S. HRG. 106–217

SELF-DETERMINATION AND EDUCATION ASSISTANCE ACT AND CONTRACT SUPPORT COSTS

HEARING

BEFORE THE

COMMITTEE ON INDIAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

ON

OVERSIGHT HEARING ON THE COMPLEX ISSUE OF CONTRACT SUPPORT COSTS PAYABLE TO INDIAN TRIBES TO CARRYOUT SELF-DETERMINATION ACT CONTRACTS AND COMPACTS

SEPTEMBER 15, 1999
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SELF-DETERMINATION AND EDUCATION ASSISTANCE ACT AND CONTRACT SUPPORT COSTS

WEDNESDAY, SEPTEMBER 15, 1999

U.S. SENATE,
COMMITTEE ON INDIAN AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m. in room 485, Russell Senate Building, Hon. Ben Nighthorse Campbell (chairman of the committee) presiding.

Present: Senators Campbell, Inouye, Conrad, Murkowski, and Wellstone.

STATEMENT OF HON. BEN NIGHTHORSE CAMPBELL, U.S. SENATOR FROM COLORADO, CHAIRMAN, COMMITTEE ON INDIAN AFFAIRS

The CHAIRMAN. Good morning. The committee will come to order.

This morning we will receive testimony on the complex issue of contract support costs payable to Indian tribes to carryout Self-Determination Act contracts and compacts. In 1970, President Nixon delivered his now-famous special message to Congress on Indian affairs, rejecting the failed Federal policies of termination and assimilation. In their place, he encouraged an Indian policy based on Indian self-sufficiency and self-government.

Congress responded in 1975 with the enactment of the Indian Self-Determination and Education Assistance Act. By allowing tribes to step into the shoes of the United States and to provide law enforcement, health care and other services to tribal members, the Act has resulted in less Federal bureaucracy, more capable tribal governments, more efficient use of Federal funds and a better quality of services to tribal members.

Contract support is a key incentive to tribes to enter self-determination and to enable them to carry out self- determination contracts. The Act requires that tribal contractors be paid for the administrative activities associated with the contracts such as equipment, insurance, legal services, administrative and personnel management and other key functions.

In recent years, as more and more tribes enter self- determination, the supply of contract support funds appropriated have not kept pace with the demand, resulting in numerous lawsuits against the United States and several appropriations measures designed to reduce Federal liability.

Today we will hear from the GAO, Federal agencies and the tribes themselves about ways to overcome contract support cost shortfalls, so that Indian tribes can continue to assume greater control over their lives and their destinies, and achieve the goals of Indian self-determination.

Senator Inouye is not here yet, so we will just go ahead and proceed with panel 1, which will be James Wells, from the General Accounting Office, Kevin Gover, Assistant Secretary for Indian Affairs, and Michael Lincoln, Deputy Director of Indian Health Service.

With that, I would tell our witnesses welcome this morning, and your complete testimony will be included in the record. If you would like to abbreviate, that will be fine. We'll go ahead and start in that order, with Mr. Wells first.

STATEMENT OF JIM WELLS, DIRECTOR, ENERGY, RESOURCE AND SCIENCE ISSUES, RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JEFF MALCOLM, SENIOR EVALUATOR, GAO DENVER REGIONAL OFFICE

Mr. WELLS. Thank you, Mr. Chairman.

I'd like to introduce my colleague, Jeff Malcolm, who is sitting behind me, who was responsible for leading the review of the Indian contract support costs. I want to thank you for the opportunity to report on our work for you. We did the work and we delivered our report to you in June, which I'd like to briefly summarize.

My comments this morning will focus on three areas: defining what contract support costs are; the reasons for increasing contract support cost shortfalls; and alternatives for funding contract support costs.

Indian tribes are authorized by law to clearly take over administration of former government programs like law enforcement, social services and health clinics. In addition to receiving the program funds, the tribes would also receive funds for contract support costs, that is, the costs that the tribes incur for running their programs.

Theoretically, these costs are similar to moneys that it would have taken for the Federal Government agencies to run these programs. BIA and IHS commonly refer to these three categories of contract support costs that we'll talk about today, indirect costs, direct contract support costs, and startup costs.

Indirect costs are costs for a tribe's common support services, such as accounting. The direct contract support costs are costs or activities that are program-related, but the tribe does not receive program funds like workman's compensation. And finally, startup costs, one-time expenses like computer hardware or software type things.

The tribes are to receive funds for contract support costs by way of annual appropriation acts. Shortfalls in contract support costs have been increasing in the last 5 years. For example, in fiscal year 1998, $375 million was allowable, yet only $280 million was appropriated. We hope our June report, Mr. Chairman, gives you the facts and figures you need to help make some decisions that need to be made.

Contract support costs have clearly increased, mostly because the tribes have been contracting more. They have been successful. But also because their costs of administering these contracts are increasing. The more you contract, the more it costs. As we've learned, about half of BIA and IHS programs are currently now under contract. Tribe support costs are up to $375 million. Shortfalls clearly have increased, because the appropriations have not kept pace with the tribes' costs, particularly over the last 5 years.

While the exact amount of future contract support cost is going to be difficult to predict, given the continuing success, there clearly is an intention that they will be contracting more programs, therefore it's a clear conclusion that costs can and probably will go up.

Our report gives you the facts, figures and numbers about what existed, as well as covering some of the litigation issues and moratoriums that the agencies and the tribes are dealing with today. The litigation involves the question of whether the Government must pay support costs, and if so, whether their non-payment is a breach of contract.

In light of the continuing shortfalls, I'd just like to briefly discuss four alternatives for funding contract support costs. We know that clearly, these are not the only alternatives. There could be many other alternatives or even various combinations.

While we do not make recommendations to you, Mr. Chairman, or the Congress at this time, as to which alternatives are best, we do want to assist the Congress in your deliberations on how to resolve this impasse. These alternatives are presented in no particular order.

The first alternative is to fully fund contract support costs. The second alternative may be to eliminate the full funding provision currently in the act, and continue funding at the current level. A third alternative would be to impose a limited cap on tribal indirect costs. A fourth alternative may be to consolidate program funding and contract support funding, which are done separately now, putting them together and allow tribes to fully recover their indirect costs from that total amount.

If the desired outcome in terms of the wisdom of the Congress and a policy call is to reimburse all the tribes for all their contract support costs, then alternative one, which would be full funding, or alternative four, a consolidated amount, would work. If the desired outcome is to deal with limited appropriations, then alternatives two, three or four could also work. A disadvantage to alternatives two, three or four would be that they would probably require amending the act.

I'm sure the officials beside me today have opinions and I know many of the tribes have already taken opinions as to which alternative they would prefer. I'll just stop right here today and just say that the program clearly has legislative intent, passed by this committee. It clearly has estimated needs from the tribal standpoint. And clearly, at least in the last five years, there has not been enough appropriated money on an annual basis to cover these costs.

The challenge facing the Congress is to find some common ground. And we at GAO are ready to do what we can to help today.

Thank you, Mr. Chairman.

[Prepared statement of Mr. Wells appears in appendix.]

The CHAIRMAN. Thank you, Mr. Wells.

Mr. Gover, why don't you proceed. You don't look too badly barked up for all the trials and tribulations I read about you in the press lately. You look in pretty good shape.

Mr. GOVER. I've slept them off, Mr. Chairman. [Laughter.]

STATEMENT OF KEVIN GOVER, ASSISTANT SECRETARY FOR INDIAN AFFAIRS, DEPARTMENT OF THE INTERIOR

Mr. GOVER. What this issue boils down to is in many respects just an old story. It's a commitment that the United States has made to the tribes that it has not fulfilled. When we began in 1975 with self-determination contracting, the idea of contract support was simply to allow the tribes to have what amounted to the overhead costs, the administrative cost to the Bureau of Indian Affairs [BIA], in addition to the program amounts. And that was a good idea, because without that provision, the BIA would have held on to the administrative costs and the tribes would have been unable to operate the programs, just on the basis of the programmatic funding.

In 1988, Congress upped the ante somewhat, and said, not only are we going to require you, BIA, to give the tribes what it costs you to provide these services, we're going to have you provide whatever it costs them to support these contracts, whatever it costs the tribes. So the amount of contract support that was anticipated in the statute went up.

Unfortunately, Congress wasn't completely clear on what that obligation was. So while it said to the Bureau and to the Indian Health Service, you may not fund the tribes for less than the full amount of their contract support requirements, it then went on to add that wonderful phrase, subject to appropriations.

Well, what does that mean? Does that mean, we really mean it, that we're going to pay all these costs, or does it mean, we'll pay them when we feel like it? That's really what the question boils down to. And the sad reality is, we all know what the answer to that question is going to be. It's going to be, we're going to pay those costs when we feel like it, and that's what we've done. The administration has never requested adequate funding for contract support, the Congress has never appropriated it.

So we've got to decide, are we going to keep the promise or are we going to change the promise, the guarantee that's been made to the tribes? The administration at this point, Mr. Chairman, has no cogent proposal to make as to which of those alternatives to choose. But it seems to me that all of the policy direction that this Congress and that several administrations have taken now suggest that the proper course is to pay these costs.

We want the tribes to operate these programs. That is the unambiguous policy of this administration, of every administration since President Nixon. But in order to do that, we're going to have to fund them. A tribe has a right to sit back and say, if you're not going to give us enough money to succeed, we're going to leave you with the burden, you, the BIA, you, the IHS. And in fact, that's what many of them have chosen to do.

If on the other hand we begin to fund these programs and these indirect costs adequately, I think we would see a steady increase in the amount of contracting that tribes do. And as GAO points out, with it comes a steady increase in the amount of contract support required.

That is the goal that was set out in 1975. Unfortunately, this issue has now halted progress toward that goal, so that in fiscal year 1999, for the first time in 25 years, the BIA will make no new contracts with the tribes, and the amount of tribal contracting will not increase. That is to my mind a dreadful setback in the policy that we all agree is the correct policy.

So Mr. Chairman, we want to work with the Congress, we want to work with the tribes. But the bottomline is going to have to be that we'll have to make the commitment real by putting the dollars into it to meet this obligation. If we're not going to meet the obligation, then we should stop misleading the tribes by creating not just the expectation, but perhaps the entitlement to these funds. Because we've not yet met it.

We're going to pay for this one way or the other. We either pay for it in terms of a failed policy that does not fully implement self-determination, or we pay for it with real dollars. And obviously, at a time when the Government is running a surplus, it's very difficult for me or any other, any of us, to explain to the tribes why it is that these funds are not being provided.

The other dilemma that we face, and the reason that neither we no the Congress provide all the contract support that's needed is quite simply the competing priorities. What do we cut in order to fully fund contract support? Do we cut housing improvement? Do we cut school construction? Do we cut law enforcement? Do we cut a BIA administrative budget that is incredibly lean right now?

There are no good choices there. And yet, as long as this item remains on-budget and a part of the discretionary spending of the United States, I don't believe it will ever find its way to the top of the list of priorities for the Bureau, for the IHS or even for the tribes.

So Mr. Chairman, I regret that I can only sort of pose the dilemma today. But I do look forward to a conversation with the committee and a continuing conversation with the tribes on how we go about meeting this obligation that the United States has undertaken.

[Prepared statement of Mr. Gover appears in appendix.]

The CHAIRMAN. Thank you.

Mr. Lincoln, why don't you go ahead before I ask my colleagues if they have any comments.

STATEMENT OF MICHAEL E. LINCOLN, DEPUTY DIRECTOR, INDIAN HEALTH SERVICE, ACCOMPANIED BY PAULA WILLIAMS, DIRECTOR, OFFICE OF TRIBAL SELF-GOVERNANCE AND RON DEMARAY, OFFICE OF TRIBAL PROGRAMS

Mr. LINCOLN. Thank you, Mr. Chairman.

We do appreciate this opportunity again to talk about contract support costs, because it is critical from a variety of perspectives.

I have with me today Paula Williams, to my far left here. Paula is the director of our office of tribal self-governance. And joining us

in addition is Ron Demaray, who is within our office of tribal programs. Both individuals have great expertise in this area and have been working in this area for a number of years.

I need to mention indeed, Mr. Demaray is probably our most knowledgeable individual relative to the policy implications, and has been on the NCIA work group and other work groups that we have dealing with this issue.

Mr. Chairman, the full statement is submitted for the record, and I will just briefly summarize some of the important facts associated with that statement and contract support costs. First of all, the context within which the Indian Health Service views all funding resources, including contract support costs, is really within a health context.

In addition, it's within the government-to-government context. We can't really divorce ourselves from the actual program that is occurring out in Indian Country, whether it be a tribal program operated by the tribe or the Indian Health Service.

We believe that by not funding fully contract support costs, it does have a health impact. The GAO concluded that some program dollars that were having to be used for contract support cost purposes are diverted away from the health programs in order to meet these obligations. That is not a good situation.

Alcoholism continues to kill Indians seven times more than non-Indians. The same can be said for diabetes, 3.5 times greater for the Indian population in general. But the rates across Indian country are enormously large, above 13, 14, 15 percent in some areas, and lesser in other areas. Motor vehicle crashes are a 3.3 times greater cause of mortality than it is for the United States all races. Homicides, suicides, heart disease and cerebral vascular disease are all in excess of what a non-Indian person, or the United States all races would experience in this country. So there is still a great health need out there.

Just briefly, over 40 percent of the Indian Health Service budget, or approximately $1 billion, is allocated to tribally operated programs under the authority of the Indian Self-Determination and Education Assistance Act. Approximately 20 percent of this amount, or $200 million, represents contract support costs, which include, as Mr. Wells has said, indirect costs, recurring direct contract support costs, and non-recurring startup costs.

Contract support costs are defined under the act as an amount for those activities that must be conducted by a tribal contractor to ensure compliance with the terms of the contract and prudent management. The act requires contract support costs to be added to the contracted tribal health program and contract support costs to tribal governments and the Indian Health Service, because they support administrative and related functions that are vital to the delivery of health care services.

The need for contract support costs within the Indian Health Service has increased dramatically since 1995. At present, we have a shortfall of approximately $52 million for fiscal year 1999, based upon the latest information that we have. In fiscal year 1999, we will be able to fund an average of approximately 86 percent of the contract support costs needed for tribes contracting or compacting under the act.

We will continue to work with tribes and the Congress to reduce the disparity in contract support cost funding for those tribes within the Indian Health Service system.

In summary, I'd like to emphasize that I am just as committed to upholding and promoting the principles of self-determination, the empowerment of tribal governments and the government-to-government relationship that exists between Indian nations and this country. We are also committed to working closely and collaboratively with you, the Congress, with the Indian tribal government and national Indian organizations in regard to contract support cost issues.

Mr. Chairman, thank you for the opportunity to be here today.

[Prepared statement of Mr. Lincoln appears in appendix.]

The CHAIRMAN. I'd like to thank you for your testimony, Mike.

I tell you, this is my fourth meeting today, I had a meeting this morning with some farmers and some educators and with some veterans. Every one of them told us what a rotten job we're doing in Washington. I'm beginning to think no matter what we do, we do it wrong around here. And I sure wish there was some way we could fix all the problems. We seem to stumble from one to another.

I know, Mr. Wells, you mentioned the four options. Clearly, that number two you mentioned, funding at current levels, is not going to work, with increased costs every year and increased birth rates in Indian tribes going up every year. To keep the funding at the same level as last year is the same thing as a decrease, when it comes to actually providing a service, as you know. So we've got to find a better option than that.

Senator Inouye, did you have comments or questions, before I ask them myself?

Senator INOUYE. I would like to ask Secretary Gover, what is the real intention of the Government of the United States in maintaining a contract support type program?

Mr. GOVER. What is the real intention? The intention originally was to make sure that when the tribes adopted, took over the responsibility for using these program dollars that were appropriated to the BIA, that they would be able to develop an adequate infrastructure, meaning accountants, legal advice, all the overhead, all the indirect costs that the Government has when it provides these services.

And that was the intent. It is the intent. It's on the books.

Senator INOUYE. It was to serve as an incentive for self-determination and self-governance?

Mr. GOVER. Yes; and certainly at a minimum, to ensure that it was not a disincentive to contracting, that they would incur these additional costs that were not necessarily directly related to the programs.

Senator INOUYE. If we continue to have shortfalls, or if we follow some of the advice provided by GAO to set a cap, would that serve as a disincentive to self-governance and self-determination?

Mr. GOVER. Yes, sir; and of course, we have the biggest disincentive of all in place right now, with the moratorium on contracting and compacting in our fiscal year 1999 appropriations legislation.

Senator INOUYE. And this is being carried out, because there is a solemn promise on the part of the United States to serve as trustee?

Mr. GOVER. Yes, sir; and I consider any commitment the Congress makes in the form of a statute to be a promise to the tribes that is the equivalent of a treaty.

Senator INOUYE. Do you believe that one of the solutions to this problem is for Indian nations to sue the Government of the United States?

