



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

APR 11 2004

Jack Martin, Chief Financial Officer
U.S. Department of Education, Room 4E313
400 Maryland Avenue, SW
Washington, DC 20202

Dear Mr. Martin:

This Final Audit Report (Control Number ED-OIG/A07D0005) presents the results of our audit of the U.S. Department of Education's (Department's) oversight of grantees subject to the restricted indirect cost rate (RICR) provisions in 34 C.F.R. Parts 75 and 76. The objectives of our audit were to determine whether

- Grantees subject to the RICR provisions have current and approved indirect cost rate (ICR) agreements;
- Grantees without current and approved RICR agreements have charged indirect costs to a grant; and
- The Department's monitoring of the use of RICRs is adequate to ensure that grantees satisfy the requirements of the RICR provisions.

Audit Results

The Department's monitoring of grant costs with respect to grantees subject to the RICR provisions is not adequate to ensure that

- Grantees do not claim indirect costs if they do not have negotiated ICR agreements;
- Grantees do not claim more than eight percent of Modified Total Direct Cost (MTDC)¹ if they do not have RICR agreements; and

¹ 34 C.F.R. § 75.562 defines a modified total direct cost base as total direct costs less stipends, tuition, and related fees, and capital expenditures of \$5,000 or more. 34 C.F.R. § 76.564 defines a restricted indirect cost rate = (General management costs + Fixed costs) / (Other expenditures). 34 C.F.R. §76.567 (b) defines costs that must be excluded from the base used to compute the indirect cost rate.

- Grantees provide enough information for program officials to ascertain the details of costs included in the indirect cost pool and in the base used for computing indirect costs.

We identified these specific deficiencies by reviewing a sample of official grant files in light of the following criteria:

- “A grantee must have a current indirect cost rate agreement to charge indirect costs to a grant. To obtain an indirect cost rate, a grantee must submit an indirect cost proposal to its cognizant agency and negotiate an indirect cost rate agreement.” (34 C.F.R. § 75.560 (b) and 34 C.F.R. § 76.560 (b))
- “If a grantee decides to charge indirect costs to a program that has a statutory requirement prohibiting the use of Federal funds to supplant non-Federal funds, the grantee shall use a restricted indirect cost rate computed under 34 CFR 76.564 through 76.569.” (34 C.F.R. § 75.563)
- A grantee subject to the RICR provisions may use “[a]n indirect cost rate of eight percent unless the Secretary determines that the subgrantee or grantee would have a lower rate” according to the formula in 34 C.F.R. § 76.564 (a). (34 C.F.R. § 76.564 (c)(2))

We randomly selected for our review 111 direct grants from a universe of 3,638 direct grants (stratified by principal office component (POC)) with start dates in FY 2002² and subject to the RICR provisions. This review covered 19 programs in the following 6 POCs:

- OVAE (Office of Vocational and Adult Education) – 2 programs
- OSERS (Office of Special Education and Rehabilitative Services) – 4 programs
- OPE (Office of Postsecondary Education) – 7 programs
- OII (Office of Innovation and Improvement) – 2 programs
- OESE (Office of Elementary and Secondary Education) – 2 programs
- OELA (Office of English Language Acquisition) – 2 programs

We found that 69³ of the 111 grants in our sample budgeted indirect costs, which, in total, amounted to about \$1.8 million. Twelve (or 17 percent) of these 69 grants did not have

² FY 2002 began on October 1, 2001, and ended on September 30, 2002.

³ This figure does not include 20 formula grants, for which information regarding amounts budgeted for indirect costs is not available.

an ICR agreement, which is required for grantees to claim indirect costs. In spite of the fact that there was no evidence in the information provided to us by the Department or available via the U.S. Department of Health and Human Services' Division of Cost Allocation website (www.psc.gov) that they had the required ICR agreements, these 12 grantees budgeted \$172,116 in indirect costs.

