



John Keel, CPA
State Auditor

An Audit Report on

Indirect Cost Recovery Funds at State General Academic Universities

August 2006
Report No. 06-058



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SAO Report No. 06-058
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Overall Conclusion

The State Auditor's Office could not determine whether state general academic universities budget indirect cost recovery funds in a manner that enables them to spend these funds in accordance with statutory requirements.

Texas Education Code, Chapter 145, requires universities to spend indirect cost recovery funds for specific types of projects to encourage further research at the level at which research was originally conducted (see text box for additional details). However, most universities do not identify specific revenue streams during their budgeting processes and, therefore, cannot identify the specific source of funds used to make specific research expenditures.

We conducted audit work at three universities: the University of Texas at Austin, Texas A&M University, and the University of Houston. We also surveyed 25 other universities. The results of that work, which are summarized in

Appendix 2 of this report, indicated that most universities pool all revenue sources and allocate their funds based on university-wide needs and predefined objectives. Universities reported that they have a large number of revenue streams, which (1) makes it impractical for them to budget each stream separately and (2) makes it impossible for them to determine the sources of the funds used to purchase any specific item.

The 3 universities we audited and the 25 others we surveyed reported that they received a total of approximately \$112 million in indirect cost recovery funds in fiscal year 2005. To hold universities accountable for the use of indirect cost recovery funds, the Legislature should consider requiring them to account separately for the uses of those funds. An alternative approach would be for the Legislature to consider using outcome measures as a way to ensure accountability for the use of those funds.

Background Information

The 78th Legislature (Regular Session) passed House Bill 1887, which amended Texas Education Code, Chapter 145. Effective beginning in fiscal year 2004, the change in statute:

- Allowed all "defined institutions" including general academic institutions, medical and dental schools, and other educational institutions, to retain 100 percent of indirect cost recovery funds.
- Provided general guidance on the research-related items that institutions could purchase with indirect cost recovery funds.

General academic universities had previously retained only 50 percent of the indirect cost recovery funds they earned, and the remaining 50 percent had to be returned to the State for appropriation.

See Appendix 3 of this report for an excerpt from Texas Education Code, Chapter 145.

Summary of Management's Responses

Responses from the three universities we audited are presented in Appendix 4.

Summary of Information Technology Review

At the three universities we audited, auditors reviewed the aspects of automated systems that were related to indirect cost recovery funds. We did not identify any reportable issues. These three universities use their automated accounting systems to calculate the amount of indirect cost recovery funds they earn. Our testing confirmed that these systems were properly calculating and posting indirect cost recovery fund amounts based on the provisions in the universities' grant agreements. We also tested these systems' access and data input rights that were related to indirect cost recovery calculation and did not identify any reportable issues.

Fifty-two percent of the other 25 universities surveyed reported that they use automated systems to calculate the amounts of indirect cost recovery funds they earn.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to:

- Review institutional budgets to determine whether indirect cost recovery funds are properly budgeted to ensure compliance with Texas Education Code, Chapter 145.
- Survey general academic universities to identify dollar amounts expended from indirect cost recovery monies and the purposes for which these monies were spent for fiscal years 2002 through 2005.

The scope of this audit covered indirect cost recovery funds earned, budgeted, and spent from fiscal year 2002 through fiscal year 2005.

The audit methodology consisted of performing on-site audits at the University of Texas at Austin, Texas A&M University, and the University of Houston. During these audits, we conducted interviews with management, tested various reporting systems, and tested compliance with indirect cost recovery fund provisions within federal grant agreements. We also conducted an online survey of 25 other general academic universities that reported indirect cost recovery expenditures to the Texas Higher Education Coordinating Board.

