Re: Cost Principles for Educational Institutions,

Dear Mr. Tran:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section's governing Council and substantive committees contain members representing these three segments, to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

The proposed revisions to OMB Circular A-21 were published in the Federal Register on September 10, 1997. Comments were due on November 10, 1997. We tried several times, unsuccessfully, to contact your office by telephone to request an extension of time. We request that you consider our comments, although they are submitted after the November 10th deadline.
The Section believes the proposed rule contains some useful clarifications. We offer specific comments in the following areas, which we believe could be improved: (1) the proposed imposition of benchmarks for construction costs; (2) the proposed use of a fixed increment for utilities costs; (3) gains and losses included in depreciation; and (4) clarification of rate to be applied for life of award.

**Construction and Renovation Costs**

OMB proposes to add a new Section F.2b, detailing a new process for reviewing the reasonableness of research facility construction costs. The review process would require federal cost negotiators to determine, prior to including a new facility's costs in an educational institution's indirect Facilities and Administration ("F&A") rate, whether the cost per gross square foot of new facilities is reasonable when compared with benchmarks for construction of similar facilities. The benchmarks will vary by geographic region, and will be based on data collected by the National Science Foundation ("NSF") in biennial surveys. The benchmark for each region would be equal to 125 percent of the most recent cost per square foot data collected by the NSF. The proposed revision would not accomplish the stated goal of encouraging efficient construction and renovation of research facilities and would greatly increase administrative burdens.

The proposed rule does not state why the revisions are felt to be necessary, nor does it cite any evidence that there is in fact a problem with the reasonableness of facilities costs in universities. Absent such a finding, OMB should be reluctant to add to the administrative burden and paperwork required of universities and Government agencies, particularly in light of recent legislative and regulatory initiatives to reduce complexity and burden in Government rules and contracting.

Circular A-21 currently requires that facilities construction and renovation costs be "reasonable" and gives the Government negotiators and auditors the flexibility to determine what, in each individual circumstance, is or is not reasonable. OMB Circular A-21, § C.3. The current method is widely used in public procurement, and better protects the Government's interests than a benchmark comparison of costs that may or may not be reasonable for a particular project. Indeed, the proposed revisions imply that if the project's cost is within the 125 percent benchmark for the region, the cost will be considered reasonable; however, that project may still be one for which the costs are not reasonable. This proposal seems to conflict with section E.2.d.(1) of Circular A-21 which provides that actual conditions at each university are to be taken into account in determining the method of cost allocation to be used.

If a benchmark is to be set, one other than the current grouping is likely to lead to a more equitable result. In fact, OMB has requested suggestions of other geographic groupings. The proposed revisions, while acknowledging that construction costs are geographically sensitive, uses an arbitrary grouping of states to establish regional benchmarks. For instance, it is unlikely that the costs in a seismically sensitive, urban area in California are the same as those in small towns in Arizona, even though both are in the same region. Similarly, costs in New York City are likely to be higher than costs in more rural areas in New York or New Jersey. If regions must be used, a better approach would be to do a study to determine the costs of construction in different areas in the United States and group the regions by the results of that study. There may already exist construction industry data that would be helpful. For instance, you could still have 10 regions, but they would be ranked by how high the construction costs are so that areas of like costs are treated the same.

Use of one benchmark for all kinds of construction also raises problems, since not all construction is equally costly. Thus, it may be more efficient for a building to have virtually all biotechnology research laboratories in it, which will maximize the benefit of special air handling systems for that type of research. Such a building would be much more expensive than a building with different kinds of research, or as is often the case, a building that had laboratories, offices and classrooms. The incentive would be not to do the most efficient design, which would likely cost more than 125 percent of the benchmark and thereby imperil the federal reimbursement, but to spread out the expensive research facilities in different buildings so that the cost on a gross square foot per building basis will not trigger a review. Given that OMB has recognized certain types of research facilities are more expensive to construct and renovate than others, the benchmarks should reflect those differences and not put the burden on each individual university to establish what OMB states is already recognized. In this vein, we believe OMB should reconsider using the
National Science Foundation study, which NSF concedes uses averages that mask individual differences, and therefore is not suitable for determining what is an appropriate individual building cost.

The proposed rules further provide that detailed justifications must be submitted if the building costs more than 125 percent of the benchmark and provide that justifications must address lower life cycle costs, unique research needs and, if in Alaska or Hawaii, the higher costs in those states. Although the rules do not expressly prohibit universities in other states from providing justifications based on costs in their particular area, the language should be clarified to provide that high costs in any area can be an acceptable reason.

Another anomaly in the proposed rules is that the need for the detailed justification is triggered only when 40 percent or more of the facility's depreciation or use allowance is assigned to federally-sponsored agreements "at any time during the life of the building." Thus, so long as less than 40 percent of the building is used for federally sponsored research, there is no review. Again, this may do nothing more than provide incentives to spread out research space among many buildings. In addition, when a building is built is the best time for a review of the costs, but the costs of a building are not assigned to the Government until after the building is done and research is underway in that building. A building could then be subject to the 125 percent of benchmark limitation in some years and not in others, and may first come up for review many years after the construction when the information about the costs is difficult to obtain. A better standard would be to provide that for any building or renovation project for which it is reasonably expected that a significant portion of the space will be charged to Government sponsored research, the review will apply.

The proposed benchmarks for facilities costs should be withdrawn and only resubmitted if, after thorough study, they are determined to be necessary and are tailored to be equitable and not to discourage needed research construction.

Utility Costs

The proposal would eliminate special studies, which are currently used at a number of universities to determine the costs of utilities for research space. It is recognized that research facilities use more utilities than other types of university space, such as classrooms and offices. In place of the studies done at each university to determine the costs at that university as mandated by section E.2.d.(1), the proposed change would allow any university that previously submitted special utility cost studies to add an extra 1.3 percent to its F&A rate. There is some debate as to whether this really represents the average increment obtained by conducting studies, but even if it does, it is not equitable. By definition, some institutions will recover too much and some will recover too little.

The fixed increment will discourage universities from taking on projects which are energy intensive, such as high energy physics and semiconductor research or, if they do that kind of research, will penalize them for doing so.

We agree with OMB's proposal to defer elimination of library special studies until the issue is studied further.

Depreciation

We agree with the proposal to include gains and losses on the disposition of depreciable assets in the year in which they occur, as a credit or charge to the asset cost groupings in which the depreciable property was included. This change makes Circular A-21 consistent with the cost recovery rules for other institutions, and specifically with FAR 31.205-16.

Use of Fixed Rates for Life of Award

OMB also provided clarification that the 1996 change to Circular A-21, § G.7 to require agencies to use the "negotiated rate" at the time of the initial award to determine the total funding and reimbursement of costs
of a multi-year project, does not include provisional rates in the definition of "negotiated rate." This clarification is appreciated; however, further clarification would be helpful. It is unclear what rate will be used if at the time of award there is only a provisional rate. It is likely that OMB intended that the first negotiated rate applicable to the contract is the one to be applied. If so, we recommend that OMB state as such in a further clarification.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Marcia G. Madsen
Chair
Section of Public Contract Law

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