BASICS OF THE COST ACCOUNTING STANDARDS

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Table of Contents

What are the Cost Accounting Standards (CAS)? ................................................................. 2

What is a Disclosure Statement (DS-2)? .................................................................................. 2

What is the history of the CAS’s applicability to educational institutions? .............................. 3

What is the CAS applicability now that they have been incorporated into OMB Circular A-21? ......................................................................................................................... 4

What are the significant implications of each of the four standards to universities? ............... 4

What is the significance of the DS-2 for universities? ............................................................ 6

What occurs if an institution changes its cost accounting practices? ...................................... 7

What is the status of Harvard’s DS-2? ...................................................................................... 8
Introduction

Research universities, particularly those which receive large amounts of federal funding for research, have been subjected to increased governmental scrutiny in recent years.

Probably the most significant change adopted by the Office of Management and Budget (OMB) into Circular A-21, Cost Principles for Educational Institutions, was the inclusion of four of the nineteen Cost Accounting Standards (CAS) in the May 1996 revision of A-21.

In addition to the four standards, A-21 also now requires institutions receiving in excess of $25 million during their most recently completed fiscal year to disclose their accounting practices by filing a Disclosure Statement (DS-2) – something completely unheard of in the higher education arena until now.

This guide has been prepared to provide a basic overview of the CAS and the DS-2 as well as a brief description of Harvard University's experience with these new standards thus far.

Hopefully, this guide will assist you in thinking about the implications of the CAS and the DS-2 if you are required to file one.
What are the Cost Accounting Standards?

The Cost Accounting Standards (CAS) were originally promulgated under Section 719 of the Defense Production Act of 1950 and were subsequently adopted as an Act of Congress under Public Law 100-679. The original intention of the CAS was to achieve uniformity and consistency in the cost accounting practices governing measurement, assignment and allocation of costs to contracts with the United States government. Now that the standards have been incorporated into A-21, other types of awards (grants, cooperative agreements) are covered as well. There are nineteen standards in total—four of these nineteen currently apply to universities. These four are:

- CAS 501 – consistency in estimating, accumulating and reporting costs
- CAS 502 – consistency in allocating costs incurred for the same purpose
- CAS 505 – accounting for unallowable costs
- CAS 506 – consistency in cost accounting periods

What is a Disclosure Statement (DS-2)?

The DS-2 is a twenty page document containing a series of questions divided into various parts. The parts require that the person completing that part select a response provided after each question. Some selections require that in addition to the response selected, a detailed written explanation or description of that particular costing practice (e.g., how unallowable costs are identified) be included on a “continuation sheet”. The parts are:

- Part I. General Information
- Part II. Direct Costs
- Part III. Indirect Costs
- Part IV. Depreciation and Use Allowance
- Part V. Other Costs and Credits
- Part VI. Deferred Compensation and Insurance Costs
- Part VII. Central System or Group Expenses
The intent behind each question in each part is to determine how costs are measured, accumulated, directly assigned and/or allocated to federally sponsored agreements (grants, contracts, cooperative agreements).

The DS-2 is only required for universities receiving in aggregate sponsored agreements totalling $25 million or more (note – this figure does not include student financial aid funding). For those institutions falling within this threshold, a DS-2 must be submitted to the institution’s cognizant agency.

The DS-2 requires a signed certification under penalty of perjury from an authorized signatory of the reporting unit (for Harvard, we have interpreted this as the Financial Vice President and the Financial Deans).

What is the history of the CAS’ applicability to educational institutions?

From its inception in the early 1970s, the Cost Accounting Standards Board exempted educational institutions from compliance with these rigorous cost accounting rules. Some felt that these rules, for the most part, were already addressed in the provisions of OMB Circular A-21. Others felt that the mission of an educational institution was different enough from that of a defense contractor (the original beneficiary of these rules) that these rules did not have inherent applicability within educational institutions. Still others understood that the rigid costing requirements of these rules did not “fit” within universities – university researchers do not “cost out” their time spent on each project as one would expect to see in a defense contractor environment. Others felt that the 26% administrative cap that universities are subject to would offset the need for an additional administrative burden. However, since the original exemption in the 1970s, information that certain universities were inappropriately allocating costs to federal research projects, and in some cases, directly charging unallowable costs to federal projects, led to a change in thought about the original exemption. On November 8, 1994, the CAS Board issued a final ruling extending CAS coverage to universities engaged in contracting with the federal government. Then just over a year and a half later, OMB A-21 adopted the four standards for all institutions covered by A-21 (for grants, contracts and cooperative agreements) and the DS-2 requirement for those institutions receiving in excess of $25 million in federally sponsored agreements.
What is the CAS’ applicability now that they have been incorporated in OMB Circular A-21?