*An Audit Report on
Indirect Cost Recovery Funds at State General Academic Universities
SAO Report No. 06-058*

Recent SAO Work		
Number	Product Name	Release Date
06-001	An Audit Report on the Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium	September 2005

Contents

Detailed Results

Chapter 1	
Most Universities Do Not Identify Specific Revenue Streams During Their Budgeting Processes and, Therefore, Cannot Identify the Specific Source of Funds Used to Pay for Specific Research Expenditures	1
Chapter 2	
Overview of the Process Through Which Universities Earn Indirect Cost Recovery Funds.....	4

Appendices

Appendix 1	
Objectives, Scope, and Methodology.....	6
Appendix 2	
Summary of Survey Results	9
Appendix 3	
Excerpt from Texas Education Code, Chapter 145	11
Appendix 4	
Management's Responses from the University of Texas at Austin, Texas A&M University, and the University of Houston	13

Detailed Results

Chapter 1

Most Universities Do Not Identify Specific Revenue Streams During Their Budgeting Processes and, Therefore, Cannot Identify the Specific Source of Funds Used to Pay for Specific Research Expenditures

We conducted audit work at three universities--the University of Texas at Austin, Texas A &M University, and the University of Houston--and surveyed 25 other universities. The results of that work indicated that, during their budgeting processes, most universities pool all revenue sources and allocate their funds based on university-wide needs and predefined objectives (see text box for additional details).

Most Universities Pool All Revenue Sources

According to the results of our audits at 3 universities and survey of 25 other universities:

- Seventy-five percent of universities reported that they pool revenue amounts during their budgeting processes.
- Seventy-one percent of universities reported that they cannot determine which specific dollar of federal revenue paid for any specific expense.

Universities receive revenue from a variety of public, private, and local sources. In accordance with higher education standard accounting principles, they have the flexibility to combine and make transfers within and among accounts and funds that do not have legal, grantor, or donor restrictions.

After universities pool their revenues together, they allocate their budget resources based on university needs and predefined objectives as determined by management and the board of regents. Most universities cannot trace a specific dollar of revenue earned to the subsequent expenditure of that same dollar. This makes it very difficult to identify the exact expenditures that are made with the indirect cost recovery funds that universities earn.

Some universities maintain combination revenue and expenditure general ledger accounts or “cost centers” specifically for indirect cost funds. This approach provides a partial audit trail to follow when trying to identify the flow of indirect cost recovery funds through the universities’ accounting systems. However, this approach does not enable universities to track a specific dollar of revenue through the budgeting process to the final expenditure of that particular dollar.

Universities Reported They Spent Indirect Cost Recovery Funds on Allowable Items Specified in Statute

The 28 universities we audited or surveyed reported that they spent most of their indirect cost recovery funds on allowable items listed in Texas Education Code, Section 145.001 (c) (see Table 1 below). It is important to emphasize that universities *estimated* this information because the categories by which they track expenditures do not necessarily align with the allowable expenditure categories specified in statute.

Table 1

Percent of Indirect Cost Recovery Funds that 28 Universities Estimate They Spent Fiscal Years 2002 through 2005				
Allowable Expenditure Category Specified in Texas Education Code, Section 145.001 (c)	Percent of Indirect Cost Recovery Funds Spent in Allowable Expenditure Category			
	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005
Conducting pre-grant feasibility studies	2%	2%	1%	2%
Preparing competitive proposals for sponsored programs	5%	4%	4%	4%
Preparing carryover funding for research teams	0%	0%	0%	3%
Supporting new researchers pending external funding	4%	4%	2%	2%
Engaging in research programs of critical interest to the citizens of Texas	2%	2%	2%	2%
Purchasing capital equipment directly related to expanding the research capability of the institution	3%	3%	3%	3%
Research or project administrative costs	21%	21%	22%	22%
General research support	52%	53%	55%	52%
Totals^a	89%	89%	89%	90%

^a The totals in this table do not sum to 100 percent because the universities did not spend all of the indirect cost recovery funds they received within the same year in which they earned those funds.

Source: Unaudited information estimated by 28 universities.

The 3 universities we audited and the 25 others we surveyed reported that they received a total of approximately \$112 million in indirect cost recovery funds in fiscal year 2005. Table 2 presents the amounts each university received.