Mr. GOVER. It's certainly proved an effective solution to this point. We've just paid an $80 million judgment to the tribes for our failure to provide adequate contract support in the past. There are several lawsuits still pending that could increase that liability several fold.

Senator INOUYE. Thank you very much.

The CHAIRMAN. We were thinking, just musing here when you talked about that $80 million judgment, you got the judgment, but the tribes didn't get the money yet. And it's going to be interesting to see where that money comes from, if they take it from other programs, or if we're going to have to come up with a separate line item to pay that or what.

But clearly the original concept of direct funding, if you have $100 to spend and you're in a fiscal position like we were for years and years, you're better off giving it directly to the user, rather than having so much of it eaten up in the bureaucratic administration of the money. But it only works if you're going to give them the money. And we have not been doing that adequately, that's for sure.

Senator MURKOWSKI.

Senator MURKOWSKI. Mr. Chairman, it would be interesting to see, and have the record reflect the ultimate results of that suit, as to how much the tribes would get and how much would be taken out by the lawyers or administrative fees. Maybe Mr. Gover could tell us what's anticipated to go to the tribes.

Mr. GOVER. My understanding, Senator Murkowski, I think the actual number was $79 million. That's the settlement that we agreed to, that the attorneys in the suit will get, I believe it's 11 percent as a contingency, which is a modest contingency, as contingencies go, actually.

So that money will be paid into a pot that will be distributed to all of the contracting tribes by formula. The more difficult question is, when the Bureau has to pay that, that will be paid out of a judgment fund, where all judgments against the United States are paid. The interesting question is whether or not we are required at the BIA to reimburse the judgment fund.

That remains unresolved. The court has retained jurisdiction over the issue. But the government lawyers are concerned that the Contract Disputes Act, under which this case was brought, will require us to repay the judgment fund. No matter what we did to try to pay that judgment, some of it would have to come out of the tribes' allocations, from our budget.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM ALSAKA

Senator MURKOWSKI. Mr. Chairman, if I may just advise the Chairman, I have to leave at 10 o'clock to open the hearing on the deputy nominee for the Department of the Interior, as Chairman of the Energy Committee.

I would just like to recognize three Alaskans that are here that will testify. Ed Thomas, who is a member of the Board of SeaAlaska Corporation, and President of the Central Council of the Tlingit-Haida group, as well as Tim Gilmartin, who is the Mayor of Metlakatla, and a long-time acquaintance. And Lloyd Miller, who has worked tirelessly in the efforts of tribal and Alaska native interest groups, will be testifying as well.

I want to commend you for holding the hearing on contract support, and I hope we can reach a solution. I'm very disturbed with the Department of the Interior and their inability and unwillingness to proceed with any compact agreement with the native villages in Alaska, to contract for services.

We have some of the isolated parks, where we have more visitors who are actually Park Service personnel than actual visitors, and the reluctance of the Department of the Interior to contract for services is something I find very distasteful and continue to pursue with the Secretary of Interior. But he has certainly shown an unwillingness to proceed under any compact arrangement.

So I want to compliment those, the workability and the success that we've had so far. I hope we can reach an accord on the adequacy of the funding.

Please excuse me.

The CHAIRMAN. As I understand, he's saying you're not going to enter any new contracts this year. But there's a moratorium on your not entering any more contracts, is that correct?

Mr. GOVER. That's correct.

The CHAIRMAN. And the reason for the moratorium is they are worried about being sued if they don't comply with the contract?

Mr. GOVER. I assume that that is the motivation of the appropriations committee in including that provision. So we're prohibited by law this year, Senator, from entering into any new contracts.

Senator MURKOWSKI. I'm not concerned with the BIA, though. I'm concerned with the Department of the Interior. They're not prohibited, and they're not willing.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Mr. Chairman, I think we should point out, it's not the Department of the Interior's fault. We put the moratorium on them.

Senator MURKOWSKI. No; the Department of the Interior is unwilling to do it under any terms and circumstances. The Secretary has been quite outspoken in his opposition. He feels it would diminish the professionalism of the Park Service to contract for management of certain areas. And we feel otherwise, particularly when our village communities have to go out and find the Park Service personnel that move up for the first time and promptly get lost.

Senator CONRAD. But we, as a matter of law, have put a moratorium on them. If he wanted to, I don't know if he wants to or not——

Senator MURKOWSKI. He doesn't want to.

Senator CONRAD. But, it doesn't matter whether he wants to or not. We've put on a moratorium, by law. We've said, you can't do it. So it doesn't matter what he wants to do, we've said, you can't. And the reason we've said you can't is because we're going to get sued again and lose, because we're not providing the money.

So I think in fairness, it's not the Department of the Interior's fault here. It's our fault. We've not provided the money. As a result, we get sued. As a result, we lose. As a result, we've put on a moratorium.

So I think in fairness, the blame lies right here with us.

The CHAIRMAN. Well, perhaps shared by the administration that didn't request the money, either.

Senator CONRAD. They should be requesting the money, no question. But you know, even if they don't request the money, the evidence before us is abundantly clear. And we've not responded.

So you know, I mean, it's easy to point fingers in this town, but sometimes it's hard to point a finger when you're looking in the mirror. Maybe we ought to be doing some looking in the mirror.

The CHAIRMAN. Don't you enjoy this job? [Laughter.]

Mr. GOVER. Well, Mr. Chairman, there's plenty of blame to go around here. We've not asked for the money, Congress has not given it, I don't think either of us, and I don't blame the Congress, I don't think we're in a position to cast blame. I should add, though, that IHS also is subject to this moratorium. It's just an extraordinary interruption in the self-determination policy that we've got to overcome.

The CHAIRMAN. Mr. Wells, your testimony says that in 1998, the Oglala Sioux Tribe, which is one of the poorest in the Nation, as you know, was shortchanged a million and a half dollars in contract support costs by the Bureau and the IHS. Did you discover other instances where other tribes are having to use their own money to subsidize the obligation that the United States should have done?

Mr. WELLS. Yes, sir; Mr. Chairman. As we interviewed and talked to a number of the tribes, many, many of them talked to the shortfall and the pain that was caused between the expectations of getting full funding versus the realization that the money was not available. Many talked to having to reduce services, many talked to actually reducing program availability.

The CHAIRMAN. The list of tribes, that's a matter of record somewhere?

Mr. WELLS. We can supply the actual list of tribes.

The CHAIRMAN. Would you supply that to me?

Mr. WELLS. Yes, sir.

The CHAIRMAN. Thank you. If the tribes assume control over the remainder of all BIA and IHS programs, wouldn't further contract support cost requirements decrease as a percentage of the total amount of the programs they administer?

Mr. WELLS. Would you repeat the last part of the question?

The CHAIRMAN. If the tribes assume control of the remainder of all BIA and IHS contracts, all the programs, would future contract support cost requirements go down as a percentage of the total amount of programs that they administer?

Mr. WELLS. Clearly, mathematically, one would assume the greater numbers of contracts, you might gain some economies of efficiency of scale in terms of the numbers of people that would have to be hired, might be less if you were to double your contracts. But the bottom line would be the actual dollar outlay would in fact be larger, no question.

The CHAIRMAN. Kevin, with no new funding for contract requests or appropriated, what's the practical effect of the current moratorium on new and expanded contracts in the appropriations bill?

Mr. GOVER. Well, the practical effect is just what you would expect. We are unable to make any new contracts. We have probably, I know of one dozen requests that are pending now in tribes that had intended to contract or compact in fiscal year 1999 that are now asking, are we going to be able to do this in fiscal year 2000.

That in turn means that those programs remaining in the hands of the BIA, mostly those that the self-determination policy is—what we've really done here with the moratorium is to amend the Self-Determination Act in the worst possible way, which is to say, we're not going to do this any more, we're not going to contract any more. We can't do that, we can't turn away from that policy.

The CHAIRMAN. You mentioned there's enough blame to share, and certainly we're responsible, too. But can you tell us why it hasn't been a priority with the administration? Because as I understand it, we're talking about $95 million in 1998, which around here, we spill more than that, pretty regularly.

Mr. GOVER. Let me put it this way, Mr. Chairman. We discuss with the Indian Health Service every year before you, either of us submit our budget, what our intentions are. And every year we advise each other that we intend to request full funding for contract support.

As that budget moves further through the process, that policy objective is never attained. To some degree I understand it, in the sense that if I'm at OMB, or if I'm on the appropriations committee, and I ask myself, I've got this many million dollars to spend, do I spend it on school construction or do I spend it on contract support. We all have our own views. But most of us I think would say school construction.

We've got to make the pot larger. Because as long as contract support is competing as a priority with these very basic needs that the Indian communities have, it will never become a priority. The only way to resolve that is to again take our statements about self-determination seriously and spend the money that's required to implement that policy completely.

The CHAIRMAN. Mr. Lincoln, the IHS, why do you enter contracts, knowing that the agency won't be able to pay for them?

Mr. LINCOLN. Under the Indian Self-Determination and Education Assistance Act, especially Title I of that Act, there are provisions that require the agency to receive and accept a proposal from a tribe. We have——

The CHAIRMAN. You're required to do so?

Mr. LINCOLN. I think we're required to do so. I think there's a statutory requirement for us.

The CHAIRMAN. Under the new IHS method of distributing contract support, you state that you will cover only 80 percent of the

tribal need. What would it take to get the IHS to fund the contracts up to 100 percent?

Mr. LINCOLN. Based upon the fiscal year 1999 date that we're in right now, we would project it would take an additional $50 million, $52 million in fiscal year 2000 to bring us whole.

The CHAIRMAN. Okay, thank you.

Senator Inouye, did you have any questions?

Mr. LINCOLN. Oh, Mr. Chairman, if I could correct that, that would bring us whole for fiscal year 1999. The total amount of the appropriation to bring us whole in fiscal year 2000, the total amount is $290 million, of which Congress has already appropriated approximately $204 million. As I know you are aware, the Administration has requested an additional $35 million. The House has included that through its Interior Appropriation subcommittee and the Senate has not included any amount of money for the contract support costs in the appropriations.

The CHAIRMAN. That would leave you about $65 million or $70 million short of full funding?

Mr. LINCOLN. I think so, for 2000.

The CHAIRMAN. Yes; all right, I want to thank this panel for appearing this morning. I appreciate it very much. We'll go to the next panel, if Senator Inouye has no questions.

That will be Ron Allen, President of the NCAI; Ed Thomas, President of the Tlingit-Haida Council; Tim Gilmartin, the Mayor of the Metlakatla Indian Community; and Lloyd Miller, of Sonosky, Chambers, Sachse, Miller and Munson. We'll start in that order, with Mr. Allen going first. And your complete testimony will be included in the record, if you will abbreviate your comments, the committee would appreciate that.

STATEMENT OF W. RON ALLEN, PRESIDENT, NATIONAL CONGRESS OF AMERICAN INDIANS

Mr. ALLEN. Thank you, Mr. Chairman.

On behalf of the National Congress of American Indians, it's always a pleasure to come before the committee to talk about these important matters that affect Indian country. You have our testimony that you have entered into the record.

We also submit to you a copy of our final report that the National Congress put together with a work group that has worked over the course of the last year. It is a culmination of 13 months of meetings, 11 national meetings, countless smaller work groups and literally tens of thousands of hours of work into this agenda. And it resulted in this final report.

I would like the committee to consider entering this report into the record.

The CHAIRMAN. Without objection, we will put that into the record.

[Material to be inserted appears in appendix.]

Mr. ALLEN. Thank you very much. We sincerely appreciate that. We believe that it is as important as the GAO report and other documents that you are receiving on this very delicate topic.

Without a doubt, the Self-Determination Act, as you well know, is an act that was intended to empower tribal governments. Back in the 1970's, they came to the notion that the only way to respect-

fully and appropriately deal with the Indian and native nations across America was to empower them, to empower them to deal with their responsibilities. It had some very simple objectives: Reduce the Federal bureaucracy, place the Indian programs in the hands of the Indian people and their leadership, and to enhance and empower the tribal governments. So the objective of the act is very simple and very straightforward.

So our intent, because this has been an ongoing problem, is to examine the whole process of the contract support, the whole system itself, Federal-wide, not just within the area of BIA, IHS and the Federal system, but how does it work within the Federal system period. We also wanted to examine, does it work, does it not work and what are the problems, and come up with some solutions. And that's what we believe the report does do, that it examines those matters.

We wanted it to be an inclusive process, so we did not want to be out there isolated, so one could say, well, it was the tribes, or it's a self-serving agenda, so sure, they're going to come up with a report. We wanted the BIA involved, from their perspective, the IHS, the Inspector General's office that negotiates it. We wanted HHS' Division of Cost Allocation involved in it, and OMB. And we have gotten quite a bit of support from each of those areas.

My compliments to both BIA and IHS, they were extensively involved in this process and this report that we put together.

Our concern is that out of this report, we came up with a number of fundamental ideas and fundamental notions. In it, we have a number of findings and a number of recommendations that we came up with. But in it, we came up with the observation that indirect cost rates is not a problem. Unfortunately, in the Congress, in the administration, there has been a long-held misperception about what the contract support costs and indirect cost rates are all about.

The indirect cost rates in Indian country is not out of line. As a matter of fact, it's a very modest rate. And we have provided this same testimony over on the House side, and reminded them that the average rate for Indian country is only about 25-percent. Now, the average rate that the Federal Government charges each other, whether it's HHS or other agencies, is 50 percent, in that range. The average rate that you pay for universities is over 50 percent.

And we can show that the universities and State agencies far exceed what the tribes are asking for for these fundamental administrative costs that are part of the Self-Determination Act for contracting and compacting. They go hand in hand.

And in our judgment, the shortfalls on contract support is a clear, unequivocal impediment to advancing the devolution movement, to empower tribal governments, to serve the Indian communities from Alaska to Florida. We consider that a serious problem.

We have regularly heard from the appropriations committees and their staffs and others on the Hill that we can't afford the contract support problem, and we can't close this gap. Well, quite frankly, it's not that big of a gap. When you look at it from the perspective that on the IHS side, we are talking in the $120 million, $130 million range, their total cost expectation next year is somewhere in the neighborhood of $310 million, BIA is about $180 million, which

includes the Rama. Even if you paid the Rama through BIA, it's only $180 million.

Then if you've got us fully paid, our projections are that the increase in contracting and compacting is very modest. So this moratorium is incredibly disturbing to us, because the notion is that we can't close the gap, and that once we close the gap, that it is a high spiraling up escalation of contracting and compacting. That is simply not the truth. The fact is that we expect, on the BIA side, we would expect it to be around 7 percent, IHS side, we expect it to be around 3 percent. It's just not going to be out of control.

Now, having said that, we always talk about, well, it's the numbers, and it's the allocation of resources made available to the committees. You talked about problems we have elsewhere. Well, the Congress has come up with moneys to solve big problems. We've come up with $3 billion, not $3 million, $3 billion to deal with veterans, we've come up with billions of dollars to deal with airports, we've come up with billions of dollars to deal with cost increases for Federal pay scale.

I say to myself, and the tribal leaders say across Indian country, that we can't come up with a couple hundred million to own up to the Federal obligation to these contracts that are out there today, to assure quality and effective services. So our view of the world is this: There are three simple courses here. First is, pay in full, like you should, because it is the Federal obligation.

Second is, don't pay it, continue on with the current course, and force us to sue. Senator Inouye made the comment in the *Rama* case, well, we're going to have to sue to get the money back. The *Rama* case did not get us full recovery it was a settlement, it was a reduction from the actual cost. So that was an issue for us.

The third option is making it an entitlement. Because the *Rama* case did say that it was an entitlement. Now, quite frankly, that's an interesting and novel idea that the Congress could take into consideration. Put it into the entitlement category, because the courts have also argued that it's an entitlement part of this thing, it is an area where you could put it in, and it is an infinitesimal part of that area of cost.

So we think that it is an important part of this arena.

I know I'm out of time here, and I want to point out that we've made a number of recommendations that we think are constructive for consistency, that we think can work. We think that OMB should have a circular, OMB 638, that is consistent with tribes. We are not the same as States. Unfortunately, we don't have the resources they have available to them, so we need circulars that are reflective just of the State.

A novel idea, like GAO's report, number four, the ideas where tribes are interested, as they're stabilizing them, putting them into the base, it works. So our point is this, that we made a commitment. Tribes made a commitment with the United States that if you want to empower the tribes, if you want us to solve our own problems, because you can't solve all of our problems, you must be able to provide us the stable base to allow us to get the job done.

And we're here to help. We have good solutions, and we think they're viable solutions, and we believe that moratorium is unnec-

essary in that the Congress can afford to fix this problem. Thank you.

[Prepared statement of Mr. Allen appears in appendix.]

The CHAIRMAN. Your testimony, as always, is strong and precise. We appreciate it.

We'll go next to Ed Thomas.

STATEMENT OF EDWARD K. THOMAS, PRESIDENT, CENTRAL COUNCIL OF TLINGIT AND HAIDA INDIAN TRIBES OF ALASKA

Mr. THOMAS. Thank you, Mr. Chairman. My name is Ed Thomas, I'm the President of the Tlingit-Haida Central Council from Southeast Alaska.