The fact that the four CAS have been formally incorporated into the body of A-21 signifies that the government is looking for more explicit regulation governing the consistent application of cost accounting practices at colleges and universities.

Also noteworthy through A-21 adoption of the CAS is the extension of CAS coverage from federal “contracts” in excess of $500K to now, “all sponsored agreements” as A-21 covers all sponsored agreements. In essence, this means that all colleges and universities who receive federal funding for sponsored projects (regardless of sponsored funding level) are now subject to the four standards.

Until the incorporation of CAS into A-21, one could imagine either a separate accounting system (perhaps on a desktop) or extra care taken for those costs directly charged to federal “contracts”. However, it is unlikely and moreover, impractical, to consider a separate accounting system that is “CAS compliant” for costs charged directly or indirectly to sponsored agreements. This is to say that through A-21’s adoption of the CAS, colleges and universities will now be forced to ensure that their accounting systems consistently measure, accumulate, assign and allocate costs in all cases – not just to sponsored agreements, as it is impractical to separate this piece from the other activities within the university (instruction, service, other institutional activity, etc.).

What are the significant implications of each of the four standards to universities?

CAS 501 – consistency in estimating, accumulating and reporting costs implies more thought must be given to the method used to propose costs on sponsored awards. Questions such as the following should be raised:

- how were the percentages of effort for personnel determined?
- are these percentages reasonable given the individual’s other commitments?
- how were the “supply” costs estimated?
- is there a direct “causal-beneficial” relationship between the costs proposed and the objectives of the project?
Additionally, with CAS 501, one must ask, do our systems accumulate costs in the level of detail that are proposed on the sponsored award? If “petri dishes” are a cost proposed on the budget, but the object code used to accumulate petri dishes and other scientific supplies is “supplies”, we have an inconsistency and a violation of CAS 501. Under CAS 501, if we propose a cost in a fine level of detail (test tubes) but our systems can only report those costs at a less granular level (scientific supplies) we have a CAS problem.

One potential solution here is to encourage the use of object code terminology in the proposal budget that is consistent with that of the accounting system. Detail about budget categories can be provided as a footnote in the proposal (i.e., “supplies” includes test tubes, petri dishes).

Another relevant example comes to mind with the implications of CAS 501 and that is cost sharing. If a principal investigator promises the use of equipment or quantifies another investigator’s effort on the project (with no corresponding salary directly charged to the project) do we have systems to accumulate and report these costs? Clearly, cost sharing is a controversial issue and becoming more so under CAS 501. It is safe to assume that we (universities, funding agencies, and government auditors and negotiators) are only beginning to understand the implications of cost sharing to the indirect cost/facilities and administrative rate under CAS 501. One can imagine setting up separate accounts to accumulate cost shared expenses in the general ledger so that these costs can be more readily identified for internal and external purposes.

CAS 502 – consistency in allocating costs incurred for the same purpose implies again, more thought be taken before costs typically considered “indirect” be directly charged to a sponsored project. An institution might consider implementing a procedure before routinely charging administrative salaries to what in the past, may have been considered a perfectly appropriate circumstance. The procedure might include requiring an affirmative response to all of the following questions:

1. Can the cost be identified with the project with a high degree of accuracy?
2. Is the project considered one that has a different purpose or circumstance (e.g. a survey award)?
3. Has the cost been included in the project budget, with sufficient written justification, and been approved by the sponsor?

