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Report to Congressional Committees

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INDIAN SELF-DETERMINATION ACT

Shortfalls in Indian Contract Support Costs Need to Be Addressed

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Resources, Community, and
Economic Development Division

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June 30, 1999

The Honorable Slade Gorton
Chairman
The Honorable Robert C. Byrd
Ranking Minority Member
Subcommittee on Interior and Related Agencies
Committee on Appropriations
United States Senate

The Honorable Ben Nighthorse Campbell
Chairman
The Honorable Daniel K. Inouye
Vice-Chairman
Committee on Indian Affairs
United States Senate

As directed in Senate Report 105-227, we are reporting on the Bureau of Indian Affairs' and the Indian Health Service's management of contract support funding under the Indian Self-Determination and Education Assistance Act. Our report contains recommendations to the Departments of the Interior and Health and Human Services designed to help ensure that contract support costs are paid consistently. The report also describes alternative methods for funding contract support costs, which the Congress may consider as it debates how to best carry out the provisions of the Indian Self-Determination Act.

We will send copies of this report to the Secretaries of the Interior and Health and Human Services and to the heads of the Bureau of Indian Affairs and the Indian Health Service.

Please contact me at (202) 512-3841 if you or your staff have any questions. Major contributors to this report are listed in appendix VIII.

Victor S. Rezendes
Director, Energy, Resources,
and Science Issues

Executive Summary

Purpose

The Indian Self-Determination and Education Assistance Act was passed in 1975 to encourage tribal participation in, and management of, programs that for years had been administered on their behalf by the departments of the Interior or Health and Human Services. Within the act, title I (referred to as the Indian Self-Determination Act) authorizes tribes to take over the administration of such programs through contractual arrangements with the agencies that previously administered them: Interior's Bureau of Indian Affairs and Health and Human Services' Indian Health Service.[1] For the Bureau, the programs that can be contracted include social services, law enforcement, road maintenance, and forestry, and for the Health Service, the programs include mental health, dental care, hospitals and clinics. According to the act, tribal contractors must receive funding equivalent to what each of the agencies would have provided if they had operated the programs. The act, as amended, also provides that tribal contractors are to receive funding for the reasonable costs of activities that they must perform to manage a program's contract.[2] These latter costs, referred to in the act as contract support costs, have grown considerably over the past 25 years—so much so that, for the past decade, the appropriations made to fund them have fallen short of the amounts required.

In 1998, a year of concern and controversy over contract support costs culminated in a statutorily imposed 1-year moratorium for fiscal year 1999 on all new contracting under the Indian Self-Determination Act. This moratorium was prompted by concerns over sustained increases in tribes' allowable contract support costs—that is, their costs that the Bureau and the Health Service determine are eligible for reimbursement —increases in the shortfalls between these costs and the funding available for them, and litigation over such shortfalls. In fiscal year 1998, the shortfall between tribes' costs for contract support and the funding provided for them through appropriations to the Bureau of Indian Affairs and the Indian Health Service exceeded $95 million.

[1]Throughout this report, the term "tribes" will refer both to tribes and tribal organizations eligible to contract programs under the Indian Self-Determination and Education Assistance Act. Also, the term "contracts" will refer to contracts, grants, self-governance agreements, cooperative agreements, or annual funding agreements entered into pursuant to the Indian Self-Determination and Education Assistance Act, as amended, that receive contract support funds. Title IV of the Indian Self-Determination and Education Assistance Act, as amended, authorizes the Department of the Interior to enter into annual funding agreements with tribes for self-governance, and provides for program funding and contract support costs equivalent to what was provided elsewhere under the act. Title III of the act authorizes the Department of Health and Human Services to enter into similar agreements annually with a limited number of tribes.

[2]The act also provides that contract funding is subject to the availability of appropriated funds. Tribal contractors and the Indian Health Service are presently litigating the questions of whether this provision limits the amount of funding the agencies must provide and whether the failure to provide full funding is a breach of contract.

In light of tribes' increasing allowable contract support costs and the shortfalls between the costs and the funds actually appropriated, GAO was asked to review various aspects of these costs. Specifically, GAO examined the following three questions: (1) To what extent and for what reasons have contract support costs and the associated funding shortfalls changed over the past decade, and what can be expected in the future for these costs? (2) How have the shortfalls in funding for contract support costs affected tribes? (3) Have the act's provisions for contract support costs been implemented consistently? Additionally, in light of the controversy over increases in contract support costs, GAO describes a number of alternatives that the Congress may wish to consider in its deliberations over contract support funding. As requested, appendixes II and III contain a description of the process by which contract support funding is provided to tribes.

Results in Brief

Tribes' allowable contract support costs have tripled from 1989 through 1998—increasing from about $125 million to about $375 million.[3] This increase occurred for two principal reasons. First, the total amount of program dollars contracted by tribes—upon which contract support costs are based—has increased. Second, the total cost of tribes' administration of contracts has increased. Although the amounts appropriated for contract support costs have increased, the Congress has not funded contract support to keep pace with these increases, resulting in funding shortfalls. In fiscal year 1998, almost $280 million of the about $375 million that was allowable for contract support costs was appropriated, resulting in a shortfall of about $95 million. Projections of future contract support costs are difficult to calculate because the number of programs tribes will elect to contract and the amount of funding they will receive are uncertain. For the foreseeable future, tribes' allowable contract support costs are unlikely to dip below the fiscal year 1998 level of $375 million and will likely increase, as they have done in the past.

According to the 94 tribes that we communicated with during our review, shortfalls in funding for contract support costs have caused financial difficulties and frustration for the tribes administering the programs. They have had to take a number of steps to cope with shortfalls in contract support funding. Reducing their contract support costs to within the amount of funding provided has been one such step. However, the tribes noted that this has decreased the efficiency and productivity of their tribal administrative functions. To make up for the shortfall, the tribes reported

[3]Dollar figures used throughout the report have been adjusted to constant 1998 values.

using program funds, which reduced services to tribal members, or using tribal resources, which precluded the use of those resources to supplement program funds or to develop tribal business ventures. In addition, a few tribes reported having to refuse or postpone opportunities to contract federal programs, which impeded their progress toward self-determination.

The contract support policies and practices of the Bureau, the Health Service, and Interior's Office of Inspector General have been inconsistent, which may result in some tribes receiving more contract support funding than they are allowed and in others receiving less. Since 1988, the Bureau and the Health Service have reimbursed tribes for different categories of contract support costs. The Bureau has reimbursed tribes for indirect costs and startup costs; the Health Service has reimbursed tribes for these two cost categories plus a third one, direct contract support costs.[4] This difference has caused confusion among tribes as well as differences in the amount of contract support funding paid by the two agencies. GAO also found some inconsistencies in the calculation and the application of indirect cost rates that were used to determine tribes' allowable contract support costs and makes recommendations to address those inconsistencies. For example, in some cases, the Bureau and the Health Service provided funding based on provisional rates and did not make adjustments to funding when those rates were finalized.

The impasse between providing full funding for contract support costs and limiting these costs continues in the Congress. The fallout has included litigation relevant to the issue, as well as a 1-year moratorium on new contracting under the Indian Self-Determination Act. To assist the Congress in its deliberations over how to resolve the impasse over contract support costs, GAO presents four alternative funding approaches, each of which can be considered individually or which can be combined. These alternatives range from providing appropriations sufficient to fund tribes' allowable contract support costs each year to amending the act to remove the provision for funding contract support costs over and above the direct program amount and instead provide a single, consolidated contract amount. Each of the alternatives has advantages and disadvantages. Three of the four alternatives, for example, offer the advantage of better controlling future increases in contract support costs. The disadvantage of these same three alternatives would be that they

[4]Joint agency regulations request tribal contractors to include direct, indirect, and startup costs in their initial contract proposals under title I of the Indian Self-Determination and Education Assistance Act, as amended (25 C.F.R. 900.8.).

require changes to the funding provisions of the Indian Self-Determination Act.

Background

The Indian Self-Determination and Education Assistance Act of 1975, as amended, authorizes Indian tribes to take over the administration of programs that had been previously administered on their behalf by the departments of the Interior or Health and Human Services. In passing the act, the Congress recognized that the government's administration of Indian programs prevented tribes from establishing their own policies and making their own decisions about program services. The act removes that impediment; it allows tribes to contract for a range of Indian programs that are managed by the Bureau of Indian Affairs and the Indian Health Service on their behalf. Once having contracted a program, a tribe assumes responsibility for all aspects of its management, such as hiring program personnel, conducting program activities and delivering program services, and establishing and maintaining administrative and accounting systems. Typical programs that are contracted by tribes include such Bureau programs as law enforcement, social services, road maintenance, and forestry as well as such Health Service programs as hospitals and health clinics; mental health; dental care; and environmental health services, such as sanitation.

The Congress amended the act in 1988 and 1994 to provide that, under self-determination contracts, tribes would receive funds for contract support costs in addition to the base program amount to manage their contracts. Since 1988, the Congress has provided funding for contract support costs in annual appropriations acts. The funding available for a tribe's contract is the total of the program funds transferred by either the Bureau or the Health Service and the contract support funds provided for that tribe's allowable contract support costs. When a tribe contracts for a program under the act—for example, a forestry program with the Bureau—the agency identifies the amount of funding in that program's budget for that tribe. In addition, the agency provides contract support funding for the costs of that tribe's management and administration of the contract. Each agency has established a separate budget line item specifically for this purpose. In fiscal year 1998, appropriations for the Bureau and the Health Service totaled about $3.8 billion. Of that amount, about half was administered by tribes through contracts. The amount contracted includes about $280 million that the Bureau and the Health Service provided for contract support costs.

In implementing the act's provisions for contract support costs, the agencies commonly refer to the following three categories of contract support costs: (1) indirect costs, which are the costs incurred for a tribe's common services, such as financial management and accounting; (2) direct contract support costs, which are the costs of activities that tribes incur but that are not provided in program funding or indirect funding, such as the cost of program-specific training; and (3) startup costs, which are the one-time costs of beginning a contract, including the purchase of computer hardware and software. In 1996, the Bureau and the Health Service published joint regulations implementing the Indian Self-Determination Act and these regulations allow tribes to request funding for these three categories of costs. The majority of contract support funds paid by both the Bureau and the Health Service are for tribes' indirect costs, which are based on indirect cost rates established by independent offices. These offices, which are the Department of the Interior's Office of Inspector General or the Department of Health and Human Services' Division of Cost Allocation, review tribes' indirect costs to determine if they are reasonable and allowable.

Principal Findings

Increases in Contract Support Costs Will Likely Continue in the Future

As the amount of program funds contracted by tribes has increased over the past decade, so has the amount of contract support funding they have used to administer them. In the past decade, the contract volume (total dollars contracted) for programs that tribes have contracted with the Bureau or the Health Service has more than doubled from about $800 million in fiscal year 1989 to about $1.9 billion in fiscal year 1998.[5] Tribes' contract support costs have also increased for these programs; the amount of contract support funding for tribes' administrative and other management costs has increased from about $125 million to about $375 million. Although appropriations from the Congress and the payments from these two agencies for contract support have increased, they have not been sufficient to cover tribes' allowable costs identified by the Bureau and the Health Service. In fiscal year 1998, the Congress appropriated almost $280 million to fund almost $375 million in tribes' allowable contract support costs, resulting in a shortfall of about $95 million.

[5]Because the Bureau does not have fiscal year 1998 data, this information is fiscal year 1997 data expressed in constant 1998 dollars.

The exact amount of future contract support costs is difficult to predict, but will likely increase in future years beyond the $375 million for fiscal year 1998. The extent of future increases will depend on (1) the amount of future appropriations the Bureau and the Health Service receive for contracted programs, (2) the extent to which tribes choose to contract new programs in the future, and (3) the future changes in tribes' costs of administering contracts. Currently, only about half of the funding for the Bureau of Indian Affairs and the Indian Health Service is being administered through contracts with tribes; the remaining programs are being administered by the Bureau and the Health Service and most of them could be contracted by tribes. If the amount of funding for programs contracted by tribes were to double in the future and if indirect cost rates were to stay about the same, contract support costs would increase—from the fiscal year 1998 amount of about $375 million to about $750 million.

Tribes Say They Have Been Adversely Affected by Shortfalls in Contract Support Funding

Over 90 tribes reported to GAO that they have used various methods to cope with the shortfalls in funding for contract support. For example, they said they have (1) reduced their indirect costs; (2) used either tribal resources, when available, or program funds to offset shortfalls in contract support costs funding; and (3) in a few cases, refused or postponed opportunities to contract programs. According to the tribes, each of these methods has had negative effects over the years; they could not further reduce their indirect costs and their administrative infrastructures have begun to deteriorate. For example, noncompetitive salaries have prevented them from hiring skilled staff, financial audits have not been done, and computer equipment has not been upgraded. In turn, tribes' use of their resources or direct program dollars to make up for shortfalls generally has reduced program services. For example, when a tribe uses direct program dollars to compensate for shortfalls in contract support funding, fewer dollars are available for program services. And when a tribe uses its own resources to make up for contract support shortfalls, it loses the opportunity to use those funds for other purposes to help its members. A few tribes said that when they simply cannot afford to take over or continue administration of a federal contract, they forego significant opportunities to advance their self-determination.

Inconsistencies in How Contract Support Costs Are Calculated

The Bureau of Indian Affairs and the Indian Health Service have inconsistently calculated payments for contract support costs to tribes. Since 1988, the Bureau and the Health Service have reimbursed tribes for different categories of contract support costs. Recently, the Bureau

acknowledged that it is considering providing tribes with funding for direct contract support costs, which it has not funded in the past but which the Health Service has funded. This change could increase the contract support funding for programs contracted from the Bureau. The increase could be about $10 million to $30 million per year more than the over $135 million in funding provided to support programs with the Bureau that are currently contracted by tribes.

In addition, inconsistencies in calculating indirect rates have caused confusion among tribes as well as potential differences in how funding has been calculated. Since 1992, two regional offices within Interior's Office of Inspector General, the primary office responsible for negotiating indirect cost rates with tribes, have calculated adjustments to indirect cost rates differently. In certain circumstances, the tribes negotiating indirect cost rates with the Western Region receive higher indirect cost rates than they would receive if the Eastern Region's method of calculation had been used. GAO did not calculate the effect this difference would have had on funding, but did note that if lower rates had been used funding requirements would have decreased. Interior's Office of Inspector General is aware of this problem and is prepared to change how the Western Region calculates rates to make it consistent with the Eastern Region. However, the federal government and tribes are engaged in efforts to reach agreement on the appropriate method for calculating the indirect cost portion of contract support costs. Any agreement will require court approval because the current method of calculation was found to be invalid.[6] GAO also found that the Bureau and the Health Service were inappropriately applying one type of indirect cost rate and, as a result, were not making adjustments for over- or underpayments to tribes.

Alternatives for Funding Contract Support Costs

As contract support costs continue to increase, the tension between providing full funding for these costs and limiting them will increase as well. The issue has already reached an impasse, with tribes having initiated lawsuits on payment of contract support costs and the Congress having imposed a 1-year moratorium for fiscal year 1999 on new contracting under the Indian Self-Determination Act. GAO presents four possible alternatives that the Congress may wish to consider as it deliberates on how best to provide funding to carry out the intent of the Indian Self-Determination Act and presents estimates of what these alternatives may cost and their major advantages and disadvantages.

[6]Ramah Navajo Chapter v. Lujan, 112 F. 3d 1455 (10th Cir. 1997). In addition to the efforts to reach an agreement in the Ramah case, the Bureau, the Health Service, and the National Congress of American Indians all have work groups studying contract support costs.

- Alternative 1: Provide appropriations sufficient to fully fund tribes' allowable contract support costs each year.
- Alternative 2: Amend the act to remove the requirement that contract support be funded at 100 percent of the allowable costs identified by the Bureau and the Health Service.
- Alternative 3: Amend the act to provide the indirect cost portion of contract support costs by using a flat rate or a ceiling rate.
- Alternative 4: Amend the act to change the current funding mechanism—in which contract support costs are identified and funded apart from program funds—to one consolidated contract amount.

Recommendations

To ensure consistent implementation of the Indian Self-Determination Act, GAO recommends that the Secretary of the Interior and the Secretary of Health and Human Services direct the Assistant Secretary for Indian Affairs and the Director of the Indian Health Service, respectively, to work together, and with the Congress and tribes, to develop a standard policy on funding contract support costs under the act so those agencies can consistently provide funding. An additional recommendation to the Secretary of the Interior and the Secretary of Health and Human Services regarding the use of one type of indirect cost rate is presented in chapter 4.

Matters for Congressional Consideration

The Congress, in its deliberations on how to best provide funding for the Indian Self-Determination Act, may wish to consider a number of alternatives to the current mechanism for funding contract support costs. GAO presents four alternatives in chapter 5 of this report.

Agency Comments

We provided a draft of this report to the departments of the Interior and Health and Human Services for review and comment. In responding, the Department of the Interior and the Department's Office of Inspector General each provided us with comments. We are handling these comments as separate responses.

The departments of the Interior and Health and Human Services agreed with GAO's recommendations that the Bureau of Indian Affairs and the Indian Health Service should have consistent policies on funding direct contract support costs and that adjustments should be made when provisional-final indirect cost rates are used. The Department of the Interior's Office of Inspector General did not comment on these two recommendations.

GAO's draft report concluded that having Interior's Office of Inspector General negotiate indirect cost rates limited its ability to audit the same function and recommended that the Secretary of the Interior move the function from the Office of Inspector General. In separate responses, the Department of the Interior and its Office of Inspector General differed on whether the responsibility should be moved. While the Inspector General's office agreed with GAO's recommendation to remove the rate negotiation function, the Department raised several concerns about moving the function. Specifically, it stated that sufficient separation of duties exists within the Inspector General's office because the office dedicates staff to indirect cost negotiations who are not assigned to conduct other activities such as audits. The Department also stated that it has limited ability to change the current system of negotiating indirect cost rates because of current litigation related to indirect cost rates. GAO continues to have concerns about the Inspector General's role in negotiating cost rates, and plans to review the issue in more depth in a separate study, taking into account the differences in the responses to our draft report, the legislative history of the Inspector General Act, generally accepted government auditing standards, current litigation, and any other pertinent guidance. As a result, GAO is not making the recommendation to remove the rate negotiation function from the Inspector General's office at this time.

None of the department or agency comments addressed the four alternatives GAO put forth as a matter for congressional consideration. Interior's Office of Inspector General suggested several technical comments, which we incorporated as appropriate. The comments from the Department of the Interior, the Department's Office of Inspector General, and the Department of Health and Human Services and our specific responses appear in appendixes V, VI, and VII, respectively.

Contents

Abbreviations

BIA	Bureau of Indian Affairs
GAO	General Accounting Office
HHS	Department of Health and Human Services
IHS	Indian Health Service
OMB	Office of Management and Budget

Introduction

By late 1998, concern and controversy over the funding of contract support costs had culminated in a statutorily imposed 1-year moratorium (for fiscal year 1999) on all new contracting by tribes and tribal organizations.[1] Under the Indian Self-Determination and Education Assistance Act of 1975, as amended, tribes can contract for specific federal programs and receive program funding and contract support funding. Contract support funds—which, as implemented by the Department of the Interior's Bureau of Indian Affairs (BIA) and the Department of Health and Human Services' (HHS) Indian Health Service (IHS), include funding for indirect costs, direct contract support costs, and startup costs—are provided to tribes to cover the costs of managing their contracts. Over the 25 years since the passage of the act, the amount of funding required by tribes to pay for such contract support costs has steadily increased—so much so that, by the early 1990s, appropriated funds were insufficient to cover them, causing funding shortfalls. The shortfalls have not only caused budgeting and financial difficulties for tribes, they have also led to current litigation about the extent of the U.S. obligation to fund contract support costs when congressional appropriations provide insufficient funding.[2]

The Funding Provisions of the Indian Self-Determination Act

Within the act, originally passed in 1975, title I (referred to as the Indian Self-Determination Act) encourages tribal participation in program planning and management by allowing tribes to contract programs previously administered on their behalf by the Secretaries of the Interior and Health, Education, and Welfare (now Health and Human Services). The act also provides that the amount of funding for tribal contracts shall cover program costs and contract management costs. In passing the act, the Congress recognized that having the government provide such services on behalf of tribes prevented them from achieving self-determination—that is, becoming involved in planning, conducting, and administering their own programs. When a tribe contracts a program, it assumes responsibility for managing and staffing that program; that is, the tribe makes management decisions about personnel and services, operates and maintains facilities, and accounts for funds. Primarily, the programs contracted are the ones administered by BIA and IHS and include law enforcement, social services, hospitals and clinics, dentist services, and

[1]Throughout this report, the term "tribes" will refer both to tribes and to tribal organizations eligible to contract programs under the Indian Self-Determination and Education Assistance Act. Also, the term "contracts" will refer to contracts, grants, cooperative agreements, self-governance agreements, or annual funding agreements entered into pursuant to the Indian Self-Determination and Education Assistance Act, as amended, that receive contract support funds.

[2]Miccosukee Corp., 98-1457 (Fed. Cir.) and Oglala Sioux Tribal Public Safety Department, 99-1033 (Fed. Cir.).

others. The act and its amendments identify the types of funding to be provided when tribes contract such programs.

As originally enacted, the Indian Self-Determination Act specified that the amounts to be provided for tribes' self-determination contracts would "not be less than the appropriate Secretary would have otherwise provided for direct operation of the programs." This type of funding is commonly referred to as "direct program" dollars or funds. Shortly after the act was passed, BIA and IHS began providing tribes with support funds, in addition to direct program dollars. These funds were to assist tribes in establishing and maintaining the support systems (e.g., administrative and accounting systems) needed to administer the contracts.

In 1988 and in 1994, the Congress amended the Indian Self-Determination Act to require that funding for contract support costs be provided in addition to direct program dollars. Through these amendments, the Congress wanted to prevent tribes from having to use their program funds to pay for contract support activities, a problem that had been identified as one of the major impediments to self-determination contracting. The amendments provide for funding the reasonable and allowable costs of a tribe's activities to carry out a contracted program—that is, the tribe's allowable contract support costs. These costs include both direct program expenses and administrative and other overhead expenses.[3] (See app. I for the act's contract support cost provisions.) The 1994 amendments also added title IV to the Indian Self-Determination and Education Assistance Act, which authorizes the Department of the Interior to enter into self-governance funding agreements with tribes. These agreements must provide funding for direct program costs and contract support costs that is equivalent to the funding required in other parts of the act.[4]

BIA and IHS have developed implementing guidelines that specify the types of costs that will be reimbursed under the act. In policy and practice, the agencies commonly refer to three categories of contract support costs. Table 1.1 defines and provides examples of these cost categories.