My tribe has 23,000 members and we've been involved in Federal contracting since 1971. I personally have been involved in managing Federal contracts since 1975.

My verbal comments will not be mirroring my written comments. Since the writing of my testimony, I've found it to be better to kind of explain some of the things that got us as a tribe in Tlingit-Haida in the pickle we're in, and some of the problems we have been confronting.

We for a long time knew that the moneys that have been appropriated to the BIA for our people have been largely consumed by administration. In 1986, the Arizona Republic reported that less than 10 percent of BIA funding went to Indian beneficiaries and Alaska natives. In 1987, there was a House hearing in which my tribe was one of 14 tribal leaders invited to testify at that particular hearing.

And in 1988, the Indian Self-Governance demonstration program was added as part of the amendments to the Self-Determination Act. This allowed us to get into compacts.

So my tribe got involved in a compact in 1992. We converted the entire southeast agency of Alaska, administration, into program dollars. We also took our small portion of the area in central office dollars and converted those into programs for our people. In the one year, we nearly doubled the amount of BIA dollars that went to our tribal beneficiaries.

Now, I come from a part of the country which is called Southeast Alaska. In rural Southeast Alaska, the economic and social conditions have been and continue to be deplorable. Prior to compacting, the native unemployment in rural Southeast Alaska was between 70 and 80 percent. Now it averages just around 54 percent. And that unemployment rate, by the way, is more than twice the employment rate during the Depression in this country.

Prior to compacting, only 14 native college students were on the honor roll, and today, I am pleased to report than more than 100 of the college students that we assist are on the honor roll. And we have just about twice as many applicants for assistance under the college student assistance program.

I bring that out to show that we're making progress in some very difficult situations. We have some very serious challenges as a tribe managing programs. For example, we have to pay taxes on our office space. Many of the tribes don't have to do that, they are on trust land. We have to buy insurance from competitive insurance

vendors in order to stave off some liabilities, both to us as well as to our employees.

It is extremely expensive to move about within our region, because we do not have highways that connect our communities. So we have to fly or catch a ferry. When we catch a ferry, that means employees have to give up a couple days of work just to go to one community.

Everything in Alaska is very expensive. But we as tribal managers must be allowed to stay the course. We cannot afford to lose the battle, and we will not have long-term impacts, positive impacts, on our people unless we stay the course and are allowed to do our job. And we cannot do it without administrative dollars.

Let me draw your attention to my written testimony, on page four. I provide you with a graphic that shows, the vertical bar charts, the dark ones show the Federal programs, the light bars show our State programs. The top line chart is what our administrative costs would be if we were to adjust our administrative costs in line with inflation over those years that are on the chart, from 1987–98.

The bottomline is our actual costs. As you can see, we did not even keep pace with inflation for administration. Let me also point out that during that same period of time, our cumulative under-recovery was about $2.4 million. In other words, we paid to manage those programs out of our earnings of our tribal trust fund about $2.4 million on top of keeping a flat, a very flat administrative rate, as you can see by the chart.

In my 24 years of managing Federal programs, I've been to many, many meetings on this particular topic. I've been to numerous task force and commission meetings, I've served on many of them. I've testified to many, many Congressional and administrative committees. And throughout the years, we've been told we just cannot fully fund indirect costs.

In the 1970's and 1980's, we said, well, the national budget has grown so fast, we just can't fund you. Then in the 1990's, the BIA says that the Congress doesn't appropriate the money. Congress says, well, the BIA doesn't request it. So then we don't get funded. Now we want to set up more studies and commissions.

I was opposed to the TPA task force, and I look at the report that they put forth and I'm very pleased with it. But what happens right now is the administration totally ignores it again. Why do we set up these commissions, why do we set up these task forces if we're simply going to keep ignoring what they say? If we converted the dollars that we're spending on these studies, commissions and hearings into the dollars we need it would take a big cut at the shortfall in our indirect costs.

And I want to echo what Ron was saying, you know, what it seems like no matter what happens, or in the world, we seem to find money to bomb Yugoslavia, to investigate Waco again, for tax breaks, and even studying seagulls in Glacier Bay. Now, where do we get money to study seagulls in Glacier Bay and what for? What are we studying them for? I just can't figure this out.

Now, last summer, a couple of our subsistence people were gathering seagull eggs for subsistence, and they were told, you can't take them, we need them to study. So they were confiscated.

Mr. Chairman, I want to close by thanking you and this distinguished committee for taking this very important issue to heart. I realize that the commitment by people that are here is very sincere, and I hope that something will come of this hearing. I think the only solution is, the only option is fully funding. Without full funding, it becomes like an accumulated interest rate.

The deficit keeps growing, and for the tribes, the expenses to tribes go up, because the money's got to come from somewhere. We're required by our audits to fulfill our agreements. So that's why we ended up paying $2.4 million over the past decade, is because if we didn't do it, then our contracts would get pulled. There's a consequence to us, but there's no consequence to the Government.

Thank you, Mr. Chairman.

[Prepared statement of Mr. Thomas appears in appendix.]

The CHAIRMAN. Thank you.

Mayor Gilmartin.

STATEMENT OF TIMOTHY E. GILMARTIN, MAYOR, METLAKATLA INDIAN COMMUNITY, ACCOMPANIED BY SAUL ATKINSON, VICE MAYOR AND JOSEPH WEBSTER

Mr. GILMARTIN. Good morning, Mr. Chairman, other distinguished committee members. I'm Tim Gilmartin, mayor of the Metlakatla Indian Community-Annette Islands Reserve in Southeast Alaska. Accompanying me is our vice mayor, Saul Atkinson, and our attorney, Joseph Webster, Hobbs, Straus, Dean and Walker.

Thank you for the opportunity to present Metlakatla Community's view on the current contract issue and its relationship with the implementation of the Federal Indian Self-Determination policy. We have a long history with tribal self-determination contracting to directly operate all our BIA and Indian Health Service programs since the early 1980's.

While we consider the tribal self-determination policy to be the most successful Indian policy ever adopted by the United States, the lack of full Federal compliance with 106(a)(2) of the act, which entitles tribal contractors to be paid for their reasonable contract support costs continues to be an obstacle to successful implementation of that policy.

In our written statement, we discuss a number of factors that have contributed to the problem and to which we will continue in fiscal year 2000, unless we work together to develop a reasonable solution in due time constraints. I will limit my remarks to explaining a possible solution to address the present funding crisis in contract support funding.

The compromise proposal we suggest would temporarily pause the growth in total contract requirements while preserving the right of tribes to contract additional Federal programs. It would also provide Congress with an opportunity to resolve the existing contract shortfall under this proposal for the years between fiscal year 2000 and fiscal year 2002. Tribes would be required to provide IHS and BIA with notice of their anticipated contract support requirements 2 years in advance of payment, instead of the current 90 day notice period. Tribes would have the option to contract be-

fore the end of the two year period, but they would do so without any right or claim to contract support during that period.

By delaying any increase in contract support funding requirements for the new programs for 2 years, this notice provision would provide Congress with a 2-year period to address the current shortfall before additional obligations are added, allow process of self-determination to move forward, and coincide the 2-year budget formulation period, allowing both agency and Congress to better fund these costs.

We believe that this proposal addresses Congress' concerns about funding current system while preserving the overall policy of Indian self-determination. Our experience under Title I, Public Law 93–638, has for the most part been good, and we support the right of other tribes to exercise the same rights as we have under the act, to administer Federally funded programs for their people.

We think the present system of determining contract support rates is fair except for the failure of Congress to fund contract support requirements in full. However, it is our understanding that key members of Congress feel that the present system needs correction. We would gladly meet with Federal and tribal representatives in a discipline procedure under the negotiated rulemaking act to thoroughly explore the system and to correct whatever needs to be corrected.

Our support for the negotiation rulemaking process is also strengthened by the recent proposal offered by the Assistant Secretary of Indian Affairs which would reform contract support by making many BIA programs, which in the past have been contracted under the act, not eligible for 638 contracts, thus denying contract support for funding for such programs. We strongly oppose this latest BIA proposal which was developed hastily and without consultation with tribes or even with BIA staff most involved in this matter.

Finally, I would like to comment on the NCAI-sponsored tribal support report, which has been provided to your committee. We support the recommendations in that report that no further moratorium should be imposed on the exercise of tribal rights under the Act, and that Congress should appropriate sufficient funds to pay a full negotiated indirect cost and direct contract support costs for all tribes and tribal organizations operating self-determination programs under Public Law 93–638, as amended.

In conclusion, we urge Congress to work together with tribes to address this remaining obstacle to full implementation of Federal policy of tribal self-determination. Again, thank you for the opportunity to testify on such an important matter.

[Prepared statement of Mr. Gilmartin appears in appendix.]

The CHAIRMAN. Thank you for being here.

Mr. Miller.

STATEMENT OF LLOYD BENTON MILLER, ESQUIRE, LAW FIRM OF SONOSKY, CHAMBERS, SACHSE, MILLER AND MUNSON, ANCHORAGE, AK

Mr. MILLER. For the record, my name is Lloyd Miller. I am with the law firm of Sonosky, Chambers, Sachse, Miller and Munson. I appear today on behalf of 13 tribes and tribal organizations across

8 States that carryout approximately $150 million in BIA and IHS contracts.

The General Accounting Office [GAO] study on contract support costs confirms what tribes have been saying for over 20 years. No. 1, that contract support costs are legitimate. No. 2, that contract support costs are necessary and essential to carryout these contracts. No. 3, that underfunding contract support costs cheats the tribes, and penalizes the Indian people being served by forcing the very programs under contract to be reduced.

These conclusions are not new to this committee. Twelve years ago, this committee leveled a broadside attack on the IHS and BIA for "their consistent failure to fully fund tribal indirect costs." The committee found that, "self-determination contractors' rights have been consistently violated, particularly in the area of indirect costs," and characterized this particular failure as "the single most serious problem" with implementation of the self-determination policy.

The committee further found that the IHS and BIA had never requested full funding of contract support costs, and the GAO now tells us that that failure has continued an additional 12 years. It is directly, and I would say primarily, because of that problem that this committee enacted amendments in 1988 and 1994 to the Indian Self-Determination Act.

In winding up Senator Inouye's remarks at the time, at the key hearing on the bill that became the Indian Self-Determination Act amendments, then-Chairman Inouye put the matter quite well. I'd like to quote it:

> A final word about contracts. I am a member of the Appropriations Committee. And there we deal with contracts all the time. Whenever the Department of Defense gets into a contract with General Electric or Boeing or with any of the other great organizations, that contract is carried out, even if it means supplemental appropriations.
>
> But strangely, in this trust relationship, with Indians, they come to you, maybe halfway or three quarters through the fiscal year, and say, sorry, boys, we do not have the cash, so we are going to stop right here, after you have put up all the money. At the same time, you do not have the resources to sue the Government. Obviously, equity is not on your side. We are going to change that.

And Congress did change that in 1988 and in 1994, through tremendous amendments to the funding provisions of section 106 of the act to the shortfall and supplemental appropriations provisions of section 106 of the act to the model contract provisions in Section 108 to the court remedies of section 110 that have proven to be so important since then.

Along the way, it bears mentioning that Congress, by statute, declared that tribes are "entitled" to be paid contract support costs, that these costs are "required to be paid," that the agencies "shall add these costs to the contract," and that the amount a tribe is entitled to be paid "shall not be less than the amount determined under the Act."

Today, the world is different in one respect. Although the agency's shortcomings have not changed, thanks to the amendments the courts have stepped in to fill the void. They have consistently awarded damages against the agencies, just as Congress intended. And the Interior Board of Contract Appeals has done this under ordinary government contract law. So have the Federal courts.

They have awarded damages, and there are additional cases still pending. In my testimony, I've listed all of the litigation outstanding at this time.

Now, this is the legal, contract-law framework in which we are operating today and in which the tribal witnesses come before this committee and ask Congress to help make the funding mechanisms square with the statutory obligations under the act. Because we are not here dealing with discretionary activities. We are dealing with Government contracts. They are being carried out on behalf of the United States, for the beneficiaries of Federal programs.

If tribal contractors are going to accomplish that Federal mission, they should not be relegated to second class status with fewer rights than Boeing or General Electric or General Dynamics. And the least Congress can do is assure that prompt payment is made each year. Prompt payment should not be dependent on the whims of the budget process, on the competing demands of the agencies and OMB, or on the fortitude of tribes to take on the United States in litigation over the course of many years.

In closing, there are two matters I think that bear special mention here. First, as Ron Allen testified, tribal contractors are exceptionally efficient in operating these programs. Their indirect rates are less than one-half the indirect rates of the Department of Health and Human Services, educational institutions, State public service providers and private foundations, less than one-half.

Second, other comparable Federal Government contractors are paid these costs. These are the audited general and administration costs, what we know of as G&A costs, that are customarily paid to any Government contractor other than a firm, fixed-price contractor. They are paid in full.

Tribal contractors only ask that they be treated just the same. Thank you, Mr. Chairman.

[Prepared statement of Mr. Miller appears in appendix.]

The CHAIRMAN. Thank you, Mr. Miller.

I missed the first part of your testimony, Mr. Miller. What tribes did you say you represent?

Mr. MILLER. We represent the Cherokee Nation, the Chickasaw Nation of Oklahoma——

The CHAIRMAN. A total of 15 or something?

Mr. MILLER. Correct.

The CHAIRMAN. How many of those have sued under the denial of contracts money?

Mr. MILLER. Four of those tribes have brought claims against the United States.

The CHAIRMAN. Have any of them been settled?

Mr. MILLER. No case has gone to final judgment without an appeal. The United States has appealed every successful suit, and appeals are now pending in the 9th Circuit, the 10th Circuit, the Federal Circuit. The United States has really taken a policy of never settling any of these cases. Try as we have to settle them at 50 cents on the dollar, we're unable to settle these cases.

The CHAIRMAN. I see.

Ron, what percentage of the BIA and IHS programs are currently administered by the tribes under the Self-Determination Act, do you know?

Mr. ALLEN. Right now our projects, well, I have a number here that is current with regard to IHS. It's barely over $1 billion of the $2.2 billion that is in the IHS budget. So I would guess it's in the upper 40 percent in IHS. So somewhere in that range is the contractible programs.

On the BIA side, the last estimate we had was somewhere in the range of 50 percent, but I note in the GAO report that they note that it's $546 million of the $1.7 million. So I'm not sure exactly where that number comes from. Our estimates were it was more in the low 50 percent range on the BIA side.

The CHAIRMAN. Do you have any idea how many have been turned back to the BIA or IHS? I know sometimes they contract to do their own law enforcement and find out they don't have the resources, so they turn it back.

Mr. ALLEN. I don't know of any that have been turned back. There have been a few programs that I'm aware of which the Bureau entered into agreements with the tribes to assist them in addressing some of the specific programs, such as an enforcement program and so forth. But none that I know of have actually been turned back. The tribes so much want to be in control of their own affairs that they are willing to expend their available resources to keep those contracts and make it work.

The CHAIRMAN. Mr. Thomas, from 1996 until 1999, after negotiating agreements with the Bureau, your tribe was shorted $954,000, as I understand, money that you had to make up by using money from your own trust fund. How does that affect employment or other tribal programs like seniors or education?

Mr. THOMAS. Well, it's hard to really pinpoint the exact affect. But any time you take a million dollars out of your tribal accounts, those are missed opportunities for us to get involved in other programs.

Many of our dollars are used to leverage moneys from foundations, from other funding sources that requires a match.

The CHAIRMAN. Trust funds.

Mr. THOMAS. Right. So if you were to multiply that by about four times, I think you can pretty much calculate the missed opportunities for our region.

The CHAIRMAN. Mayor Gilmartin, your testimony includes a proposal to provide Federal agencies 2 years notice before assuming any contracts. What would that accomplish?

Mr. GILMARTIN. I'd like our attorney to answer.

The CHAIRMAN. Yes; if you'll give your name for the record.

Mr. WEBSTER. Mr. Chairman, my name is Joseph Webster. I'm an attorney with the District of Columbia office of Hobbs, Straus, Dean and Walker. Mr. Chairman, what the proposal is intended to accomplish are a number of things. One, by providing 2 years of notice, it will allow the agencies and Congress to better plan for funding these costs, while also giving Congress a window of opportunity here to address the exiting shortfall.

It is a compromise. It's less onerous than the moratorium, because it would allow contracting to continue during the 2-year period. But during that period, tribes wouldn't——

The CHAIRMAN. Have you floated that idea with other tribes?

Mr. WEBSTER. We've talked to others of our clients that do support it, yes.

The CHAIRMAN. Not through NCAI, however?

Mr. WEBSTER. We've discussed it with NCAI. This isn't a new proposal. It's been floating around for some time now.

The CHAIRMAN. Senator Inouye, did you have some questions?

