate of Indirect (F&A) Costs set forth in subsection 2., below. The certificate must be signed on behalf of the organization by an individual at a level no lower than vice president or chief financial officer for the organization.
2. Each indirect cost rate proposal must be accompanied by a certification in the following form:
Certificate of Indirect (F&A) Costs
This is to certify that to the best of my knowledge and belief:
(1) I have reviewed the indirect (F&A) cost proposal submitted herewith;
(2) All costs included in this proposal [identify date] to establish billing or final indirect (F&A) costs rate for [identify period covered by rate] are allowable in accordance with the requirements of the Federal awards to which they apply and with Subpart E of part 75.
(3) This proposal does not include any costs which are unallowable under Subpart E of part 75 such as (without limitation): public relations costs, contributions and donations, entertainment costs, fines and penalties, lobbying costs, and defense of fraud proceedings; and
(4) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the Federal awards to which they are allocated in accordance with applicable requirements.
I declare that the foregoing is true and correct.
Nonprofit Organization:
Signature:
Name of Official:
Title:
Date of Execution:

P.L. No. 115-245

2) Department of Defense and Labor, Health and Human Services, and Education Appropriations Act, 2019 and Continuing Appropriations Act, 2019, Sec. 202 – None of the funds appropriated in this title shall be used to pay the salary of an

individual, through a grant or other extramural mechanism, at a rate in excess of Executive Level II.

GOVERNMENT ACCOUNTABILITY OFFICE
STANDARDS FOR INTERNAL CONTROL IN THE FEDERAL GOVERNMENT (GREEN BOOK)

Principle 12 – Implement Control Activities
12.03 Management documents in policies for each unit its responsibility for an operational process's objectives and related risks, and control activity design, implementation, and operating effectiveness.

12.04 Management communicates to personnel the policies and procedures so that personnel can implement the control activities for their assigned responsibilities.

Principle 16 – Perform Monitoring Activities
16.05 Management performs ongoing monitoring of the design and operating effectiveness of the internal control system as part of the normal course of operations. Ongoing monitoring includes regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Ongoing monitoring may include automated tools, which can increase objectivity and efficiency by electronically compiling evaluations of controls and transactions.

CAS POLICIES AND PROCEDURES
Review Guide

Section A: Required Documentation
Negotiator should determine whether the proposal package submitted is complete, provides sufficient detail to permit an adequate review and is in a format that can be readily followed.

Section C: Reconcile Proposal to the Financial Statements
Costs included on the proposal must be reconciled to the financial statements. If the proposal has not been reconciled to the financial statements, the nonprofit should be notified immediately. A review of the proposal should be delayed until this step is completed.

--the negotiator is also required to gain assurance that the direct and indirect costs included in the proposal reconcile to the audited financial statements. Then analyze the proposal for adjustments, for unallowable and extraneous costs that should be excluded, and for costs that should be allocated adequately.

--the negotiator should 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 proposal review.

Section E: Trend Analysis
A trend analysis of the nonprofit organization indirect costs, rates and allocation base should be performed during the preliminary review of each cost proposal.
--trend Analysis Step 1. Perform a detailed trend analysis of the nonprofit organization's indirect costs rates, and allocation base for the latest three years, including the proposal year; to compare how much certain indirect costs are increasing when compared to the increases in the nonprofit organization's direct base.

Section G: Concluding Steps and Rates
--step 4. Complete Summary of Negotiations which shows the amounts negotiated that are different from the amounts submitted, and the reasons for the negotiated differences.

Section H: File Documentation: The negotiation workpapers should contain sufficient documentation to clearly show a.) what aspects of the proposal that were reviewed, b.) what significant aspects of the proposal were not reviewed and why, c.) what adjustments were made to the proposal and the reasons for the adjustments, d.) how the approved rates were computed and negotiated, e.) how any cost savings was computed, and f.) required certifications.

V. Comments regarding certain "Selected Items of Cost" –

Rental Costs – Rental costs are allowable; however, they are subject to several conditions.
c) Rental costs under less than arm's length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization.