Table 2

Indirect Cost Recovery Funds Received by 28 Universities Fiscal Year 2005	
University	Amount of Indirect Cost Recovery Funds Received
The University of Texas at Austin*	\$58,921,402
University of Houston*	9,950,841
Texas A&M University*	9,596,969
The University of Texas at El Paso	5,967,593
The University of Texas at Dallas	4,620,000
Texas Tech University	4,493,661
The University of Texas at Arlington	3,886,364
The University of Texas at San Antonio	3,781,347
University of North Texas	1,750,415

Indirect Cost Recovery Funds Received by 28 Universities Fiscal Year 2005	
University	Amount of Indirect Cost Recovery Funds Received
Prairie View A & M University	1,434,287
The University of Texas - Pan American	1,293,186
The University of Texas at Brownsville	1,216,039
Texas State University- San Marcos	868,747
Texas A & M University Kingsville	853,434
Tarleton State University	532,598
Texas A & M University Corpus Christi	517,772
Sam Houston State University	512,049
Texas A & M University at Galveston	392,256
Lamar University - Beaumont	369,575
Stephen F. Austin State University	285,804
University of Houston - Clear Lake	228,000
Texas Woman's University	202,201
West Texas A & M University	199,759
Sul Ross State University	114,490
Texas A & M International University	85,017
The University of Texas at Tyler	60,209
The University of Texas of the Permian Basin	22,910
Texas A & M University - Commerce	5,031
Total	\$112,161,956
* These amounts are audited totals.	

Source: Information reported by 28 universities. Unless otherwise indicated, this information is unaudited.

Recommendation

To hold universities accountable for the use of indirect cost recovery funds, the Legislature should consider requiring them to account separately for the uses of those funds. An alternative approach would be for the Legislature to consider using outcome measures as a way to ensure accountability for the use of those funds.

Overview of the Process Through Which Universities Earn Indirect Cost Recovery Funds

Universities earn indirect cost recovery funds on certain research grant contracts as determined by the grant sponsor. The amount of indirect cost recovery funds received is based on the amount of direct research expenditures a university makes for each research project.

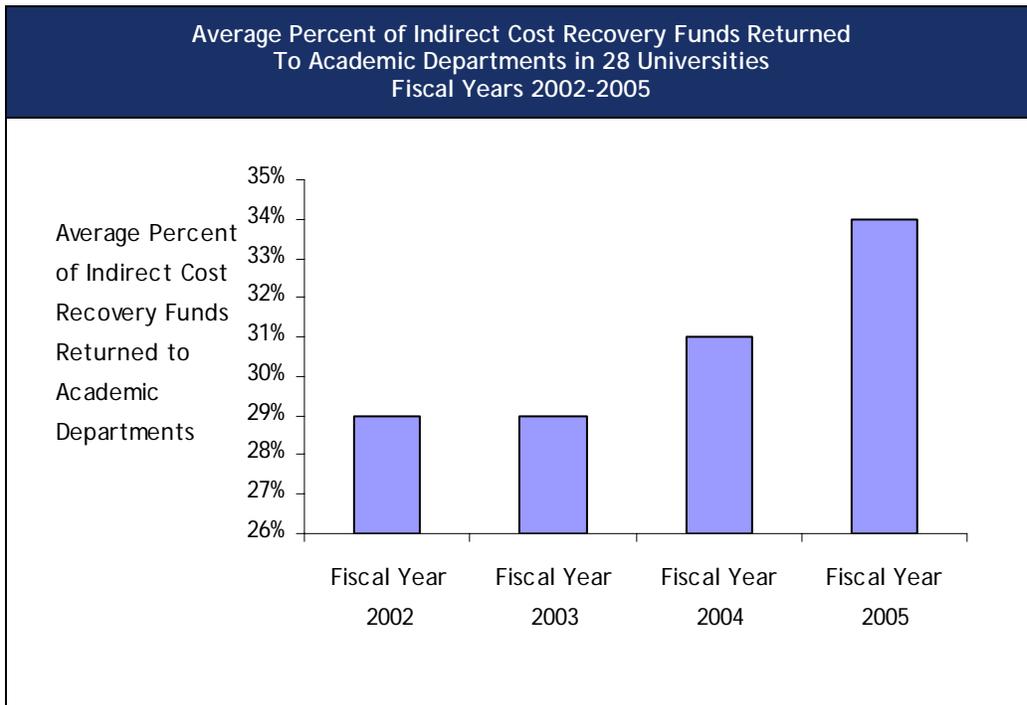
A university negotiates an indirect cost recovery rate with the grant sponsor prior to undertaking a research project. It then applies this “overhead” rate to all direct research expenditures for the project. The amount of indirect cost recovery funds received is calculated by multiplying the total direct research expenditures for a specified period by the negotiated indirect cost recovery rate.