Senator INOUYE. Yes; President Allen, have you seen the GAO recommendations.

Mr. ALLEN. Yes.

Senator INOUYE. With the exception of the first one, which says to fully fund the negotiated costs, what do you think about the other three?

Mr. ALLEN. I don't believe that two and three are viable at all. In our judgment, they are unacceptable as options, caps, simply are not a solution and so forth. The fourth one is one that we have been exploring and have been trying to encourage the Congress to consider, because many tribes are out there and they have very stable programs and stable rates. So they would like to take those numbers and put them right into our base.

We think it is a very viable option and it creates the consistency that we believe that Congress and the appropriations committees are interested in.

Senator INOUYE. This is combining indirect and direct costs?

Mr. ALLEN. And allowing the tribes to put it into their base and the deal is the deal, as far as that goes. If there's new programs, then you are allowed to adjust the contract support base with a new program. But with the existing program, from that point forward, you will continue to negotiate rates, because you have other programs. But you will not ask for more money. There is a stabilizing factor there.

Senator INOUYE. This would presume that these are costs that are negotiated?

Mr. ALLEN. Yes.

Senator INOUYE. And you fully fund it.

Mr. ALLEN. It assumes that we would also have a consistency how we deal with the other costs, such as the startup costs and the direct contract support. So those matters are sorted out and they are agreed upon. But once you have taken care of those two areas, the direct contract support and indirect can be weaved right into the base and you can have stability.

Now, I would point out, because this is relative to the proposal the BIA is exploring, and has been circulating, and we believe that that is very, very dangerous. We think that would set us back, and I really want the committee to understand that the notion of separating out a large number of programs and calling them grant assistance programs is contrary to the intent of the Self-Determination Act.

It literally cuts our programs in one-half, and we don't think that that price, that to do that, to undermine the Self-Determination Act, is a price acceptable to remove the moratorium. That really does cause some serious problems, because it assumes all those other programs, enforcement, courts, Johnson-O'Malley and so forth, don't have administrative functions. They do. The same costs.

Senator INOUYE. And on a matter of principle, you would say that the second and third are violating treaty obligations and our trust responsibilities?

Mr. ALLEN. Ask the question again?

Senator INOUYE. The second and third alternative, one, the cap. Would you consider that to be not keeping faith with treaty obligations?

Mr. ALLEN. Absolutely. Absolutely. And it's absolutely inconsistent with the way it is applied anywhere else in the Federal system.

Senator INOUYE. And also in violation of our trust responsibilities?

Mr. ALLEN. Absolutely.

Senator INOUYE. I thank you very much.

If I may ask Mr. Thomas, in your written statement, you said that the more you spend, the less you get. Can you explain that?

Mr. THOMAS. That's on administrative dollars. If we spend, let's say, $1 million, and we spend more than what our allowable indirect cost is, we still only get funded 80 percent of whatever our allowable cost is. So it doesn't make any sense for us to spend more, because we'll end up getting less. The gap will be larger.

So if we spend less, then we still get 80 percent of the lesser amount. So we end up getting less of what our total expenditures are, if they're less than what inflation is or what is on our chart. And that's the case with us right now. We get 80 percent of what you see on the line chart.

Senator INOUYE. Would your answers to my question to President Allen be the same?

Mr. THOMAS. No; I think the only way alternative four would work is if number one was taken care of first. Because it becomes a shell game. Right now, my tribe is experiencing just about $390,000 shortfall this upcoming fiscal year. And all it would do would be consumed in a single block grant, so to speak, and then we'd still end up having to take from other programs.

As you can see by what I stated in my verbal testimony, the unemployment rates, the poverty levels in my region, in my villages, are too severe to be taking money from those programs for administration. So it just becomes borrowing from Peter to pay Paul again, and we're not interested. We feel very strongly that the only option is number one.

Senator INOUYE. As a general rule, GAO recommendations carry much weight. So that is why I am asking the same question of all of you.

Mr. Mayor, what would your responses be to that question of the GAO recommendations? Would it be the same as Mr. Allen?

Mr. GILMARTIN. No; I believe full funding is the only answer. Our community, not to get into a personal matter, but it has been impacted by the shut-down of the timber industry in the Tongass, which is out of our control. Now the moratorium is limiting our options as far as developing new contracts. Contract support is causing us to cut the few remaining trees we have on our small island to meet those costs, to maintain those contracts. Full funding is the only way we're going to survive.

Senator INOUYE. Mr. Miller, you represent 13 tribes. What would the tribes say to the GAO recommendations?

Mr. MILLER. Senator Inouye, the tribes have discussed this on several occasions. They are absolutely opposed to options two and three as a violation of their contract rights and treating them as second class Government contractors. They oppose them unequivocally.

We do believe that option four can work in conjunction with option one, as President Thomas and President Allen have testified. And indeed, the Indian Health Service has experimented with option four and one combined for two tribes I represent. In fiscal year 1998, the Shoshone Paiute Tribes received 100 percent of their contract support cost requirements, and put it into a lump sum base amount. In fiscal year 1998, the Chippewa Cree Tribe of the Rocky Boys Reservation did the same thing, under an experimental program that will last 5 years.

So far, the program is working well. It has given them predictability and stability. They can adopt budgets 2 years ahead of time. It has proven so far to be a successful experiment. We'll wait and see what comes at the end of the 5 years. But we think there is promise so long as it's fully funded at the beginning.

Senator INOUYE. Chairman Campbell was suggesting that the most effective alternative is for Indian nations and Indian tribes to begin developing political muscle. That's when the Government of the United States would consider you as powerful as General Electric and Boeing. But as long as Indian nations somehow are reluctant to participate fully in Federal elections, they may not be taken seriously. So Mr. Allen, I think you've got a job ahead of you.

The CHAIRMAN. He does it very well, I might add. The reason I mentioned that earlier is because one of our witnesses talked about the money we spent on an eagle study, and I was mentioning to my friend Senator Inouye that sometimes money is put in there because the Sierra Club has about 4 million voting members around this Nation, and they have a lot of political clout. I'm convinced than when Indians get more attention, it's because they've got some political clout around here.

I was interested in the comments by Mayor Gilmartin about funding. This year, I was responsible in the Interior appropriations committee for reducing some money for timber management, since you mentioned timber, and putting it into Indian education. Did I get in trouble. Because I found out later that the money came from some timber management in the State of Colorado.

And boy, I tell you what, talk about a political tug of war, even when you want to do something that's right and helpful, you can get in a terrific backlash sometimes when you take money out of other programs. Under these budget caps we're supposed to try to offset any new expenditures. I think it was the right thing to do, but I mention that to you, because I got a lot of heat in my own State for reducing money to timber sales and putting it into Indian education where, from a philosophical standpoint, I thought it was more important.

Mr. GILMARTIN. We understand, as you talk about political power, my job is to provide employment for my people. Coming here is a great expense for our small community, but it has to be done. But what am I taking away from? What job am I impacting to be here? That's the base where we're at, it is trying to provide

those basic needs, not like the Sierra Club members who probably golf and then pay their dues to the Sierra Club. Our people are not in that league. It's difficult.

The CHAIRMAN. Your trying to stay alive. I understand.

Well, with that, I appreciate this panel being here. Did you have anything further?

Mr. THOMAS. Mr. Chairman, may I comment on the political thing? In my region of Southeast Alaska, with the urging of Senator Inouye and others, we more than doubled our participation in State elections. We had two of the State legislators that are native elected to the State legislative body.

The stark reality of it is, we're still a minority. And what happens, the majority from Anchorage, Juneau, and Fairbanks have the numbers and they suppress the programs to our region, to the villages. That is the stark reality.

The same thing on the Federal level. As long as we are clumped into minorities and we depart from the government-to-government relationship, we end up having a small voice, no matter how many people participate. And that is a stark reality on this date on this particular topic right now.

The CHAIRMAN. Don't give up.

With that, the record will stay open 15 days. I might mention, tomorrow Ron Allen will be in a nice, secure, warm building here in Washington, DC., but those who are flying back to Alaska may want to leave today, because I understand that hurricane is coming in tonight or in the morning with some pretty ferocious winds.

Thank you again for appearing here today. This hearing is concluded.

[Whereupon, at 10:53 a.m., the committee was adjourned, to reconvene at the call of the Chair.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF HON. KENT CONRAD, U.S. SENATOR FROM NORTH DAKOTA

I know the issue of contract support costs shortfalls has been a particularly difficult one for tribes throughout the country. Without support funding, tribes face difficulties in administering services to their members.

One example from my State is the indirect costs owed to United Tribes Technical College. UTTC's President David Gipp writes that it is owed more than $1 million in indirect costs by the BIA. He says, "This has meant, among other things, reduced programs, fewer staff salary increases, and deferral of important maintenance of educational and administrative buildings." Other tribal leaders have told me that a lack of contract support funding draws money away from direct health care services for tribal members. I think we can all agree that we need to put every dollar possible toward health care services program dollars that are drawn away due to a lack of contract support funds do not serve those in need.

In order to provide services to its members, tribes need not only program funding, but also the funds necessary to structure sound operations to run those programs.

The General Accounting Office has confirmed for this committee that unmet contract support costs are on the rise and, as more tribes elect to run their own programs and provide services, these costs will continue to rise. I believe this is a fundamental problem that needs to be addressed in order for self-determination to work well in Indian country.

I look forward to hearing from today's witnesses about possible alternatives to solve this chronic underfunding of contract support costs.

PREPARED STATEMENT OF HON. SLADE GORTON, U.S. SENATOR FROM WASHINGTON

I am encouraged by the committee's decision to hold a hearing on the issue of Contract Support Costs. Just before the August recess, the committee attempted to markup S. 979, the Tribal Self-Governance Amendments of 1999, to expand the current self-contracting program at the Indian Health Service.

I offered an amendment during this markup to resolve an issue that the sponsors of the bill were unwilling to address—contract support costs. S. 979 would permit the Indian Health Service to approve as many as 50 new self-governance compacts each year. As the committee memorandum for this hearing states, the current contract support cost shortfall is at least $95 million below the level at which the Indian Health Service has signed contracts with self-governance tribes. To expand this liability to 50 new tribal programs each year is simply irresponsible without first addressing how the Federal Government will pay for existing contract support cost commitments.

I understand we will hear from the General Accounting Office this morning, which recently completed a study that enumerates the shortfall in contract support costs. This information is useful, although I have to say that I still haven't heard a concrete solution to meeting these liabilities. I have been forced to put a morato-

rium on the approval of self-governance contracts in order to protect the Federal Government from further lawsuits. Until the members of this committee and the representatives of the tribes can reach an agreement on how to continue self-governance within the bounds of available appropriations, we will have to limit the approval of additional contracts. I have suggested solutions in the past, such as pro rata distribution of contract support cost funding. These suggestions have been rejected, and we have reached a stalemate. But I don't think we can move forward with S. 979 before the end of the year, despite its many positive provisions, until a reasonable approach to contract support cost funding is developed.

Unfortunately, I think many people have concluded that I am opposed to self-governance due to provisions I have inserted in the Interior Appropriations bill over the past 2 years. I am attempting to address a real problem, and I need this committee's support, the administration's support, and the support of the tribes to find a realistic and sustainable solution.

As members of this body know, I have supported self-governance compacting in the past. The general philosophy surrounding the move to tribal self-governance contracts represents my personal philosophy on many issues. Local communities, whether we are considering education reform or environmental protection, know how best to address their own problems. In the same way, tribal governments know how best to structure their own health programs in way that most benefits tribal members.

However, we must recognize this success has come at a cost, both in real dollars and in unfulfilled promises. The Indian Self-Determination and Education Assistance Act promised tribes direct funding for programs assumed under self-governance contracts. In addition, the Indian Self-Determination and Education Assistance Act guaranteed full funding for contract support costs.

This issue can't be resolved by telling the President to request more funding for Contract Support Costs. We also can't point our fingers at the appropriations committee for failing to find more money for Contract Support Costs.

To put this dilemma in perspective, I understand the Indian Health Service's "needs-based" budget request for fiscal year 2001 would amount to over $13 billion. This figure amounts to nearly the entire allocation I receive for the Interior bill. We have broader issues that must be addressed, and the problem isn't limited to the Indian Health Service. Medicare and Medicaid are on the road to insolvency.

As an appropriator, and many members of this committee sit on the Appropriations Committee, it would be irresponsible to exacerbate the Federal Government's liability until we honestly address this issue, and it would be unfair to misrepresent to tribes the funds that may or may not be available to meet their needs. Although I support the goals of self-governance, as an appropriator, it is irresponsible to expand the Federal Government's commitment to provide contract support costs to more tribal programs when members of this committee cannot reach a consensus on how to address the current shortfall of more than $95 million.

I am aware S. 979 provides many very positive opportunities for self-governance tribes, such as allowing the tribes to purchase pharmaceuticals in bulk and acquire excess Federal properties. However, these positive changes should not lure us into forgetting the growing Contract Support Cost funding shortfall.

I hope this hearing will provide the committee some new approaches to dealing with the contract support cost shortfalls, and I look forward to reviewing the testimony.

PREPARED STATEMENT OF KEVIN GOVER, ASSISTANT SECRETARY FOR INDIAN AFFAIRS, DEPARTMENT OF THE INTERIOR, WASHINGTON, DC

Mr. Chairman and members of the committee, I welcome the opportunity to appear before you today to work toward a solution to the long-standing problems associated with the payment of contract support to Indian tribes.

Several weeks ago, I testified before the House Resources Committee on this same subject. During the hearing, Chairman Young indicated that the committee did not want to amend the Indian Self-Determination and Education Assistance Act [Public Law 93–638] and the written material from the committee also indicated that any proposed changes in contract support that lacked endorsement from the National Congress of American Indians would be "dead on arrival." While I respect Chairman Young's concern that opening the Self-Determination Act [Public Law 93–638] to further amendments may provide an additional opportunity to impose limits on Indian gaming, I believe the act must be amended if we are to reach resolution on contract support.

Almost from the beginning of Public Law 93–638 there have been significantly different points of view between the appropriations committees and the authorizing committees on payment of contract support costs, with the department and Indian tribes caught in the middle. In the last 2 years, this conflict has taken on the utmost importance since the appropriations committees decided that one way to hold down contract support costs was to impose a moratorium on additional Self-Determination awards. This action, Mr. Chairman, represents a tremendous set-back for Federal Indian policy and we must find a way to resolve this impasse.

After reviewing the reports prepared by the General Accounting Office, the National Congress of American Indians and a BIA/Tribal Work Group, I put together a series of draft proposals that were subject to tribal consultation. We received responses from 61 tribes or their lawyers. Thirty-four tribes used an optional form we had provided to record their views on the six key elements of the draft proposal. Work on the proposal is ongoing, with another opportunity for tribal consultation at the NCAI conference in October. Not surprisingly, there is no clear consensus among the tribes that responded to the initial request for views on the draft proposal.

Mr. Chairman, adverse decisions have been entered against the Federal Government in a number of lawsuits brought by tribes over contract support payments [although these decisions are not yet final]. In my opinion, one of the main reasons that we are having this difficulty is that the statute could provide clearer guidance. While the law states that the provision of funds for Self-Determination awards and contract support costs are "subject to the availability of appropriations," the law also states that nothing "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." Contracting tribes argue that contract support costs should be considered mandatory. The administration and the appropriations committees view them as discretionary. The U.S. Government's position in court cases when tribes argue that the "full amount of need" language governs is that this authorization law,is indeed "subject to the availability of appropriations," that these discretionary appropriations have not been provided by Congress, and there is no authority to pay any other claims. Congressional assistance in clarifying the act would help resolve the problems faced by the appropriations committees in trying to find the right balance between providing funding for direct Indian program services and providing funding for tribal indirect expenses.

Once this question is resolved, there remains one other issue that requires a legislative solution and that is the treatment of indirect costs associated with awards made by other Federal agencies. Many Federal programs limit indirect cost recovery by grantees. In the *Ramah* case, the plaintiffs seek to have BIA and IHS adjust the indirect cost rates upward so that we essentially cover the indirect costs that other agencies are not paying. While we do not believe that to be the intent of Public Law 93–638, we also recognize that most tribal governments depend on Federal support for a majority of their program services and lack outside revenue to cover administrative costs that cannot be charged to the Federal award. The costs of other Federal agency awards should not be shifted to BIA and HHS at the expense of those activities like education, law enforcement, and trust asset management. I will work with Congress and within the administration to develop legislative amendments regarding the cost effective treatment of indirect costs associated with grant awards.

Mr. Chairman, I realize that time is short in this session of Congress. I remain hopeful, however, that we can fashion a solution acceptable to the appropriators, the authorizing committees, and the administration.