CAS Internal Guidance/Key Performance Indicators (KPI)

Per the CAS KPI, to have 95 percent initial indirect cost rate proposals be completed within 90 days and 85 percent renegotiated indirect cost rate proposals be completed within 180 days.

Indirect Cost Proposal Checklist (ICP Checklist)

The ICP Checklist, which is to be submitted with the indirect cost rate proposal by the grantee, requires the grantee to include a trend analysis of the indirect cost rate proposal cost categories between the current and previous submission and explain any increases or decreases of 10 percent or more.

APPENDIX C: INSTANCES OF NONCOMPLIANCE

Sample Items	Non-Compliance With Federal Regulations	Did Not Follow Its Review Guide	Did Not Follow Its Internal Guidance	Potentially Unallowable Compensation Costs	Total
Sample #1	0	0	1	0	1
Sample #2	1	1	0	1	3
Sample #3	0	0	0	0	0
Sample #4	0	1	1	0	2
Sample #5	0	0	2	0	2
Sample #6	0	0	1	0	1
Sample #7	0	0	2	1	3
Sample #8	0	1	0	1	2
Sample #9	0	0	0	1	1
Sample #10	0	2	1	0	4
Sample #11	0	0	0	0	0
Sample #12	1	1	0	1	3
Sample #13	1	0	1	0	2
Sample #14	0	1	2	0	3
Sample #15	1	1	1	0	3
Sample #16	0	0	0	0	0
Sample #17	1	0	0	0	1
Sample #18	0	1	1	1	2
Sample #19	0	1	1	0	2
Total	**5**	**10**	**14**	**6**	**35**

APPENDIX D: INSTANCES OF INDIRECT COST RATES NOT COMPLETED IN A TIMELY MANNER

Sample Item	Initial/Renegotiation	Days Overdue
Sample #4	Renegotiated	1
Sample #5	Renegotiated	9
Sample #7	Renegotiated	17
Sample #13	Initial	43
Sample #14	Renegotiated	32
Sample #15	Initial	36
Sample #18	Initial	133
Sample #19	Renegotiated	140

APPENDIX E: COST ALLOCATION SERVICES COMMENTS

DEPARTMENT OF HEALTH & HUMAN SERVICES

Program Support Center
Financial Management Portfolio
Cost Allocation Services

7700 Wisconsin Ave., Suite 8100
Bethesda, MD 20814
PHONE: (301) 492-5625
EMAIL: CAS-Bethesda@psc.hhs.gov

March 8, 2022

TO: Amy J. Frontz
Deputy Inspector General for Audit Services

FROM: Arif Karim
Director
Cost Allocation Services
Program Support Center, Financial Management Portfolio

Arif M. Karim -S
Digitally signed by Arif M. Karim -S
Date: 2022.05.17 13:31:48 -05'00'

SUBJECT: Cost Allocation Services comments to OIG Draft Report: *Cost Allocation Services Needs To Update Its Indirect Cost Rate-Setting Guidance*, A-06-20-01000

HHS/PSC/FMP/COST ALLOCATION SERVICES (CAS)
RESPONSE TO HHS OIG DRAFT AUDIT REPORT A-06-20-01000

Thank you for the opportunity to provide our responses to the audit findings contained in the draft HHS/OIG Audit Report A-06-20-01000, titled "Cost Allocation Services Needs To Update Its Indirect Cost Rate-Setting Guidance". Our responses to each recommendation are below and on the following pages.

On page 17 of the Audit Report, OIG lists Recommendations. We concur with Recommendations 1-4, but not 5 and 6. However, part of the Audit Report supporting Recommendation 2 is not factually correct (following the bulleted order of the Recommendations):

FACTUAL ERRORS

We disagree with statements on page 12 of the report. Our primary reason for disagreeing with the characterizations is that the Non-Profit Review Guide is not a bible that negotiators should follow without regard to professional judgment, experience, and materiality. That would lead to a misuse of limited Federal resources, and also result in an unnecessary administrative burden on the grantee community. The Non-Profit Review Guide states on page 3, "While this guide is reasonably detailed and comprehensive, it is not intended to be a substitute for professional experience and judgement." Where negotiators and Branch Chiefs

explained their professional judgment during the interviews, such as "related parties", arm's length leases, and increases in indirect costs that do not change the indirect cost rate or are inherently low-risk types of costs should have been accepted by the auditors, in accordance with the Non-Profit Review Guide.