To receive indirect cost recovery funds, a university submits a summary of the direct project expenditures and the associated indirect cost recovery amount it has earned to the grant sponsor. The grant sponsor then reimburses the university an amount of indirect cost recovery funds that is based on the direct research expenditures the university has already made.

University administration typically uses a portion of the indirect cost recovery funds earned to reimburse the administration for overhead costs. The remainder of the indirect cost recovery funds is typically returned to the office of the university’s vice president for research. The vice president for research then decides how to allocate the remaining indirect cost funds. Usually, the vice president for research retains a portion of the indirect cost recovery funds to distribute at his or her discretion and distributes the remainder to the deans of the departments that generated the indirect cost recovery funds. This distribution is normally based on a predetermined distribution percentage that is typically driven by the amount of the indirect cost recovery funds each department earned in the previous year. The department deans then have discretion to use their portion of the indirect cost recovery funds based on their assessment of department needs.

Information reported by the 28 universities we audited or surveyed indicates that universities generally return roughly one-third of total indirect cost recovery funds to the departments that generated that revenue. As Figure 1 shows, the average percent of indirect cost recovery funds returned to academic departments in fiscal years 2002 through 2005 ranged from 29 percent to 34 percent.

Figure 1



Source: Unaudited information reported by 28 universities.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Review institutional budgets to determine whether indirect cost recovery funds are properly budgeted to ensure compliance with Texas Education Code, Chapter 145.
- Survey general academic universities to identify dollar amounts expended from indirect cost recovery monies and the purposes for which these monies were spent for fiscal years 2002 through 2005.

Scope

Our scope included indirect cost recovery funds earned, budgeted, and spent from fiscal year 2002 through fiscal year 2005.

Methodology

The audit team performed on-site audits at the University of Texas at Austin, Texas A&M University, and the University of Houston. During these audits, we conducted interviews with management, tested various reporting systems, and tested compliance with indirect cost recovery fund provisions within federal grant agreements.

We also conducted an online survey of 25 other general academic universities that reported indirect cost recovery expenditures to the Texas Higher Education Coordinating Board.

Information collected and reviewed included the following:

- University data regarding federal revenue and expenditure transactions
- Reconciliations of universities' federal revenue and expenditure data with financial statements
- Population of all federal grant awards
- Grant award documentation
- University data regarding aging of federal receivables

- University budget worksheets
- University information regarding user access to key indirect cost accounting system screens at universities
- University accounting system user manuals
- Responses to online surveys sent to universities not audited

Procedures and tests conducted included the following:

For the three universities audited, we:

- Compared the population of federal grants to the population of grants in University data
- Reconciled the client system data provided by the universities to amounts reported in university financial statements
- Tested a sample of grant contracts for fiscal years 2002 through 2005 to determine whether grant information was properly entered into accounting systems
- Manually recalculated indirect cost recovery amounts for accuracy
- Reviewed the universities' aging of federal accounts receivable amounts to ensure collection
- Reviewed budget documentation to determine whether indirect cost recovery funds were being budgeted in compliance with Texas Education Code, Chapter 145
- Reviewed access to key indirect cost recovery accounting system screens at universities for proper control and segregation of duties
- Tested university accounting system calculations by running test transactions through those systems
- Tested university processes for posting indirect cost recovery funds

Criteria used included the following:

- Texas Education Code, Chapter 145

Project Information

Audit fieldwork was conducted from June 2006 through July 2006. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor's staff performed the audit:

- Michael O. Clayton CPA, CFE (Project Manager)
- David Dowden (Assistant Project Manager)
- Ron Cornelius CPA
- Michael Gieringer, MS
- Namita Pai, MS
- Michael Yokie, CISA (Information Systems Auditor)
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Dave Gerber, CISA (Audit Manager)

Summary of Survey Results

Table 3 summarizes information provided by the 3 universities audited and the 25 other universities that responded to the survey.