We found that 6 (or 11 percent) of the 57 grants that had ICR agreements budgeted indirect costs greater than 8 percent of MTDC but did not have RICR agreements that may have allowed for the higher rates. These six grants budgeted indirect costs that exceeded the eight percent rate by \$103,981.⁴

We also found that 13 (or 23 percent) of the 57 grants that had ICR agreements budgeted indirect costs using a base other than MTDC. As a result, these 13 grants budgeted \$68,926 more in indirect costs than allowed by Department regulations.

The cumulative effect of the inappropriate budgeting of indirect costs discussed in the previous three paragraphs is \$345,023, which is 20 percent of the total \$1,759,722 budgeted for indirect costs in the non-formula grants we reviewed. While we cannot project these figures to the full universe of the Department's grants that are subject to the RICR provisions, given the size of our sample, our results do suggest that there may be a significant amount of federal funds inappropriately budgeted for indirect costs in these grants. We estimate that the Department could better utilize at least \$4.6⁵ million by implementing the recommendations in this report.

A major reason that grantees charge more indirect costs than allowed under Department regulations is that program staff responsible for monitoring grants are not adequately informed about evaluating and monitoring such costs during the grant budgeting process. Some program officials told us that they accepted an eight percent rate for indirect costs without questioning whether grantees had current ICR agreements.

Some program officials noted that their grantees could charge a flat eight percent rate since the programs had been determined to be training grant programs. Their understanding of the RICR training grant provision was in error. Under 34 C.F.R. § 75.562 (c)

⁴ This figure does not include amounts for which there is not adequate information in the budgets submitted by the grantees to determine whether the amounts should be included in the MTDC.

⁵ This is the minimum amount estimated based on a 90 percent confidence level.

Indirect cost reimbursement on a training grant is limited to the recipient's actual indirect costs, as determined by its negotiated indirect cost rate agreement, or eight percent of a modified total direct cost base, whichever amount is less. [The underlining has been added for emphasis.]

According to this provision, even grantees with training grants must have ICR agreements. The eight percent rate is simply a maximum rate, not a rate that can be claimed in lieu of a negotiated rate.

The recently revised Handbook for the Discretionary Grant Process (the Handbook) does not address this and other issues that may arise in a program officer's review of proposed grant budgets. The only statement in the Handbook regarding indirect costs is the following:

Grantees must have a federally-approved indirect cost rate to charge indirect cost to a federal grant. If a grantee does not have an indirect cost rate, the program staff must contact the Indirect Cost Group in the Office of the Chief Financial Officer to obtain a temporary rate for the grantee (EDGAR § 75.560(c)). Grantees may not charge a cost already included in their indirect cost pool as a direct cost.

The Handbook does not address several important issues. For example, it does not provide guidance on how to

- Determine if a grantee has a federally approved ICR and what it is;
- Notify grantees who do not have approved ICRs of the requirements for obtaining an ICR and respond to grantees that have lapsed ICR agreements;
- Calculate the MTDC of a grant budget;
- Administer ICRs for training grants as distinct from non-training grants;
- Determine if a grantee is budgeting for a cost already included in its indirect cost pool as a direct program cost or as partial or full satisfaction of a cost-sharing requirement;
- Calculate the allowable indirect costs if the grant budget period does not coincide with the grantee's fiscal year; and
- Administer provisional ICRs.

Recommendations:

We recommend that the Chief Financial Officer

- 1.1 Ensure that the excess indirect costs identified in this audit be reprogrammed to direct cost categories;
- 1.2 Require program offices, for current grants, to rescind or reprogram to direct cost categories amounts budgeted for indirect costs
 - 1.2.1 If a grantee does not have a negotiated ICR,
 - 1.2.2. In excess of the grantee's ICR if the grantee does have a negotiated ICR, and,
 - 1.2.2 In excess of eight percent of MTDC if the grantee is subject to the RICR provisions, unless the grantee has a negotiated RICR permitting a higher rate;
- 1.3 Ensure that grantees are informed of the level of detail they must provide to the Department for the calculation of the MTDC of a grant budget;
- 1.4 Revise the Handbook for the Discretionary Grant Process to clarify how program officers, as part of their responsibility for monitoring grant costs, are to determine the correct indirect cost figure for a grant budget, including instructions on how to
 - 1.4.1 Determine if a grantee has a federally approved ICR and what the approved rate is;
 - 1.4.2 Notify a grantee that does not have an approved ICR of the requirements for obtaining an ICR and respond to a grantee that has a lapsed ICR agreement;
 - 1.4.3 Calculate the MTDC of a grant budget;
 - 1.4.4 Apply the ICR requirements to a training grant as distinct from a non-training grant;
 - 1.4.5 Determine if a grantee is budgeting for a cost already included in its indirect cost pool as a direct program cost or as partial or full satisfaction of a cost-sharing requirement;
 - 1.4.6 Calculate the allowable indirect costs if the grant budget period does not coincide with the grantee's fiscal year; and
 - 1.4.7 Administer a provisional ICR; and
- 1.5 Provide training to program managers and officers for administering the regular ICR, as well as the RICR provisions, including the determination of indirect costs in a grant budget and documentation of the steps taken to identify a grantee's ICR.

OCFO Comments and OIG Responses

OCFO stated that it generally concurs with our findings and recommendations. It noted, however, that “additional audit information or support schedules may be necessary to achieve the desired result.” Its comments (full text enclosed) specifically addressed the recommendations. The following is a summary of the OCFO comments and our responses.

OCFO Comment on Recommendations 1.1 and 1.2

OCFO stated that it would need detailed information regarding the affected grants, i.e., award numbers, grant periods, and both direct and indirect cost claims to respond to these recommendations.

OIG Response

After the final report is issued for this audit, OIG will provide to OCFO the information it requested. OIG will also provide to each program office the same information for the affected grants for which that particular office is responsible, if any.

OCFO Comment on Recommendation 1.3

OCFO stated that it is revising its “Cost Determination Guidance” publication and is developing a new listing of programs subject to the RICR provisions. It added that this information would be available in hard copy as well as on the Department’s website. It also notes that many grantees under Department programs have cognizant agencies for negotiating indirect cost rates that are not the Department.

OIG Response

Recommendation 1.3 is that OCFO is to ensure that grantees are informed of the level of detail they must provide to the Department for the calculation of the MTDC of a grant budget. The information being developed by OCFO may be an initial step, but at some point the needed information would have to be directly communicated to the affected grantees and not simply made available to them. Our recommendation does not speak to the matter of the negotiation of indirect cost rates, but instead, to the level of detail the Department needs to see on a grantees budget for it to determine allowable indirect costs given the indirect cost rate, regardless of the cognizant agency that determines the rate.

OCFO Comment on Recommendation 1.4

OCFO stated that its Indirect Cost Group (ICG) provided to its Grant Policy and Oversight Staff (GPOS) draft language on administering indirect costs for inclusion in future revisions of the Department's Discretionary Grant Process Handbook. It noted that the revisions would clarify the responsibilities of the Department's program officers for approving and monitoring indirect costs under grant awards.

OCFO Comment on Recommendation 1.5

OCFO stated that a training curriculum for Indirect Cost Oversight under Federal Programs is now being drafted and that it would provide OIG an opportunity to comment on the curriculum.

Other OCFO Comments

OCFO addressed the footnote in the report that mentioned that information about amounts budgeted for indirect costs is not available for the Department's formula grants. It stated that if the condition is due to a Grant Administration and Payment System (GAPS) deficiency, we should develop a recommendation to remedy the situation. We did not review GAPS as to the accuracy and completeness of its indirect cost information since we determined that the focus of the audit was on the Department's monitoring of indirect costs, rather than whether certain information was entered into GAPS.

The concluding paragraph to OCFO's letter notes that it is important that program offices be held accountable for proper oversight of grantee administration of indirect costs. We agree.

Background

Indirect costs are costs incurred for common purposes that benefit more than one activity. An indirect cost rate determines the proportion of indirect costs each program should carry. This rate is expressed as a percentage of the indirect cost to a direct cost base. Department programs that have a statutory requirement prohibiting the use of federal funds to supplant non-federal funds require the use of a restricted indirect cost rate computed under 34 CFR §§ 76.564 through 76.569. The restricted rate is computed by removing certain items from the indirect cost pool, which results in a lower indirect cost rate.