[3]The act also provides that, not withstanding any other provision of the act, the provision of funds is subject to the availability of appropriations. The model agreement for self-determination contracts contains similar language. Tribal contractors and IHS are currently litigating the question of whether, with regard to Indian self-determination contracts, this phrase limits the funding the act requires the agencies to provide. Two Interior Board of Contract Appeals cases, which are on appeal to the Court of Appeals for the Federal Circuit, decided that this phrase does not limit the contractual obligation to pay tribal contractors for all of their contract support costs.

[4]Title III of the act authorizes HHS to enter into self-governance agreements with tribes as part of a demonstration program. The title provides for the payment of direct program funds and indirect costs.

Table 1.1: Categories of Contract Support Costs, Definitions, and Examples

Cost category	Definition	Examples
Indirect costs	Costs incurred for a common or joint purpose benefiting more than one cost objective and not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved.[a]	Indirect costs (often thought of as overhead costs) typically include those incurred for financial and personnel management, property and records management, data processing and office services, utilities, janitorial services, building and grounds maintenance, insurance, and legal services.[b]
Direct contract support costs[c]	Costs of activities that are not contained in either the indirect cost pool or the direct program funds.	Direct contract support costs can include the training required to maintain the certification of direct program personnel and the costs related to direct program salaries, such as unemployment taxes, workers' compensation insurance, and retirement costs.
Startup costs	Costs incurred St on a one-time basis to plan, prepare for, and assume operation of the program, function, service, or activity that is the subject of the contract and to ensure compliance with the terms of the contract.	artup costs can include the costs of purchasing computer hardware and software, providing required training and staff development, establishing requiredadministrativeand management systems,and purchasing equipmentand furniture to supportan administrativeunit.

[a]A cost objective is a function, contract, grant, or other activity for which cost data are needed and costs are incurred.

[b]Office of Management and Budget Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," states that "There is no universal rule for classifying certain costs as either direct or indirect under every accounting system." The types of costs classified as indirect costs may vary by tribe depending on its particular circumstances.

[c]Chapter 4 discusses the inconsistent policies on the payment of direct contract support costs between the two agencies.

Source: Office of Management and Budget's Circular A-87 "Cost Principles for State, Local, and Indian Tribal Governments," BIA, and IHS.

In 1996, BIA and IHS issued joint regulations implementing the act, as amended, with respect to self-determination contracts. These regulations describe the three types of costs in Table 1.1 as costs that tribes can request in their contract proposals.

Funding for Self-Determination Contracts

In general, the funding available to a tribe for a self-determination contract is the total of the direct program funds transferred from either BIA or IHS, plus any contract support funds as allowed by those agencies. To calculate the full amount allowed a tribe for its contract, the funding agency usually (1) identifies the direct program funds it will transfer to the tribe; (2) identifies, as appropriate, direct contract support costs for the contracted program; (3) multiplies the total direct amount, minus any appropriate exclusions, by the tribe's indirect cost rate to determine the amount of indirect funds that should be added to the contract; and (4) identifies any additional contract support costs, such as startup costs. Once the funding agency has identified the direct funds to be transferred to the tribe, that amount becomes recurring—that is, the same amount is provided to the tribe in its contract every year unless, among other things, the Congress changes the funding or until the contract is ended. BIA and IHS transfer direct program funds from the budget line items for their programs, such as law enforcement or hospitals, but fund contract support costs from separate budget line items that were established specifically to pay for these costs.

In contrast to direct program funding, the amount of contract support funds (predominantly funds for indirect costs) can vary each year as the tribes' indirect cost rates change. Figure 1.1 shows an equation for the way the agencies calculate the allowable indirect costs for tribes.

Figure 1.1: Formula for Determining the Funding for Indirect Costs

Direct funding base for BIA's or IHS' programs x (Tribe's indirect cost pool / Tribe's total direct cost base) = Indirect costs associated with BIA's or IHS' programs

Note 1: The direct funding base consists of the contract funding amounts for either BIA's or IHS' programs, adjusted to be consistent with the direct cost base. The ratio of a tribe's indirect cost pool to its direct cost base is referred to as the tribe's indirect cost rate. A tribe's indirect cost pool consists of all its indirect costs. The total direct cost base consists of all the tribe's direct program costs, including those for BIA's and IHS' programs as well as those for programs from other federal agencies, state agencies, private organizations, and tribal programs, if applicable, less any exclusions.

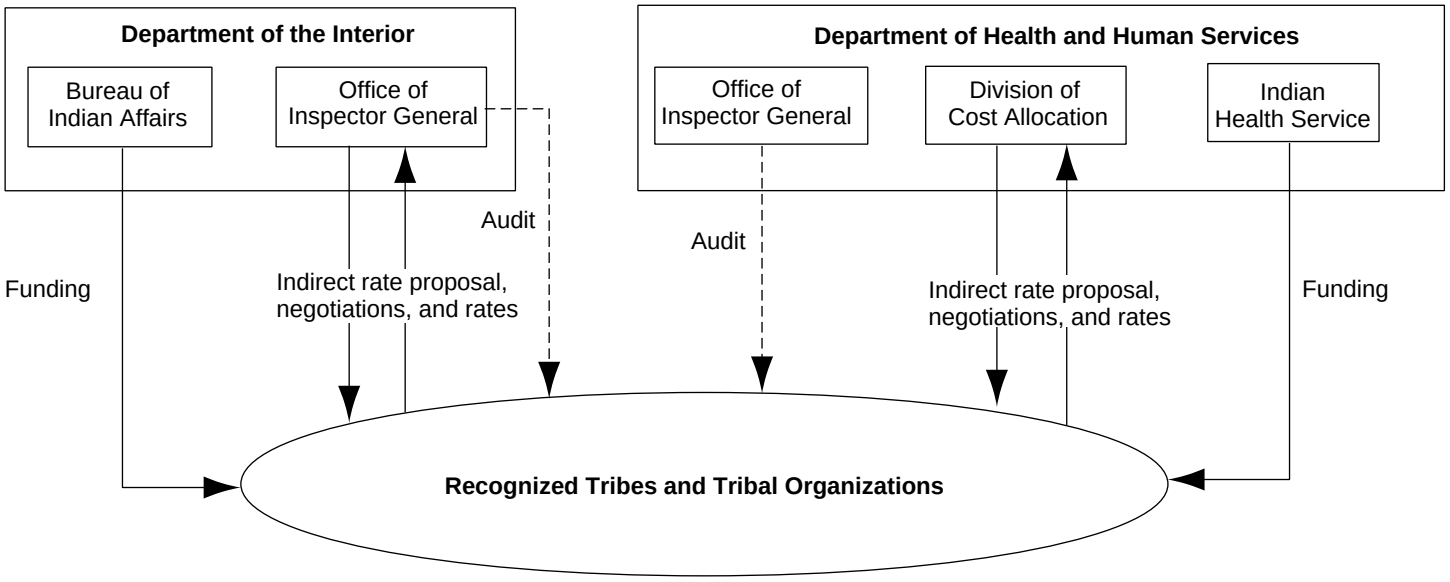
Tribes negotiate indirect cost rates annually in accordance with federal cost allocation principles and departmental guidance. In general, an indirect cost rate is determined by dividing a pool of indirect costs by a direct cost base. The direct base consists of program costs minus certain exclusions and can be either based on salaries or on total direct costs. The purpose of the indirect cost rate is to reasonably allocate a tribe's indirect costs to each of its programs (BIA, IHS, other federal agencies, state agencies, private organizations, and tribal programs). For example, if IHS' programs represented 30 percent of a tribe's total direct cost base, then IHS programs would be allocated 30 percent of that tribe's indirect cost pool.[5]

The Key Players in Implementing the Indian Self-Determination Act

The key players in implementing the Indian Self-Determination Act are (1) those that fund and oversee the contracts, (2) those that calculate indirect cost rates, and (3) those that administer the contracts. The Indian Self-Determination Act applies only to programs under the jurisdiction of the departments of the Interior or Health and Human Services. Predominantly, these are the programs operated by BIA or IHS. Figure 1.2 shows the key players involved in implementing the act.

[5]A recent court decision found that this method of allocating a tribe's indirect cost pool to every program in the direct cost base was incorrect. Ramah Navajo Chapter v. Lujan, 112 F. 3d 1455 (10th Cir. 1997). The court concluded that other federal and state programs that do not provide funding for indirect costs should not be part of the direct cost base. The court ruled that the Department of the Interior had not paid the indirect costs associated with tribes' self-determination contracts. On May 14, 1999, the court approved a partial settlement of about $80 million to settle these claims for fiscal years 1989 through 1993. The parties are also engaged in efforts to reach agreement on the appropriate method for calculating the indirect cost portion of contract support costs. The new methodology will require the court's approval. This report does not directly address the issues raised by the court in the Ramah case. In addition, BIA, IHS, and the National Congress of American Indians all have work groups studying contract support costs.

Figure 1.2: Key Players in Implementing the Indian Self-Determination Act



Source: GAO's analysis.

In general, the funding agencies are BIA and IHS. Under the act, tribes may contract for nearly any program managed by BIA or IHS. BIA's programs include law enforcement; road maintenance; and such social services as child protection and welfare assistance, adult education, and housing. IHS' programs include hospital or clinic administration; preventive care; alcohol treatment; contract health services; diabetes care; mental health care; and dental care. BIA and IHS are the agencies with which tribes contract and the ones that provide the associated funding.

BIA is the primary federal agency with responsibility for administering Indian policy and discharging the federal government's trust responsibility for American Indian tribes and Alaskan Native villages, and IHS is responsible for delivering health services to American Indians and Alaska Natives. BIA's fiscal year 1997 funding was about $1.7 billion, of which over $1 billion was used for contracted programs, including education and construction programs. Tribes contracted about $546 million of BIA's programs, excluding, among other things, education and

construction—$450 million for direct program funds and $96 million for contract support costs.[6] IHS' fiscal year 1998 funding was more than $2 billion. Of this amount, about $719 million was for program costs of self-determination contracts (including construction contracts), and almost $169 million was for contract support costs for tribes participating in self-determination contracting.

Interior's Office of Inspector General and HHS' Division of Cost Allocation have responsibility for calculating tribes' indirect rates. In general, Interior's Office of Inspector General calculates indirect rates for tribes, and either the Inspector General or the Division of Cost Allocation does so for tribal organizations. During the rate negotiation process, tribes submit indirect cost proposals, which are supported by audited financial statements and supporting documentation that substantiate the propriety of the indirect costs.[7] Appendix II contains information on the process to negotiate indirect cost rates.

Finally, the entities that administer the contracts are the federally recognized tribes that choose to do so under the provisions of the act. As of December 1998, there were 556 federally recognized tribes. Agency officials estimate that nearly all of the federally recognized tribes administer at least one BIA or IHS contract either directly or as a member of a tribal consortium. Tribes may administer multiple contracts from BIA and IHS.

Objectives, Scope, and Methodology

The Subcommittee on Interior and Related Agencies, Senate Committee on Appropriations, and the Senate Committee on Indian Affairs asked us to study issues related to contract support costs for contracts entered into pursuant to the Indian Self-Determination and Education Assistance Act,

[6]Construction and education funds are not included in this discussion because contract support costs for these BIA programs are generally paid from a separate source of funds. For construction contracts, the contractor receives one contract amount, from which indirect costs are recovered. Under the Indian Education Amendments of 1988 (P.L. 100-297, title V), education contracts can receive administrative cost grants, as prescribed by a formula in the act, to cover their indirect costs. For school year 1998-99, $42.16 million was provided for administrative cost grants, which was enough to fund just under 90 percent of the costs calculated using the formula prescribed in the act. In certain circumstances, some contract support funds are also expended for these education contracts in addition to the administrative cost grants.

[7]Tribes make the decision whether or not to request an indirect cost rate. Office of Management and Budget circular A-87 states that "Each Indian tribal government desiring reimbursement of indirect costs must submit its indirect cost proposal to the Department of the Interior (its cognizant federal agency)." Some tribes contracting with BIA have chosen not to seek reimbursement for their indirect costs. However, the circular also permits federal agencies to work with government units that wish to test alternative methods of cost recovery, such as lump sum amounts. Guidance from BIA and IHS provides that a lump sum amount may be negotiated when a tribe does not have an indirect cost rate.

as amended. As agreed with the committees' staff, this report addresses the following questions: (1) To what extent and for what reasons have contract support costs and the associated funding shortfalls changed over the past decade, and what can be expected in the future? (2) How have shortfalls in funding for contract support costs affected tribes? (3) Have the act's provisions for contract support costs been implemented consistently? We also describe alternative ways of funding contract support costs in the future, and, as requested by the committees' staff, we provide a detailed explanation of how contract support costs are calculated. (See app. II.)

To determine the extent and the reasons for changes in contract support costs and the associated funding shortfalls, we interviewed various officials of the departments of the Interior and HHS, including officials of BIA, IHS, Interior's Office of Inspector General, and HHS' Division of Cost Allocation. We also reviewed and analyzed various reports and data assembled by BIA and IHS, including budget justifications and reports on contract support shortfalls to the Congress. To adjust for the effects of inflation, we used the Department of Commerce's chain-type price index for gross domestic product to express all dollar figures in constant 1998 dollars.

To determine how shortfalls in funding for contract support costs have affected tribes, we visited several reservations and held open forums, at which tribal representatives were invited to discuss contract support funding. Two such forums were held during two large Indian conferences: the annual conference of the National Congress of American Indians, in October 1998, and the joint BIA/IHS Self-Governance Conference, in November 1998. Other forums were held in conjunction with GAO staff visits to various BIA and IHS offices: in Oklahoma City and Anadarko, Oklahoma; in Albuquerque, New Mexico; and in Portland, Oregon. Representatives from 77 tribes or tribal organizations attended one or more of these forums. In addition, 25 of those tribes and tribal organizations, as well as 17 other tribes or tribal organizations with whom we did not meet, submitted documents, such as financial statements and tribal budgets, that described the extent and the effects of funding shortfalls on program services.

To determine whether the act's provisions for contract support costs have been implemented consistently, we reviewed legislative and regulatory requirements, applicable court cases, and interviewed officials of various Department of the Interior offices, including BIA, the Office of Inspector

General, and the Office of the Solicitor. We also interviewed officials of Department of Health and Human Services offices, including IHS and the Division of Cost Allocation. We also discussed applicable court cases with the lawyers involved with them. Furthermore, we reviewed the agencies' documents and gathered and analyzed relevant data from the agencies. As part of this process, we visited agency offices in several locations around the country, including Sacramento, California; Albuquerque, New Mexico; Portland, Oregon; Seattle, Washington; and Washington, D.C.

We conducted our review from July 1998 through April 1999 in accordance with generally accepted government auditing standards. In conducting our work, we did not independently verify or test the reliability of the data provided by agencies or tribes. We used these data for descriptive purposes only and did not rely on them to make our conclusions and recommendations. In collecting tribal officials' views about how they have been affected by shortfalls in contract support funding and how they have coped with such shortfalls, we did not use a standardized data collection instrument, such as a questionnaire. Instead, we invited tribal representatives to describe their experiences, either orally or in writing, with contract support shortfalls.

Past Increases in Contract Support Costs Will Likely Continue

Over the past decade, tribes' contract support costs and the shortfalls between these costs and the funding provided for them through annual appropriations have increased. Tribes' allowable contract support costs associated with contracting BIA's programs have more than doubled and those associated with contracting IHS' programs have more than quadrupled. These increases have largely been due to an increase in tribes' indirect costs, the primary component of contract support costs.[1] The need for funding has increased due to increases in the dollar amounts contracted from BIA and IHS, coupled with increases in tribes' indirect costs. For fiscal year 1998, BIA reported a shortfall in funding for contract support costs of over $25 million, and IHS reported a shortfall of about $70 million. The future costs for contract support are difficult to estimate because of the unpredictable nature of (1) the levels of future appropriations, (2) the extent to which tribes might elect to contract new programs, and (3) tribes' indirect cost pools. Currently, however, tribes are only contracting programs worth almost half of BIA's and IHS' annual appropriations. Therefore, barring any major changes (e.g., in the circumstances of the tribes or in the law), contract support costs will likely continue to increase in the future.

Tribal Contracting and the Funding Shortfalls for Contract Support Costs Have Increased in the Last 10 Years

Over the past decade, increases in indirect costs have been responsible for the majority of the increase in funding for contract support costs. The need for indirect cost funding has increased due to increases in the dollar amounts contracted from BIA and IHS coupled with increases in tribes' indirect cost pools. Across all the indirect cost rates negotiated by Interior's Office of Inspector General, the aggregate indirect cost rate has remained relatively stable over the past 10 years at just under 25 percent. However, appropriations have not been sufficient to reimburse tribes for their costs of administering BIA's and IHS' programs. The most significant funding shortfalls have occurred in the last 5 years. During this period, neither agency has requested full funding for these costs, nor has the Congress appropriated full funding for them.

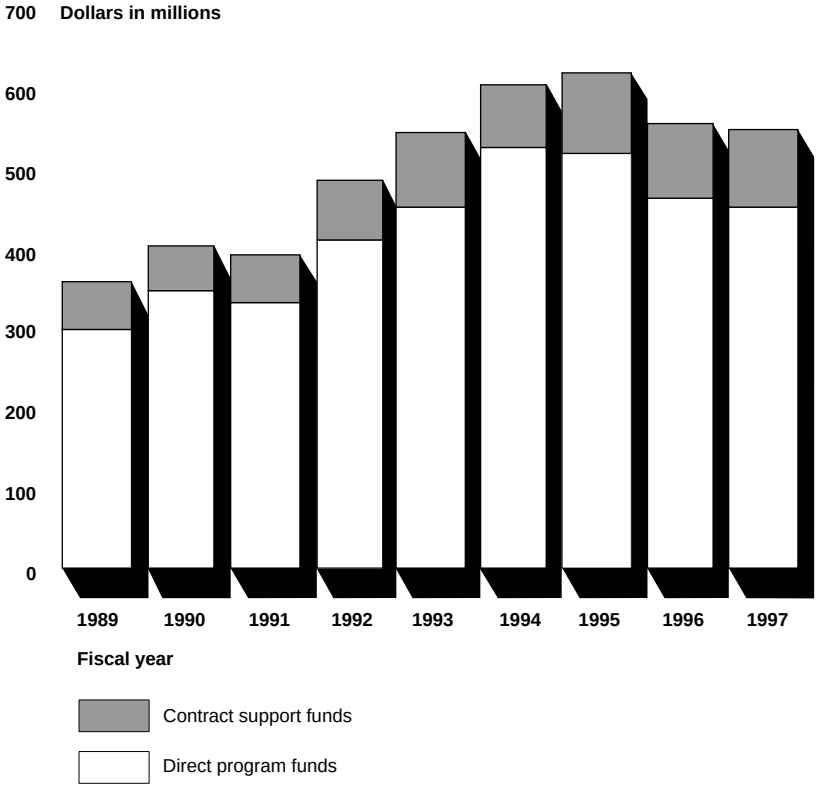
[1]The legislative history of the 1988 amendments to the Indian Self-Determination and Education Assistance Act discloses that the Congress substituted "contract support costs" for "contract costs" in the provision prescribing funding of reasonable costs to manage the contracts. It specifically chose not to use "direct and indirect" costs when describing what these costs cover. In the 1996 joint agency regulations, contract support costs include direct costs, startup costs, and indirect contract costs. Prior to the regulations, it was the agencies' practice to use the term indirect costs as the largest component of contract support costs.

Tribes Are Contracting More, and Their Indirect Cost Pools Have Increased

Over the past decade, the need for indirect cost funding from BIA and IHS has risen due to increases in the dollar amounts contracted, coupled with increases in tribes' indirect cost pools. Each agency determines a tribe's allowable indirect costs by multiplying that tribe's direct funding base (for programs contracted from that agency) by the same tribe's indirect cost rate. Although comprehensive data on tribes' direct funding bases for BIA's and IHS' programs for the past 10 years were not readily available, a close approximation is the contracting volume, or the total dollar amounts contracted. Over the past 10 years, tribes have continued to contract new programs and to expand their existing contracts. Generally, some or all of the increases in contracting volume would result in increases in tribes' direct funding bases for BIA's and IHS' programs.[2] Figures 2.1 and 2.2 show the growth in tribes' contracting of BIA's and IHS' programs, respectively.

[2]Changes in a tribe's contracting volume for BIA's and IHS' programs may not result in dollar-for-dollar changes in its direct funding base. The direct funding base consists of the contract funding amounts for either BIA or IHS programs adjusted to be consistent with its direct cost base. A small number of tribes choose to use a "salaries only" or a "salaries with fringe benefits" direct cost base as opposed to total direct costs. In those cases, a change in the overall contract volume will affect the direct funding base only if the change results in different salaries. Also, for those tribes that use a total direct cost base, that base reflects adjustments for excluded costs and passthrough funds. Generally, when a tribe administers a program for which it incurs little or no administrative expense, that program's costs are excluded from the direct cost base. For example, programs that a tribe contracts out to another entity are generally excluded, as are passthrough funds, such as scholarships and general assistance.