Table 3

Summary of Information Provided by 3 Universities Audited and the 25 Universities that Submitted Survey Responses	
Question	Summary of University Responses
1 Do you have written policies and procedures specifically related to the accounting for indirect cost recovery amounts?	<ul style="list-style-type: none"> ▪ Yes-96% ▪ No-4%
2 Do you have general ledger accounts that are used to account solely for indirect cost recovery revenues and no other revenue streams?	<ul style="list-style-type: none"> ▪ Yes-96% ▪ No-4%
3 Do you do draw downs on federal lines of credit to receive your federal indirect cost recovery payments?	<ul style="list-style-type: none"> ▪ Yes-86% ▪ No-14%
4 Does your university accounting system perform an automated calculation of the indirect cost recovery amounts earned by your university?	<ul style="list-style-type: none"> ▪ Yes-57% ▪ No-43%
5 During the budgeting process for your university, are all revenues pooled together in one revenue pool and budgeted?	<ul style="list-style-type: none"> ▪ Yes-75% ▪ No-25%
6 Are there any specific revenue sources or streams (e.g., HEAF funds) that are budgeted separately from the other revenues?	<ul style="list-style-type: none"> ▪ Yes-93% ▪ No-7%
7 Can your university determine which specific source of federal revenue paid for a specific expense?	<ul style="list-style-type: none"> ▪ Yes-29% ▪ No-71%
8 Do you have a process in place to ensure that indirect cost recovery funds are budgeted in compliance with Texas Education Code, Chapter 145?	<ul style="list-style-type: none"> ▪ Yes-68% ▪ No-32%
9 If the answer to the previous question was yes, who reviews the process to ensure indirect cost recovery funds are budgeted in accordance with Texas Education Code, Chapter 145 for you university?	<p>Various responses were provided. Examples include the following:</p> <ul style="list-style-type: none"> ▪ Vice President of Research ▪ Vice President of Finance ▪ Provost ▪ Grants accountant ▪ Dean of Research ▪ Budget Office ▪ Budget Committee
10 Do you have a process in place to ensure indirect cost recovery funds are expended in compliance with Texas Education Code, Chapter 145?	<ul style="list-style-type: none"> ▪ Yes-89% ▪ No-11%
11 What percentage of the indirect cost recovery funds received in each of the following years was budgeted back to the departments that earned the revenues?	<p>The average percent of indirect cost recovery funds returned to academic departments in fiscal years 2002 through 2005 ranged from 29 percent to 34 percent (see Chapter 2 of this report for additional details).</p>
12 Are the indirect cost recoveries budgeted to departments that generated the revenues adjusted for actual amounts received once the actual is known?	<ul style="list-style-type: none"> ▪ Yes-68% ▪ No-32%