W. RON ALLEN, PRESIDENT
NATIONAL CONGRESS OF AMERICAN INDIANS
TESTIMONY BEFORE THE
SENATE COMMITTEE ON INDIAN AFFAIRS
HEARING ON
INDIAN SELF-DETERMINATION AND EDUCATION ASSISTANT ACT
AND CONTRACT SUPPORT COSTS
September 15, 1999

Good morning Chairman Campbell and distinguished members of the Senate Committee on Indian Affairs. My name is W. Ron Allen. I am President of the National Congress of American Indians (NCAI) and Chairman of the Jamestown S'Klallam Tribe located in Washington State. On behalf of NCAI, the oldest, largest and most representative Indian organization in the nation, I would like to thank you for the opportunity to testify this morning on the issues of the Indian Self-Determination and Education Assistance and Contract Support Costs. NCAI was organized in 1944 in response to termination and assimilation policies and legislation promulgated by the federal government which proved to be devastating to Indian Nations and Indian people throughout the country. NCAI remains dedicated to the exercise of tribal sovereignty and the continued viability of tribal governments. NCAI also remains committed to advocating aggressively on behalf of the interests of our 250 member tribes on a myriad of issues including the development of contract support costs solutions and funding options in the Bureau of Indian Affairs and the Indian Health Service.

I. INTRODUCTION

The Indian Self-Determination and Education Assistance Act (ISDEAA) authorizes tribes to contract to operate Bureau of Indian Affairs (BIA) and Indian Health Services (IHS) government programs serving the Indian recipients of those programs. The point, as you well know, is multi-faceted: (1) to reduce the federal bureaucracy; (2) to place Indian programs in the hands of the Indian people being served; and (3) to enhance and empower local tribal governments and institutions.

However, the shortfall in contract support costs due under the Act has impeded the achievement of those goals, and has, in fact, penalized our tribal people–the real and ultimate victims of the shortfall. Given the severity of those shortfalls, the impact on the programs themselves, and the growing drumbeat of litigation, last year NCAI took the initiative to form a National Policy Workgroup on Contract Support Costs.

II. NCAI NATIONAL WORKGROUP ON CONTRACT SUPPORT COSTS FINAL REPORT

The purpose of our workgroup was to come to a thorough understanding of the contract support cost system as it has evolved over the years, to identify the problems that have developed and to explore solutions. After thirteen months of work, eleven national meetings, countless smaller working sessions and thousands of hours of volunteered time, we are proud to present to you our Workgroup's Final Report. It is important to underscore the fact that our Report and recommendations is the result of a great deal of hard work and diligence on the part of Tribal leaders, and technical and legal representatives who are experts in this specialized topic.

In preparing this Final Report, it was our intent and desire to be as inclusive as possible. All relevant agencies were invited to participate, including the BIA, IHS, the Office of Inspector General of the Department of the Interior, the Department of Health and Human Services Division of Cost Allocation, and the Office of Management and Budget. Indeed, we even had hopes early on that our report would be a joint tribal-federal report, although eventually that was not possible. While federal representatives actively participated in our Workgroup meetings and discussions, this effort and final report was initiated by the tribes.

In July 1999, the BIA released a separate contract support cost policy which was developed without our knowledge or involvement. I am greatly disturbed and outraged over the substance of this proposal as well as the process utilized in developing this document. NCAI objects to the draft policy as a whole; and strongly urge that the BIA work with the NCAI Workgroup to develop solutions. Despite these problems and disappointments, our NCAI final report went forward, resulting in 31 key findings, 8 guiding principles and 16 major recommendations, some of which I will mention here.

III. NCAI FINAL REPORT - FINDINGS

In the findings section, our work confirmed the integrity of the indirect cost negotiation system as carried out by the Department of the Interior Office of Inspector General. We found it to be free of collusion, over-reaching or abuse, a finding echoed in the General Accounting Office report.

Second, we found that this indirect cost negotiation system has proven to be appropriately flexible to differing tribal conditions. Tribes, like states, counties and cities, are all different. They not only use different accounting systems, practices and materials, but they face vastly different circumstances. Workers' compensation systems may in one part of Indian Country cost many times what the cost is somewhere else. Salaries vary–just as do utilities, rent and the like. Climate alone can play a large role, as can the extent of isolation, and we found the indirect-cost system to be uniquely sensitive to all these factors.

Many in the Administration and Congress have been led by the perception that indirect cost rates have been out of control leading to radically escalating contract support costs. Interestingly, just like the BIA and IHS, we found that indirect rates had in the aggregate remained surprisingly stable–even flat–at under twenty-five percent. This finding directly answered the concern by some that indirect costs were out of control and abused by tribes who saw the sky as the limit on indirect costs. That myth is now firmly dispelled.

Our report reveals that the increase in contract support costs is directly related to the success of the implementation of the ISDEAA. Tribal contracting and compacting activities accelerated to their peak in the mid-1990s in response to the 1994 ISDEAA Amendments and extension of the self-governance initiative to IHS. The trend in the transfer of federal Indian programs to tribal operation under the ISDEAA has leveled off from the peak experienced in the mid-1990s, and with a few notable exceptions should remain constant in the years ahead.

We also found that this static, aggregate, twenty-five-percent rate was less than one-half the indirect rate of DHHS itself, as well as various other federal agencies, universities, state agency service

providers and most private foundations.

We found that the contract support cost shortfall is projected to be relatively small in fiscal year 2000 compared to the overall agency budgets and the magnitude of tribal contracting and compacting. At IHS, it is about $100 million, including a small inflation factor (estimated at 3.5 percent). At BIA, it is approximately $65 million, including adjustment for inflation and factors related to the *Ramah* case (estimated at $21 million). These numbers are actually smaller than what we expected to find.

Finally, we found that contract support costs are for the most part expected to rise slowly in the years ahead. For the BIA, whose total estimated contract support costs requirements are roughly $180 million (which includes adjustment related to the *Ramah* case), the expected annual increase is less than $12 million a year, or about 7 percent. For the IHS, whose total estimated contract support cost requirements are roughly $310 million, the expected long-range increase is $10 million a year, or about 3 percent. These are modest increases indeed.

IV. NCAI FINAL REPORT - RECOMMENDATIONS

In light of these and other findings, we made several recommendations, including the following:

First, we concluded that contract support costs can and must be fully funded. They are an obligation of the federal government, both legally and contractually. This payment is also morally right–consistent with the devolution movement and local empowerment, tribal governments should not be required to permanently reduce funding for their programs and services. Although not specifically addressed in our report, there are really only three choices to address contract support cost funding issues:

- The appropriations committees can appropriate the full amount required–which under today's caps is difficult, at best;
- The appropriations committees can appropriate less, and leave tribes to sue to recover the rest; or
- Appropriate measures can be enacted to make contract support costs a true entitlement in terms of its funding mechanism in Congress.

Given the genuine pressures facing the appropriators, I suggest this Committee give this third option very serious consideration. Cost-wise, the impact is infinitesimal relative to the non-discretionary federal budget. In terms of American Indian and Alaska Native governmental, social and health care programs, however, the impact would be clear, immediate and substantial.

Second, we recommend that the OMB issue a new cost circular specifically devoted to tribes and the unique laws that affect tribes. OMB continues to aggregate tribes in circulars with state and local governments, although Congress regularly recognizes that tribal governments do not have the same available resources to accommodate such circular conditions. Such a proposal was included in the 1994 amendments to the ISDEAA, but was deleted at the last moment at OMB's request. Particularly

since Congress, in the ISDEAA has enacted special cost accounting principles applicable only to tribes, an OMB circular specific to tribes will eliminate the current confusion that exists between those statutory provisions and the existing general circular.

Third, we recommend that Congress authorize one to two years for the development and field testing of a potential "bench-marking" idea that would help bring greater consistency among similarly situated tribes. The idea here is to develop ways of bench-marking particular contract support cost components, so that tribes and government negotiators would have signposts to guide their negotiations, without actually dictating the outcome. If successful, such a proposal could help even out the highs and lows among tribes, thus achieving greater equity between all. Unfortunately, coming up with the precise benchmarks is a fairly technical undertaking that was beyond what we could do in the first year of our work.

Fourth, we believe IHS and BIA should be encouraged to work jointly together in the development of a contract support cost "base budget" approach such as is already under development, and as also described in alternative four to the General Accounting Office report. The agencies should be asked to inform Congress whether any further authorization is necessary to proceed with this efficiency innovation.

Fifth, we recommend that the BIA immediately come into compliance with the law and with the applicable regulations by recognizing and paying direct contract support costs such as workers' compensation and unemployment insurance. Not only must the BIA come into conformity with the law, but it must aggressively go forward and inform each and every tribal contractor that the Bureau will now begin complying with the ISDEAA in this critical respect.

Sixth, we recommend that BIA payment policies more closely mirror IHS policies by promoting first, and foremost, financial stability. As judges have held, neither tribes nor the ultimate Indian beneficiaries are well-served by a system under which the BIA holds back substantial contract support funding until the end of the fiscal year. Rather (and unless overpayments would result) tribes should receive at least the same amount of funding they received in the prior year, and such funds should be paid at the beginning of the fiscal year, not at the end.

Finally, we recommend that the so-called "other federal agency" finally be tackled head-on by Congress. Currently, we operate under a system where a government-wide OMB circular establishes the rules for determining tribal indirect-cost needs, but not all federal agencies feel bound by the circular. As a result, tribes are once again squeezed in the middle. As a first step here, we recommend that Congress call upon the GAO to study the source of each federal agency's restriction on the recovery of indirect costs. Once the source of those restrictions is known, Congress can consider appropriate legislation to overcome the barriers that currently pose such difficult problems for tribes.

V. S. 979 - PERMANENT IHS SELF-GOVERNANCE LEGISLATION

During this session this Committee considered S. 979, permanent authorization for Self-Governance at the Indian Health Service, and study of Self-Governance's applicability to other agencies within the

Department of Health and Human Services. Issues were raised, however, that the permanent authorization would also lead to a significant increase in the need for contract support cost funds.

The ISDEAA authorizes and requires tribes to be Self-Determination contractors before transferring to Self-Governance status. To date, all Self-Governance compacts with IHS were preceded by Self-Determination contracting. This means that most, if not all, contract support costs are already in the system under self-determination contracting and were not new costs.

Since the permanent Self-Governance legislation in S. 979 focuses on tribe/agency relationship issues, rather than not expanded eligibility, it does not significantly implicate the contract support cost debate and quest for solutions in a meaningful way. As such, S. 979 should not be held hostage as we struggle with the difficult resolutions to the shortfall in contract support funding. To the extent that S. 979, can play any role in identifying the solutions, it does so by requiring clear reporting from the Administration as to programmatic funding needs as well as contract support cost requirements; one of the issues that GAO noted to be a problem in their report.

VI. CONCLUSION

In closing, we strongly recommend that all members of the Committee take the time to review the executive summary included in our NCAI final report. I would like to close my remarks by quoting two short paragraphs from our report which I believe put the issue well:

> No single policy in the history of American Indian affairs has more forcefully and effectively permitted tribes to empower their tribal institutions and their people. No single policy has more effectively served to break the cycle of dependency and paternalism. No single policy has better served the philosophy of devolution–moving federal resources and decision making to that level of local government that is closest to the people. And, no single initiative has contributed more to the improvement in the conditions facing American Indian people.
>
> As the Nation enters the new millennium, it is essential that the American people recommit fully and keep faith with the Self-Determination Policy and empowerment of tribal governments consistent with the devolution movement. Only through the continuation of that policy can America both respect the fundamental government-to-government relationship that exists between tribes and the United States, and fulfill the Federal Government's trust responsibility to protect the interests of Native American tribes.

Thank you, Mr. Chairman, for the honor to testify today on this most critical issue. NCAI, Tribal leaders as well as our legal and technical representatives, look forward to continuing to work with you on the development of contract support costs solutions and funding options.

* * * * * *

THE HONORABLE JOHN "ROCKY" BARRETT
CHAIRMAN, CITIZEN POTAWATOMI NATION
TESTIMONY BEFORE THE U.S. SENATE COMMITTEE ON INDIAN AFFAIRS
OVERSIGHT HEARING ON CONTRACT SUPPORT COSTS
SEPTEMBER15, 1999

Chairman Campbell and distinguished members of the Senate Committee on Indian Affairs. My name is John "Rocky" Barrett. I am Chairman of the Citizen Potawatomi Nation located in Shawnee, Oklahoma. On behalf of the 24,414 Citizen Potawatomi enrolled tribal members, located in all 50 states of this great country, I would like to thank you for the opportunity to provide written testimony on the most important issue of contract support costs.

I. INTRODUCTION

The Citizen Potawatomi Nation has signed self-governance compacts with the United States through the Department of Health and Human Services/Indian Health Service (IHS) and the Department of Interior/Bureau of Indian Affairs (BIA). Self-Governance as authorized through P.L. 93-638, as amended, the Indian Self-Determination and Education Assistance Act (ISDEAA). This Act authorizes tribes to contract programs from the BIA and the IHS and therefore enables tribal governments to directly provide services to the American Indian populations residing within the tribe's individual jurisdictional area.

The ISDEAA has proven to be one of the most powerful pieces of Indian legislation enacted in this century. This Act has given tribal governments a resource base that has helped to create local governmental infrastructures from which effective strategies have been launched that have drastically improved the quality of life of Indian people. It has put Indian programs, historically operated by the federal government through inflated IHS and BIA bureaucracies, directly into the hands of Indian people who are most knowledgeable of local needs. Finally, it served to empower local tribal governments and institutions to maximize limited funds by carefully focusing programs on locally identified needs, thus providing local control over limited resources.

Since enacted in its original form in 1975, Congress has consistently supported the Indian Self-Determination concept and for this the Citizen Potawatomi Nation is grateful. However, the point of this hearing speaks to an issue that has the potential to disrupt and undo the progress that has been made in the past twenty-four years, Contract Support Costs for Self-Determination programs.

II. CONTRACT SUPPORT COST AND THE CITIZEN POTAWATOMI NATION

Indian Health Service

The process that the Citizen Potawatomi Nation has been required to endure to access Indian Health Service Contract Support Cost funds has been long and frustrating. The Citizen Potawatomi Nation stood in the IHS queue for a period of one year and was only funded at 11% of need. In December of 1998, the Citizen Potawatomi Nation negotiated in good faith with the Oklahoma City Area Office. These negotiations resulted in a mutually acceptable CSC request based on IHS Circular 94-06. However, in March of 1999, rather than accepting the request that was agreed upon between the Area office and the Tribe, the IHS Department of Financial Management (DFM) made a unilateral decision to reduce the Nation's request in two ways:1) the P.L. 93-638, as amended, 106(a)(1) amount was reduced by $100,000; and. 2) direct contract support recurring costs were slashed by almost $60,000. On April 9th, 1999, the Nation provided additional justification and requested restoration of the Contract Support Cost request.

In an April 26th response letter, Mr. Carl Fitzpatrick made only one adjustment to restore the Nation's CSC request by allowing a one-time start-up training allowance of $5,000 for the five members of the Health Board. Clearly the goal of the DFM was to cut the CSC request to the maximum extent possible. This led us to question if IHS Circular 96-04 was no longer applicable. Again, on May 14th, the Nation provided additional information and requested a reconsideration of our CSC request. The Nation finally received a response to this letter from Dr. Michael Trujillo, Indian Health Service Director, written July 23, 1999. Dr. Trujillo stated he asked Mr. Carl Fitzpatrick, Director DFM to schedule a meeting with the Nation to discuss our concerns about the FY 1000 CSC proposal. He further stated that CSC requests received by the IHS were reviewed in the context of applicable laws and policies expressed in IHS Circular 96-04 to ensure equity and consistency among all tribes on the ISD queue.

To this date, the Nation has not seen or heard from Mr. Fitzpatrick in response to Dr. Trujillo's request that he set up a meeting date to discuss our CSC request. Further, as a result of the actions the DFM has taken regarding the Nation's CSC request, it is our position that we have, indeed, not been treated according to IHS Circular 96-04 and surely not treated equitably and consistently with other tribes that have received funding as a result of the IHS ISD queue policy. For example, during the Nation's negotiations with the IHS for Fiscal Year 2000 funding, it came to the attention of the Nation, that a portion of our Direct Contract Support Costs were classified as "non-recurring" by the Financial Management Office. In the past, all Direct Contract Support Costs, other than start up, were by definition "recurring" and consequently paid each subsequent year without negotiation. Again, it appeared that the IHS Circular 96-04 did not apply to the Citizen Potawatomi Nation. This situation speaks directly to the inequity in funding to various tribes. Other tribes had rightfully received funding for some of the same direct contract support cost items that the Citizen Potawatomi Nation included in its CSC request. The difference is that the Citizen Potawatomi Nation was denied access to CSC funds for these same items.

Start-up Costs: According to the IHS's Indian Self-Determination (ISD) queue, there are three tribes that will be hurt should IHS not pay prior year start up costs. The Citizen Potawatomi Nation is one of those three tribes; yet, we have not, to date, had the opportunity to discuss this issue with the IHS. To date, IHS has refused to pay the Nation its start up costs. If these costs are not paid, we will find ourselves in a $388,867 shortfall. The reason IHS gave the Nation for not paying this amount was an Office of General Council (OGC) interpretation of Section 314 of the Appropriations Bill. On April 24th, the Nation expressed its disapproval of this reduction and requested an appeal for start-up payment based upon the fact that the requested funds are associated with resources made available in our FY 1998 Annual Funding Agreement, the first year the Citizen Potawatomi Nation compacted with the IHS. To date the Nation has not received a response to this second appeal request.