ICG is the Department's focal point for cost oversight management duties. Among other duties, ICG establishes and approves indirect cost methods used to charge costs under federal awards through desk audits and site visits. In addition, ICG develops cost policy and other financial oversight guidance.

Audit Objectives, Scope, and Methodology

The objectives of our audit were to determine whether grantees subject to the RICR provisions have current and approved ICR agreements, grantees without current and approved RICR agreements have charged indirect costs to a grant, and the Department's monitoring of the use of RICRs is adequate to ensure that grantees satisfy the requirements of the RICR provisions.

To accomplish our objectives we

- Reviewed applicable federal law and regulations,
- Interviewed Department personnel,
- Obtained and analyzed documents from Department grantee files,
- Reviewed indirect cost rate agreements on the U.S. Department of Health and Human Services' website,
- Obtained and analyzed grant data from GAPS, and
- Randomly selected 111 grants from a universe of 3,638 grants subject to the RICR provisions with start dates from October 1, 2001, through September 30, 2002, to determine whether the grantees with budgeted indirect costs had current indirect cost rate agreements.

To achieve the assignment's objectives we relied on computer-processed data contained in GAPS for the purpose of sample selection. We did not determine the reliability of the GAPS data because the use of GAPS data for this purpose is not significant to our findings, conclusions, or recommendations.

We performed onsite fieldwork at various Department offices in Washington, D.C. intermittently from January to February 2003, and continued to collect and analyze data in our offices through August 2003. We held an exit conference with Department officials on August 5, 2003. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.

Statement on Management Controls

As part of our audit, we made an assessment of the Department's management control structure, policies, procedures, and practices applicable to the scope of our audit. The purpose of our assessment was to determine the level of control risk, e.g., the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of the substantive tests needed to accomplish our audit objectives.

To make our assessment, we identified significant controls and classified them into the following categories:

- Use of regular and restricted indirect cost rate agreements,
- Application of restricted rates to the modified total direct cost base, and
- Monitoring of grants subject to the restricted indirect cost rate provisions.

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in the Department's controls over the use of restricted indirect cost rates. These weaknesses and their effects are fully discussed in this report.

Administrative Matters

The conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by your office. An electronic copy of this report will be provided to your Audit Liaison Officer as well as the six POCs from which we selected grants for our review.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's automated audit tracking system. Department policy requires that you develop a proposed Corrective Action Plan (CAP) for our review in the automated system within 30 days of the issuance of this report. The CAP should set forth the specific action items and targeted completion dates necessary to implement final corrective actions on the recommendations contained in this report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given us during this review. If you have any questions, please call Janice D. Keeney, Assistant Regional Inspector General for Audit, at (816) 268-0500.

Sincerely,

A handwritten signature in cursive script that reads "Helen Lew".

Helen Lew
Assistant Inspector General
for Audit Services

Enclosure

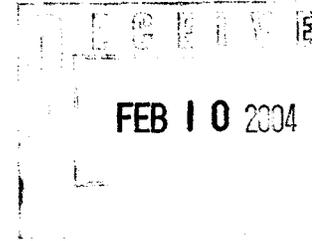


UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

THE CHIEF FINANCIAL OFFICER

FEB - 3 2004



Mr. William Allen
Regional Inspector General
U.S. Department of Education (ED)
Office of Inspector General (OIG)
8930 Ward Parkway, Suite 2401
Kansas City, MO 64114-3312

Re: Draft Audit Report (Control Number ED-OIG/A07D0005)

Dear Mr. Allen:

Thank you for giving the Office of the Chief Financial Officer (OCFO) an opportunity to review and provide comments on the draft audit reporting on the Department's (ED) oversight of restricted indirect cost rates (RICR) under ED grant awards.