**Summary of Information Provided by 3 Universities Audited
and the 25 Universities that Submitted Survey Responses**

Question	Summary of University Responses
13 Approximately how much in federal indirect cost recovery dollars did your university receive in fiscal year 2005?	The 3 universities we audited and the 25 others that responded reported that they received a total of approximately \$112 million in indirect cost recovery funds in fiscal year 2005 (see Chapter 1 of this report for additional details).
14 What percentage of total indirect cost recovery revenues were earned by federal grants in each of the following years?	Averages for all 28 universities: <ul style="list-style-type: none"> ▪ Fiscal Year 2002: 81% ▪ Fiscal Year 2003: 73% ▪ Fiscal Year 2004: 75% ▪ Fiscal Year 2005: 71%
15 Please outline by use of percentages, how your indirect cost recovery amounts were expended, based on the expense categories outlined below from fiscal year 2002 to fiscal year 2005 (these categories are mandated by Texas Education Code, Chapter 145). <ul style="list-style-type: none"> ▪ Conducting pre-grant feasibility studies ▪ Preparing competitive proposals for sponsored programs ▪ Preparing carryover funding for research teams ▪ Supporting new researchers pending external funding ▪ Engaging in research programs of critical interest to the citizens of Texas ▪ Purchasing capital equipment directly related to expanding the research capability of the institution ▪ Research or project administrative costs ▪ General research support 	See Table 1 in Chapter 1 of this report for a summary of the responses to this question.

Source: Unaudited information provided by 28 universities.

Excerpt from Texas Education Code, Chapter 145

Texas Education Code, Section 145.001. GRANTS AND RESEARCH EXPENSES.

(a) In this section:

(1) "Defined institution" means:

(A) "general academic teaching institution" as defined by Section 61.003(3) of this code;

(B) "medical and dental unit" as defined by Section 61.003(5) of this code; and

(C) "other agency of higher education" as defined by Section 61.003(6) of this code.

(2) "Funding entity" means a governmental or private entity that provides a defined institution with the funds to conduct research and pay the overhead expenses of conducting research.

(b) Each defined institution shall retain and deposit or invest in accordance with Section 51.003 or Section 51.0031 of this code any funds received from a funding entity designated for paying overhead expenses of conducting research.

(c) The funds retained by a defined institution under Subsection (b) may not be accounted for in an appropriations act in such a way as to reduce the general revenue funds to be appropriated to a general academic teaching institution or a medical or dental unit. The retained funds are subject to the following requirements:

(1) The funds shall be expended under guidelines approved by the institution's governing board for projects encouraging further research at the unit, agency, or department level at which the research was conducted, including:

(A) conducting early pregrant feasibility studies;

(B) preparing competitive proposals for sponsored programs;

(C) providing carryover funding for research teams to provide continuity between externally funded projects;

(D) supporting new researchers pending external funding;

(E) engaging in research programs of critical interest to the general welfare of the citizens of this state;

(F) purchasing capital equipment directly related to expanding the research capability of the institution; and

(G) research or project administrative costs; and

(2) the funds remaining after the application of Subdivision (1) shall be used by a general academic teaching institution or a medical or dental unit to support research as approved by a general academic teaching institution or a medical or dental unit.

(d) Each general academic teaching institution and each medical or dental unit shall report to the Legislative Budget Board as part of the biennial budget reporting process:

(1) the actual amounts of money retained and expended under this section; and

(2) the estimated amounts of money to be retained and expended under this section during the next biennium.

Management's Responses from the University of Texas at Austin, Texas A&M University, and the University of Houston



THE UNIVERSITY OF TEXAS AT AUSTIN

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University Distinguished Teaching Professor
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August 18, 2006

The State Auditor of Texas
P. O. Box 12067
Austin, Texas 78711-2067

Below is the University's response to your audit report regarding the Indirect Cost Recovery Funds at State General Academic Universities.

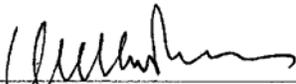
We agree that there are opportunities to enhance public accountability for use of indirect costs recovered from sponsors of research awards. We believe that the most effective and economical way to enhance accountability is to establish outcome-based measures against which recipient institutions must publicly report. One such measure might be growth in total sponsored research dollars, given the rationale for allowing institutions to retain 100% of its recovered indirect cost. The proposed measure is to reinvest it in a manner that would grow its research base. In this regard, for the fiscal year immediately preceding the change in the law allowing 100% retention, UT Austin reported \$320 million in total sponsored research excluding indirect cost recovered. By comparison, for the fiscal year following the change in the law, UT Austin reported \$357 million of total sponsored research excluding indirect cost recovered. This was a growth of \$37 million (11.6%). We believe one factor that contributed to the increase in sponsored research was the reinvestment of recovered indirect cost.