Figure 2.1: Tribes' Contracting of BIA's Programs, Fiscal Years 1989 Through 1997



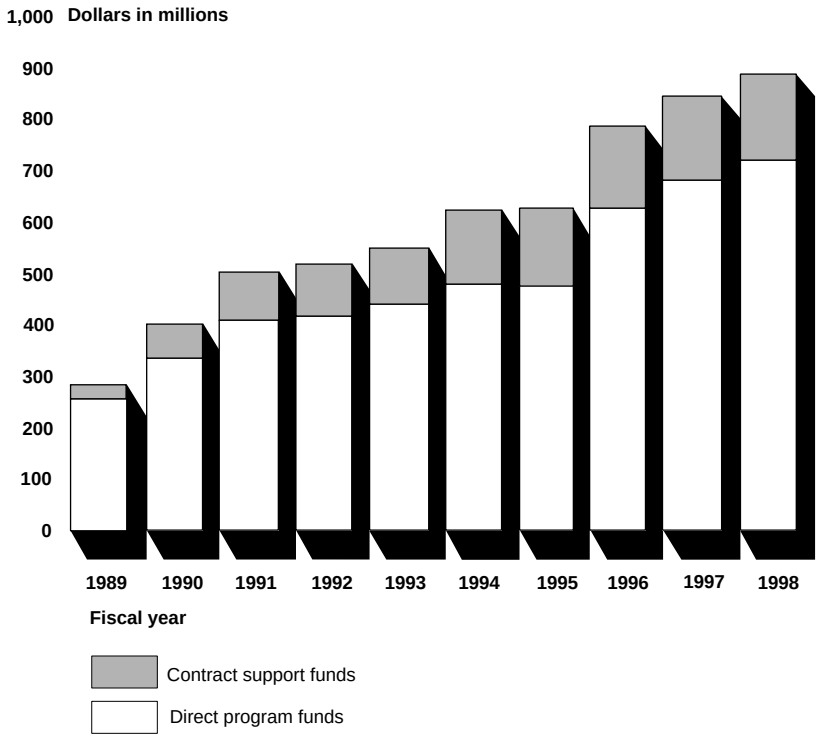
Note 1: Funds are in constant 1998 dollars.

Note 2: The total amount of funds contracted from BIA for fiscal year 1997 was about $1 billion. Contracts for construction and education programs, among other things, were generally excluded from the data presented in the figure. Contract support costs for these programs are generally paid from a separate source of funds.

Note 3: Data for fiscal year 1990 include additional funding for tribes choosing to convert from fiscal year to calendar year contracts.

Source: GAO's analysis of BIA's data.

Figure 2.2: Tribes' Contracting of IHS' Programs, Fiscal Years 1989 Through 1998



Note: Funds are in constant 1998 dollars.

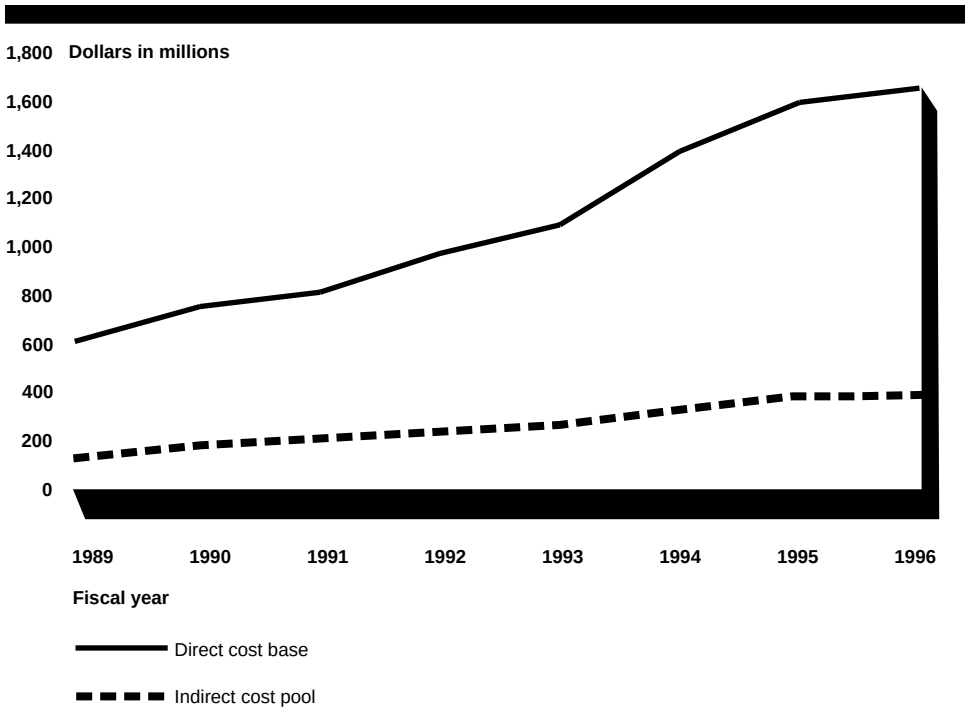
Source: GAO's analysis of IHS data.

Over the past 10 years, contracting has increased primarily due to an increase in the overall amount of funds available to contract and in new contracting procedures. Over the 10-year period, BIA's total appropriation increased by about $280 million in real terms (i.e., adjusted for inflation), while IHS' total appropriation increased by about $730 million (in real terms). New contracting procedures, such as self-governance agreements, have also been introduced over the past 10 years through amendments to the Indian Self-Determination Act.

Tribes' indirect costs have increased as well. Between fiscal years 1989 and 1996, their indirect cost pools increased by about $250 million (in real terms). This $250 million increase was allocated to all the programs in the direct cost base, including BIA's and IHS' programs. In aggregate, the

indirect cost pool for all tribes has increased in proportion to the direct cost base. Figure 2.3 shows the relationship between the increases in the aggregate indirect cost pool and increases in the aggregate direct cost base.

Figure 2.3: Aggregate Indirect Cost Pool and Direct Cost Base for Agreements Negotiated by the Department of the Interior's Office of Inspector General, Fiscal Years 1989 Through 1996



Note 1: Funds are in constant 1998 dollars.

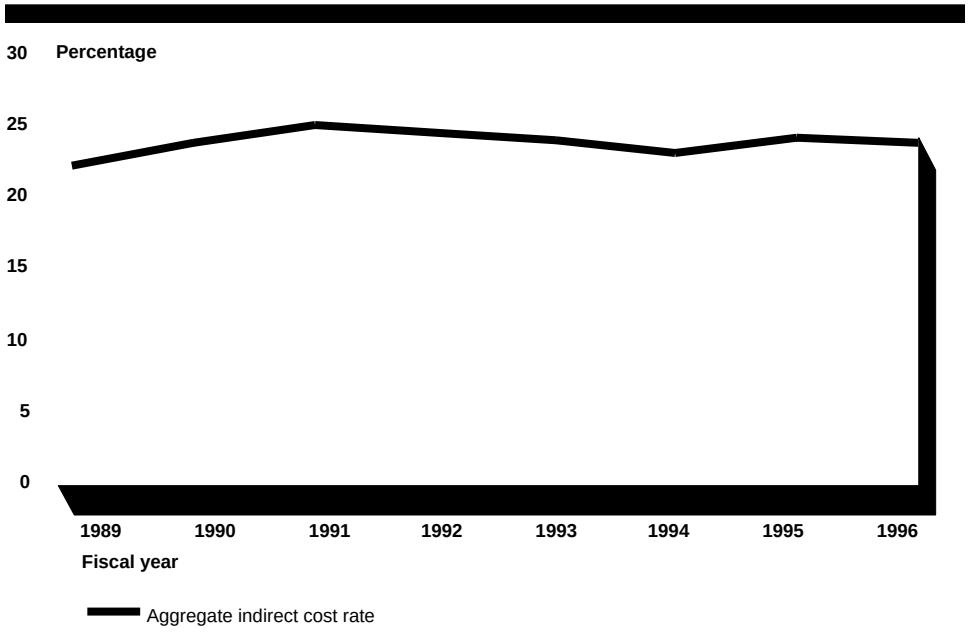
Note 2: Data on the indirect cost pool represents tribes' total indirect costs for all rates negotiated by Interior's Office of Inspector General. Only a portion of these costs would be allocated to BIA's and IHS' programs. The direct cost base also represents the total direct cost base for all tribes' indirect rates negotiated by Interior's Office of Inspector General. The aggregate direct cost base data include BIA's and IHS' programs, as well as programs from other federal agencies, state agencies, private organizations, and tribes' programs, if applicable.

Source: GAO's analysis of data from the Department of the Interior's Office of Inspector General.

While the aggregate indirect cost pool increased by $250 million, the aggregate direct cost base increased by about $1 billion (in real terms). The ratio of the change is 4 to 1; meaning that, in aggregate, for every $4

increase in the direct cost base, the indirect cost pool increased $1.[3] Therefore, as shown in Figure 2.4, the aggregate indirect cost rate among all the tribes has remained relatively stable at just under 25 percent.

Figure 2.4: Aggregate Indirect Cost Rate for Tribes' Rates Negotiated by the Department of the Interior's Office of Inspector General, Fiscal Years 1989 Through 1996



Source: GAO's analysis of data from the Department of the Interior's Office of Inspector General.

While the aggregate indirect cost rate has remained relatively steady, the rates of individual tribes have varied from single to triple digits, depending on each tribe's indirect cost pool and direct cost base. This variation in tribes' indirect cost rates, which are subject to a thorough approval process as described in appendix II, does not necessarily mean that tribes with high rates receive more funding or that tribes with low rates are more efficient. For example, if one tribe has an indirect cost rate of 50 percent and a direct funding base of $80,000 in direct salaries, while another tribe has an indirect cost rate of 20 percent and a total direct funding base of $200,000, both tribes would receive the same indirect cost funding of $40,000.

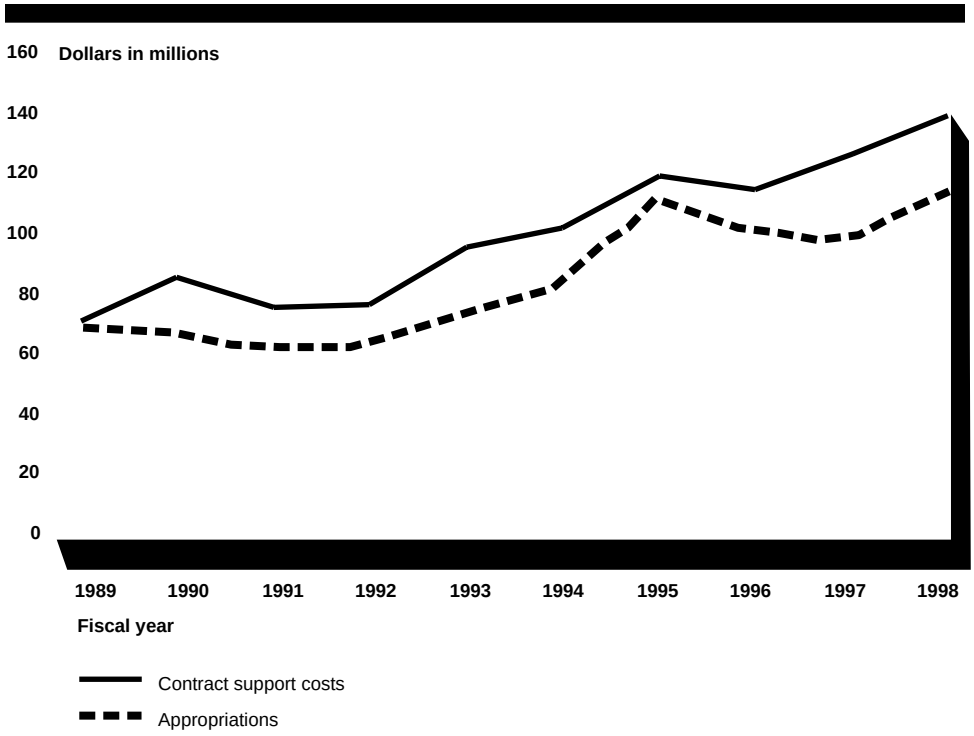
[3]This ratio reflects only the indirect cost component of contract support costs. According to IHS officials, the ratio would be closer to 3 to 1 when direct contract support costs and startup costs are included.

There are two views about whether an indirect cost pool should rise in proportion to an increase in the direct cost base. The first view is that the indirect cost pool would be expected to increase as a tribe contracts additional programs. For example, if a tribe were to decide to contract a multimillion-dollar health facility with a large staff, it may need to upgrade its centralized accounting system and personnel offices to handle the increased workload. The second view is that a tribe may not always experience increased indirect costs as it expands its direct costs because many of the elements included in indirect cost pools are generally fixed costs and therefore should not increase proportionally to the increases in direct cost bases. For example, two-thirds of the tribes that Interior's Office of Inspector General negotiates indirect cost rates for each have a total direct cost base greater than $1 million. Under the second view, tribes with large direct bases could generally contract additional programs without upgrading their accounting system and personnel offices.

Appropriations Have Not Kept Pace With Increases in Contract Support Costs

Over the past decade, appropriations from the Congress and subsequent funding from federal agencies have not been sufficient to reimburse tribes for their costs of administering BIA's and IHS' programs. During this period, tribes' allowable contract support costs have more than doubled for BIA's programs and have more than quadrupled for IHS' programs. Over the same timeframe, appropriations for contract support costs did not keep pace, creating shortfalls. The shortfall for fiscal year 1998 alone totaled $95 million for the two agencies. Figure 2.5 shows tribes' allowable contract support costs for BIA's programs and the appropriations provided for them.

Figure 2.5: BIA's Shortfalls in Contract Support Costs, Fiscal Years 1989 Through 1998



Note 1: Funds are in constant 1998 dollars.

Note 2: Data for fiscal years 1989, 1990, and 1991 include allowable costs and appropriations for administrative cost grants for education programs as provided by the Indian Education Amendments of 1988 (P.L. 100-297, title V). During these 3 years, while administrative costs grants were being phased in, all or a portion of the administrative costs grants were paid out of BIA's contract support funds. For example, the allowable costs for fiscal year 1989 include about $7 million for administrative cost grants, and a portion of the 1989 appropriation for contract support funds was used to cover those costs.

Note 3: Data for fiscal year 1990 include additional funding for the tribes that chose to convert from fiscal year to calendar year contracts.

Note 4: The total appropriation for contract support costs for fiscal year 1994 was about $98 million. The appropriation bill specified that the amount was for fiscal year 1994 and the shortfalls in funding for contract support costs in previous years. BIA used about $17.5 million of the 1994 appropriation to cover the shortfalls from previous years.

Note 5: Data for fiscal years 1995, 1996, 1997, and 1998 contain allowable costs and appropriations for BIA's Indian Self-Determination fund. The fund was created in 1995 exclusively to fund contract support costs for new and expanded contracts. Each year, BIA has had a carryover balance in the fund, meaning that all the funds appropriated were not spent each year, and some amount was carried over to the next fiscal year. The amounts included in the figure as the contract support costs and the appropriations are the amounts actually expended each year. At the end of fiscal year 1998, the available carryover balance in the Indian Self-Determination fund was $1.88 million.

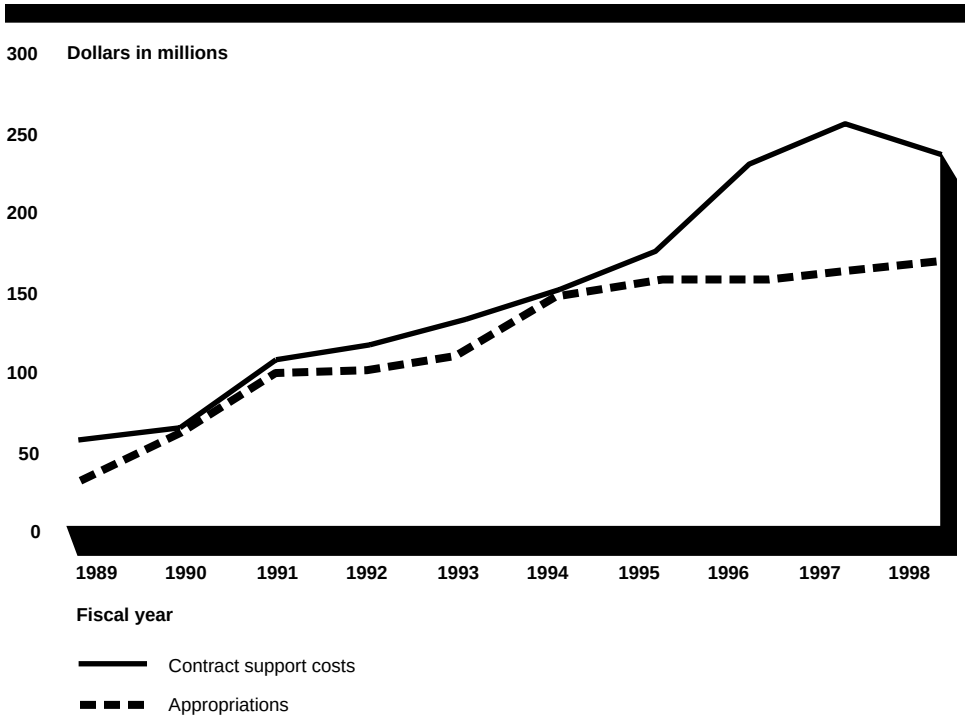
Source: GAO's analysis of BIA's data.

Although the initial appropriations were less than the allowable contract support costs for the past 10 years, for fiscal years 1989 through 1993, BIA was generally able to use other funds to alleviate the shortfalls. In fiscal years 1989, 1990, 1992, and 1993, BIA used reprogramming—or the transfer of unobligated funds from other programs at the end of the year—to make up for shortfalls. In 1994, BIA used fiscal year appropriations for contract support funds to cover prior shortfalls, predominately from fiscal year 1993. Beginning in 1994, annual appropriations for contract support costs have been capped in BIA's annual appropriations acts, and reprogramming for this purpose has been prohibited.

Figure 2.6 shows tribes' allowable contract support costs for IHS' programs and the appropriations provided for them. Like BIA, IHS experienced shortfalls in funding, but did not handle them the same way. Since 1992, IHS has maintained a waiting list called the Indian Self-Determination queue (queue) of requests for contract support funding.[4] (See app. III for information on IHS' allocation of funding.)

[4]In a recent decision, Shoshone-Bannock Tribes of the Fort Hall Reservation v. Shalala, 988 Fed. Supp. 1306 (D.C. Or. 1997), a federal district court determined that the use of the queue for new and expanded contracts is in violation of the Indian Self-Determination Act's provision on contract support funding. IHS is currently rewriting its policy on contract support costs to eliminate the queue. Under a draft policy, IHS plans to continue listing requests for new or expanded contract support funding, but will distribute funding to all tribes on the list, as funding is available. The funds will be distributed according to greatest needs. If funds are not available, then the unfunded requests will be considered part of the year's shortfall.

Figure 2.6: IHS' Shortfalls in Contract Support Costs, Fiscal Years 1989 Through 1998



Note 1: Funds are in constant 1998 dollars.

Note 2: The contract support costs for fiscal years 1995 through 1998 may be overstated. The data for these years include funding requests on the Indian Self-Determination queue, which IHS did not review and approve until funding became available. In fiscal year 1999, IHS has undertaken a review of all the requests on the queue. The contract support costs in the figure for fiscal year 1998 reflect changes through April 30, 1999. Furthermore, the costs may also be overstated because IHS did not subtract the direct funds it uses to offset contract support costs from the allowable costs. When a tribe contracts for a share of an area office's or headquarters' programs, IHS generally considers 20 percent of the funds to offset contract support costs and reduces that tribe's allowable costs accordingly.

Note 3: IHS has had an Indian Self-Determination Fund since 1988, and this funding is reflected in the data for fiscal years 1991 through 1998. The Indian Self-Determination Fund contained $2.5 million every year from fiscal years 1988 through 1992, then was increased to $5 million in fiscal year 1993, and to $7.5 million annually for fiscal years 1994 through 1998.

Note 4: IHS' funding in 1991 includes $24 million for direct contract support costs for pre-1988 contracts. IHS began paying direct contract support costs to tribes in fiscal year 1988.

Source: GAO's analysis of IHS' data and budget requests.

The 1988 amendments to the act require the agencies to provide contract support costs to tribes for their reasonable costs associated with

administering BIA's and IHS' programs. However, since at least 1993, neither BIA nor IHS has requested full funding for these costs, nor has the Congress appropriated full funding for them. The agencies did not request full funding for two reasons. First, it is difficult for them to predict what the total need for indirect cost funding will be in advance. The agencies do not know which tribes will be contracting which programs, at what level the contracted programs will be funded, and what a tribe's indirect cost rates will be. Second, in addition to the difficulty of predicting the future contract support requirements, the agencies have had other funding priorities in recent years. For example, BIA's priorities have been to seek additional appropriations for law enforcement to reduce crime on the reservations and for Indian education.

Beginning in fiscal year 1994, through the annual appropriations acts, the Congress has specifically capped the amount of funds BIA could spend on reimbursing tribes for their contract support costs. A similar cap was introduced for IHS in fiscal year 1998. In distributing their limited funds for contract support costs, BIA and IHS have developed two different distribution methods. (See app. III for a discussion of funding distribution methods for BIA and IHS.)

Tribes are engaged in litigation to enforce the act's full funding language and to recover funding shortfalls. In one recent case involving fiscal year 1994, the Interior Board of Contract Appeals decided that under both the Indian Self-Determination Act and the individual contract agreements, a tribe is entitled to full funding of its contract support costs—i.e., indirect costs—in spite of a specific limitation on the amount of such funding in the fiscal year 1994 appropriations act.[5] The theory of this case is that both the act and the contract bind the federal government to fully fund contract support costs. According to the Board, provisions of the act and the agreement stating that funding is subject to the availability of appropriated funds do not eliminate the requirement for full funding. To eliminate that, the appropriations act would have to clearly reveal congressional intent to override the statutory requirement for full funding of contract support costs. BIA has appealed this decision to the Court of Appeals for the

[5]Appeal of Miccosukee Corp., 31 IBCA 389, Dec. 4, 1998, reaffirmed Mar. 2, 1998 98-2 IBCA. The Miccosukee case is now on appeal to the Court of Appeals for the Federal Circuit. Another IBCA case involving fiscal year 1995 has been added to the Miccosukee appeal, Oglala Sioux Tribal Public Safety Department.

Federal Circuit.[6] However, recent legislation could affect the court's decision. In 1998, the Congress enacted legislation to prevent the payment of any shortfall in contract support funding for fiscal years 1994 through 1998.[7] This provision retroactively establishes that amounts appropriated or earmarked in committee reports are all the funds available to pay for contract support costs for these fiscal years.[8] It may affect other cases presently before Interior's Board of Contract Appeals.