It is appalling that the Indian Health Service chooses to ignore Section 106(a)(5) of the Indian Self-Determination Act which provides start-up funding. Clearly, the ISDEAA provides authority for funding one-time start-up costs. Further, the Act does not limit costs to those obligated in the first year nor does it absolve IHS of all responsibility to pay start-up simply because no money was available in the first year of the self-determination contract.

Currently, the Citizen Potawatomi Nation is building an addition to its Health Complex to house all health services. When completed, the patients will be served in a 24,000 square foot facility. Funding for the facility was obtained through a Department of Housing and Urban Development, Indian Community Development Block Grant along with a sizable Tribal contribution. If the Nation is denied start-up costs to pay for such necessary items as telephone systems, computer systems, and office furniture, we will be forced to use precious health resources. In essence, limited health funds for direct services to patients will be diverted at a time when Congress has allocated an unprecedented amount for contract support costs and when many other Indian Tribes have been paid for their start-up expenses, many of which entailed similar costs. Unquestionably, this situation is in direct opposition to the intent of Congress and negatively impacts the Native American service population of the Citizen Potawatomi Nation.

In conclusion, the Citizen Potawatomi Nation is extremely disappointed with the actions and inaction of the Indian Health Service throughout the past nine months regarding Contract Support Costs. The Division of Financial Management has made arbitrary and unilateral decisions contrary to the Indian Self-Determination Act and has corrupted the entire process. Requests for a response to our earlier letters of appeal and the opportunity to negotiate to close this issue with the appropriate IHS officials have not been honored. Without a viable appeals process, the Nation may be left no other alternative than to seek legal remedies. The IHS process has left us with no way of knowing who or whom has the authority to negotiate. We are seeking the Committee's help in remedying this inequity.

Bureau of Indian Affairs:

The Bureau is considering separating the Indian Programs budget into two appropriations: federal operations and self-determination awards; and, grants to tribes, individuals and organizations. The Citizen Potawatomi Nation strongly opposes this proposal that would result in two classes of BIA programs with grants disqualified from receiving contract support costs. Further, the Nation strongly opposes any policy that the Bureau develops without meaningful participation of tribal governments. The Bureau sent out a form to the tribes in June of this year and the tribes were asked to comment. The CPN provided comments to the Bureau that includes the opposition stated in this testimony. However, the CPN does not believe that this is meaningful consultation. The tribes should have the opportunity to fully discuss the contract support issues with the Bureau and jointly develop strategies for addressing this most important issue.

III. RECOMMEDATIONS

The Citizen Potawatomi Nation strongly recommends that prior year start up cost be paid immediately. The Nation further agrees with the National Congress of American Indians that appropriate measures be enacted to make contract support costs a true entitlement in terms of its funding mechanism in Congress. The Citizen Potawatomi Nation further agrees with the NCAI final report on Contract Support Costs on the following recommendations:

- The Office of Management and Budget issue a new cost circular specifically devoted to tribes and the unique laws that affect tribes.
- IHS and BIA work jointly together in the development of a contract support cost "base budget" approach such is already under development and is also described in alternative four to the General Accounting Office report. The agencies should be asked to inform Congress whether any further authorization is necessary to proceed with this efficiency innovation.
- The BIA should immediately come into compliance with the law and with the applicable regulation by recognizing and paying direct contract support costs. The BIA must also aggressively go forward and inform each and every tribal contractor the Bureau will now begin complying with the ISDEAA in this critical respect.
- The BIA payment policies should more closely mirror IHS policies by promoting first, and foremost, financial stability.
- We strongly concur with the NCAI recommendation that the so-called "other federal agency" finally be tackled head-on by Congress. Currently tribes operate under a system where a government-wide OMB circular establishes the rules for determining tribal indirect-cost needs, but not all federal agencies feel bound by the circular. As a result, tribes once again find themselves in the middle. As a first step here, we recommend that Congress call upon the GAO to study the source of each federal agency" restriction on the recovery of indirect costs. Once the source of those restrictions is known, Congress can consider appropriate legislation to overcome the barriers that currently pose such difficult problems for tribes.

IV. SUMMARY

The Citizen Potawatomi Nation strongly urges the Congress to consider Contract Support Cost as an entitlement. Under this approach, the long, tedious and inexcusable procedures employed by the IHS regarding Contract Support Cost will no longer be able to be employed resulting in a barrier to self-determination. A major reason The Citizen Potawatomi Nation entered into Self-Governance was to escape the bureaucratic conditions employed by the BIA and IHS. The shortfall in contract support costs due under the Act has already impeded the achievement of local goals. Because of this shortfall, many tribal governments like the Citizen Potawatomi Nation have been forced to pay for administrative costs from direct program service dollars. These costs should have been borne by contract support dollars. Contract support costs are a legal, contractual obligation. Perhaps more importantly, they are a moral obligation of the federal government. Tribal governments should not be penalized for implementing local programs that have been authorized by Congress. Further, tribal governments should not be required to reduce funding for their program and services to fund administrative costs associated with providing these services when payment of these contract support costs have been authorized.

The Citizen Potawatomi Nation is appalled that the DHHS Division of Cost Allocation refused to show up and to share their historic data with the National Congress of American Indians (NCAI) National Workgroup on Contract Support Costs. The Nation is further appalled that the BIA released a separate contract support cost policy developed without the NCAI Workgroup knowledge and without tribal involvement. Development of policy of this magnitude without meaningful tribal involvement is analogous to the "taxation without representation" concept that the forefathers of this country so adamantly fought against and fled from.

Contract Support Costs are vital to tribal progress under the Indian Self-Determination and Education Assistance Act. We ask to be treated fairly and on the same basis as other tribes. We also ask to be treated on the same basis that Congress treats private contractors. We are reminded of the Honorable Senator Inouye's remarks approximately ten years ago as he testified as Chairman of the Senate Indian Affairs Committee. He stated that neither government agencies nor the appropriators ever consider simply not paying large government contractors such as Boeing, but that the attitude of government agencies becomes much more cavalier when it comes to Indian tribes.

Indian tribal governments are not mere government contractors but nations within a mighty and honorable nation, the United States of America. Treaties were among the first legal documents signed by the United States as a newly formed government and these were signed with Indian tribes. These relations established the government to government relationship that American Indian tribes and the United States employ today. It is a unique relationship, based on a foundation of honor. Mighty nations stay mighty only when they honor God and country and keep their word and that is the basis of the testimony offered by the Citizen Potawatomi Nation today.

Thank you, Mr. Chairman, for the honor to testify before the Senate Committee on Indian Affairs on the issue of Contract Support Costs, an issue critical to the continued progress of tribal governments and the American Indian people. As we proceed together into the new millennium, let us work jointly to honor the commitments entrusted to us by our great forefathers; and let us leave our children with the legacy that we have kept our commitments. Thank you.

CHAIRMAN
John "Rocky" Barrett

99 SEP 28 PM

SECRETARY-TREASURER
Gene Bruno

CITIZEN POTAWATOMI NATION

September 27, 1999

The Honorable Ben Nighthorse Campbell
Chairman, Senate Committee on Indian Affairs
838 Hart Senate Office Building
Washington, D.C. 20510

Re: September 15, 1999 Hearing on Contract Support Costs

Dear Senator Campbell:

As Chairman of the Citizen Potawatomi Nation, representing 24,414 enrolled tribal members, please accept my gratitude for your exemplary support and knowledge of the contract support issue. Enclosed, for the record, is written testimony regarding the hearing on contract support cost held on September 15, 1999. The testimony includes a description of the patently unfair process the Citizen Potawatomi Nation has endured in an attempt to access contract support costs associated with the Nation's Indian Health Service (IHS) Self-Governance Compact under P.L. 93-638, as amended.

The Citizen Potawatomi Nation stood in the IHS ISD "queue" for almost two years during which the Nation was funded at only 11% of CSC need. Furthermore, after the Nation finally negotiated a mutually acceptable agreement for payment of contract support costs with the Oklahoma City Area Office in December 1998, direct contract support costs were arbitrarily reduced by a unilateral decision of the IHS Department of Financial Management (DFM).

While the years in the ISD queue and the arbitrary reduction in direct contract support have been a financial strain for the Nation, it is the refusal by IHS to pay start-up costs which will have the most immediate negative impact on our ability to render necessary health services to our service area population. According to the Indian Health Service, "Section 314, Public Law 105-277... prohibits the IHS from paying prior year start-up costs from FY 1999 appropriations." As a consequence, the Citizen Potawatomi Nation has not and may never receive $388,867 in start-up funding for the Tribal Health Clinic. We are currently expanding our health clinic to a 24,000 square foot facility and without these vital start-up funds will be forced to take precious health dollars to pay for items such as telephone and computer systems, office furniture, etc. It is important to note that in all previous years Tribes received start-up funds regardless of "prior year" status and those Tribes receiving Contract Support funds for 1999 start-ups received funding as well. It is just those tribes that have been on the ISD queue for the past several years with pending prior year start-up requests that are penalized by IHS interpretation of Section 314 of Public Law 105-277. Surely this is not the intent of Congress.

Thank you for your ongoing support of Tribal Self-Governance and Self-Determination. Please do not hesitate to contact us if any further information or clarification is needed or if we may be of any help to the committee on resolving this most important issue.

Sincerely,

John A. Barrett, Jr.
Chairman

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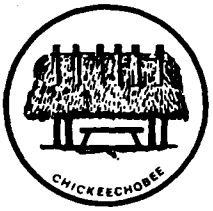

Miccosukee Tribe of Indians
of Florida

Business Council Members
Billy Cypress, Chairman

Jasper Nelson, Ass't. Chairman
Max Billie, Treasurer

Andrew Bert Sr., Secretary
Jerry Cypress, Lawmaker

Statement of Billy Cypress, Chairman
Miccosukee Tribe of Indians of Florida
For the Senate Committee on Indian Affairs
Hearing Record on
Indian Tribal Self-Determination and Contract Support
September 15, 1999

The Miccosukee Tribe of Indians of Florida submits the following statement regarding the Indian Self-Determination Act and contract support costs. We thank the Committee for the opportunity to testify at the hearing and regret that due to the threat of Hurricane Floyd, we were unable to personally present our remarks. Having reviewed the testimony of the other witnesses at the hearing, the Miccosukee Tribe fully supports the compromise proposal offered by the Metlakatla Indian Community for the reasons described below.

Our Tribe has been in the vanguard of the federal policy of tribal self-determination for over a generation. In 1971, we negotiated a contract to operate all the programs of the BIA Miccosukee Indian Agency. Our contract was one of the models for the Indian Self-Determination Act, and we have operated all our BIA and Indian Health Service programs since 1976. We have been actively involved in each of the major amendments to the Act, especially the 1988 and 1994 amendments. We also actively participated in the negotiated rulemaking under the 1994 amendments.

We consider the tribal self-determination policy to be the most successful Indian policy ever adopted by the United States. However, lack of full federal compliance with section 106(a)(2) of the Act, which entitles tribal contractors to be paid for their reasonable contract support costs, continues to be an impediment to the successful implementation of that policy. As we discuss below, a number of factors have contributed to the problem and will continue in FY 2000 unless we work together to develop a reasonable solution.

First, the FY 2000 appropriation bill (S. 1292) approved by the Senate Appropriations Committee proposes to bar for another year the further transfer of programs from federal to local tribal control. This moratorium is justified by its supporters as necessary to halt the growth in the need for contract support funding.

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Constitution Approved by the Secretary of the Interior, January 11, 1962

It is certainly true that the need for contract support funding has grown significantly in recent years. However, this growth is not an indication of a problem with the policy of self-determination. Rather, it is a sign that self-determination is working. As found by the GAO in its recent study, more contract support is required because tribes are taking control of more federal programs – just as Congress intended.

The Miccosukee Tribe firmly believes that the Congress should encourage tribes to take control of programs that would otherwise be operated by federal bureaucrats in Washington. The best way to encourage this devolution of power to the local level is to fully fund contract support costs. These costs are necessary for tribes to assume responsibility for federal programs without being forced to divert limited program funds to administrative costs which self-determination requires but which the government would not incur in its direct operation of the program. For FY 2000, the projected shortfall for contract support for IHS programs is nearly $115 million and approximately $50 million for BIA programs.

We understand that there may be budgetary reasons that hinder the ability of Congress to fully fund contract support as quickly as tribes would like to take control of additional federal programs. Even so, it is simply not acceptable to respond to this situation by bringing the policy of Indian self-determination to a halt, as was done in FY 1999 and proposed to be continued in FY 2000. We also object to the moratorium because it bars our plans to expand our self-determination programs or to exercise rights under the Act to contract with agencies in the Interior Department other than the BIA. There are far less drastic solutions available. For example, the compromise proposal offered by the Metlakatla Indian Community.

We concur that the proposal would not only temporarily delay the growth in total contract support requirements, it would still preserve the rights of tribes to contract additional federal programs. More importantly, tribes would have the option to determine for themselves whether to contract before the end of the two-year notice period, knowing they would do so without any right or claim to contract support during that period.

We believe that this proposal addresses Congress' concerns about funding the current system, while preserving the overall policy of Indian self-determination. The Miccosukee Tribe's experience under Title I of P.L. 93-638 has been beneficial for our people. Thus, we support the right of other tribes to exercise the same rights that we have under the Act to administer federally funded programs for themselves.

The two-year notice period under the proposal would also allow time for a negotiated rulemaking committee to examine the present contract support system and develop any necessary long-term improvements to assure fairness and eliminate obstacles to the achievement of the goals of the Act. Such regulations would provide consistent standards for both HHS and Interior and would be designed to ensure both equity and reliability.

Our support for the negotiated rulemaking approach was strengthened by the Assistant Secretary–Indian Affairs' proposal which would "reform" contract support by making many BIA programs which in the past have been contracted under the Act not eligible for 638 contracts. Rather, these programs would be categorized as "grants," thereby denying contract support funding for such programs. This latest BIA proposal was developed hastily and without consultation with tribes or even with the BIA staff most involved in this matter, and was not mentioned in BIA's own contract support study (dated June 1999). While the Assistant Secretary's written statement for this hearing indicated that the BIA proposal was a work in progress and further tribal consultation would be held, the Tribe believes the negotiated rulemaking process is the best forum to ensure that tribal concerns are considered.

We also suggest a negotiated rulemaking because our recent experience in indirect cost negotiations with the Inspector General indicates that there are aspects of indirect cost procedures, which require clarification to assure conformity with the Act and an efficient negotiating process. In general, the Inspector General has determined that certain costs in our indirect cost proposal cannot be charged to the existing single indirect pool and should be charged to direct costs. The BIA guidelines, however, specify that these costs do not qualify as direct costs. Alternatively, the Inspector General has proposed using a multiple indirect cost rate system under which these disputed costs would all be charged to the BIA. While we may be willing to resolve this matter as proposed by the Inspector General, we view multiple rates as an unnecessary complication in the process.

We note that Assistant Secretary Gover indicated in his February 24, 1999, testimony before the House Resources Committee that the BIA policy of not paying direct costs from contract support funds is being re-examined. There is no indication, however, when or if the policy may be amended. Thus, the Tribe views the negotiated rulemaking as the best avenue for identifying and addressing the improvements necessary to the contract support system.

Finally, we have participated through our legal counsel in the development of the NCAI-sponsored Tribal Contract Support Report, which has been provided to your Committee. The Tribe supports the recommendations that no further moratorium should be imposed on the exercise of tribal rights under the Act, and that Congress should appropriate sufficient funds to pay in full the negotiated indirect costs and the direct contract support costs of all tribes and tribal organizations operating self-determination programs under P.L. 93-638, as amended.

We appreciate the opportunity to present the views of the Miccosukee Tribe. We urge that you work with others in the Congress and with tribes in addressing contract support, the remaining obstacle to full implementation of the federal policy of tribal self-determination.

Statement of Timothy E. Gilmartin, Mayor
Metlakatla Indian Community
for the Senate Committee on Indian Affairs Hearing on
Indian Tribal Self-Determination and Contract Support
September 15, 1999

On behalf of the Metlakatla Indian Community–Annette Islands Reserve, I submit the following statement regarding contract support and the Indian Self-Determination Act. The Metlakatla Indian Community is a federally recognized tribal governing body which exercises jurisdiction over the Annette Islands Reserve under a constitution and by-laws approved by the Secretary of the Interior. The Community is the beneficial owner of the Reserve and operates federal programs for its members under tribal self-government agreements with the Secretary of the Interior and the Secretary of Health and Human Services.