CORRECTIVE ACTION PLAN

1. CAS has formed a Work Group to update the CAS Review Guide for Non-Profit Organizations. We have started the process of updating the Review Guide to conform with applicable Federal regulations and CAS internal policies and procedures. We will post the updated CAS Review Guide for Non-Profit Organizations to our website no later than September 30, 2022. The Guide had not been previously updated due to CAS not having a National Specialist for Non-Profit Organizations for many years. The updated Review Guide will incorporate applicable internal Guidance Memoranda issued to the staff in recent years. The updated Review Guide will also be provided to our staff, and we will conduct an orientation for the staff, to explain significant revisions.

2. CAS will update the Indirect Cost Proposal Checklist for New Grantees to include the requirement for a Certificate of Indirect Costs by June 30, 2022. CAS will also correct the Standard Review and Limited Review Checklists to include sub-steps for negotiators to check off separately that the following three documents are included in the proposal and were signed by the grantee:
    (a) Certificate of Indirect Costs
    (b) Lobbying Certificate
    (c) Indirect Cost Proposal Checklist

   CAS will update the Review Checklists by June 30, 2022.

   In addition, CAS is currently in the procurement process to engage a contractor company to create a new integrated information technology system for CAS. Currently, indirect cost rate proposals are submitted by e-mail and have to be manually reviewed by the Branch Chief and/or negotiator to determine that all required forms are included and are signed. For the planned new system, CAS will ask the contractor to create a web-based portal where grantees can directly upload their proposals. We plan to have all current required forms on the portal website, and if feasible, the new system will give the grantee an error message informing them if a required form is missing from the proposal or is not signed.

   ii) CAS Did Not Negotiate a Final Rate Based on Actual Costs

   As previously noted, CAS will update the Review Guide for Nonprofit Organizations by September 30, 2022, and the updated Review Guide will include clear guidance that indirect cost rates should not be finalized any higher than the actual final rate calculated in accordance with Federal regulations. We believe that the one instance identified by HHS/OIG was an isolated occurrence, and that there was not significant harm to Federal programs, since there was not a large difference in the rates. To

put it in perspective, CAS saved Federal programs $925 million in Fiscal Year 2021, due to our rate adjustments.

iii) CAS Did Not Always Follow Its Review Guide Procedural Steps

HHS/OIG seems to be criticizing CAS for exercising professional judgment in determining the scope of reviews. CAS does not agree that the Review Guide is a substitute for professional judgment. The Non-Profit Review Guide states on page 3, "While this guide is reasonably detailed and comprehensive, it is not intended to be a substitute for professional experience and judgement." CAS is an operational organization and does not have the authority or responsibility to write HHS policy. The CAS Non-Profit Review Guide is an internal tool for Branch Chiefs and negotiators. As noted previously, we have Review Checklists within our Non-Profit Workpaper Template. Internal CAS guidance, such as the Review Guide, is not Federal or HHS regulation or policy. The Branch Chiefs and negotiators exercise professional judgment based upon professional experience, the materiality of each grantee's Federal awards, and the materiality of each indirect cost item to the rate calculation. It would be impractical and a poor use of HHS resources to perform every possible review step for every single grantee proposal.

3. CAS will update checklists to include all federally required documents on checklists provided to the nonprofit organizations and on checklists used by CAS officials by June 30, 2022.