The Future Amount of Increases in Contract Support Costs Is Difficult to Predict

Predicting the future amount of increases in contract support costs for BIA's and IHS' programs is difficult because of the unpredictable nature of (1) the future levels of appropriations for BIA's and IHS' programs, (2) the extent to which tribes will choose to contract new programs from the BIA and IHS, and (3) the changes in tribes' indirect cost pools. Increases in the dollar amounts contracted will occur when future increases in program funding are added to existing contracts or when tribes begin contracting new programs. If the tribes' indirect cost pools also continue to increase and the aggregate indirect cost rate remains at about 25 percent, then as we stated earlier, every $4 increase in the direct cost base for BIA or IHS, either through increasing existing contracts or contracting new programs, will lead to an additional contract support requirement of $1.

For fiscal year 1998, tribes' allowable contract support costs for these programs were about $375 million. In its fiscal year 2000 budget request, BIA estimated, based on the tribes' current allowable costs, that the contract support requirement for tribes' existing contracts of BIA's programs would rise to about $145 million, an increase of $13 million over the fiscal year 1998 level. IHS estimated its fiscal year 2000 requirement for contract support funding for its existing contracts will be almost $295 million. For new contracts, BIA estimated it would need an additional $5 million to fund tribes' support requirements during fiscal year 2000, and IHS estimated it will need $12.5 million for that year.

[6]By contrast, an earlier federal appellate court decision has described the words of the act as a limitation on the amount of funding BIA had to distribute. This decision did not address the issues in the Miccosukee case. However, the court's characterization was not essential to the court's decision in this case. Ramah Navajo School Board, Inc. v. Babbitt, 87 F. 3d 1338, 1341 (Cir. D.C. 1996).

[7]Section 314 of the Omnibus Consolidated and Emergency Supplemental Appropriations Act for fiscal year 1999, P.L. 105-277, 112 Stat. 2681-288, Oct. 21, 1998.

[8]The legality of this provision has been challenged in several proceedings and cases, Seldovia Village Tribe v. Shalala, IBCA Nos. 3782-97, 3862-97, and 3863-97; Cherokee Nation of Oklahoma v. Shalala, IBCA Nos. 3877-98, 3878-98, and 3879-98; California Rural Indian Health Board, Inc. v. Shalala, (D. N. Cal. 1989); and Shoshone-Bannock Tribes of the Fort Hall Reservation v. Shalala, 988 Fed. Supp. 1306 (D. Or. 1997).

Since tribes currently contract programs representing only about half of all of BIA's and IHS' appropriations, the potential exists for significant increases in tribes' contracting. If current contracting levels doubled, and assuming indirect cost rates stay about the same, contract support requirements would also double from the current requirement of almost $375 million to about $750 million. However, some of this increase would likely be offset by decreases in BIA's and IHS' administrative costs. For fiscal year 1997, BIA reported that tribes' contracts totaled over $1 billion out of a total appropriation of about $1.7 billion, or about 64 percent. For fiscal year 1998, IHS reported that about 45 percent of its program funding was contracted by tribes—almost $892 million out of a total appropriation of more than $2 billion.

Tribes Said They Have Been Adversely Affected by Shortfalls in Funding for Contract Support Costs

According to officials of the more than 90 tribes with whom we communicated during the course of this review,[1] tribes have been adversely affected by the shortfalls in contract support funding. The effects varied, depending on the number and the type of methods the tribes employed to deal with these funding shortfalls. To compensate for them, nearly all the tribes have reduced their indirect costs to manage programs within the funds provided, thereby lessening administrative productivity and efficiency. Furthermore, many tribes have had to cover the shortfalls with tribal resources, if available, thereby foregoing the opportunity to use those resources to promote the tribes' economic development. Many tribes had to use direct program funds to cover the shortfalls, thereby reducing direct program services. In addition, a few tribes said they have refused or postponed the opportunity to contract programs, thereby stalling their progress toward self-determination.

As has been reported by various studies over the past 15 years, as well as emphasized to us by tribal officials, the problems posed by funding shortfalls go beyond BIA's and IHS' contracts. That is, many tribes contract programs from other federal agencies, as well as from the states and private organizations. Although funding entities other than BIA and IHS are also allocated their share of a tribe's indirect costs, as required by federal cost-allocation principles, some of these other entities allow the recovery of less than their allocated share of costs and others allow none. As has been reported by various studies, such situations worsen the shortfalls and exacerbate their effects on tribes. The scope of our review did not include funding entities that are not subject to the Indian Self-Determination Act. Nevertheless, because shortfalls attributed to such entities were an important issue for the tribal officials we spoke with, we have included their views on the matter.

[1]Appendix IV lists the tribes we communicated with during our review. As noted in the appendix, representatives of 77 tribes and tribal organizations attended one or more of the open forums we held to discuss contract support issues, and 42 tribes and tribal organizations (including 17 that had not attended a forum) submitted letters or other documents pertaining to shortfalls and their effects. Not all of the tribal representatives spoke at the forums, however; in many cases, representatives indicated their agreement with the observations of other representatives but contributed no examples of their own. Furthermore, we did not use a standardized data collection instrument to gather views of tribal officials. Thus, we cannot definitively report how many of the tribes with whom we communicated were affected by shortfalls in contract support funding, nor can we report which or how many methods each tribe used to cope with shortfalls.

Shortfalls in Funding for Contract Support Costs Have Adversely Affected Tribes in Various Ways

Shortfalls in funding for contract support costs have adversely affected tribes in various ways, depending on the number and the type of methods the tribes used to compensate for such shortfalls. Nearly all of the tribes we spoke with said they have used not one, but a combination of methods to deal with the shortfalls' effects. For example, in addition to cutting back on their indirect expenditures as much as possible, they have also had to dip into tribal resources and program resources to compensate for the shortfalls. As a result of such measures, the tribes' administrative infrastructures (e.g., personnel, computer systems, and accounting systems) have deteriorated; opportunities to improve the tribes' economic conditions have been lost; and program services have been diminished. In only a few cases did the tribes indicate that they have refused contracting activities because they could not afford them, although several tribes mentioned having considered that option.

The Tribes Have Pared Their Indirect Costs to Manage Programs Within Available Funding

Nearly all of the tribal officials mentioned having had to cut back on their indirect costs to manage programs with the available funding. The tribal chairman of one Oklahoma tribe said that she and her staff had taken various measures to make up for shortfalls in funding for contract support costs. For example, they reduced staff salaries, shared job tasks, left vacant positions unfilled, reduced the use of air conditioning in the administrative offices, and turned off the lights when not in use. The chairman refused to accept either a salary or compensation for the use of her personal vehicle for tribal business purposes. Officials of many other tribes reported having to leave critical vacancies unfilled, forego staff salary increases, and postpone or forego equipment purchases or repairs. Furthermore, tribal officials said, at some point it becomes impossible for any more reductions to occur. For example, one Alaska tribe reported that it cannot make any additional cutbacks in administrative activities without risk of being unable to meet the terms and conditions of its funding agreement.

According to tribal officials, tribes can reduce their indirect expenditures only so much before the reductions negatively affect their ability to maintain productivity and efficiency. For example, according to a letter submitted by a Washington tribe, the tribe's need to contain its indirect costs has prevented it from hiring another accountant to assist with its backlog of accounting/bookkeeping work, particularly reconciling its monthly general ledger. Because the tribe cannot afford to pay competitive salaries, it has had to hire untrained or underqualified people instead of a certified public accountant. Similar difficulties in attracting qualified

personnel because of the inability to pay competitive salaries were frequently mentioned by other tribal officials.

According to a letter submitted by an organization that represents 11 northern tribes, funding shortfalls in contract support costs "make an efficient organization inefficient." According to the organization's letter, shortfalls in BIA's funding for contract support costs have caused delays in upgrading the organization's financial management system. The planned upgrade included purchasing and installing new accounting software to enable more efficient compliance with OMB's audit guidelines for nonprofit organizations, leasing new accounting workstations and a network server to ensure year 2000 compliance and adequate computing capacity for the new accounting software, providing training on the use of the new software for all accounting staff, and revising the organization's accounting manual to reflect system changes and to help ensure that proper checks and balances were maintained during the switch to the new system. Due to shortfalls in BIA's contract support funding, however, the organization had to delay the planned training and the revision of the accounting manual. These delays, in turn, have compounded problems the organization has experienced in installing and operating the new software and getting the fiscal year accounts ready for the auditors.

Tribes Have Used Their Own Resources and Program Resources to Cover Shortfalls in Funds for Contract Support Costs

According to the tribal officials we interviewed, a combination of tribal resources and program resources have been used to make up for shortfalls in funds for contract support costs. Tribes drew upon their own resources from several sources, including trust funds and tribal businesses. For example, a New Mexico pueblo provided documents showing withdrawals of hundreds of thousands of dollars from its trust accounts in fiscal year 1998 to pay for indirect costs (the largest portion of contract support costs). The pueblo would otherwise have used its trust funds to purchase land or to improve its infrastructures. A Washington tribe said it has used large amounts of resources from its geoduck-processing enterprise to cover funding shortfalls.[2] According to a tribal official, if funding shortfalls did not have to be compensated for, the tribe would have used its tribal resources to expand its processing business or to supplement its federally funded programs.

Tribes that are waiting for contract support funds from IHS feel that they are the hardest hit by shortfalls in contract support funding, as they must

[2]A geoduck (pronounced gooey-duck) is a large edible clam, sometimes weighing over 5 pounds, that is found in Pacific coastal waters.

bear all the costs of administering the contracted programs (or choose to postpone the contract until the funding can be provided).[3] These costs can be significant, and no provision is in place to reimburse tribes for their contract support expenditures during their years on the queue. One Nevada tribe reported that shortfalls in contract support funding have seriously affected its ability to administer health services and its administration of BIA's programs. Specifically, for 2 years the tribe had to operate the contracted hospital, a "huge and costly undertaking," without any contract support funding from IHS. When the tribe contracted to take over hospital operations in fiscal year 1996, it was to receive about $7.3 million to do so: more than $5 million for direct costs; over $1.4 million for indirect costs (in accordance with the tribe's negotiated indirect cost rate of 26.6 percent); about $495,000 for other contract support costs; and about $367,000 for startup costs. The tribe planned to use the startup funds to hire additional staff and install a new accounting system to handle the planned expansion of services. Furthermore, the tribe recognized that the administrative transition would require extensive development and training and the assistance of specialists and consultants.

When the tribe subsequently received no funding for contract support costs for the first 2 years, it said it had to use a significant portion of the funds designated for direct costs to pay for administrative support. When the tribe took over hospital operations, 27 of the 66 staff positions were vacant. The tribe had planned to immediately fill many of the vacancies, but it had to postpone hiring for all but the most critical ones for the first 2 years. In addition, without contract support costs, the tribe could not afford to resolve critical deficiencies, including some safety-related ones. Nor could the tribe afford to replace certain pieces of medical equipment or refer patients to specialists when needed, except in cases deemed emergencies or needing acute care. For the first 2 years of tribal operation, no optometric or podiatric care was available at the hospital, despite the tribe's large diabetic population. According to the tribe, program administration suffered as well, particularly in the areas of personnel, fiscal management, and accounting. For example, the tribe found it extremely difficult to properly monitor and reconcile purchases, disbursements, and the related statistics necessary to efficiently run the hospital, and numerous budget revisions were necessary.

[3]IHS provides contract support funding only to tribes that have ongoing contracts (see app. III). When tribes first indicate a desire to contract a program or to expand an existing one, they are put on a waiting list, or queue, for funding. In some cases, a tribe can wait on the queue for 2 or 3 years before receiving contract support funds for a new or expanded program. In the Shoshone-Bannock case, the use of the queue was held to be beyond IHS' authority.

According to a number of tribes, drawdowns from tribal resources can also result in lost opportunities for tribes to advance their social or economic development. If they had not needed to use tribal resources to make up for shortfalls in funding for contract support costs, some tribes said they would have used their resources to supplement program funding; others said they would have used the resources to "grow" their tribal businesses or expand their economic development. For example, officials of an Alaskan Indian community said that they routinely use tribal resources to make up for shortfalls in contract support funding. Otherwise, the community would have used its resources to supplement direct program services (such as law enforcement and emergency services) and to support community enterprises, community jobs, and economic development.

The effect on some tribes has been more than one of lost opportunities for program supplementation or economic development. For example, a letter from a Maine tribe reported that it "cannot continue to absorb contract support shortfalls. The tribe's financial stability is being jeopardized by the lack of adequate contract support." The tribe said that, since fiscal year 1991, its accumulated shortfalls of about half a million dollars "have created a deficit within the tribe's general fund budget." Thus, the tribe has had to use direct program dollars to compensate for the shortfalls; it has also had to lay off vital tribal employees and reduce expenditures. Such cutbacks, said the tribe, have made it difficult to develop and maintain the required management systems necessary to comply with the requirements of federal contracts and provide direct services to its tribal members.

Many tribes continue to use their own resources as supplemental funding; nevertheless, some tribes have had no choice but to use direct program dollars to cover indirect expenses. For example, according to a letter from a New Mexico tribal organization, the failure of an agency to meet its contract support obligations "creates a financial vacuum that can only be filled through the use of unrestricted funds." But for nonprofit organizations, such as this one, unrestricted funds are quite limited, so the organizations bear "a tremendous burden" when those funds must be used to make up for unrecovered indirect costs. A reduction in indirect expenditures is not necessarily an effective solution to the problem. For example, according to the same New Mexico tribal organization, about two-thirds of its indirect cost pool consists of expenses for salaries and fringe benefits. Thus, if meaningful reductions in costs are to take place, they will surely affect the size or the quality of the staffing. Because its

staff is small in relation to the complexity, the volume, and the diversity of the organization's operations, the organization's representative believes that any reduction in staff would significantly impair its ability to provide the necessary program services.

A Few Tribes Have Postponed or Refused Programs Because They Cannot Afford to Administer Them

A few tribes said they have had to postpone or return management of their contracted programs to the agencies, or are considering doing so, because they cannot afford to administer them. For example, in a December 1998 letter, a Nevada tribe said that, as a relatively small tribe without many other economic resources, it has had to postpone for 5 years its assumption of IHS' Contract Health Service program. According to IHS officials, some tribes have found themselves in a similar situation. According to these officials, some tribes on the funding queue postponed contracting programs until they reached the top of the funding queue because they could not afford to run the programs without contract support funding.

Other tribes have not yet retroceded or returned the management of their contracted programs to the agencies, but have considered doing so or are holding that decision in reserve. For example, by resolution of its legislative council, an Arizona tribe authorized the retrocession of programs for which insufficient or no contract support funding has been provided. Similarly, a Washington tribe said that it coped with its fiscal year 1997 contract support shortfall by not filling five positions that are key to the tribal government infrastructure and that normally would be funded from the indirect cost pool. According to a tribal official, "Each year we receive less and less to administer programs and services to our tribal members and the Indian people living in our service area; and though we work very hard to minimize this negative impact, we fear that the day might come when we may have to retrocede our programs back to BIA and IHS."

Officials of several tribes, however, said that they are reluctant to retrocede programs back to the federal government because they were unhappy with the level of services they received when federal agencies ran the programs. For example, an official of an Oklahoma tribe said that, despite funding shortfalls, his tribe continues to administer contracts because it feels it can provide better services to its members than the federal government had provided.

Lack of Adequate Funding From Other Entities Contributes to Shortfalls in Funds for Indirect Costs

Many of the tribal representatives we interviewed said that much of their funding shortfalls for contract support costs, as well as the associated negative effects, arises from contracting with funding entities other than BIA and IHS, such as other federal agencies, state governments, and private organizations. Frequently, other entities with which tribes contract—under authorities other than the Indian Self-Determination Act—limit indirect cost recovery; others allow no recovery of indirect costs. Although these policies and practices, which have existed for years, exacerbate the negative effects of funding shortfalls, many tribes continue to contract such programs.

Entities other than BIA and IHS are not subject to the provisions of the Indian Self-Determination Act. Accordingly, they are not required to pay indirect costs over and above the program amount they provide to tribes that contract with them. Nevertheless, under the provisions of OMB Circular A-87, each such entity is allocated its share of the costs that make up a tribe's indirect cost pool. Thus, when one funding entity does not reimburse its share of the indirect costs incurred, that shortfall may be borne by the tribe. Some of the funding entities that are not subject to the Indian Self-Determination Act and some statutes place a limit on the indirect costs that a tribe can recover. Among the entities and programs that tribal officials mentioned as limiting the recovery of indirect costs were the Department of Health and Human Services' Head Start program, the Department of Labor's Job Training Partnership Act program, and various state programs.

According to various tribal officials, Department of Justice programs, as well as many programs funded by grants from private sector organizations, do not allow any recovery of indirect costs. For example, the Department of Justice's Community Oriented Policing Services Universal Hiring Program, which provides grant money for hiring police officers, specifically restricts the use of the grant money to salaries and benefits. No funds can be diverted for such other costs as uniforms or weapons. Despite their need for increased law enforcement, several tribal officials said they avoid contracts and grants that allow little or no recovery of indirect costs. For example, in a 1996 letter to the Department of Justice, an Oklahoma tribe's police department declined a grant from Justice's program of about $107,000 for two full-time officers. Citing its inability to fund the indirect costs allocable to such a grant, the tribal police department said it must "respectfully decline on receiving this most important source of funding which would have been a great asset in police operations."

The problem posed by funding entities that do not share in funding indirect costs is not a new one. In discussing the problem of nonrecovery, a 1997 study of contracting costs cited the following excerpt from a 1983 letter by Interior's Inspector General to the Deputy Director of the Office of Management and Budget as going "right to the heart of the matter."

"The indirect cost guidelines [OMB Circular A-87] require an allocation of allowable costs to all benefiting programs to establish an indirect cost rate. That would be a fair and equitable process if every agency honored the established rate; but they do not. Some cite legislative restrictions; others cite administrative regulations; and a few base their refusal on the notion that a good administrator is obliged to negotiate a lower rate. What we have here is a 'Catch 22' situation. One set of rules says that you can have an indirect cost rate, but other rules say you cannot be paid on the basis of that rate . . . ."[4]

Although the problem of nonrecovery is particularly vexing to tribes and has been so for many years, its solution has been elusive. The major challenge with solving the problem is that grants and contracts awarded to tribes by agencies other than BIA and IHS are not, by their very nature, intended for the sole or primary use of Indian tribes. Instead, they are designed for use by an array of institutions, including state and local governments and nonprofit organizations. The agencies that fund these grants and contracts have the authority to establish the amount of indirect costs, if any, that may be recovered from the contract or grant funds. Thus, in deciding whether to apply for such a contract or grant, any entity—be it a state or local government or an Indian tribe—must consider its financial ability to handle any accompanying restrictions on indirect cost recovery. In some cases, such as with tribes that receive most or all of their funds from the federal government and with nonprofit organizations, little if any unrestricted, or disposable, income is available to make up for indirect costs that are not reimbursed by funding entities. Although we understand and include in this report tribes' concerns about their inability to fully recover their indirect costs from all funding entities with which they contract, the scope of our review did not include funding entities other than those specified in the Indian Self-Determination Act. Accordingly, we present no conclusions or recommendations on this matter.

[4]James M. Sizemore, CPA, Determining the True Cost of Contracting Federal Programs for Indian Tribes, Sec. Ed. (the Northwest Portland Area Indian Health Board and the Affiliated Tribes of Northwest Indians, Portland, Oregon, May 1997), p. 32.

Federal Policies and Practices for Paying Contract Support Costs Are Inconsistent

Inconsistencies in determining and funding contract support costs exist. Since 1988, BIA and IHS have reimbursed tribes for different categories of contract support costs. This difference has caused confusion among tribes and differences in funding from the two agencies. In addition, since 1992, the two regional offices within Interior's Office of Inspector General that are responsible for negotiating indirect cost rates with tribes have calculated adjustments to indirect cost rates differently. In certain circumstances, tribes negotiating indirect cost rates with the Western Region receive higher indirect cost rates than they would receive if the Eastern Region's calculations had been used. Furthermore, BIA and IHS have not been making the necessary adjustments when tribes receive a final indirect cost rate after having been initially provided indirect funding based on a provisional indirect cost rate.[1] Moreover, having the rate-setting function conducted by Interior's Office of Inspector General is inconsistent with the audit function of that office.

BIA and IHS Have Implemented Contract Support Provisions Differently

BIA and IHS have implemented the contract support provisions in the Indian Self-Determination Act, as amended, differently. Since 1988, IHS has provided additional contract support funding to tribes, for a cost category called "direct contract support costs," but BIA has not. In 1996, the two agencies issued joint regulations implementing the act and its amendments, and these regulations identify direct contract support costs as something that tribes should include in their contract proposals for BIA's and IHS' programs. Currently, IHS is reconsidering the types of costs it allows as direct contract support costs, while BIA plans to consider requests for funding direct contract support costs.

In 1988, IHS began paying direct contract support costs based on its interpretation of the 1988 amendments to the Indian Self-Determination Act. In funding these costs, IHS recognized that certain types of costs contractors incurred were being categorized as direct costs under OMB's guidance that should be reimbursed by IHS as direct contract support costs. Included in IHS' justification for the new category of direct contract support costs were such items as equipment repairs and replacement, workers' compensation, unemployment taxes, and general insurance. These costs are either not incurred by IHS in administering the program (i.e., costs unique to tribes, such as insurance) or costs paid by IHS from resources other than those under contract (i.e., equipment, workers' compensation, and unemployment taxes).

[1]A provisional indirect cost rate is calculated based on a tribe's estimated direct and indirect costs and is applied until a final rate is calculated based on actual costs, which are typically audited at the end of a fiscal year.

In determining the amount of direct contract support funding to provide, IHS' general practice has been to provide, for such benefits as workers' compensation and unemployment taxes, an amount equal to 15 percent of a tribe's direct salaries, plus an amount to cover the actual costs of other types of direct contract support costs, such as special training costs.[2] However, IHS area offices have discretion to negotiate with tribes the amount of funding provided for direct contract support costs. IHS headquarters officials have recently raised some concerns about the duplicate payment of costs that the agency has allowed as direct contract support costs. As a result, IHS has proposed a new policy that will make direct contract support costs subject to negotiations and that will eliminate the 15 percent rule. According to IHS officials, this policy is more rigorous; however, it will only apply to new or expanding contracts. The proposed policy does not provide the opportunity for IHS officials to revise direct contract support costs for existing contracts unless a tribe asks for its costs to be reviewed.