The University's present accounting practices are identical in concept to those of the State of Texas in its accounting for the use of State general revenue expenditures by source of funds. The state pools various taxes and other revenues, and appropriates "General Revenue" funds to institutions and agencies. Accountability is established through the setting and reporting of goals and strategies for achieving certain results (outcome-based measures). The source of the general revenue allocated to a particular state agency is not usually linked to a specific agency or institution, let alone a particular expense.

The State Auditor of Texas
August 18, 2006
Page 2

Similarly, universities pool tuition, fees, indirect cost recoveries, and other revenues to allocate funding to colleges and departments. Accountability is similarly maintained by goals, strategies, and electronic systems controls, and an individual college or departmental expense is not linked to a particular revenue type.

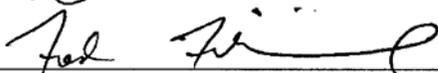
While it is possible for the University to change its present accounting practices to allow tracking the expenditure of recovered indirect cost by source, it would be prohibitively expensive to do so. We believe that public accountability is best enhanced by the use of outcome-based measures, such as growth in total sponsored research.



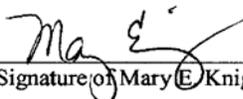
Signature of William C. Powers Jr., President 8/21/06
Date



Signature of Kevin P. Hegarty, Vice President and Chief Financial Officer 8/21/2006
Date



Signature of Glenn "Fred" Friedrich, Associate Vice President and Controller 8/18/06
Date



Signature of Mary E. Knight, Associate Vice President and Budget Director 8/18/06
Date



TEXAS A&M UNIVERSITY

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Office of the President
Robert M. Gates

August 18, 2006

Mr. John Keel, CPA
State Auditor
P.O. Box 12067
Austin, TX 78711-2067

Dear Mr. Keel,

Comments related to the audit report titled "Indirect Cost Recovery Funds at State General Academic Universities" are attached. Texas A&M University appreciates the working relationship with your office and the efforts of your staff to understand the budgeting strategy at Texas A&M University regarding indirect cost recovery.

Thank you for the opportunity to comment on the recommendation included in the audit report. As always, my staff and I are available for further discussion and answer any questions you may have.

Sincerely,

A handwritten signature in black ink, appearing to read "R. M. Gates", written over a printed name.

Robert M. Gates

Attachment

cc: Dr. Robert D. McTeer, Chancellor, The Texas A&M University System
Dr. David Prior, Executive Vice President and Provost
Ms. K. Sue Redman, Senior Vice President and Chief Financial Officer
Ms. Catherine A. Smock, Chief Internal Auditor, The Texas A&M University System
Mr. Charley B. Clark, Associate Vice President

***State Auditor's Office Report on the Indirect Cost Recovery Funds at State
General Academic Universities***

Texas A&M University Comments on Recommendations

SAO's Overall Conclusion:

The State Auditor's Office could not determine whether state general academic universities budget indirect cost recovery funds in a manner that enables them to spend these funds in accordance with statutory requirements. Texas Education Code, Chapter 145, requires universities to spend indirect cost recovery funds for specific types of projects to encourage further research at the level at which research was originally conducted (see text box for additional details). However, most universities do not identify specific revenue streams during their budgeting processes and, therefore, cannot identify the specific source of funds used to make specific research expenditures. We conducted audit work at three universities: the University of Texas at Austin, Texas A&M University and the University of Houston. We also surveyed 25 other universities. The results of that work, which are summarized in Appendix 2 of this report, indicated that most universities pool all revenue sources and allocate their funds based on university-wide needs and predefined objectives. Universities reported that they have a large number of revenue streams, which (1) makes it impractical for them to budget each stream separately and (2) makes it impossible for them to determine the sources of the funds used to purchase any specific item. The 3 universities we audited and the 25 others we surveyed reported that they received a total of approximately \$112 million in indirect cost recovery funds in fiscal year 2005. To hold universities accountable for the use of indirect cost recovery funds, the Legislature should consider requiring them to account separately for the uses of those funds. An alternative approach would be for the Legislature to consider using outcome measures as a way to ensure accountability for the use of those funds.