We outline below a possible compromise measure designed to address the present funding crisis in contract support funding, while still preserving the rights of tribes to contract additional federal programs. The Community feels the proposal may also offer an opportunity for developing a permanent solution to the contract support "problem" which would be acceptable to both the tribes and to Congress.

We note that this proposal is presented in the context of a major challenge by some in Congress to the core principles underlying tribal sovereignty and the policy of self-determination. It is our firm belief that tribes must strenuously fight any effort to erode tribal sovereignty and the policy of self-determination. Measures such as the proposal to continue the moratorium on new contracting are simply unacceptable. In our view, the most effective method to fight such challenges is to develop a solution that answers the questions and concerns that have been raised about "contract support" funding, makes no compromises on issues of tribal sovereignty, makes only minimal changes to the Indian Self-Determination Act, and preserves the overall policy of self-determination. We believe that the proposal outlined below is consistent with these goals.

We urge the Committee to keep in mind the key role 'contract support' funding has played in permitting tribes to exercise their rights under P.L. 93-638 without paying a financial penalty for contracting. That is, without having to reduce the level of services to pay tribal overhead costs which do not burden federally operated programs. While we have never received the full amount to which we are entitled under section 106(a)(2) of the Act, we have received sufficient funding for contract support to enable us to proceed with self-determination and self-governance on a financially viable basis.

We think that the proposal explained below, when combined with full funding for contract support, would assure that Indian tribes could continue on the road to effective tribal self-government.

Contract Support Reform Proposal

Our proposal (bill language for which is attached) would temporarily pause the growth in the overall amount of contract support funding required and provide a process for identifying and addressing improvements to the contract support system. The proposed plan would require that between FY 2000 and FY 2002, tribes desiring new or expanded contracts would provide the IHS and BIA two years advance notice of their anticipated contract support requirements. (Presently, there is only a 90-day notice period.) The tribes would, however, have the option to contract prior to the end of the two-year notice period although they would do so without any right or claim to contract support funds during that period.

The longer notice provision would provide the Congress a two-year window in which to address the current contract support shortfall before additional obligations are added. Unlike the moratorium, the proposal would enable the self-determination process to move forward since additional contracting would be permitted. The two-year notice period also coincides with the two-year budget formulation period. Thus, the agencies and the Congress would be able to plan better for funding the contract support costs.

The two year notice period would also allow time for a negotiated rulemaking committee to review the present system and develop, if necessary, long-term improvements. The resulting regulations would provide consistent standards for the Departments of the Interior and the HHS, designed to ensure equity and reliability. We provide, for your consideration, proposed bill language to establish a negotiated rulemaking committee, which would -- within a specified period of time -- develop regulations to ensure fairness and eliminate the obstacles to achievement of the goals of the Indian Self-Determination Act.

Our support for such a process has been strengthened by two recent problems we have had with the IHS and BIA. Under the Community's FY 1999 annual funding agreement with the Indian Health Service, and in accordance with IHS Circular 96-04, it was specified that we would be paid the amount owed to us as provided by sections 106(a)(2) and 106(a)(3) of the Act as well as payment for negotiated start-up costs, both with a priority date of May 7, 1996. Unfortunately, when funds became available, IHS failed to follow the guidelines established by the Circular and instead adopted a different policy for distribution of contract support which resulted in the Community not receiving any of the $83,772 in start-up costs to which it was contractually entitled. In the second instance, the Community has been underfunded in its contract support funds received under its contract with the BIA. This is due to the Inspector General's method for calculating indirect cost rates, which has been held in the Ramah case to wrongly include non-fully funded federal programs in the calculation.

It is our hope that the proposal offered, which provides for negotiated rulemaking, will clarify the contract support system so that further inconsistencies and errors in the system are prevented.

We appreciate the opportunity to present the views of the Metlakatla Indian Community. Thank you for the Committee's attention to an issue of great importance to tribes and the future implementation of the federal policy of tribal self-determination.

NOTICE PROVISION

Notwithstanding any other provisions of law, including but not limited to section 106 of the Indian Self-Determination and Education Assistance Act (Pub. L. 93-638), during FY 2000 - FY 2002, neither the Secretary of the Interior nor the Secretary of Health and Human Services shall pay or obligate the United States to pay contract support funds for any new or expanded contract or compact based upon a request submitted after July 1, 1999, except under the following terms and conditions:

(1) the Indian tribe or tribal organization must provide the Secretary of the Interior or the Secretary of Health and Human Services with notice of its anticipated contract support requirement two years in advance of payment for such costs;

(2) although an Indian tribe or tribal organization is entitled to begin contracting or compacting after the existing 90 day notice period, the Indian tribe or tribal organization shall have no right, entitlement or claim to any contract support funding for the new or expanded contract or compact during the two year notice period;

(3) within six months after an Indian tribe or tribal organization notifies the Secretary of the Interior or the Secretary of Health and Human Services of its anticipated contract support requirement, the appropriate Secretary shall conduct an initial negotiation with the Indian tribe or tribal organization to determine the estimated amount that the Indian tribe or tribal organization is eligible to receive for contract support costs;

(4) a final negotiation of the request will take place within two years after the date of the initial notice by the Indian tribe or tribal organization;

(5) the Secretary of the Interior and the Secretary of Health and Human Services shall report updated estimates of contract support requirements for the next two fiscal years to the applicable authorizing and appropriations committees of Congress on each April 1 and October 1 after October 1, 1999; and

(6) all increases in funds available for contract support in FY 2000 and FY 2001 shall be utilized by the Secretary of the Interior and the Secretary of Health and Human Services to address the shortfall in contract support for programs contracted or compacted, or requested to be contracted or compacted, on or before July 1, 1999.

Provided, nothing herein shall diminish the right of an Indian tribe or tribal organization to receive its full share of funds other than contract support funds as otherwise provided in the Indian Self-Determination and Education Assistance Act.

NEGOTIATED RULEMAKING PROVISION

Section 107 of the Indian Self-Determination and Education Assistance Act (25 U.S.C. § 450k) is amended by adding a new subsection (f):

(f) (1) Notwithstanding any other provisions of law, including but not limited to subsection (a), paragraph (1), the Secretary of the Interior and the Secretary of Health and Human Services are authorized and directed to promulgate regulations to govern the manner in which contract support costs shall be calculated in accordance with the requirements of section 106(a)(2) and 106(a)(5) and the manner in which funds for the payment of such costs shall be distributed to tribes and tribal organizations.

(2) (A) Not later than 60 days after the date of enactment of this Section, the Secretary of the Interior and Secretary of Health and Human Services shall establish a negotiated rulemaking committee pursuant to section 565 of Title 5, to promulgate such regulations as are necessary to carry out this part.

(B) The Secretary shall adapt the negotiated rulemaking procedures to the unique context of Self-Governance and Self-Determination and the government-to-government relationship between the United States and the Indian tribes to ensure that the rulemaking committee represents the interest of diverse small, medium and large tribes, large and small contractors, and tribes operating under Title I, III and IV of this Act.

(C) A negotiated rulemaking committee established pursuant to section 565 of Title 5, to carry out this section shall have as its members only Federal representatives of the Office of Management and Budget, the Department of the Interior Office of Inspector General and Office of the Secretary and DHHS Division of Cost Allocation and tribal government representatives. The rulemaking committee shall comply with the requirements of the Federal Advisory Committee Act, P.L. 92-463, as amended; provided, however, that the committee shall not be required to file its charter with the Administrator of General Services before meeting or taking any action.

(D) The negotiations referred to in paragraph (a) shall be conducted in a timely manner. Proposed regulations to implement this part shall be published in the Federal Register not later than 180 days after enactment of this Act and final regulations shall be published in the Federal Register on or before January 1, 2001.

(3) The regulations promulgated under this subsection shall be promulgated—

(A) in conformance with sections 552 and 553 of Title 5, United States Code, and subsections (c) and (e) of this section; and

(B) as a single set of regulations in Title 25 of the Code of Federal Regulations.

(4) The regulations so promulgated shall be designed to:

(A) provide for uniform rules and standards for the Secretary of the Interior and the Secretary of Health and Human Services concerning the determination and distribution of contract support funds;

(B) provide for simplicity in both application and interpretation;

(C) be fair and equitable to all tribal contractors, with due consideration for such differences as to size and geographic location;

(D) permit prompt payment of contract support funding without unreasonable delay beyond the date that performance commences; and

(E) avoid unreasonable disruptions to existing tribal programs based upon past practices and funding levels.

(5) Notwithstanding any other provision of law (including any regulation), the Secretary of the Interior and the Secretary of Health and Human Services are authorized to jointly establish and fund such interagency committees or other interagency bodies, including advisory bodies comprised of tribal representatives, as may be necessary or appropriate to carry out the provisions of this subsection.

(6) The regulations promulgated under this subsection shall govern notwithstanding any other federal regulation, circular or guideline.

# # #

MICHAEL D. HUGHES ▲▼▲▼▲▼▲▼▲▼▲▼▲▼▲▼▲▼▲▼
CONSULTANT ON INDIAN AFFAIRS • P.O. Box 26540 • Phoenix, AZ 85068-6540 • Telephone 602-395-1136

Bureau of Indian Affairs Funding for Contract Support Cost Funds Fiscal Years 1995-2000

September 28, 1999

I. INTRODUCTION

For the past five years, the Bureau of Indian Affairs has requested funding increases each year for Contract Support Cost (CSC) funds and for the Indian Self-Determination Fund (ISDF).

The Congress cut the funding for CSC funds in FY 1996 and denied a funding increase in FY 1997. The Congress allowed small increases for CSC funds in FY 1998 and FY 1999. The Congress cut the funding for the Indian Self-Determination Fund (ISDF) in FY 1996 and denied funding FY 1999.

II. ANALYSIS OF FUNDING BY FISCAL YEAR

Fiscal Year 1995

The FY 1995 appropriations for Contract Support Cost (CSC) funds and the Indian Self-Determination Fund (ISDF) were:

Contract Support Cost	$95,640,000
Indian Self-Determination Fund	7,486,000

In FY 1995, CSC funds and the ISDF were contained in the Other Recurring account in the BIA budget.

Fiscal Year 1996

Members of the BIA Reorganization Task Force lobbied the BIA to transfer Contract Support Cost Funds and Welfare Assistance Grants from the Other Recurring account to the Tribal Priority Allocations (TPA) account in the FY 1996 budget request. The BIA transferred $96,640,000 in CSC funds, along with $7,486,000 in FY 1995 ISDF funds that were converted to CSC funds for on-going contracts and compacts in FY 1996. The total amount (CSC + ISDF) transferred to TPA was $103,126,000. In addition, the

BIA requested a program increase of $6,500,000 for CSC funds over the FY 1995 level. The BIA's FY 1996 request was:

Contract Support Cost	$109,626,000
Indian Self-Determination Fund	7,000,000

The Congress approved the transfer of the Contract Support Cost funds and the Welfare Assistance Grants to the TPA account, but then imposed a general reduction on TPA funds. The general reduction was $92.1 million (-12.7%) below the FY 1995 appropriation (adjusted for the transfer of CSC and WAG). The FY 1996 appropriations were:

Contract Support Cost	$90,829,000
Indian Self-Determination Fund	5,000,000

The ISDF remained in the Other Recurring account and was not affected by the general decrease to TPA. However, the Congress cut the funding for ISDF by $2.0 million.

Fiscal Year 1997

The BIA requested an increase of $19,779,000 for CSC and $5,000,000 for the ISDF. The BIA's request was:

Contract Support Cost	$110,608,000
Indian Self-Detemination Fund	5,000,000

The Congress rejected the increase for the CSC funds. The FY 1997 appropriations were:

Contract Support Cost	$90,829,000
Indian Self-Determination Fund	5,000,000

Fiscal Year 1998

The BIA requested a program increase of $10,000,000 over FY 1997 for CSC, along with a transfer of $5,000,000 from FY 1997 ISDF funds to CSC. In addition, the BIA asked for another $5.0 million for ISDF for FY 1998. The BIA's request was:

Contract Support Cost	$105,829,000
Indian Self-Determination Fund	5,000,000

The Congress approved the increases. The FY 1998 appropriations were:

Contract Support Cost	$105,829,000
Indian Self-Determination Fund	5,000,000

Fiscal Year 1999

In the FY 1999 budget request, the BIA proposed to transfer the Indian Self-Determination Fund from the Other Recurring account to Tribal Priority Allocations. (The BIA also proposed to transfer FY 1998 ISDF funds to the CSC account for on-going contracts and grants in FY 1999.) The BIA requested another $5,000,000 for ISDF for FY 1999. In addition, the BIA requested a program increase of $4,015,000 for CSC for FY 1999. The BIA's request was:

Contract Support Cost	$114,917,000
Indian Self-Determination Fund	5,000,000

The Congress approved the transfer of the ISDF to the TPA account. However, the Congress did not appropriate any funds for ISDF for FY 1999 because the Congress imposed a moratorium on new and expanded self-determination contracts and self-governance compacts in FY 1999. The Congress approved the transfer of the $5.0 million in FY 1998 ISDF funds to CSC and approved the increase of $4.0 million for CSC. The FY 1999 appropriations were:

Contract Support Cost	$114,891,000
Indian Self-Determination Funds	0

Fiscal Year 2000

The BIA requested a program increase of $6,109,000 for CSC for FY 2000, plus an inflation adjustment of $338,000. This would bring the FY 2000 appropriation to CSC to $121,338,000 which would be an increase of $6,447,000 (5.6%) over the FY 1999 appropriation of $114,891,000.

In addition, the BIA requested $5,000,000 for ISDF for FY 2000, and proposed to allow new and expanded Self-Determination contracts and Self-Governance compacts in FY 2000.

The BIA budget request for FY 2000 was:

Contract Support Cost	$121,338,000
Indian Self-Determination Fund	5,000,000

The House of Representatives denied the program increase for CSC, but allowed an increase of $338,000 for inflation. The House agreed to lift the moratorium on contracting and compacting and recommended $4,976,000 for the ISDF.

The Senate also denied the program increase for CSC and allowed an inflation increase of $338,000. The Senate proposed to extend the moratorium for one more year, and denied the $5.0 million requested for the ISDF.

III. Summary

The BIA has asked for increases in funding for Contract Support Cost funds and the Indian Self-Determination Fund every year for the past four years. The BIA has requested the following program increases for CSC: $6.5 million in FY 1996; $19.8 million in FY 1997; $10.0 million in FY 1998; $4.0 million in FY 1999 and $6.1 million in FY 2000. The Congress rejected the increases in FY 1996 and 1997 and cut the funding for CSC in FY 1996.

CONTRACT SUPPORT COST		
Fiscal Year	BIA Budget Request	Congressional Appropriation
1995	95,823,000	95,640,000
1996	109,626,000	90,829,000
1997	110,608,000	90,829,000
1998	105,829,000	105,829,000
1999	114,917,000	114,891,000
2000	121,338,000	115,229,000*

*Recommended by the House and the Senate

The BIA requested $7.0 million for the Indian Self-Determination Fund in FY 1996; the Congress appropriated $5.0 million. The BIA requested $5.0 million each year from FY 1997 to FY 2000 for the Indian Self-Determination Fund. The Congress has approved the $5.0 million increases each year, except for FY 1999.

INDIAN SELF-DETERMINATION FUND		
Fiscal Year	BIA Budget Request	Congressional Appropriation
1995	0*	7,486,000
1996	7,000,000	5,000,000
1997	5,000,000	5,000,000
1998	5,000,000	5,000,000
1999	5,000,000	0
2000	5,000,000	?

*The Congress created the ISDF in FY 1995

If the Congress had approved the funding increases requested by the BIA for CSC funds and the ISDF during the past five fiscal years, it is possible that the annual CSC shortfall problem would have been solved by now.

OPENING STATEMENT
MICHEL E. LINCOLN, DEPUTY DIRECTOR

Good morning. I am Michel Lincoln, Deputy Director of the Indian Health Service (IHS). Today, I am accompanied by Mr. Ronald Demaray, Office of Tribal Programs; and Ms. Paula Williams, Director, Office of Tribal Self-Governance. We welcome the opportunity to testify on the issue of contract support costs in the Indian Health Service. Contract support cost funding helps finance the provision of quality health care by Indian tribal governments and other tribal organizations contracting and compacting under the Indian Self-Determination and Education Assistance Act (ISDEA), Public Law (P.L.) 93-638).

The IHS has been contracting with Tribes and Tribal Organizations under the Act since its enactment in 1975. We believe the IHS has implemented the Act in a manner consistent with Congressional intent when it passed this cornerstone authority that re-affirms and upholds the government-to-government relationship between Indian tribes and the United States.

At present, the share of the IHS budget allocated to tribally operated programs is in excess of 40%. Over $1 billion annually is now being transferred through self-determination agreements to

tribes and tribal organizations. Contract support cost funding represents approximately 20% of this amount. On average, contract support costs represent an additional cost of approximately 30% above funding for direct program costs. The assumption of programs by tribes has been accompanied by significant downsizing at the IHS headquarters and Area Offices and the transfer of these resources to tribes.