After the 1988 amendments to the Indian Self-Determination Act, BIA did not change its policy regarding the use of contract support funds and has not requested any funds to pay direct contract support costs over and above the base amount in a program's contract. In a 1993 memorandum to all BIA area directors, contract officers, and budget officers, the acting Deputy Commissioner of Indian Affairs stated that the payment of certain direct contract support costs could be justified under the Indian Self-Determination Act, but that BIA did not have sufficient contract support funding to pay for these costs. Furthermore, the acting Deputy Commissioner stated that the use of contract support funds to pay for direct contract support costs was in "violation of long-standing Bureau policy."

The different implementation of direct contract support costs by BIA and IHS has caused confusion among tribes and funding differences between the two agencies' programs. To help standardize the implementation of the act by BIA and IHS, the Congress directed the two agencies to issue a single set of regulations on implementing the act. The final joint regulations were issued in June 1996. Despite BIA's position on direct contract support costs, the joint regulations require that contract proposals contain "an identification of the amount of direct contract support costs . . . ." Confusion still exists because BIA has not changed its position on direct contract support costs to follow the new regulations. However, on

[2]In the past, IHS paid direct contract support costs for such items as long-distance telephone service and postage but has stopped this practice as funds for these functions have been transferred with direct program funds.

February 24, 1999, in testimony before the U.S. House of Representatives' Committee on Resources, the Assistant Secretary for Indian Affairs stated that BIA is reexamining its position on direct contract support costs and "will evaluate tribal requests for payment of certain direct costs." Other Interior officials have pointed out that because the Congress has capped BIA's annual appropriations for contract support costs at less than full funding since 1994, recognizing an additional category of contract support costs may not result in any additional funding to the tribes. Instead, it would only increase the amount of the shortfall, unless the Congress provided additional funding. Estimates of direct contract support costs for BIA's programs have ranged between about $10 million and about $30 million annually.

Inconsistencies in Calculating and Using Indirect Cost Rates

Inconsistencies exist in the calculation of indirect cost rates by Interior's Office of Inspector General and in the use of certain types of rates by BIA and IHS. Since 1992, two regional offices within Interior's Office of Inspector General, the primary office responsible for negotiating indirect cost rates with tribes, have calculated adjustments to indirect cost rates differently. Under certain circumstances, tribes receive higher indirect cost rates under the Western Region's calculation method than they would receive under the Eastern Region's method. Furthermore, for one particular type of indirect cost rate, BIA and IHS are not applying the rate correctly. That is, when a provisional-final rate is used and funding has been provided based on the provisional rate, BIA and IHS are not later adjusting the contract funding as necessary to reflect the final rate.

Interior's Office of Inspector General Uses Two Different Calculation Methods

Since 1992, a significant difference has existed between how the Western and Eastern Regions of Interior's Office of Inspector General have calculated the carryforward adjustment for tribes with "fixed with carryforward" indirect cost rates. Most tribes have a "fixed with carryforward" type of indirect cost rate, which means that the rate is fixed during the year that it is used; after that year has ended and the actual costs have been audited, the rate is recalculated based on the actual costs. If the fixed rate was too high or too low, an adjustment is made to the next year's rate. Through that adjustment, referred to as the "carryforward" adjustment, any overpayment in indirect costs can be recovered.

While the Eastern Region of Interior's Office of Inspector General requires that all overpayments be recovered through a carryforward adjustment, in certain circumstances, the Western Region allows an overpayment in

indirect costs from one agency to be used to offset an underpayment from another agency. According to officials in the Office of Inspector General, the Western Region's method of calculating indirect cost rates produces higher rates than the Eastern Region's method.

Although the Western Region's method helps tribes, it is contrary to Interior's legal opinions. In a 1990 decision, its Office of the Solicitor determined that one agency's funds could not be used to offset deficits in funding from another agency. Interior's Office of Inspector General is aware of the different calculation methods and would like to standardize the process; however, it cannot do so at this time, as any changes to the current process require federal court approval. In its recent decision on the Office of Inspector General's method to calculate indirect cost rates, the United States Court of Appeals for the Tenth Circuit ruled that the method was invalid.[3] Subsequently, court orders were issued allowing the resumption of the negotiation of indirect cost rates for fiscal years 1998 and 1999 under the system in place prior to the Tenth Circuit decision. According to the Inspector General's Office of General Counsel, the orders prevent the Office of Inspector General from changing the process of negotiating indirect cost rates without the approval of the District Court.

BIA and IHS Are Not Making Necessary Adjustments for Provisional-Final Indirect Cost Rates

When tribes use a provisional-final rate, BIA or IHS must determine whether an overpayment was made, and if so, recover it. The Office of Inspector General does not adjust the indirect cost rate, as it does with the fixed with carryforward type of rate, to recover any overpayments. The funding agencies should use the provisional indirect cost rate to determine a tribe's initial funding for indirect costs. Usually, 2 years later, a final rate will be issued based on a tribe's actual audited costs. The final rate may be the same as, higher, or lower than the provisional rate. If the final rate is higher, then the tribe's funding for indirect costs would have increased and if the final rate is lower, then the tribe's funding for indirect costs would have decreased, in which case an overpayment may have occurred. Several of the BIA and IHS area office officials we talked to during our review told us that they were not making funding adjustments when the final indirect cost rates were issued for tribes using provisional-final indirect cost rates.

For example, if a tribe with an IHS direct funding base of $1 million had a provisional rate of 25 percent, the tribe would receive $250,000 in funding for indirect costs allocated to IHS' programs for that fiscal year. If that

[3]Ramah Navajo Chapter v. Lujan, 112 F. 3d 1455 (10th Cir. 1997).

tribe's final indirect cost rate for that year was 20 percent, then the tribe actually only needed $200,000 rather than $250,000 and the tribe should return the overpayment of $50,000 to the agency. If the final rate was higher than the provisional rate, the agency should provide additional funding to the tribe.

BIA officials noted that because it has not been able to fully fund tribes' indirect costs, it is unlikely that any overpayments have occurred. To continue using the same example, if the tribe received only 80 percent of the required $250,000 to begin with, that would mean the tribe received $200,000. Even with the lower final rate of 20 percent, the tribe therefore, would not have been overpaid. However, based on our discussions with BIA and IHS officials, it appears that neither agency makes this calculation to determine whether, in fact, overpayments have been made to those tribes using provisional-final indirect cost rates.

Rate-Setting Function Is Performed by Interior's Office of Inspector General

In 1986, the Office of Management and Budget designated the Department of the Interior as the cognizant agency for developing indirect cost rates for tribes. Within Interior, the Office of Inspector General performs the rate-setting function.[4] That office is also responsible, however, for auditing expenditures by tribes under departmental contracts as well as reviewing and processing tribes' audited financial statements on which their indirect cost proposals are based.

The inherent conflict between the functions performed by Interior's Office of Inspector General has long been recognized. In 1989, OMB concluded that having Interior's Office of Inspector General negotiate indirect cost rates was contrary to the principle of separation of duties under OMB circular A-123, "Internal Controls," and counter to the intent of the Inspector General Act of 1978. In 1989, recommendations to move the rate-setting function were made, but were not implemented, partly because tribes objected to the transfer. Tribes view Interior's Office of Inspector General as a fair and impartial representative of the federal government and were concerned that moving the rate-setting function into Interior's Office of Policy, Management, and Budget (now the Office of Policy, Management, and Budget and Chief Financial Officer) would politicize the process, preventing the office from being impartial and

[4]The Office of Inspector General and its predecessor organizations have been negotiating indirect cost rates with tribes since 1976, approximately 1 year after the enactment of the Indian Self-Determination and Education Assistance Act in 1975. In contrast, at HHS, the rate-setting function is performed by the Division of Cost Allocation within the Department's Program Support Center, not by the Department's Office of Inspector General.

neutral in setting indirect cost rates. The rate-setting function was not moved, and it continues to be performed by Interior's Office of Inspector General.

Conclusions

Two inconsistencies in determining funding for contract support costs continue to cause confusion for tribes who receive self-determination funds, and, more importantly, cause funding inequities among the tribes. Although BIA and IHS issued joint regulations for implementing the program, the inconsistent payment of direct contract support costs continues because they have not yet changed or coordinated their practices and policies to reflect the regulations.

The agencies also do not make proper adjustments in contract support funding based on provisional-final rates. Because they do not make these adjustments, they do not know if they are providing the correct amount of funding to tribes.

The importance of making the funding of contract support costs easier to understand and implement extends to the way in which the funds are audited. The calculation and use of indirect rates is a complex process, which varies by tribe, and even though tribes provide independent audited financial statements, the federal government must maintain an independent audit capability over indirect rates. Because the Office of Inspector General is both the rate-setting and audit entity for tribes' indirect rates, a potential conflict of interest exists in ensuring this audit capability.

Recommendations to the Secretaries of the Interior and Health and Human Services

We recommend that the Secretaries of the Interior and of Health and Human Services ensure that

- BIA and IHS work together, and with the Congress and Indian tribes, to coordinate their current practices and policies governing the payment of direct contract support costs and to help ensure that their payment is consistent between the two agencies and
- the two agencies correctly adjust funding when tribes use provisional-final indirect cost rates.

Agency Comments and Our Evaluation

We provided a copy of a draft of this report to the departments of Interior and Health and Human Services for review and comment. Both

departments provided us with comments, as did the Department of the Interior's Office of Inspector General. We are handling the comments from Interior and its Inspector General as separate responses.

The Department of the Interior agreed with GAO's recommendations that its Bureau of Indian Affairs and HHS' Indian Health Service should have consistent policies on the payment of direct contract support costs and that adjustments should be made when provisional-final indirect cost rates are used. Interior said that although differences in BIA's and IHS' budget structures may continue to make having consistent direct contract support costs difficult, it will strive to improve the degree of consistency between its methods and those of IHS. With regard to our recommendation about adjusting provisional-final indirect cost rates, Interior said that although the BIA does not believe overpayments have been made, BIA will remind its awarding officials of the need to compute adjustments when provisional-final indirect cost rates are used. Comments from the Department of the Interior and our specific responses appear in appendix V.

Our draft report concluded that having Interior's Office of Inspector General negotiate indirect cost rates limited its ability to audit the same function and recommended that the Secretary of the Interior move the function from the Inspector General's Office. In separate responses, the Department of the Interior and its Office of Inspector General differed on whether the responsibility should be removed. While the Inspector General's Office agreed with the recommendation to remove the rate negotiation function from the Office, the Department raised several concerns about moving the function. Specifically, it stated that sufficient separation of duties exists within the Inspector General's Office because the staff dedicated to indirect cost negotiations are not assigned to conduct other audits. The Department also stated that it has limited ability to change the current system of negotiating indirect cost rates because of current litigation related to these rates. We continue to have concerns about the ability of the Inspector General's Office to perform both the rate negotiation function and audit functions and plan to review the issue in more depth in a separate study, which will take into account the differences in the responses to our draft report, the legislative history of the Inspector General Act, generally accepted government auditing standards, current litigation, and any other pertinent guidance. As a result, we are not making the recommendation to remove the rate negotiation function from the Inspector General's Office at this time. In its response, the Office of Inspector General also provided technical comments that we

have incorporated in the report where appropriate. The Inspector General's comments and our specific responses are in appendix VI.

The Department of Health and Human Services agreed with GAO's recommendations that its IHS and Interior's BIA should have consistent policies on the payment of direct contract support costs and that adjustments should be made when provisional-final indirect cost rates are used. The Department stated that IHS has historically paid direct contract support costs and has met recently with BIA to discuss the development of a consistent policy. The Department also stated that the issue of adjustments for provisional-final rates will be covered by IHS in a training session scheduled for this summer. The Department had no comment on our recommendation in the draft report to move the responsibility for negotiating indirect cost rates from Interior's Office of Inspector General. The Department's comments are in appendix VII.

Alternatives for Funding Contract Support Costs

The tension between providing full funding for contract support costs and limiting contract support costs will continue to increase as these costs increase. For the past several years, appropriations for contract support costs have been insufficient to fully fund tribes' allowable contract support costs, and tribes have faced increasing shortfalls in funding for their contract support costs. The Congress' decision to control increasing contract support costs by limiting annual appropriations has been challenged by tribes through several cases. One of these cases, which is currently being appealed, was decided in favor of the tribes to receive payment for past shortfalls of contract support funding. In late 1998, the Congress enacted a 1-year moratorium on any new contracting under the Indian Self-Determination and Education Assistance Act. In response to the need for a permanent solution to the current impasse, we are offering four alternatives for funding contract support costs.

In this chapter, we present the advantages, the disadvantages, and the cost implications of several alternatives that the Congress may wish to consider as it deliberates how best to carry out the Indian Self-Determination Act. These alternatives range from fully funding tribes' allowable contract support costs to amending the act to remove the funding mechanism that requires the payment of contract support funds over and above a program's amount. The alternatives discussed are as follows:

- Alternative 1: Provide appropriations sufficient to fund 100 percent of allowable contract support costs each year.
- Alternative 2: Amend the act to eliminate the provision requiring that contract support costs be funded at 100 percent of the allowable costs identified by BIA and IHS.[1]
- Alternative 3: Amend the act to limit the indirect costs that would be paid by imposing either a flat rate or a ceiling rate.
- Alternative 4: Amend the act to eliminate the provision for payment of contract support costs over and above the program base and instead provide a single, consolidated contract amount.

We do not consider all the possible alternatives for funding contract support costs, nor do we prescribe which alternative or combination of alternatives should be selected. In discussing the costs of these alternatives, we do not address funding shortfalls for years prior to fiscal year 1998, nor do we address additional funding that would be necessary if

[1]This alternative may not be necessary if federal courts determine that the requirement for contract support funding under the Indian Self-Determination Act is limited to the amount actually appropriated. Cases presently before the Court of Appeals for the Federal Circuit are considering this issue.

changes in determining direct contract support costs are made by BIA and IHS, as discussed in chapter 4.[2] The cost estimates we provide are illustrative rather than actual, because they involve two major assumptions. First, using the agencies' estimated funding level for new contracts for fiscal year 2000, we assume that $17.5 million would be the annual cost of supporting new contracts. Second, using fiscal year 1998 appropriations of about $280 million, plus the agencies' fiscal year 1998 shortfall estimate of about $95 million for existing contracts, we assume that $375 million would be the cost of fully funding the existing contracts the first year under an alternative funding method. Finally, we are not able to estimate the costs of changes to existing contract costs because of the ever-changing nature of tribes' indirect cost rates and direct cost bases.

Alternative 1: Fully Fund Contract Support Costs

The first alternative for congressional consideration is to make appropriations sufficient to fully fund (i.e., at 100 percent of allowable costs) tribes' allowable contract support costs (this alternative assumes that BIA and IHS would request the full amount of tribes' allowable costs). With this alternative, BIA and IHS would continue to identify tribes' allowable costs as they do now, by using tribes' indirect cost rates, and would pay direct contract support costs in a consistent way, as discussed in chapter 4. The agencies would identify and request the funds necessary to support new contracts.

The Advantages and the Disadvantages

The first alternative has the advantage of fulfilling the provisions of the Indian Self-Determination Act that allow tribes to receive funding for their allowable contract support costs. By fully funding these costs, the Congress and the funding agencies would eliminate funding shortfalls as well as the lawsuits that could potentially stem from such shortfalls.

This alternative would be advantageous to tribes because it would help ensure that they receive their allowable contract support funds for the federal programs they contract from BIA and IHS. As tribes contract more programs, they may need to build up their administrative systems to properly administer and manage their contracts. The costs of these administrative systems are used in determining tribes' indirect cost rates, yet tribes do not receive full funding from either BIA or IHS for these costs.

[2]In 1998, the Congress included language in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for fiscal year 1999 (P.L. 105-277, section 314, 112 Stat. 2681-288, Oct. 21, 1998) that limited the obligation to fund contract support costs to the amounts the Congress appropriated for that purpose in fiscal years 1994 through 1998. This would mean that no funding would be provided to pay for any shortfalls for these years.

If this alternative were adopted, tribes that contract with IHS would no longer have to wait several years for contract support funding, and tribes that contract with BIA would no longer receive less than the full amount of their allowable contract support costs.

The primary disadvantage of this alternative is that its implementation would require the Congress to fully fund all allowable contract support costs, which may continue to increase each year. As discussed in chapter 2, it is difficult to predict future contract support costs for several reasons, including the difficulty of determining the number of tribes that will begin new contracts during the year. However, tribes' allowable contract support costs could double as tribes continue to contract more of the agencies' programs. While tribes can contract almost all of the programs and services that BIA and IHS currently provide, according to officials at both agencies, tribes are currently contracting only about half of the agencies' resources. As BIA and IHS transfer more and more programs to the tribes, the agencies' administrative costs should decrease, and some of this funding could become available to offset increases in contract support funding. Nevertheless, most of the funding for the increased allowable costs would have to be provided through federal appropriations.

Another disadvantage of this alternative, in terms of cost efficiency, is that it does not provide tribes with incentives to limit the growth of contract support costs and, particularly, indirect costs. Although tribes must justify their indirect cost rates through the process discussed in appendix II, and under the law tribes should not receive duplicate funding for the same task from program funding and contract support funding, Interior's Office of Inspector General and others have noted that the current method of funding indirect costs could encourage tribes to classify as "indirect" as many costs as possible to receive more funding. For example, in a 1983 letter to the Deputy Director, Office of Management and Budget, Interior's Inspector General criticized the funding mechanism for creating this motivation rather than promoting economy and efficiency. Similarly, a 1982 study by the American Indian Law Center, Inc., concluded that the funding mechanism encouraged tribes to shift as many expenses as possible to the indirect, rather than direct, cost category.

The Cost of the First Alternative

As the need for contract support funding will, in all probability, continue to increase each year, the "full funding" alternative will involve ever-increasing amounts. The cost of this alternative would be as follows:

- about $375 million the first year, based on the fiscal year 1998 funding for existing contracts (including the fiscal year 1998 funding shortfall);
- about $17.5 million for new and expanded contracts, according to the agencies' estimates for fiscal year 2000;[3] and
- an undetermined amount for changes to existing contracts due to changes in indirect cost rates or program funding.

Alternative 2: Amend the Act to Eliminate the Provision for Full Funding of Contract Support Costs

A second alternative is for the Congress to amend the act to eliminate the provision for fully funding allowable contract support costs and, instead, provide funding strictly on the basis of annual appropriations. With this alternative, BIA and IHS would continue to identify tribes' allowable costs, using their indirect cost rates, in the agencies' budget requests.

The Advantages and the Disadvantages

This alternative has the advantage of limiting the growth of contract support funding; funding amounts would be established by the amount the Congress appropriates each year. At the same time, this alternative would allow the Congress to fund contract support costs at whatever level it deems appropriate. The Congress has appropriated increased amounts for contract support; in fiscal year 1989, it provided about $100 million; in fiscal year 1998, it provided about $280 million. If adopted, this alternative would eliminate the expectation, created by the 1988 and 1994 amendments to the law, that full contract support funding will be available, when, in fact, appropriations and funding have been limited and have caused shortfalls.

A disadvantage of this alternative is that it may discourage tribes from entering into new self-determination contracts. The current policy fosters self-determination by encouraging tribes to assume managerial responsibility for federal programs that the government previously managed on their behalf. Yet, as has been explicitly stated by the Senate authorizing committee, tribes' assumption of responsibility for these programs was not intended to result in a diminution of program resources.[4] Avoiding this effect was the goal behind providing full funding of the contract support costs that tribes incur in running these programs. Tribes have stated that if they are not able to achieve full funding of their contract

[3]In the second year of contracting under this alternative, we assume that the funding for existing contracts would increase by $17.5 million, and another $17.5 million would fund additional new and expanded contracts.

[4]S. Rep. No. 103-374 at 9 (1994).

support costs, and particularly their indirect costs, they may not continue to contract for federal programs or they may reduce the number of programs they contract. However, several tribes have also stated that they are interested in providing services to their members and that they have continued to provide these services despite shortfalls because they believe they can provide better services than BIA and IHS have provided.

Another disadvantage of this alternative for tribes is that funding for their contract support costs would be subject to the uncertainties of the appropriations cycle. Unless the Congress decides to appropriate amounts sufficient to fully fund tribes' contract support costs every year, this alternative would result in shortfalls between the amounts provided and those identified as allowed for contract support. Although the Congress has not funded allowable contract support costs at the level currently provided by law, it has increased funding for these costs over the past several years. With this alternative, contract support costs might not increase; they could decrease. Appropriations could fluctuate from year to year, and this could negatively affect tribes' ability to plan and budget for administering their programs.

The Cost of the Second Alternative

The cost of this alternative would depend on the annual appropriations provided by the Congress. For fiscal year 1998, the Congress appropriated $280 million for contract support. That amount included funds to support existing contracts as well as an amount for support of new and expanded contracts. With this alternative, the Congress could opt to appropriate more or less than the $280 million.

Alternative 3: Amend the Act to Impose Limits on Indirect Cost Rates

A third alternative would be to amend the law to limit the amount of funding tribes could receive for contract support by limiting the amount of indirect costs tribes can receive. For example, one way to limit funding would be to establish one indirect cost rate—such as the current aggregate rate of 25 percent—as a flat rate that would apply to all tribes. Another method would be to fund tribes' indirect costs according to their rate, up to a specific limit, or ceiling—such as 25 percent—above which a tribe could recover no more costs.