Summary of Management's Responses

(We will summarize management's response here and refer to Appendix 4 for the actual responses.)

TAMU's Response:

Texas A&M University appreciates the quality work and professional manner in which the engagement was conducted by the State Auditors Office. While we understand that their intent was to trace indirect cost expenditures at the transaction level, there is currently no accounting standard or State law that requires this level of detailed accounting.

Texas A&M University supports accountability for indirect cost expenditures through outcome measures and proposes that the legislature consider supporting Higher Education institutions in developing and reporting accountability outcome measures reflective of the research institution groups.

Detailed Results from Appendix

SAO's Recommendation:

To hold universities accountable for the use of indirect cost recovery funds, The Legislature should consider requiring them to account separately for the uses of those funds. An alternative approach would be for the Legislature to consider using outcome measures as a way to ensure accountability for the use of those funds.

Appendix 4: Texas A&M University's Management Response:

Accountability:

Texas A&M University accounts for the indirect cost recovery received and spent according to accounting standards including, Governmental Accounting Standards Board (GASB) standards, Texas State law, and The Texas Higher Education Coordinating Board (THECB) guidelines and requirements.

Currently, Texas A&M University believes that the costs associated with tracking specific indirect cost expenditures outweighs the benefits derived. Separately budgeting indirect cost recovery and identifying the specific source of funds used to make specific research expenditures would reduce efficiencies and increase administrative costs at the University. The multitude and complexity of various funding sources and expenditures at a research university require that we continually focus our resources on providing accounting controls in compliance with the requirements of regulatory and granting agencies. Texas A&M University does support accountability for indirect cost expenditures through outcome measures and proposes that the legislature consider supporting higher education institutions in developing and reporting accountability outcome measures reflective of the research institution groups.

Should the legislature consider using outcome measures, Texas A&M University will coordinate with the THECB and our peer research institution, as grouped by the Higher Education Accountability System, and participate on a State wide Task Force to review this issue as necessary. Currently, Texas A&M University and the University of Texas are designated as Research Universities in the Higher Education Accountability System.



**UNIVERSITY OF HOUSTON SYSTEM
UNIVERSITY OF HOUSTON**

DR. JOHN M. RUDLEY
Vice Chancellor, Administration and Finance
UH System
Vice President, Administration and Finance
University of Houston

August 18, 2006

Mr. John Keel, CPA
State Auditor
P.O. Box 12067
Austin, Texas 78701

Dear Mr. Keel:

Thank you for the opportunity to provide comments in response to your report on indirect cost recovery funds at state general academic universities. In response to the overall conclusion, I offer the following observations:

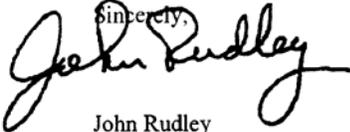
Legislative action that would provide additional accounting requirements for overhead funds is not necessary and would be very costly and unreasonably burdensome to state institutions. The methodology of pooling funds and allocating to specific strategies employed at our University is similar to practices at other higher education institutions across the country. This is also the methodology used by the State in allocating general revenue funds to state agencies. The University's budgeting and accounting records reflect that the overhead funds collected were used in support of research related activities as required by Texas Education Code, Chapter 145. In addition to these funds, millions of additional dollars are allocated annually in support of research activities including, but not limited to, purchase of research equipment, lab renovations and startup funding for new researchers.

The use of indirect cost recovery funds and the flexibility afforded an institution to grow its research is of paramount importance. The review of institutions and their use of overhead funds from a broader perspective seems a better approach. The legislature should consider obtaining feedback from institutions in order to develop outcome measures as a means of monitoring an institution's use of overhead funds.

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Mr. John Keel
August 18, 2006
Page 2

Thank you again for the opportunity to comment on the report. Please let me know if I can provide assistance as you complete this important task.

Sincerely,

John Rudley

cc: Dr. Jay Gogue
Michael Clayton, SAO
Don Guyton

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