4. The updated CAS Review Guide for Nonprofit Organizations will contain clear guidance that Final indirect cost rates cannot be higher than the rate calculated based upon actual costs. We believe the example given in the Audit Report was an isolated instance. However, to prevent this from happening again, the updated CAS Review Guide for Nonprofit Organizations will contain clear guidance that Final indirect cost rates cannot be higher than the rate calculated based upon actual costs, in accordance with Federal regulations. When the updated Review Guide is issued to the staff, we will also conduct a training session for all staff and will reiterate how Final indirect cost rates should be negotiated. As previously stated, the updated Review Guide will be issued to the staff by September 30, 2022.

WE NON-CONCUR WITH THE FOLLOWING FINDINGS:

5. Recommendation #5 states that CAS should review its staffing levels and determine whether resources are aligned efficiently, and adjust as needed, to ensure that the indirect cost rate-setting process is conducted in a timely manner. However, CAS already maintains Performance Management Plans and Strength Reports, which are updated regularly and provided to Program Support Center (PSC) senior leadership. CAS is aware that our current staffing levels are below our authorized FTEs. CAS has and will continue to seek to hire additional staff. However, the ability to hire is not completely within the control of the Director of Cost Allocation Services, as the Director of Cost Allocation Services does not have direct hiring authority. Instead, CAS

is reliant on HHS Human Resources and Program Support Center (PSC) senior leadership to facilitate the hiring process. CAS is currently working with PSC management to update and improve our Position Descriptions, in order to facilitate Job Announcements that more closely reflect CAS' responsibilities and duties.

However, CAS non-concurs with this finding because the finding is based on internal management tools for measuring employee productivity. Specifically, HHS/OIG's basis for stating that reviews were not completed timely were based on internal Key Performance Indicators (KPI's). These KPI's are management tools for internal use to monitor the length of time that it takes for negotiators to complete reviews. These KPI's are not Federal regulation and are not HHS policy. We don't believe this is an adequate basis for an audit report finding. We believe that the audit report should instead state, as follows:

> "HHS/OIG found that low staffing levels that are significantly below CAS' authorized FTE's can impact the timeliness of reviews. However, we did not find that CAS violated any Federal regulations or HHS policies with regards to timeliness. CAS has and continues to make extensive efforts to hire. However, the Director of Cost Allocation Services does not have direct hiring authority and is dependent on the effective functioning of other organizations within HHS, such as Human Resources, in order to onboard new staff. Therefore, we are not making an official recommendation pertaining to staffing in this Audit Report."

6. Recommendation #6 recommends that CAS seek clarification on whether the policy of including executive compensation higher than the Level II statutory cap in its indirect cost pool calculation complies with Federal law and governmentwide policy. CAS does not concur with this finding. CAS is operational and is not a policy-making organization. CAS has previously informed HHS grants management policy officials in writing several times, including in 2018, 2019, and 2022, that, based upon the existing policy guidance, CAS cannot unilaterally make a policy decision to apply Appropriations law salary limitations to indirect salaries. The one exception is the HHS Administration for Children and Families' (ACF) Head Start program. Application of the salary limitation to indirect cost rates for Head Start grantees is based upon the Head Start Authorization Act and the Program Instructions issued by ACF grants management policy officials. The only written guidance for other HHS programs that we are aware of is a 1990 HHS Policy Memorandum that explicitly states that salary limitations contained in Appropriations laws do <u>not</u> apply to indirect salaries.

   Since the Director of CAS had already taken the recommended action at the time of the audit, which was communicated clearly to the auditors, this is not a valid finding. Resolution of this very complex legal issue is not within the control of Cost Allocation Services and is not a reasonable finding for an Audit Report addressed to the Director of Cost Allocation Services.

If HHS/OIG wants to mention this issue in the Audit Report, we recommend the following paragraph:

> "OIG noted that HHS ASFR/Office of Grants/Division of Policy, Oversight, and Evaluation (ODPOE) has not updated the HHS policy regarding whether Appropriations Law salary limitations apply only to direct salaries, and not indirect salaries, since 1990. However, since updating the policy is not within the authority of the Director of Cost Allocation Services, and the Director of Cost Allocation Services has repeatedly informed ODPOE in writing of this issue, we are not including this as a finding or recommendation."