The Advantages and the Disadvantages

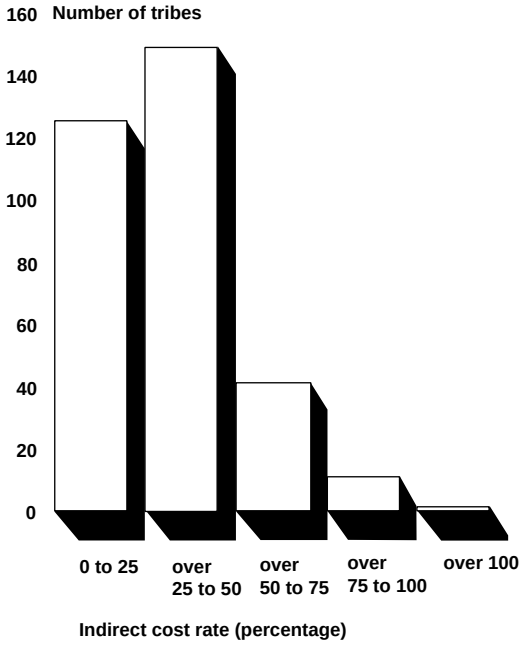
As with the second alternative, this one has the advantage of imposing limitations on the growth of contract support funding and of eliminating the expectation created by the law's current language that full contract

support funding will be available.[5] An advantage of this alternative for tribes is that their contract support costs would be funded on a consistent basis and they could better anticipate their annual contract support funding. All tribes would receive funding, and they would receive funding at the same rate. As previously stated, because of shortfalls, tribes that have new contracts with IHS can wait several years to receive contract support funding, and tribes that contract with BIA do not get the full amount of funding that the agencies have identified for tribes' allowable costs.

However, the disadvantage of this alternative to tribes is that it ignores the differences among the individual tribes' actual indirect costs. As discussed in chapter 2, contract support costs are made up primarily of indirect costs, which vary widely among tribes. By ignoring these differences, this alternative could provide a windfall for tribes who have low indirect cost rates while placing those with high rates at a disadvantage, depending on the specific rate limitation that would be applied. For example, if the Congress were to impose a flat 25-percent rate based on total direct costs, more tribes would receive reduced funding than increased funding for indirect costs. Specifically, of the 327 tribes for which indirect cost rate information was available for fiscal years 1995 through 1998, 202 tribes would receive less funding under a 25-percent rate restriction (because their rates were higher than 25 percent), and 125 tribes would receive more funding (because their rates were 25 percent or lower). The 12 tribes with the highest rates (76 percent or higher) were those with relatively low levels of program dollars. Figure 5.1 shows the indirect cost rate categories for the 327 tribes.

[5]The idea of imposing a cap on indirect cost rates is similar to the approach used to limit the growth of indirect costs at colleges and universities. Beginning in fiscal year 1992, a 26-percent cap was imposed on federal reimbursements to universities for certain indirect costs associated with the performance of federally funded research, as we reported in a previous review of such costs. University Research: Effect of Indirect Cost Revisions and Options for Future Changes (GAO/RCED-95-74, Mar. 6, 1995).

Figure 5.1: Tribes' Indirect Cost Rates



Note: We compiled information on indirect cost rates negotiated by Interior's Office of Inspector General and HHS' Division of Cost Allocation. There are 382 tribes and organizations in the database; of these, 25 tribes had multiple rates, and 35 had indirect cost rates calculated with direct cost bases composed of salaries only or salaries and fringe benefits (5 tribes had both of these). Therefore, these 55 tribes are not included in the data presented in this figure.

Source: GAO's analysis of data from BIA and HHS' Division of Cost Allocation.

To implement this change, BIA and IHS would have to redistribute funding among tribes, which could cause financial and administrative disruption for tribes that would lose funding. On the other hand, this alternative would provide an incentive for tribes with high indirect cost rates to lower their indirect costs.

Furthermore, as with the second alternative, this alternative represents a change from the current self-determination legislation. Tribes have stated that if funding shortfalls continue they may not continue to contract BIA's and IHS' programs. Of the tribes we communicated with, none indicated they had returned the management of their programs to BIA and IHS; however, there is no way to know how many tribes might stop or reduce their contracting.

The Cost of the Third Alternative

- The cost of this alternative would depend on the type of rate limit established. If, for example, the Congress chose a flat rate of 25 percent, this alternative would cost about the same as the current method costs, about $375 million, for the first year.
- As with the first alternative, if the Congress provided $17.5 million the first year to support new and expanded contracts, then the funding for existing contracts would increase accordingly the second year, and another $17.5 million would support new and expanded contracts.
- If the Congress chose a rate lower than 25 percent, allowable contract support costs would decrease; if the Congress chose a higher rate, allowable contract support costs would increase.

Alternative 4: Amend the Act to Replace the Current Funding Mechanism With a Consolidated Contract Amount

A fourth alternative would be to amend the act to eliminate the current funding mechanism, which provides contract support funding over and above the program funding, and replace it with one that would combine the current categories of contract costs into one contract amount from which both direct and indirect costs would be recovered. The revised contract amount would consist of the sum of (1) a program's dollars; (2) the allowable indirect costs; and (3) any allowable direct contract support costs, as calculated by an agreed-upon method (as recommended in chapter 4). Upon consolidation into a single contract amount, these cost categories would lose their individual identities and would thereafter simply comprise the contract total. BIA's and IHS' budget requests, then, would no longer contain a separate line item for contract support; those funds would be contained within the agencies' program line items. BIA currently uses this funding method for tribes' contracts of construction programs. Tribes would continue to negotiate an indirect cost rate, for use in cost allocation and recovery, but differences in the rate from year to year would not affect the contract amount. The contract amount would change only as a result of increases appropriated by the Congress (e.g., for inflation or for particular programs). As with the other alternatives, a separate fund would need to be retained to support new contracts.

The Advantages and the Disadvantages

The advantage of this alternative for both the government and tribes is that it provides for the full recovery of indirect costs, although the amount of funding provided may not increase. At the same time, this alternative removes any incentive for tribes to increase their indirect costs to receive more funding each year. Funding would no longer be provided over and above a program's direct funding, so once the consolidated contract amount has been set, any increases in indirect costs would leave less

money for a program's expenditures. This would create an incentive for tribes to reduce their indirect costs as much as possible, to make more money available for direct program expenditures. In keeping with the purpose of the Indian Self-Determination Act, tribes would make the decisions about how much funding to spend on program costs and how much to spend on administrative, or indirect, activities. With this alternative, the spotlight would no longer be on the sufficiency of contract support funding, but on the sufficiency of direct program funding. That is, funding debates would center on whether the funds provided for a particular program would be sufficient to achieve its intended purpose.

A disadvantage of this alternative for tribes is that if their indirect cost rates increased over the years, the contract amounts would not increase. Changes in indirect cost rates—whether upward or downward—would no longer affect the amount of funding a tribe would receive, because contract support would no longer be funded separately from the program amounts. Thus, tribes would bear the responsibility for managing indirect costs prudently, to retain the greatest possible amount of the total contract funds for program services.

The Cost of the Fourth Alternative

- The Congress could fund this alternative in one of two ways. First, when the existing contract funding is consolidated, the funding could be combined at the current funding level, which would perpetuate the current funding shortfall. This option would cost $280 million annually for existing contracts. Tribes would continue to expect funding for their shortfalls, however, and would view these shortfalls as permanent reductions in funding, which is what happened to a similar effort in 1985.[6] Or, second, the contract funding could be consolidated at the level identified by BIA and IHS as the amount of tribes' allowable contract support costs. Using fiscal year 1998 funding, the consolidated amount would be about $375 million, including almost $280 million for existing contracts and about $95 million for the shortfall. As with the other alternatives, contract support costs would continue to be needed for new contracts. According to BIA's and IHS' estimates for fiscal year 2000, the costs of new contracts would be about $17.5 million, annually, and these costs would accumulate as the tribes continued the contracts.
- Under this alternative, future increases in contract support costs would be slowed, because the funding mechanism would no longer provide contract support funding over and above the direct program amounts for existing

[6]BIA consolidated funding for the programs and contract support for fiscal year 1985; however, the total amount was $5 million short of tribes' allowable costs. For a number of reasons, this process failed and was reversed in fiscal year 1988.

contracts. Thus, if the Congress decided to increase funding for a particular program, this decision would not create a corollary obligation for increased contract support funding.

Matters for Congressional Consideration

The Congress, in its deliberations on how to best provide funding for the Indian Self-Determination Act, may wish to consider a number of alternatives to the current mechanism for funding Indian contract support costs.

Agency Comments

We provided copies of a draft of this report to the departments of the Interior and Health and Human Services for review and comment. We received comments from both departments and from Interior's Office of the Inspector General (see app. V, VI, and VII). Neither of the departments nor the Inspector General commented on the alternatives presented in this chapter.

Contract Support Cost Provisions of the Indian Self-Determination and Education Assistance Act

The following text presents those parts of title I of the law that cover contract support costs for Indian Self-Determination and Education Assistance Act contracts.[1] The provisions in the law apply to both tribal governments and organizations (hereafter referred to as tribes). The text is found at 25 U.S.C. 450j-1, and is commonly referred to as section 106(a) and (b) of the act, as amended.

[1]The act includes authorization for self-determination contracts and self-governance agreements.

Section 450j-1. Contract funding and indirect costs

(a) Amount of funds provided

(1) The amount of funds provided under the terms of self-determination contracts entered into pursuant to this subchapter shall not be less than the appropriate Secretary would have otherwise provided for the operation of the programs or portions thereof for the period covered by the contract, without regard to any organizational level within the Department of the Interior or the Department of Health and Human Services, as appropriate, at which the program, function, service, or activity or portion thereof, including supportive administrative functions that are otherwise contractable, is operated.

(2) There shall be added to the amount required by paragraph (1) contract support costs which shall consist of an amount for the reasonable costs for activities which must be carried on by a tribal organization as a contractor to ensure compliance with the terms of the contract and prudent management, but which—

(A) normally are not carried on by the respective Secretary in his direct operation of the program; or

(B) are provided by the Secretary in support of the contracted program from resources other than those under contract.

(3)(A) The contract support costs that are eligible costs for the purposes of receiving funding under this subchapter shall include the costs of reimbursing each tribal contractor for reasonable and allowable costs of—

(i) direct program expenses for the operation of the Federal program that is the subject of the contract, and

(ii) any additional administrative or other expense related to the overhead incurred by the tribal contractor in connection with the operation of the Federal program, function, service, or activity pursuant to the contract,

except that such funding shall not duplicate any funding provided under subsection (a)(1) of this section.

(B) On an annual basis, during such period as a tribe or tribal organization operates a Federal program, function, service, or activity pursuant to a contract entered into under this subchapter, the tribe or tribal organization shall have the option to negotiate with the Secretary the amount of funds that the tribe or tribal organization is entitled to receive under such contract pursuant to this paragraph.

(4) For each fiscal year during which a self-determination contract is in effect, any savings attributable to the operation of a Federal program, function, service, or activity under a self-determination contract by a tribe or tribal organization (including a cost reimbursement construction contract) shall—

(A) be used to provide additional services or benefits under the contract: or

(B) be expended by the tribe or tribal organization in the succeeding fiscal year, as provided in section 13a of this title.

(5) Subject to paragraph (6), during the initial year that a self-determination contract is in effect, the amount required to be paid under paragraph (2) shall include startup costs consisting of the reasonable costs that have been incurred or will be incurred on a one-time basis pursuant to the contract necessary—

(A) to plan, prepare for, and assume operation of the program, function, service, or activity that is the subject of the contract; and

(B) to ensure compliance with the terms of the contract and prudent management.

(6) Costs incurred before the initial year that a self-determination contract is in effect may not be included in the amount required to be paid under paragraph (2) if the Secretary does not receive a written notification of the nature and extent of the costs prior to the date on which such costs are incurred.

(b) Reductions and increases in amount of funds provided

The amount of funds required by subsection (a) of this section—

(1) shall not be reduced to make funding available for contract monitoring or administration by the Secretary;

(2) shall not be reduced by the Secretary in subsequent years except pursuant to—

(A) a reduction in appropriations from the previous fiscal year for the program or function to be contracted;

(B) a directive in the statement of the managers accompanying a conference report on an appropriation bill or continuing resolution;

(C) a tribal authorization;

(D) a change in the amount of pass-through funds needed under a contract; or

(E) completion of a contracted project, activity, or program;

(3) shall not be reduced by the Secretary to pay for Federal functions, including, but not limited to, Federal pay costs, Federal employee retirement benefits, automated data processing, contract technical assistance or contract monitoring;

(4) shall not be reduced by the Secretary to pay for the costs of Federal personnel displaced by a self-determination contract; and

(5) may, at the request of the tribal organization, be increased by the Secretary if necessary to carry out this subchapter or as provided in section 450j(c) of this title.

Notwithstanding any other provision in this subchapter, the provision of funds under this subchapter is subject to the availability of appropriations and the Secretary is not required to reduce funding for programs, projects, or activities serving a tribe to make funds available to another tribe or tribal organization under this chapter.

(c) Treatment of shortfalls in indirect and cost recoveries

(1) Where a tribal organization's allowable indirect cost recoveries are below the level of indirect costs that the tribal organizations should have received for any given year pursuant to its approved indirect cost rate, and such shortfall is the result of lack of full indirect cost funding by any Federal, State, or other agency, such shortfall in recoveries shall not form the basis for any theoretical over-recovery or other adverse adjustment to any future years' indirect cost rate or amount for such tribal organization, nor shall any agency seek to collect such shortfall from the tribal organization.

(2) Nothing in this subsection shall be construed to authorize the Secretary to fund less than the full amount of need for indirect costs associated with a self-determination contract.

.....

(f) Addition to contract of full amount contractor entitled; adjustment

Upon the approval of a self-determination contract, the Secretary shall add to the contract the full amount of funds to which the contractor is entitled under subsection (a) of this section, subject to adjustments for each subsequent year that such tribe or tribal organization administers a Federal program, function, service, or activity under such contract.

Titles III and IV of the act include funding provisions for self-governance agreements. Title III authorizes a self-governance demonstration program for HHS and Interior and title IV authorizes a permanent self-governance program for Interior. The relevant text for title III is found in 25 U.S.C. 450f Note and for title IV is found in 25 U.S.C. 458cc.

Section 450f Note

"Sec. 303(a) The Secretaries is [sic] directed to negotiate, and to enter into, an annual written funding agreement with the governing body of a participating tribal government that successfully completes its Self-Governance Planning Grant. Such annual written funding agreement—

(1) shall authorize the tribe to plan, conduct, consolidate, and administer programs, services, and functions of the Department of the Interior and the Indian Health Service of the Department of Health and Human Services that are otherwise available to Indian tribes or Indians . . .

.....

(6) shall . . . provide for payment by the Secretaries to the tribe of funds from one or more programs, services, functions, or activities in an amount equal to that which the tribe would have been eligible to receive under contracts and grants under this Act, including direct program costs and indirect costs, and for any funds which are specifically related to the provision by the Secretaries of services and benefits to the tribe and its members . . . "

.....

Section 458cc. Funding Agreements

(a) Authorization

The Secretary shall negotiate and enter into an annual written funding agreement with the governing body of each participating tribal government in a manner consistent with the Federal Government's laws and trust relationship to and responsibility for the Indian people.

(b) Contents

Each funding agreement shall—

(1) authorize the tribe to plan, conduct, consolidate, and administer programs, services, functions, and activities, or portions thereof, administered by the Department of the Interior through the Bureau of Indian Affairs, without regard to the agency or office of the Bureau of Indian Affairs within which the program, service, function, and activity, or portion thereof, is performed, including funding for agency, area, and central office functions in accordance with subsection (g)(3) of this section . . .

. . . . . .

(g) Payment

(3) . . . the Secretary shall provide funds to the tribe under an agreement under this part for programs, services, functions, and activities, or portions thereof, in an amount equal to the amount that the tribe would have been eligible to receive under contracts and grants under this subchapter, including amounts for direct program and contract support costs and, in addition, any funds that are specifically or functionally related to the provision by the Secretary of services and benefits to the tribe or its members, without regard to the organization level within the Department where such functions are carried out. (underlining added)

Contract Support Costs and the Process for Setting Indirect Cost Rates

The payment of contract support costs has evolved since the Indian Self-Determination and Education Assistance Act (P.L. 93-638) was passed in 1975. Within the act, title I (which is referred to as the Indian Self-Determination Act), allows tribes and tribal organizations (hereafter referred to as tribes) to receive direct funding and contract support costs for contracts.[1] The majority of contract support costs are administrative and other expenses related to overhead, which include indirect costs. For this reason, tribes propose indirect cost rates according to federal cost principles in Office of Management and Budget circulars A-87 and A-122 and corresponding guidance published by the Department of Health and Human Services (HHS).[2] The process for setting an indirect cost rate involves several steps, including negotiations between tribes and the responsible federal agency.

History of Contract Support Costs

The payment by the Bureau of Indian Affairs (BIA) and the Indian Health Service (IHS) of contract support costs for Indian self-determination contracts has evolved with amendments to the enabling legislation and to the agencies' guidelines dealing with contracting. The Indian Self-Determination Act was passed in 1975, and two major amendments to the law were passed in 1988 and 1994. Throughout this time, BIA has maintained essentially the same funding practice for contract support costs, while IHS has changed its policy over time to reflect changes in the act. The agencies issued joint regulations in 1996, but neither BIA nor IHS has changed its contract support funding policies or practices as a result of them. These joint regulations identify three types of contract support costs: direct and indirect contract support costs and startup costs. Currently, BIA funds indirect costs, while IHS pays indirect costs and direct contract support costs. Both agencies fund startup costs, such as costs for computer hardware and software, equipment, furniture, and training, for tribes beginning their first year of contracting a program.

[1]In the 1994 amendment, the Congress created a self-governance project that allowed tribes to sign agreements with BIA to take over a range of programs and funding. These self-governance agreements differ from self-determination contracts in that they allow a tribe to redesign programs and reprogram funding. IHS began signing self-governance agreements with tribes in 1993. Self-governance tribes receive contract support costs in the same way as tribes with self-determination contracts.

[2]OMB circular A-87 is entitled "Cost Principles for State, Local, and Indian Tribal Governments," and OMB circular A-122 is entitled "Cost Principles for Non-Profit Organizations." HHS publishes the following guides to each of the circulars: "A Guide for State, Local, and Indian Tribal Governments: Cost Principles and Procedures for Developing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government," OASMB-10, Rev. Apr. 1997 and "A Guide for Nonprofit Organizations: Cost Principles and Procedures for Establishing Indirect Cost and Other Rates for Grants and Contracts with the Department of Health and Human Services," OASMB-5, May 1983.

Indian Self-Determination Act, Initial Legislation

With the passage of the Indian Self-Determination Act in 1975, tribes were allowed to contract for the federal services that the Department of the Interior or the Department of Health, Education, and Welfare (now the Department of Health and Human Services) provided. The act directed the Secretaries of the Interior and HHS, upon the request of any Indian tribe or Indian organization, to contract with that tribe to plan, conduct, and administer programs provided by those departments. The law provided that tribes would receive the same amount of funds that the Secretaries would have otherwise paid, but it did not specifically provide for funding of costs that tribes would incur to manage those contracts.

In 1976 and 1977, both BIA and IHS began implementing contracting programs, and began paying tribes for their indirect costs of managing them. In 1977, BIA requested more than $11 million to pay primarily for tribes' indirect costs of contracting; these funds were part of a separate budget line item called "contract support funds," which also paid for the costs of federal employees displaced by tribal contracting. In the early years of its program, IHS requested funds—called "93-638 implementation funds"—to pay for program development and training tribal leaders and tribal employees, as well as to pay for indirect costs, including audits, financial management systems, and management. Tribes began getting indirect rates from the Interior's Office of Inspector General.

Indian Self-Determination Act Amendments of 1988 and 1994

In 1987, the Congress identified contract support costs as the greatest impediment to tribes' seeking self-determination contracts, and, in 1988, it amended the act to provide for paying "contract support costs," which were the reasonable costs for activities a contractor must do to ensure compliance with the contract.[3] Specifically, these include activities that (1) would not normally be carried out by the agencies managing the program, such as financial audits or (2) would be done by the agencies, but with funds that are not transferred to the tribes, such as unemployment taxes. After this change in the law, BIA continued to pay for the indirect costs tribes incurred in managing contracts, while in 1992, IHS wrote a new policy on contract support costs stating that it would pay for the indirect costs of a contract, as well as the direct contract support costs. IHS determined that these direct contract support costs included

[3]In amending the act, the Congress selected the term "contract support costs" and rejected the use of the terms "contract costs," "direct costs," and "indirect costs." The apparent reason for its choice is that such terms relate to how costs are to be allocated and are not suitable for describing what categories of costs are to be funded. However, BIA and IHS continue to use the term "indirect costs" when referring to administrative and other expenses and "direct contract support costs" when referring to other kinds of costs, e.g., workers' compensation.

unemployment taxes, workers' compensation, postage, and long-distance phone calls. In 1993, BIA issued a memorandum to its area office directors, and others, stating that while the payment of certain direct contract support costs can be justified under the 1988 amendments to the Indian Self-Determination Act, the agency had not requested funding for such costs and the contract support funds could only cover tribes' indirect expenses.

In 1994, the Congress amended the Indian Self-Determination Act to further define the concept of contract support costs. The Congress specified that contract support costs would include (1) direct program expenses for operating the programs and (2) any additional administrative or other expense related to overhead incurred by the contractors in connection with operating the programs. The amendment also provided that, during the initial year that a contract is in effect, the amount paid shall include startup costs, which are the costs incurred on a one-time basis to plan, prepare for, and assume operation of the program using prudent management practices. Joint agency regulations, issued by the Secretaries of the departments of the Interior and HHS in 1996, state that tribes may request three categories of funding in their contracts: (1) direct program; (2) direct contract support costs, including startup costs; and (3) indirect costs. After the 1994 amendment, BIA began paying tribes for their startup costs, in addition to indirect costs. BIA is currently in the process of writing its first formal policy for contract support costs, and the Assistant Secretary for Indian Affairs has stated that the agency will consider paying direct contract support costs. IHS, which updated its policy to include direct contract support and startup costs in 1992, revised and clarified its policy in 1996 primarily to address the prioritization of tribal requests. Presently, IHS is in the process of rewriting its policy on contract support costs, including the section on direct contract support costs.

Federal Cost Principles for Indian Tribal Governments and Organizations

Federal cost principles for Indian tribal governments and organizations are found in Office of Management and Budget (OMB) circulars A-87 and A-122 and corresponding guidance published by HHS. This guidance is designed to make federal contracts bear their fair share of indirect costs, but it is also based on the presumption that each tribe will have a unique combination of staff, facilities, and experience in managing their contracts. In some cases, laws or regulations for grants and contracts other than those under the Indian Self-Determination Act may limit the amount of administrative or indirect costs allowed for a program, but OMB's guidance

does not allow the unrecoverable amounts from one federal contract or grant to be shifted to another federal contract or grant.