These type of procedures would certainly appear to demonstrate diligence and solid internal controls in the methodology employed to charge what might appear to be a similar cost directly to a sponsored award as it is under a “different purpose and circumstance”, and thereby allowable under CAS 502. Moreover, one might document through policy, examples of a similar cost charged in “an unlike circumstance”, e.g., a secretary who supports the academic department, versus a secretary who is devoted to survey distribution and collection for a research project.
CAS 505 – accounting for unallowable costs. Since the Dingell hearings in the late '80s and early '90s, we have all had a heightened sensitivity toward unallowable costs. Many of us perform exhaustive “cost scrubs” of our indirect costs pools when calculating a facilities and administrative rate. Some of us have instituted training programs to ensure that departments are aware of the risks of not culling out unallowable costs from everyday invoices. These procedures protect us from the alcohol, flowers and gifts showing up in the F&A pools. CAS 505, however, goes a step further. In the official description of the regulation, it states that “in circumstances where these unallowable costs would be part of a regular indirect cost allocation base or bases, they shall remain in such base or bases”.

What this provision is aimed at is the concept of direct cost overruns. Many of us have not considered these to be unallowable costs – until now. Our past practices have suggested that we clear out cost overruns with an unrestricted fund to bring the deficit balance to zero. However, CAS 505 suggests that this past practice would be inconsistent and we need to alter our procedures to ensure that these remain coded as direct research costs and thereby be included in the organized research base. (Note that this example correlates directly to CAS 501 – consistency in estimating, accumulating and reporting costs.)

CAS 506 – consistency in cost accounting periods. This standard might impact those universities who are, for example, associated with a hospital on a different year end. If two related entities were to have different financial year ends and are in the practice of charging costs to each other, or from one to another, the method used to determine the cost or rate charged between related entities may be impacted by the different year ends (e.g., cost may be higher at the end of the fiscal year); as such, one entity may need to change the official accounting period so that costs are synched up between and among related entities. Beyond this, it is unlikely that CAS 506 will have much of an impact on universities.

What is the significance of the DS-2 for universities?

Until now, many of us have had inadequate or nonexistent written cost accounting policies. In order to complete the DS-2, many of us were forced to take an inventory of our practices, agree on what they should be with various constituents around the university (e.g. service center business managers) and then codify them in writing. This process also involved implementation and training for departments, so the new (and often revised) practices would be appropriately followed.
Now that we have codified our cost accounting practices to complete the DS-2, we have committed to these practices. This indicates that we must not only follow them when we are directly charging awards but also when we are constructing our Facilities and Administrative (F&A) rates. The DS-2 essentially then becomes a “road map” for the construction and development of the F&A pools and research base. Auditors will require that our practices be followed (lest we complete a cost impact statement if we change our cost accounting practices!) For those of us who have been through the DS-2 process, it is an art to complete the DS-2 with enough detail and maintain flexibility at the same time – this is hard, if not impossible, to do in most cases.

What occurs if an institution changes its cost accounting practices?

Section C.14.D and G of A-21 emphasize that a change is to be reported and approved by the cognizant agency only when “the change is expected to have a material impact on the educational institution’s negotiated F&A rates.” As Harvard is in the process of implementing a new accounting system for the first time in fifty years, we brought up this question at the time we submitted our DS-2. If we changed our cost accounting practices while implementing our new system, how should we reflect these changes in our DS-2 and how would we know if we would be required to resubmit our DS-2 with an accompanying cost impact statement? The response from various federal officials and cost allocation negotiators was that we should revise our DS-2 at the same time our next F&A rate was submitted as the two have a direct correlation with each other. This response seems intuitive and sensible. However, if we were to change an accounting practice that resulted in a material effect to the way direct or indirect costs were charged, we should evaluate the need for a cost impact statement through discussion with our cognizant agency.
What is the status of Harvard’s DS-2?

For the purposes of CAS and the DS-2, Harvard has three segments as we have three “schools” with different rates. The three segments are: Harvard University Area – the Faculty of Arts and Sciences being the largest component, Harvard Medical School and the Harvard School of Public Health. The University Area’s DS-2 was submitted on July 1, 1996, audited during the Fall of 1996 and approved in May of 1997. The Harvard Medical School submitted their DS-2 on June 30, 1998, and the Harvard School of Public Health on September 30, 1998. As of this writing, neither the Harvard Medical School nor the Harvard School of Public Health have received notification as to the status of their respective DS-2s.

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