Background

The Indirect Cost Group (ICG) requested that the OIG include this particular RICR review in their previous audit work plan. While ICG establishes RICRs for grantees where ED is the cognizant Federal agency for cost negotiation, the actual responsibility for budgeting and oversight of indirect cost claims lies with the individual program offices. The OIG audit work can serve as the foundation for OCFO assistance in improving this area of grant administration and monitoring.

Findings and Recommendations

The OCFO generally concurs with the OIG audit findings and recommendations, but additional audit information or support schedules may be necessary to achieve the desired result. Below are responses to each recommendation.

Recommendations for Adjustments:

- Ensure that the excess indirect costs identified in this audit be reprogrammed to direct cost categories.
- Require program offices, for current grants, to rescind or reprogram to direct cost categories amounts budgeted for indirect costs;

If a grantee does not have a negotiated ICR,

In excess of the grantee's ICR if the grantee does have a negotiated ICR, and,

In excess of eight percent of Modified Total Direct Costs (MTDC) if the grantee is subject to the RICR provisions, unless the grantee has a negotiated RICR permitting a higher rate.

Response: OCFO will need the final OIG audit to provide supplementary schedules which detail the affected grant award numbers, grant periods and both direct and indirect cost claims. It would help if the supporting schedules are sorted by program office.

Recommendations for Guidance:

- Ensure that grantees are informed of the level of detail they must provide to the department for the calculation of the MTDC of a grant budget;

Response: The ICG is revising their current "Cost Determination Guidance" publication. The ICG also just completed an exhaustive research of program statutes and regulations in developing a new restricted programs listing by CFDA number. This information all will be available both in hard copy and on the ED-website. It is important to note here that in many instances, ED grant funds are provided to organizations where the cognizant federal agency for cost negotiation is not ED. ICG has negotiated separate Memorandums of Understanding with the Department of Health and Human Services and Department of Interior, to carry out "cooperative" restricted rate reviews with ED.

Recommendations for Policy Direction:

- **Revise the Handbook for the Discretionary Grant Process** to clarify how program officers, as part of their responsibility for monitoring grant costs, are to determine the correct indirect cost figure for a grant budget, including instructions on how to:

Determine if a grantee has a federal approved ICR and what the approved rate is.

Notify a grantee that does not have an approved ICR of the requirements for obtaining an ICR and respond to a grantee that has a lapsed ICR agreement.

Calculate the MTDC of a grant budget.

Apply the ICR requirements to a training grant as distinct from a non-training grant.

Determine if a grantee is budgeting for a cost already included in its indirect cost pool as a direct program cost or as partial or full satisfaction of a cost sharing requirement.

Calculate the allowable indirect costs if the grant budget period does not coincide with the grantee's fiscal year; and

Administer a provisional ICR.

Response: ICG provided the Grant Policy and Oversight Staff (GPOS) draft language on "indirect cost administration" for discussion and inclusion in future revisions of the Department's

Discretionary Grant Process Handbook. The revisions to the Handbook will clarify ED program officers' responsibilities for approving and monitoring indirect costs under grant awards.

Recommendations for Training:

- Provide training to program managers and officers for administering the regular ICR, as well as the RICR provisions, including the determination of indirect cost in a grant budget and documentation of the steps taken to identify a grantee's ICR.

Response: OCFO now has in place a training contract for "Indirect cost Oversight under Federal Programs." A course curriculum is now being drafted by the contractor. OCFO will provide the OIG an opportunity to comment on the curriculum when this work specification is complete.

Audit Footnote:

The draft audit included a footnote which mentioned that, information regarding amounts budgeted for indirect costs is not available under ED formula grants. If this condition is a Grant Administration and Payment System deficiency, with impact upon ED financial statements, an audit recommendation should be developed to address appropriate remedies.

To conclude, thank you again for making the RICR audit part of the OIG work plan. Since indirect costs are subtracted from revenues that are available for direct project costs, it is important that program offices be held accountable for proper oversight. OCFO will use the OIG audit to implement actions needed for technical, policy and training support.

If further information or assistance in this matter is required, please contact Ted Mueller at (202) 708-8787.

Sincerely,



Jack Martin