In general, federal contract costs are comprised of direct program costs and a share of a tribe's indirect costs. Because no universal rule for classifying costs as either direct or indirect exists, OMB's circulars state that a tribe should treat each cost consistently as direct or indirect in similar circumstances. Generally, direct costs are those that can be identified with a particular cost objective, and indirect costs are those incurred for common or joint objectives benefiting more than one cost objective. Typical examples of direct costs are salaries for employees working in particular programs, such as social service workers or police officers, the supplies and the materials used for particular programs, and any travel expenses related to those employees or programs. Typical indirect costs may include computer services, transportation, accounting, personnel administration, purchasing, depreciation on buildings and equipment, and operation and maintenance of facilities. To fairly distribute indirect expenses to cost objectives, a tribe may need to "pool" its indirect items and costs. The total amount of the indirect cost pool would then be allocated to the direct cost base.

The Process for Setting Indirect Cost Rates

A majority of BIA's and IHS' contract support costs are administrative and other overhead expenses, and both agencies use indirect cost rates to calculate a tribe's allowable indirect costs. The indirect cost rates can range from single to triple digit percentages, depending on such factors as the type and the size of the direct cost base used in calculating the indirect rate. For example, a tribe using a direct cost base that includes only salaries and wages can have a rate of 72 percent, while a tribe using a direct cost base that includes total direct costs can have a rate of 14 percent. Tribes develop their indirect cost rates following federal guidelines set out in OMB's circulars and HHS' guidance, and negotiating with the responsible—or cognizant—federal agency. The process of establishing an indirect cost rate involves five steps:

1. The tribe develops a proposed rate for indirect costs.

2. The cognizant federal agency reviews the tribe's indirect cost rate proposal.

3. The tribe and the cognizant federal agency negotiate and approve the rate.

4. The funding agencies apply the indirect rate to the direct funds to calculate the indirect costs the tribe will receive for contracting the program.

5. Independent auditors reconcile and audit a tribe's expenditures. The process is repeated each year when a tribe submits a new proposal and its audited financial statements and supporting documents for review and negotiation with the cognizant agency.

Developing the Proposal for an Indirect Cost Rate

In the first step of the rate-setting process, a tribe develops a proposal that documents the composition of its indirect and direct costs and calculates the ratio of indirect to direct costs—the indirect rate. For example, a tribe might propose to have indirect costs of $200,000, consisting of financial and administrative services, and direct costs of $1 million, including a social services program costing $300,000, a law enforcement program costing $200,000, and a health program costing $500,000. The tribe would then propose an indirect cost rate of 20 percent ($200,000 ÷ $1,000,000 = 0.2). In preparing a proposal, a tribe follows the principles laid out in OMB's circular A-87 and a tribal organization follows OMB's circular A-122, and both follow corresponding guidance issued by HHS for these circulars. According to the circulars and guidance, this proposal should list the costs for each of the items in the direct cost base and the indirect cost pool based on the expenditures for each item in the previous fiscal year or on projected costs for the upcoming year.

Indirect rates vary by tribe, depending on the size of the indirect pool, the individual tribe's administrative make-up, and the type of direct base used to calculate the rate. For example, under the cost principles, one tribe can propose an indirect pool of $1 million and another tribe can propose an indirect pool of $100,000, as long as each tribe treats the costs consistently within its proposal. Also, under the cost principles, tribes can use a direct cost base composed of salaries and wages or composed of all total direct costs, excluding capital expenditures, subcontracts, and other large expenditures that can distort the base. For example, one tribe can propose an indirect rate of 50 percent and have a direct base that includes only salaries and wages of $80,000, while a second tribe can have an indirect rate of 20 percent and use a total direct base of about $200,000. In both cases, when the indirect rate is applied for funding purposes, the tribes each get indirect funds of $40,000.

Guidance on indirect cost rates describes the three ways they can be calculated, depending on which method a tribe chooses to estimate its costs and make adjustments for actual costs. The type of rate used most frequently by the tribes is a "fixed-carryforward" rate, which is a rate that is adjusted for any under- or overrecovery of funds in the prior year (usually 2 years because of the lag time in auditing and closing financial statements and accounts). An overrecovery occurs when a tribe spends less than it collected using its rate, and an underrecovery occurs when the tribe does not collect enough funds to pay for its costs. The adjustment to the rate is made as shown in Table II.1.

Table II.1: Examples of Overrecovery and Underrecovery Calculations for Fixed-Carryforward Indirect Cost Rates

	Overrecovery calculation	Underrecovery calculation
1998 proposal		
Direct cost base	$1,000,000	$1,000,000
Indirect cost pool	200,000	200,000
Indirect rate	20%	20%
1998 actual costs		
Direct cost base	1,000,000	1,000,000
Indirect cost pool	100,000	300,000
Indirect costs recovered	200,000	200,000
Overrecovery/ Underrecovery	100,000	100,000
2000 proposal		
Direct cost base	1,000,000	1,000,000
Indirect cost pool	200,000	200,000
Adjustment	- 100,000	+ 100,000
New indirect cost pool	100,000	300,000
Indirect rate	**10%**	**30%**

Note: These examples assume full recovery of proposed costs—this means that the tribes do not have any shortfall in funding. Some tribes use the fiscal year of October 1 to September 30, while others use a calendar year.

Source: GAO's analysis of data provided by tribes.

In the overrecovery example, a tribe proposed to spend $200,000 in indirect costs and received a rate of 20 percent, given its direct cost base of $1 million. However, the tribe only spent $100,000 in indirect costs during the year. Two years later, when the tribe applied to adjust its indirect rate, it continued to propose spending $200,000 in indirect costs.

However, because it had recovered $100,000 that it had not spent 2 years before, the proposal for $200,000 is reduced by this amount to reflect the actual amount to be recovered by charging the indirect rate. As a result, the adjusted indirect rate is only 10 percent, given the tribe's $1 million direct cost base. In contrast, had the tribe actually spent $300,000 and only recovered $200,000, it would have an underrecovery of $100,000 that would be added to the proposed indirect cost pool to bring it to $300,000. In this case, the tribe's indirect rate would be 30 percent ($300,000 ÷ $1,000,000 = 0.3), given its $1 million direct cost base.

Some tribes use "provisional-final" rates. Provisional-final rates are set twice, prior to the beginning of the year (provisional) and after the end of the year (final) when a tribe's actual costs are audited and a new indirect cost rate proposal is negotiated by the cognizant agency and the tribe. The final rate is issued with a new provisional rate, and any adjustments necessary in funding are made by the funding agency. The funding agency either collects overpayments of funds—if the provisional rate was higher than the final rate—or pays funds to the tribe—if the provisional rate was lower than the final rate. For example, if a tribe had a provisional rate of 20 percent and a direct program base of $1 million, then the tribe could have collected $200,000 for indirect costs. If the tribe's final rate went up to 25 percent and the tribe actually collected $200,000 using its 20 percent rate, then the tribe would be entitled to receive $50,000 more from the funding agency. However, because this adjustment generally does not happen until at least 6 months after the fiscal year has ended, the agencies do not have funding to provide in situations such as these.

Few tribes use a predetermined rate. Whereas the previous two ways of establishing an indirect cost rate involve making adjustments for actual costs, the predetermined rate is established by using a fixed amount of indirect costs based on estimated costs. Any differences between the actual and estimated costs—either positive or negative—are absorbed by the tribe. For example, if a tribe has a predetermined rate of 20 percent and a direct base of $1 million, the tribe will receive $200,000 in indirect costs and no adjustments to this amount of funding will be made.[4]

Reviewing the Proposal

In the second step of the rate-setting process, the cognizant agency reviews the proposal, makes adjustments to it, and verifies or calculates the rate. The Department of the Interior, the cognizant agency for Indian tribal governments, has delegated the task of negotiating rates to its Office

[4]In each example of an indirect cost rate calculation, we assume full funding of indirect costs.

of Inspector General. Of the 556 tribes recognized by the federal government as of December 1998, about 350 negotiate their indirect rates with Interior's Office of Inspector General.[5] A handful of tribes and about 50 tribal organizations that receive the majority of their funding from HHS negotiate their indirect rates with its Division of Cost Allocation. Still other tribes do not have a rate or are part of a larger group that has a rate. In California, for example, several rancherias have not established indirect rates and do not receive indirect funds from BIA.[6] The responsibility for getting a rate and seeking funding based on that rate lies with the tribes, not the federal agencies, and agency officials stated that these rancherias have not sought funding, nor provided rates to receive funding for which they are eligible. In Alaska, many of the over 200 communities and groups fall under organizations that provide services to Native Alaskans. These organizations have indirect rates rather than the communities and groups.

To prepare for negotiating an indirect cost rate, both Interior's Office of Inspector General and HHS' Division of Cost Allocation review the items in each proposal and make revisions according to OMB's circulars A-87 and A-122 and HHS' guidance. The circulars and guidance state that allowable costs must be, among other things, necessary and reasonable for the proper and efficient performance and administration of contracts and must be allocable to federal contracts. Reasonable costs, generally, do not exceed that which would be incurred by a prudent person and should be the types of costs recognized as ordinary and necessary to operate the tribal government or perform the contract.

The reviewing agency, either Interior's Office of Inspector General or HHS' Division of Cost Allocation, determines whether or not the costs are allowed based on the reviewer's judgment about whether the costs appear reasonable. Officials from both the Office of Inspector General and the Division of Cost Allocation stated that determining the reasonability of costs is difficult because the decision often comes down to what the tribe says that it needs to manage its contracts. The reviewers attempt to use expenditures from prior years as a benchmark. For example, an Office of Inspector General official stated that a typical review would verify proposed salaries against salaries in the surrounding area and salaries paid in prior years by the same tribe, if available.

If a tribe uses a fixed-carryforward rate, the Office of Inspector General takes the extra step, at this point, to verify the tribe's carryforward

[5]The Office of Inspector General also negotiates indirect cost rates for tribal organizations that receive the majority of their funding from the Department of the Interior.

[6]Rancherias refer to some Indian lands and communities in California.

calculation, or the Office of Inspector General will perform the rate calculation if the tribe requests it. The reviewers first compare the costs in the proposed direct base and indirect pool with expenses from 2 years ago that are reported in the audited financial statement and supporting documents. Then, the reviewers use the amount of expenses in the audited financial statements and supporting documents to calculate the amount of indirect expenditures for BIA, IHS, and other contracts, separately. As part of this analysis, the Office of Inspector General identifies shortfall funding—funding that has not been paid by agencies for contract support costs—or surplus funding—funding that is above what the agency owed the tribe.

Negotiating the Indirect Cost Rate

After the cognizant agency has reviewed and adjusted a tribe's proposal for an indirect cost rate, the tribe and the agency negotiate the final indirect rate. These negotiations center on the reasonableness of the tribe's proposed direct base and indirect pool, and the agency's proposed adjustments to these costs. For example, the agency and the tribe may disagree on what programs are included in the direct cost base for the rate. Or, the two parties may disagree on the amount in salaries the tribe proposes to pay. For example, Office of Inspector General officials stated that they use local pay scales to compare with a tribe's salaries, but tribes justify higher salaries with the fact that reservations are usually more rural and remote than local communities and they need to pay higher salaries to attract qualified personnel. During these negotiations, the agency can request supporting information from the tribe. For example, auditors in the Office of Inspector General have requested floor plans and studies from tribes to determine the appropriate allocation of space and rent to programs. They have also requested time studies for managers whose time is being allocated to different programs. Ultimately, while the agency can request additional supporting documentation, the agency cannot reject costs or items that it cannot prove are unreasonable.

Once the cognizant agency and the tribe agree on and approve a rate, the agency issues to the tribe a notice of the results of the rate negotiation. The notice includes the rate, the type of direct base used to calculate that rate, and any exclusions from this base. Exclusions can be passthrough funds, such as general assistance funds or scholarships, or subcontracting amounts. The notice identifies these funds as having been removed from the direct base, which means they cannot be included in the base for funding purposes.

Applying the Indirect Cost Rate

Once an indirect cost rate is established, a tribe provides it to the various federal agencies, such as BIA and IHS, for use in calculating annual funding. Each year, contracting officers with BIA and IHS apply a tribe's indirect rate to its direct funding base to calculate the amount of indirect funding that tribe should receive. In the last several years, funding has fallen short of the amounts identified as required by the agencies. Both agencies use the amount of indirect funding required for each tribe in shortfall calculations. For BIA, the shortfall computation involves, on an annual basis, comparing each tribe's allowable indirect costs with the tribe's actual funding. For IHS, the computation of shortfall involves comparing total allowable contract support cost—both direct and indirect—with funds provided for the fiscal year.

Auditing and Reconciling Indirect Costs

The final step in the rate-setting process is the audit and reconciliation of a tribe's expenditures. As recipients of federal funding, tribes are required by the Single Audit Act of 1984, as amended, to have audited financial statements. The act also requires that the statement include a schedule of federal financial assistance to the tribe. OMB circulars A-87 and A-122 and the corresponding guidance issued by HHS require that the financial statements be submitted with the tribe's indirect cost proposal. Once a tribe has its audited financial statement, including supporting documents, and its proposed indirect pool, it submits them to Interior's Office of Inspector General or HHS' Division of Cost Allocation to begin the process of negotiating a new rate. If a tribe does not have a current indirect cost rate, the funding agencies continue to use the last approved rate.

BIA's and IHS' Funding of Contract Support Costs

BIA and IHS have different ways of allocating contract support funding, and, as a result, allocating any funding shortfalls that may exist. Congressional direction to BIA was to treat the tribes equally in the distribution of funds if there is a shortfall. Because no similar language has been provided in IHS' appropriations, it has continued to distribute funds on a historical basis for tribes with existing contracts, while BIA prorates funding for tribes with existing contracts. Both BIA and IHS distribute funding to tribes with new or expanded contracts on a first-come, first-served basis.

Bureau of Indian Affairs

Each year, BIA identifies the amount of funds each tribe with existing contracts should receive for contract support costs by applying each tribe's indirect cost rate to its direct funding base for BIA's programs. Between fiscal years 1989 and 1993, BIA was generally able to fully fund each tribe's contract support costs through a combination of appropriations and reprogrammings. Since fiscal year 1994, however, BIA's appropriations for contract support costs have been capped and reprogramming for this purpose has been prohibited. Since then, BIA has only been able to fund between 77 percent to 92 percent, annually, of a tribe's contract support costs.

As soon as possible after the beginning of each fiscal year, BIA allocates about 75 percent of its contract support funds to tribes. Toward the end of the fiscal year, it makes a second distribution of funds based on their indirect costs, which are calculated by using their indirect cost rates. BIA prorates its available contract support funding evenly across all tribes with ongoing contracts. For example, for fiscal year 1998, BIA's contract support funding was prorated at about 80 percent of the allowable costs for each tribe. Beginning with fiscal year 1994, BIA has published annual notices in the Federal Register on the distribution of contract support funds.

Since fiscal year 1995, when BIA established a separate Indian Self-Determination fund, the agency has provided 100 percent funding for contract support costs for new and expanded contracts during their first year. This fund, which is separate from other contract support funds, enables BIA to assist new or expanding contractors with funding, including startup costs, without decreasing the funding for ongoing contracts. In the second year of a contract, it is grouped with all the other ongoing contracts and receives a reduced prorated share of contract support funding for ongoing contracts. Table III.1 shows the funding history for BIA's Indian Self-Determination fund.

Table III.1: BIA's Indian Self-Determination Fund, Fiscal Years 1995 Through 1999

	Fiscal year				
	1995	**1996**	**1997**	**1998**	**1999**
Appropriation	$7,486,000	$4,967,431	$5,000,000	$5,000,000	$0
Carryover balance from prior fiscal year	0	562,641	1,103,392	1,415,644	1,877,406
Total available	**$7,486,000**	**$5,530,072**	**$6,103,392**	**$6,415,644**	**$1,877,406**
Funds obligated	6,923,359	4,426,680	4,687,748	4,538,238	[a]
Carryover balance to next fiscal year	**$562,641**	**$1,103,392**	**$1,415,644**	**$1,877,406**	[a]

[a]As of April 1, 1999, no funds had been obligated from the Indian Self-Determination fund for fiscal year 1999; therefore the entire $1,877,406 remains available.

Source: GAO's analysis of BIA's data.

In fiscal year 1999, no Indian Self-Determination funds for new and expanded contracts were provided because the Congress imposed a 1-year moratorium on any new contracting. In its fiscal year 2000 budget request, BIA is requesting $5 million to continue the Indian Self-Determination fund.

Indian Health Service

Like BIA, IHS identifies the amount of contract support funds a tribe should receive each year for ongoing contracts and pays 100 percent of contract support funding required for a new or expanded contract. IHS calculates the amount of contract support costs for ongoing contracts by adding a tribe's direct contract support costs to the indirect costs required. IHS calculates the amount of direct contract support cost funding—which can be provided for workers' compensation, unemployment taxes, retirement benefits, and special training—using a tribe's estimates of what these items will cost. These are all functions that IHS has determined the tribes do to manage contracts, but are not included in the direct program funding they receive. IHS area offices have discretion to negotiate these costs as part of the overall contract negotiation, and the actual costs that are included in this category vary accordingly. IHS calculates allowable indirect costs by multiplying a tribe's indirect cost rate by its direct cost base for its IHS programs.

Unlike BIA, IHS does not prorate the amount of contract support funding available to each tribe after the first year of a contract. IHS places its

emphasis on maintaining stable funding and provides ongoing contracts with the same direct and indirect contract support funds annually unless a tribe's requirements have decreased to such an extent that the amount of funding for indirect costs should be reduced.[1] A tribe's contract support costs for an ongoing contract may also increase if, for example, its indirect cost rate increases. However, if additional funds are not available, the tribe would not get an increase in contract support funds, thus creating a shortfall for "ongoing contracts."

In fiscal year 1988, IHS created its Indian Self-Determination fund, from which the agency paid for the costs of new and expanded contracts. Initially, the Congress appropriated $2.5 million for the fund, but from fiscal years 1994 through 1998, the annual amount appropriated was $7.5 million. Since about 1991, however, the funding has been insufficient to pay for 100 percent of the contract support costs for any given year. To deal with this funding shortfall for new and expanded contracts, IHS created a waiting list to track which new and expanded contract is next in line for contract support funds. Since 1995, IHS has referred to this waiting list as the "Indian Self-Determination queue." Tribes on the queue waiting for contract support costs may choose to begin a contract without the funding, or they may defer beginning a contract until contract support funds are available. The wait for these funds can take several years.

As a result of IHS' distribution methods for ongoing contracts and contracts on the queue, the overall contract support funds a tribe receives from IHS may range from zero (if all a tribe's contracts are on the queue) to 100 percent. IHS' total shortfall for fiscal year 1998 was about $70 million. In fiscal year 1999, the Congress appropriated a $35 million increase in IHS contract support funds to cover some of the agency's shortfall. IHS is currently working on a policy for distributing these funds; it is considering using the $35 million to increase tribes' funding to at least 70 percent of their contract support costs for IHS' programs.

[1]In 1992, IHS changed its contract support cost policy to pay indirect costs based on a tribe's annual indirect rates. Prior to this change, some IHS area offices had been paying the same amount of indirect costs to tribes each year, regardless of changes in their indirect rates. To allow for a transition to the new way of providing indirect funds, IHS allowed tribes in these areas to get the same amount of indirect costs if their rates decreased, and paid the difference if their rates increased.

Tribes and Tribal Organizations Contacted

During the course of this review, we communicated with 94 tribes and tribal organizations about contracting under the Indian Self-Determination Act. Representatives of 77 tribes and tribal organizations attended one or more of the various open forums we held, two in conjunction with large Indian conferences and four others in conjunction with our visits to BIA and IHS offices. In addition, 42 tribes and tribal organizations (including 17 that had not attended one of the forums) submitted documents, such as letters, financial statements, and other financial or budgetary documents, demonstrating the effects of shortfalls in contract support funding.

Not all of the representatives who attended one of the forums spoke about the effects of shortfalls or the methods used to cope with them. In many cases, however, representatives indicated—through nods or other expressions of agreement—that they shared the experiences or observations of other representatives. Thus, although we gained a good understanding about the types of concerns tribal representatives generally shared regarding shortfalls in contract support funding and the types of methods that were typically used to cope with shortfalls, we cannot definitively say how many of the tribes represented at the forums were affected by shortfalls, nor can we report which or how many methods each of them used to cope with shortfalls. Similarly, not every one of the documents submitted to us addressed each of the ways a tribe had been affected by shortfalls or each of the various methods that a tribe had used to deal with shortfalls. When we invited tribes to submit documents, we did not specify a particular format, nor did we use a questionnaire or other data collection instrument to gather information. Therefore, the documents we received varied in length, type, and content.

Following are the names of the 74 tribes and the 20 tribal organizations that were represented at one or more of the open forums or submitted documents to GAO.

Tribes

Akiachak Native Community, Alaska
Apache Tribe of Oklahoma
Blackfeet Tribe of the Blackfeet Indian Reservation of Montana
Cabazon Band of Cahuilla Mission Indians of the Cabozon Reservation, California
Cherokee Nation of Oklahoma
Cheyenne-Arapaho Tribes of Oklahoma
Chicasaw Nation, Oklahoma
Chippewa-Cree Indians of the Rocky Boy's Reservation, Montana
Citizen Potawatomi Nation, Oklahoma
Confederated Tribes of the Grand Ronde Community of Oregon
Confederated Tribes of the Siletz Reservation, Oregon
Confederated Tribes of the Umatilla Reservation, Oregon
Delaware Tribe of Indians, Oklahoma
Delaware Tribe of Western Oklahoma
Ely Shoshone Tribe of Nevada
Fort Sill Apache Tribe of Oklahoma
Gila River Indian Community of the Gila River Indian Reservation, Arizona
Hoonah Indian Association, Alaska
Jamestown S'Klallam Tribe of Washington
Jicarilla Apache Tribe of the Jicarilla Apache Indian Reservation, New Mexico
Organized Village of Kake, Alaska
Karuk Tribe of California
Kaw Nation, Oklahoma
Kenaitze Indian Tribe, Alaska
Kickapoo Tribe of Oklahoma
Kiowa Indian Tribe of Oklahoma
Lac Courte Oreilles Band of Lake Superior Chippewa Indians of the Lac Courte Oreilles Reservation of Wisconsin
Leech Lake Band of the Minnesota Chippewa Tribe, Minnesota
Lumbee-Cheraw Tribe of North Carolina (not a federally recognized tribe)
Lummi Tribe of the Lummi Reservation, Washington
Menominee Indian Tribe of Wisconsin
Metlakatla Indian Community, Annette Island Reserve, Alaska
Miccosukee Tribe of Indians of Florida
Mille Lacs Band of the Minnesota Chippewa Tribe, Minnesota
Muscogee (Creek) Nation, Oklahoma
Native Village of Barrow Inupiat Traditional Government, Alaska
Navajo Nation of Arizona, New Mexico and Utah
Northern Cheyenne Tribe of the Northern Cheyenne Indian Reservation, Montana

Oneida Nation of New York
Paiute-Shoshone Tribe of the Fallon Reservation and Colony, Nevada
Penobscot Tribe of Maine
Pinoleville Rancheria of Pomo Indians of California
Poarch Band of Creek Indians of Alabama
Port Gamble Indian Community of the Port Gamble Reservation, Washington
Prairie Band of Potawatomi Indians, Kansas
Pueblo of Acoma, New Mexico
Pueblo of Isleta, New Mexico
Pueblo of Jemez, New Mexico
Pueblo of Laguna, New Mexico
Pueblo of Pojoaque, New Mexico
Pueblo of San Juan, New Mexico
Pueblo of Sandia, New Mexico
Pueblo of Santo Domingo, New Mexico
Pueblo of Taos, New Mexico
Quinault Tribe of the Quinault Reservation, Washington
Ramah Navajo Chapter, New Mexico
Reno-Sparks Indian Colony, Nevada
Sac & Fox Nation, Oklahoma
Seneca Nation of New York
Shoalwater Bay Tribe of the Shoalwater Bay Indian Reservation, Washington
Shoshone-Bannock Tribes of the Fort Hall Reservation of Idaho
Shoshone-Paiute Tribes of the Duck Valley Reservation, Nevada
Skokomish Indian Tribe of the Skokomish Reservation, Washington
St. Croix Chippewa Indians of Wisconsin, St. Croix Reservation
Saint Regis Band of Mohawk Indians of New York
Suquamish Indian Tribe of the Port Madison Reservation, Washington
Three Affiliated Tribes of the Fort Berthold Reservation, North Dakota
Tohono O'odham Nation of Arizona
Turtle Mountain Band of Chippewa Indians of North Dakota
Valdez Native Tribe, Alaska (not a federally recognized tribe)
Walker River Paiute Tribe of the Walker River Reservation, Nevada
Wichita and Affiliated Tribes (Wichita, Keechi, Waco & Tawakonie), Oklahoma
Yurok Tribe of the Yurok Reservation, California
Zuni Tribe of the Zuni Reservation, New Mexico

Tribal Organizations

Alamo Navajo School Board, New Mexico
Alaska Native Tribal Health Consortium, Alaska
Albuquerque Area Indian Health Board, Inc., New Mexico
All Indian Pueblo Council, Inc., New Mexico
California Rural Indian Health Board, Inc., California
Eastern Aleutian Tribes, Inc., Alaska
Eight Northern Indian Pueblos Council, Inc., New Mexico
Five Sandoval Indian Pueblos, Inc., New Mexico
Gila River Health Care Corporation, Arizona
Great Lakes Indian Fish & Wildlife Commission, Wisconsin
Laguna Service Center, New Mexico
Lassen Indian Health Center, California
Maniilaq Association, Alaska
Multi-County Youth Services, Oklahoma
Norton Sound Health Corporation, Alaska
Ramah Navajo School Board, Inc., New Mexico
Southeast Alaska Regional Health Consortium, Alaska
United South & Eastern Tribes, Inc., Tennessee
United Tribes Technical College, North Dakota
Yukon-Kuskokwim Health Corporation, Alaska

Comments From the Department of the Interior

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, D.C. 20240

MAY 27 1999

Mr. Victor S. Rezendes
Director, Energy, Resources, and Science Issues
Resources, Community, and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Rezendes:

The Department of the Interior has reviewed the U.S. General Accounting Office's draft audit report entitled "Indian Self-Determination Act: Shortfalls in Indian Contract Support Costs Need to Be Addressed" (GAO/RCED-99-150). Our comments to the report recommendations are provided in the enclosure.

We appreciate receiving GAO's comments and observations on the important subject of contract support costs for the Indian Self-Determination Program. As you may know, both the National Congress of American Indians and the Tribal/Bureau of Indian Affairs Workgroup on Tribal Needs Assessment have also studied this topic and expect to issue reports during the coming months. The Assistant Secretary - Indian Affairs intends to use the results of each of these efforts in preparing a proposal to address this perplexing problem that has existed since the Indian Self-Determination and Education Assistance Act was enacted in 1975.

We appreciate the opportunity to review and comment on this draft GAO report.

Sincerely,

John Berry
for Assistant Secretary
Policy, Management and Budget

Enclosure

U.S. Department of the Interior
Comments on Draft General Accounting Office Report, entitled
"Indian Self Determination Act- Shortfalls in Indian Contract Support Costs Need to Be Addressed" - (No. GAO/RCED-99-150)

Recommendation 1: **That the Secretaries of the Interior and of Health and Human Services ensure that the heads of BIA and IHS work together, and with the Congress and the tribes, to coordinate their current practices and policies governing the payment of direct contract support costs and to help ensure that the payment of these costs is consistent between the two agencies.**

As noted in the draft report, the Department is considering the payment of direct contract support funding. The forthcoming Federal Register announcement on Fiscal Year 2000 Contract Support Costs (which is expected to be published shortly after enactment of the FY 2000 appropriations bill for BIA), will include the Bureau of Indian Affairs' definition of direct contract support, and stipulate that tribal requests for payment of direct contract support will be accepted. However, differences in the budget structures for BIA and IHS may continue to make consistency difficult. For example, the draft report notes that the IHS includes in its direct contract support payment amounts for equipment repairs and replacement and special training costs. Within BIA, however, these costs are generally borne within the individual program budgets that the tribes receive when they contract. BIA will strive to improve the degree of consistency with the methods used by IHS. Decisions regarding the outcome, however, will require input from both the Office of Management and Budget and the Congress.

Recommendation 2: **That the Secretaries of the Interior and Health and Human Services direct the heads of the BIA and IHS to ensure that the agencies are making the correct adjustments when using provisional-final indirect cost rates.**

The Bureau of Indian Affairs believes that it is unlikely that any overpayments have occurred because of the BIA's inability to fully fund tribes' indirect costs. Further, the only funds available to pay higher rates would be unobligated contract support fund balances from that prior period or amounts collected from tribes whose final rate was lower than the provisional rate. However, BIA will remind bureau awarding officials of the need to compute the contract support funds due after the final indirect cost rate has been established.

Recommendation #3: **That the Secretary of the Interior Move the Indirect Cost Rate -Setting Function Out of the Office of the Inspector General and Place the Function in a Separate Office.**

Since 1976, the Department's Office of the Inspector General and its predecessor organizations have been negotiating indirect cost rates for Indian tribal and Insular Area governments, as well as State and non-profit organizations which receive funds from the Department.

See comment 1.

The *Separation of Duties* standard described in the Comptroller General's *Standards for Internal Controls in the Federal Government* explicitly states that:

> " Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be **separated among individuals.**"
> (Emphasis added)

From inception in 1976, the Office of the Inspector General has fastidiously adhered to this fundamental precept of internal control by using a fully dedicated team of cost specialists for indirect cost rate negotiation *who are not involved in other OIG audits or reviews.*

See comment 2.

Equally important, the OIG generally does not conduct audits of the tribes or other grantees. Under the provisions of the Single Audit Act, certified public accountants from the private sector audit the expenditure of Federal funds by grantees and Indian tribes. When an occasional need arises for the OIG to conduct audits relating to overhead rates (such as a close-out of a construction contract), the OIG would typically arrange to have these audits performed by the Defense Contract Audit Agency (DCAA). In short, the existing OIG arrangement for establishing indirect cost rates for a variety of programmatic applications has, in the past, proven to be a cost effective means for performing these necessary functions.

Notwithstanding these considerations, the final outcome of the *Ramah Navajo Chapter v. Babbitt* lawsuit will likely impact the methods used by the Department for negotiating future rates. On May 8, 1997, the Tenth Circuit Court of Appeals ruled in *Ramah* that the method used to negotiate indirect costs by the Department violated the Indian Self-Determination and Education Assistance Act (Public Law 93-638), as amended. As a result of the *Ramah* decision, the Department will very likely change either the method for negotiating indirect costs, or develop a different system for estimating contract support.

The Assistant Secretary for Indian Affairs and the National Congress of American Indians are currently preparing recommendations for changes to the system for determining contract support. Until a decision on this issue is reached, the District Court has authorized only the "continued negotiation of indirect cost rates under the system in place prior to the Tenth Circuit decision". (Civil No. 90-0957, Order of District Court for the District of New Mexico, November 4, 1997.)

Furthermore, before any process changes are implemented, the Department would consult with tribal governments, in accordance with the President's Memorandum for the Heads of Executive Departments and Agencies, dated April 29, 1994. The Memorandum requires Executive Departments and agencies to "consult, to the greatest extent practicable and to the extent permitted by law, with tribal governments prior to taking actions that affect federally recognized tribal governments."

GAO's Comments

1. In response to a recommendation in our draft report that the Secretary of the Interior remove the function of indirect rate negotiation from the Office of Inspector General, Interior commented that the Inspector General's office has fastidiously adhered to the separation of duties by using a fully dedicated team of cost specialists for negotiating indirect cost rates who are not involved in other audits or reviews. Interior commented that when an occasional need arises for the Office of Inspector General to conduct audits relating to indirect cost rates, the office would typically arrange to have these audits performed by the Defense Contract Audit Agency. In separate comments, however, the Department's Office of Inspector General agreed with this recommendation in our draft report (see app. VI). We believe that the Office of Inspector General's staff, as part of the audit arm of the Department, should be available to conduct audits of tribes and tribal organizations and their use of federal funds, as appropriate. We continue to have concerns about the Inspector General's role in negotiating indirect cost rates and plan to review the issue in more depth in a separate study, which will take into account the differences in the responses to our draft report, the legislative history of the Inspector General Act, generally accepted auditing standards, and any other pertinent guidance. As a result, we are not making the recommendation to remove the rate negotiation function from the Inspector General's Office at this time.

2. We agree that moving the responsibility for negotiation of indirect cost rates out of the Office of Inspector General at the present time may require the approval of the District Court under the Ramah Navajo Chapter v. Lujan case. For the reasons discussed in our first comment, we are not making the recommendation to move this function at this time.

Comments From the Department of the Interior's Office of Inspector General

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAY 25 1999

Mr. Victor S. Rezendes
Director, Energy, Resources, and Science Issues
Resources, Community, and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Subject: U.S. General Accounting Office Draft Report "Indian Self-Determination Act - Shortfalls in Indian Contract Support Costs Need to Be Addressed" (No. GAO/RCED-99-150)

Dear Mr. Rezendes:

This letter presents our comments on the findings and recommendation in the subject draft report that are applicable to the operations of the Office of Inspector General.

See comment 1.

We agree with the recommendation that the Secretary of the Interior should "move the indirect cost rate-setting function out of the Office of Inspector General and place the function in a separate office." We strongly believe that negotiating indirect cost rates is not appropriate for our office because it places us in a position of making program-related decisions about which costs to fund and because it incorrectly places the performance and the audit of the function in the same office. Our other comments on the report are presented in the paragraphs that follow.

Inconsistencies in How Contract Support Costs Are Calculated

Now on pp. 8, 46, and 48.

The report (pages 7, 43, and 45) states that the two Office of Inspector General regional offices calculate indirect cost rates differently. The statement implies that the rate calculations are and have been entirely different. A more accurate statement is that the two field offices calculate the carry-forward amount differently for fixed rates with a carry-forward provision. In addition, the report should specify that the difference in the carry-forward computation did not occur until about 1992, which was after we had developed standard exhibits for the rate negotiation agreements. The purpose of the exhibits was to demonstrate how the carry-forward and indirect cost shortfall calculations were made subsequent to the 1988 amendment to the Indian Self-Determination and Education Assistance Act (Public Law 93-638), which eliminated the theoretical overrecovery adjustment.

The report (page 8) states that "the tribes and the government are engaged in efforts to reach agreement on appropriate method for calculating indirect costs." The term "indirect costs" should be changed to "contract support costs." Neither the National Congress of American Indians nor the Assistant Secretary for Indian Affairs is studying different ways to compute

indirect cost rates. They are studying different ways to determine contract support, which, according to the National Congress of American Indians, includes start-up costs, indirect costs, and direct contract support costs.

Table1.1: Definitions and Examples, by Category, of Contract Support Costs

Now page 18.
See comment 2.

The examples of indirect costs in the table (page 14) include "office services, utilities, janitorial services, building and grounds maintenance, and insurance." We request that those examples of facility-related costs be deleted. According to Office of Management and Budget Circular A-87, there is no universal rule for classifying certain costs as either direct or indirect under every accounting system. In that regard, costs associated with facilities can be identified as a direct cost to a contracted program based on square footage or because the facility, such as a hospital, clinic, detention center, or school, is financed by a single contract. Under Bureau of Indian Affairs contracts, there is an incentive for organizations to shift facilities costs from the direct cost base to the indirect cost pool so that the costs are funded with contract support instead of program dollars. We believe that the examples may be used by organizations as support for shifting these costs.

Mechanics of Funding Self-Determination Contracts

Now on page 20.

Footnote 5 (page 16) states:

> The court concluded that the Department of the Interior had not paid the indirect costs associated with tribes' contracts with BIA [Bureau of Indian Affairs]. The parties in the case are currently working to finalize a $76 million settlement to settle these claims for 1989 through 1993.

The statements indicate that the $76 million proposed settlement is for "contracts with BIA." However, the proposed settlement is not for contracts with the Bureau of Indian Affairs but for contracts from other Federal agencies, such as the Departments of Labor, Education, Agriculture, and Health and Human Services (excluding the Indian Health Service). The proposed settlement did not include the Bureau of Indian Affairs because of the "caps" issue. To clarify this matter, the initial statement should be changed to read as follows: "The court concluded that the Department of the Interior had not paid the indirect costs associated with tribes' Public Law 93-638 contracts."

Footnote 5 also states that working groups are attempting to "find an acceptable methodology to calculate indirect cost rates in situations involving other federal and state programs." The statement should be changed to read as follows: ". . . find an acceptable methodology to calculate contract support costs."

Tribes Are Contracting More, and Their Indirect Cost Pools Have Increased

Now page 31.

The report (page 26) states that "many of the elements included in indirect cost pools are fixed and therefore should not increase proportionally to the increases in direct cost bases." The word "generally" should be placed directly before the word "fixed" because although

many functions in the pool have the capacity to absorb increases in the direct cost base, they will eventually increase as the base increases, just not proportionally.

Now page 31.

The report (page 27) states, "For example, a tribe's council expenses included in the indirect cost pool are generally fixed; . . ." We suggest that this example be deleted because of issues concerning the placement of council costs in the indirect cost pool under a single rate mechanism. Under the 1994 amendments to Public Law 93-638, expenses of a tribal council are allowable "to the extent that the expenditure of the funds is supportive of a contracted program." However, tribal council expenses are not an allowable cost under Federal contracts and grants that are not awarded pursuant to Public Law 93-638 (see Office of Management and Budget Circular A-87, Attachment B, Item 23). Therefore, under a single indirect cost rate (which most Indian tribes use), tribal council costs cannot be included in the indirect cost pool because this would allocate council costs to all Federal contracts in the direct cost base. We are currently working with Indian organizations to resolve this matter.

Inconsistencies in the Administration of Contract Support Costs

Now page 49.

The report (page 46) states, "Although the Western Region's method is intended to help tribes, it is contrary to Interior's legal opinions." The Western Region's method was not used for the express purpose of helping tribes but resulted from a misinterpretation of Office of Inspector General internal guidance implementing the legal opinions. Therefore, we suggest that the statement be changed to read as follows: "Although the Western Region's method helps tribes, it is contrary to Interior's legal opinions."

Now page 49.

The report (page 46) states:

> The use of the old method will continue until court approval of another methodology. According to the Office of Inspector General, until that has been accomplished, it cannot take independent action to standardize its two regions' processes.

The statement should be changed to read as follows:

> Subsequently, the District Court entered an order allowing the resumption of the indirect cost rate negotiations for fiscal year 1998 "under the system in place prior to the Tenth Circuit decision" and in fiscal 1999 using "the existing indirect cost rate system." According to the Office of General Counsel, Office of Inspector General, the orders prevent the Office from changing the process without the approval of the District Court.

Attachment is not included.

We have attached the orders of the District Court.

Rate-Setting Function Is Inappropriate for Interior's Office of Inspector General

Now page 50.

The report (page 47) states, "In 1986, the Office of Management and Budget designated the Department of the Interior as the cognizant agency for developing of indirect cost rates for

tribes." We agree with the statement; however, the statement should be amplified to indicate that the Office of Inspector General and its predecessor organizations have been negotiating indirect cost rates with Indian tribes since 1976.

Federal Cost Principles for Indian Tribal Governments and Organizations

Now page 73.

The report (page 67) states, "Typical indirect costs may include computer services, transportation, accounting, personnel administration, purchasing, depreciation on buildings and equipment, and operation and maintenance of facilities." We suggest that the reference to "depreciation on buildings and equipment, and operation and maintenance of facilities" be deleted from the sentence for the reasons stated in our comments applicable to page 26 of the report (see section titled "Tribes Are Contracting More, and Their Indirect Cost Pools Have Increased").

Now page 31.
See comment 2.

If you have any questions about our comments, please contact Mr. Roger La Rouche, Director of External Audits and Special Projects, at (202) 208-5520.

Sincerely,

Robert J. Williams
Assistant Inspector General
for Audits

Attachment

cc: Assistant Secretary for Indian Affairs
Focus Leader, Management Control and Audit Followup

GAO's Comments

1. As discussed in appendix V, we are not making the recommendation to move the function of negotiating indirect cost rates from Interior's Office of Inspector General at this time.

2. The Office of Inspector General requested that we remove "office services, utilities, janitorial services, building and grounds maintenance, and insurance" from the list of indirect costs in table 1.1 because there is no universal rule for classifying certain costs as either direct or indirect under every accounting system. We agree that this is the case, but instead of removing the items from the list—which could be misleading—we noted the lack of universal rules for accounting for direct and indirect costs in the indirect cost section of the table.

Comments From the Department of Health and Human Services

DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Washington, D.C. 20201

JUN - 9 1999

Mr. Victor S. Rezendes
Director, Energy, Resources,
and Science Issues
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Rezendes:

Enclosed are the Department's comments on your draft report entitled, "Indian Self-Determination Act: Shortfalls in Indian Contract Support Costs Need to Be Addressed." The comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

The Department appreciates the opportunity to comment on this draft report before its publication.

Sincerely,

June Gibbs Brown
Inspector General

Enclosure

The Office of Inspector General (OIG) is transmitting the Department's response to this draft report in our capacity as the Department's designated focal point and coordinator for General Accounting Office reports. The OIG has not conducted an independent assessment of these comments and therefore expresses no opinion on them.

COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES ON THE U.S. GENERAL ACCOUNTING OFFICE'S DRAFT REPORT, "INDIAN SELF-DETERMINATION ACT: SHORTFALLS IN INDIAN CONTRACT SUPPORT COSTS NEED TO BE ADDRESSED" (GAO/RCED-99-150)

General Comments

- The Department fully concurs with the two General Accounting Office (GAO) recommendations addressed to the Department.
- The Department is cognizant of the Fiscal Year (FY)1999 moratorium on all new contracting and compacting under Title I and Title III; however, the GAO report acknowledges the potential for future increases in contract support costs (CSC) but it is unclear as to how tribes currently under consideration for Federal recognition will be included. The Department recognizes that with the addition of more tribes, the funding shortfall would increase.

GAO Recommendation #1

We recommend that the Secretaries of the Interior and of Health and Human Services ensure that the heads of BIA and IHS work together, and with the Congress and the tribes, to coordinate their current practices and policies governing the payment of direct contract support costs and to help ensure that the payment of these costs is consistent between the two agencies.

Department Comment

We concur. The Department's Indian Health Service (IHS)CSC policies and practices have historically recognized and paid direct CSC. Consequently, there has been no need to change the existing practices and policies of the IHS in this regard. The IHS has met with the Bureau of Indian Affairs (BIA) recently to begin discussions to develop a uniform CSC policy. Further, the IHS has offered the BIA any assistance they may need with respect to direct CSC practices or policy issues.

The Department recommends the resolution of the inconsistent methodologies used by IHS and BIA in calculating payment for CSC. A consistent policy and methodology for calculating indirect cost rates and funding would eliminate the differences and reduce the confusion among the tribes.

GAO Recommendation #2

We also recommend that the Secretaries of the Interior and Health and Human Services direct the heads of the BIA and IHS to ensure that the agencies are making the correct adjustments when using

provisional-final indirect cost rates.

Department Comment

We concur. The IHS has directed its area office staff to make such adjustments. In a training session that will be scheduled for this summer, the IHS will note the GAO concerns and re-emphasize the need to make such adjustments.

The IHS and the tribes under the auspices of the Self-Governance Demonstration Project (Title III) have entered into CSC-based budgets; therefore, the recommendation for "adjustments" would not apply to Title III.

The Department recommends that IHS and BIA allow tribes any "overpayment" of indirect costs from one fiscal year to be carried forward and used to offset the CSC allocations for the next fiscal year.

GAO Recommendation #3

To ensure the independence of its review of Federal funds, we recommend that the Secretary of the Interior move the indirect cost rate-setting function out of the Office of Inspector General and place the function in a separate office.

Department Comment

No comment.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

In addition to those named above, Len Ellis, Dick Kasdan, and Pam Tumler made key contributions to this report.

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