Contract support costs are defined under the Act as an amount for the reasonable costs for those activities that must be conducted by a tribal contractor to ensure compliance with the terms of the contract and prudent management. They include costs that either the Secretary never incurred in her direct operation of the program or are normally provided by the Secretary in support of the program from resources other than those under contract. It is important to understand that, by definition, funding for contract support costs includes funds which are not already in the program amounts contracted by tribes. The Act directs that funding for contract support costs be added to the direct program operation expenses to provide for administrative and related functions necessary to support the operation of the health program under contract.

The requirement for contract support costs has grown significantly since 1995 due, largely, to the increasing assumption of IHS programs by Tribes and Tribal Organizations. In the fiscal years 1996 and 1997 appropriations committee

reports, the IHS was directed to report on Contract Support Cost Funding in Indian Self-Determination Contracts and Compacts. In the development of its report, IHS consulted with tribal governments, the Bureau of Indian Affairs (BIA) and the Office of Inspector General within the Department of the Interior. The report detailed the accelerated assumption of IHS programs by tribes beginning in 1995 as a result of the 1994 amendments to the ISDEA and authorization of the Self-Governance Demonstration Project for the IHS. The report showed that increases in funds appropriated for contract support costs did not keep pace with the accelerated assumptions resulting in an increase in unfunded contract support costs. The report also highlights that the rates for tribal indirect costs, which are the major component of contract support costs, have remained stable, averaging around 23% of direct program costs.

In addition, pursuant to the ISDEA, the IHS gathers contract support cost data annually as a part of its annual "Contract Support Cost Shortfall Report To Congress." This report details, among other things, the total contract support cost requirement of tribes contracting and compacting under the ISDEA and how these funds are allocated among the tribes.

Congress appropriated an increase of $35 million for contract support costs in the Fiscal Year 1999 Interior Appropriations Act with accompanying Committee report language instructing the IHS that the increase should be "used to address the inequity in the

distribution of contract support cost funding in fiscal year 1999." Further, the Congress directed the IHS in cooperation with the tribes, to develop a solution to the contract support cost distribution inequity within existing resources. We have completed one objective and are close to accomplishing the other.

Allocation of $35 million

Based on the Congressional guidance and results of extensive agency consultation with Indian tribal governments, the Indian Health Service has adopted an allocation methodology for the $35 million. We believe this methodology is the most equitable given the total amount of the final negotiated CSC requests submitted by tribes that have entered into P.L. 93-638 contracts or compacts despite not receiving any contract support cost funding for those assumptions. Under the new method, those tribes that have the greatest overall contract support cost need for all programs administered through self-determination contracts and compacts will receive the greatest proportion of new CSC funding. We believe that this allocation methodology is responsive to concerns expressed by the Congress that the Agency address the inequity in contract support funding levels of tribes in the IHS system. We are presently allocating the $35 million increase and we anticipate being able to fund, on average, 86% of the total contract support cost need associated with IHS contracts and compacts based on the FY 1998 CSC shortfall report and FY 1999 ISD negotiations.

Revision of IHS Contract Support Cost Policy

Since 1992 the IHS has had an established, written contract support cost (CSC) policy that was developed and implemented in consultation with tribes and tribal organizations. This policy addresses many of the issues surrounding the determination of CSC needs authorized under the ISDEA and the allocation of CSC funds appropriated by the Congress. The first policy adopted in 1992 was subsequently revised in response to the 1994 amendments to the ISDEA.

As a part of the 1999 appropriations process, the Congress expressed its concern over the inequity caused by existing IHS CSC distribution methodologies and directed the Agency to propose a permanent acceptable solution to the CSC distribution inequity as a part of the FY 2000 budget process. Within days of receiving this instruction from the Congress, the IHS began the process to develop solution to these CSC challenges. The fact that the tribes, Congress and other stakeholders have differing views as to what constitutes "equity" was immediately apparent at the start of our work. Consequently, the tribal and Agency representatives devoted significant time, energy, and resources toward addressing the fundamental issues of equity and developing solutions within the context of the different perspectives and the key stakeholders. With a strong commitment to be as responsive as possible to the concerns expressed by tribes, the courts, and the Congress, the IHS incorporated the results of the tribal-federal work into a major third revision of the current

CSC policy. As an example, the new allocation method being utilized to distribute the new FY 1999 CSC funds is reflected in the Agency's proposed new draft CSC policy.

The IHS continues to consult and work closely with tribes, tribal organizations, and their representatives in the further refinement of the proposed revised CSC policy. This is consistent with the Administration and Congressional policy to support Indian self-determination through active consultation to ensure that all major policies, like the IHS CSC policy, are based on the cornerstone of the Indian Self-Determination Act. The IHS and the Department are both firmly committed to providing meaningful consultation on this issue.

The IHS has now nearly completed the development of a revised CSC policy that we believe addresses the expectation of Congress as stated in the Fiscal Year 1999 Appropriation Committee report. The proposed policy abandons the historic approach to the Indian Self-Determination (ISD) Fund and the maintenance of a queue system in favor of a pro-rata system whereby each eligible tribe with an ISD request receives additional funding proportionate to its overall CSC needs. Those with the greatest unfunded CSC needs will receive the greatest increases in ISD funding. CSC funding to resolve existing inequities(e.g., the $35 million FY 1999 increase) will also be distributed on a similar pro-rata basis providing the greatest CSC increases to the tribes with the greatest unfunded CSC. Basic to this policy however, is the

premise that a tribe's CSC funding will not be reduced provided that the tribe is not funded in excess of 100%. This is consistent with the statutory provisions of Section 106(b) of the ISDEA.

The new policy is much more comprehensive in addressing many of the more subtle facets of CSC than prior policy issuances. This can be seen in our approach to improved projections of CSC needs which is a specific concern of the Congress, the tracking of CSC funding based on contract agreements entered, duplication of costs, and the integration of this information into the IHS budget formulation process. We firmly believe that the proposed CSC policy takes advantage of all of the tools available under the ISDEA to manage CSC in a responsible manner. The policy has been drafted in such a way as to minimize future CSC litigation but the possibility of such litigation remains. IHS and BIA are currently prohibited from issuing regulations in this area but Tribes have from time to time raised the possibility of developing joint BIA/IHS regulations for CSC. The Agency needs to seriously consider whether it is time to pursue congressional authorization to enter into the negotiated rulemaking process to adopt a final rule concerning CSC. The IHS would welcome the opportunity to join with tribes, the BIA, and OIG in addressing these issues.

Other Contract Support Cost Efforts.

Recently, the General Accounting Office (GAO) and the National Congress of American Indians (NCAI) each completed an extensive study of CSC that have been forwarded to the Congress. The IHS cooperated fully in the completion of both of these studies which we believe accurately describe the importance of CSC to tribal governments and Indian self-determination policy. These independent studies have drawn many of the same conclusions that have been reached by the IHS in the course of implementing the ISDEA provisions governing CSC. We believe that both of these studies provide thoughtful insight into CSC issues. In our view, the revised IHS CSC policy is consistent with most of the findings and recommendations contained in these reports and we welcome the opportunity to work with tribes, the BIA, and the Congress in reaching greater agreement amongst all of the varied concerns and views.

Thank you once again for the opportunity to discuss contract support costs in the IHS. We are pleased to answer any questions that you many have.

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OVERSIGHT HEARING ON CONTRACT SUPPORT COSTS

TESTIMONY OF LLOYD BENTON MILLER SONOSKY, CHAMBERS, SACHSE, MILLER & MUNSON

SEPTEMBER 15, 1999

Mr. Chairman, for the record my name is Lloyd Miller and I am a partner with the law firm of Sonosky, Chambers, Sachse, Miller & Munson. I appear today on behalf of 13 tribes and tribal organizations that together carry out over $100 million dollars in federal self-determination contracts in the states of Oklahoma, Arizona, Washington, Nevada, Idaho, Montana, California and Alaska.[1]

The General Accounting Office's careful study of contract support costs confirms what tribes have been saying for over twenty years: that contract support costs are legitimate; that contract support costs are essential and necessary to properly carry out

[1] Our clients in contract support matters include the Cherokee Nation and the Chickasaw Nation of Oklahoma, the Gila River Indian Community Health Care Corporation of Arizona, the Squaxin Island Tribe of Washington, the Shoshone-Paiute Tribes of Nevada and Idaho, the Shoshone-Bannock Tribes of Idaho, the Chippewa Cree Tribe of Montana, the Southern Indian Health Council of California and the Ketchikan Indian Corporation, the Yukon-Kuskokwim Health Corporation, the Arctic Slope Native Association, the Kodiak Area Native Association, and the Eastern Aleutian Tribes, all of Alaska.

federal self-determination contracts; and that underfunding contract support costs cheats the tribes and penalizes the Indian people served – by forcing reductions in contract programs to make up for the government's contract support shortfall.

These conclusions are not new to this Committee. Twelve years ago this Committee leveled a broadside attack on the agencies for "the[ir] consistent failure to fully fund tribal indirect costs," S. Rep. No. 100-274 at 8 (1987). The Committee found that "self-determination contractor's rights have been systematically violated particularly in the area of funding indirect costs," and it characterized this particular failure as "the single most serious problem with implementation of the Indian self-determination policy." Id.

The Committee further found that the BIA and IHS had utterly and consistently "failed to request from the Congress the full amount of funds needed to fully fund tribal indirect costs," id. at 9, a failure which the GAO now tells us has continued unchanged for another 12 years.

It is directly – and primarily – to remedy this funding problem that Congress massively overhauled the Indian Self-Determination Act in 1988.

In winding up his remarks at the hearings on those amendments, then Chairman Inouye put the problem well:

> A final word about contracts: I am a member of the Appropriations Committee, and there we deal with contracts all the time. Whenever the Department of Defense gets into a contract with General Electric or Boeing or any one of the other great organizations, that contract is carried out, even if

> it means supplemental appropriations. But strangely in this trust relationship with Indians they come to you maybe halfway or three quarters through the fiscal year and say, "Sorry, boys, we don't have the cash, so we're going to stop right here" after you've put up all the money. At the same time, you don't have the resources to sue the Government. Obviously, equity is not on your side. We're going to change that.

Hearing on S. 1703 Before the Senate Select Committee on Indian Affairs, 100th Cong., 1st Sess. 55 (Sept. 21, 1987).

And, Congress did change that. In 1988, and again in 1994, Congress enacted massive amendments to the funding provisions of section 106 of the Act, to the shortfall and supplemental appropriations reporting provisions of section 106, to the model contract provisions of section 108, and to the critical court remedies established in section 110.

Along the way, Congress by statute declared that tribes are "entitled" to be paid contract support costs, that these costs are "required to be paid," that the agencies "shall add [these costs] to the contract," and that the amount a tribe is entitled to be paid "shall not be less than the amount determined" under the Act.

Today, the world is different. Although the agencies' shortcomings in the appropriations process have not changed, thanks to these amendments the courts have come in to fill the void. They have consistently awarded damages against the agencies, just as Congress intended. And so it is that the Interior Board of Contract Appeals (which possesses recognized expertise in this area) has ruled, under simple contract law, that "the Government's obligation to fund these indirect costs in accordance with the

[self-determination] contract remains intact, despite the dollar ceiling in the applicable appropriations act." *Appeals of Alamo Navajo School Board and Miccosukee Corp.*, 1997 WL 759411 (Dec. 4, 1997) (slip op. at 45). Similarly, the federal courts have ruled that "regardless of agency appropriations, [nothing in the Act] limit[s] [the agencies'] obligation to fully fund self-determination contracts." *Shoshone-Bannock Tribes v. Shalala*, __ F. Supp. __, 1999 WL 562715 (July 22, 1999) (slip op. at 7). The courts and the Board have awarded damages, and additional damages are still awaiting assessment in other suits now pending against both agencies.[2]

This is the legal framework in which the tribal witnesses today come before this distinguished Committee and respectfully urge that the funding mechanism for contract support costs be improved to square with the Act, and with the tribes' rights as government contractors. After all, we are not here dealing with discretionary activities;

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[2] The courts and contract appeals boards have been universal in their enforcement of tribal contracting rights to contract support costs associated with self-determination contracts. See, e.g., Ramah Navajo School Board v. Babbitt, 87 F.3d 1338 (D.C. Cir. 1996) (invalidating a BIA contract support policy of cutting some tribal contract support costs by 50%); Ramah Navajo Chapter v. Lujan, 112 F.3d 1455 (10th Cir. 1997) (awarding damages arising out of the BIA's unlawful practice of diluting its own responsibility to pay full contract support costs associated with its self-determination contracts); Shoshone-Bannock v. Shalala, 988 F. Supp. 1306 (D. Or. 1997) (Shoshone-Bannock I) and 999 F. Supp. 1395 (D. Or. 1998) (Shoshone-Bannock II) (awarding damages for the unlawful IHS practice of placing tribes on a multi-year waiting list under an agency policy of limiting the amounts available for contract support out of the agency's lump sum appropriation) pending on appeal No. 98-___ (9th Cir.); Appeals of Alamo Navajo School Bd. and Miccosukee Corp., 1997 WL 75944 (IBCA Dec. 4, 1997) (awarding damages for the BIA's failure to pay full contract support costs both in lump sum years and in a capped earmark year), pending on appeal sub nom. Babbitt v. Miccosukee, No. 98-1457 (Fed. Cir.) (appeal limited to FY1994 "capped" appropriation); Appeals of Cherokee Nation of Oklahoma, 1999 WL 440047 (IBCA June 30, 1999) (sustaining liability for damages for contract support costs payable out of lump sum appropriations), pending on appeal sub nom. United States v. Cherokee, No. 99-___ (Fed. Cir.). See also Cherokee Nation and Shoshone-Paiute Tribes v. United States, No. 99-092-S (E.D. Okla.) (complaint filed March 1999).

but with federal government contracts being carried out on behalf of the United States for the Indian beneficiaries of those contracted federal programs.

If tribal contractors are to accomplish that federal mission – if they are not to be relegated to second-class status, somehow with fewer rights than Boeing or General Electric – then the least Congress can do is assure that payment for services rendered will be forthcoming each year. Prompt payment must not be dependent on the politics of the budget process, competing demands within the agencies and within OMB, or the fortitude of tribal contractors to take on the United States in litigation.

Thank you Mr. Chairman for the opportunity to testify this morning. I am available to answer the Committee's questions.

CENTRAL COUNCIL
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TESTIMONY OF THE HONORABLE EDWARD K. THOMAS
President, Central Council of Tlingit and Haida Indians Tribes of Alaska

Oversight Hearing on Contract Support Cost Issues

Before the U.S. Senate Committee on Indian Affairs

September 15, 1999

INTRODUCTION

GREETINGS FROM ALASKA! My name is Edward K. Thomas. I am the elected President of the Central Council of Tlingit and Haida Indian Tribes of Alaska, a federally recognized Indian tribe from Southeast Alaska with over 23,000 members. I have served as the elected President of my Tribe since 1984.

Thank you for the opportunity to testify at this Oversight Hearing on the crisis confronting my Tribe as a result of the calculation and underpayment of indirect costs, also known as Contract Support Costs (CSC), by the Congress and the Administration. My testimony will focus on the programs my Tribe operates with funding from the Bureau of Indian Affairs (BIA).

BIA CSC FUNDING SHORTFALLS CHOKE OUR OPERATIONS

For the period between 1996 through 1999, the BIA failed to deliver to us a total of $953,781 in contract support cost funding which its own negotiators, applying uniform federal rules, had determined were due us for our operation of BIA-funded programs. This $953,781 is what we call our shortfall. This is non-federal money we had to pay from the earnings on our Tribal Trust Fund. The expending of these dollars to replace the federal government's contractual obligations have resulted in lost opportunities to address the many problems facing our people whose unemployment rates are on the average twice that of an unemployment rate during a depression.

Simply put, the way indirect costs are calculated and paid by the United States creates an ever-tightening chokehold on my Tribe's ability to administer programs. If we follow the law and spend what we must, we receive less money to meet these expenditures. The more we spend, the less we get. The less we spend, the less we get. As I set out in greater detail below, both Congress and the BIA have caused this crisis. Together we can solve it.

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In the early 1990s, Central Council took the first possible opportunity to fully assume the operation of all programs, functions, services and activities previously provided to us by BIA employees. We were one of the first ten tribes in the self-governance demonstration project. In our first year, we took over and completely closed down one entire unit of the federal government -- the BIA's Southeast Alaska Agency Office.

Throughout the past decade, our BIA contract support costs have been severely underfunded. In 1996 we recovered only 87% of our contract support need. This meant we faced a 1996 shortfall in funding of $129,418. We did not learn about this shortfall until about halfway through our program year. Leases had been signed. Purchases made. Employees hired. We were well into our budget year, with expenditures meeting plan when suddenly we were told that the equivalent of about six weeks of operations would be unfunded. We were forced to pull $129,418 out of our modest Trust Fund earnings in order to meet the costs we were stuck with by the United States.

Our Trust Fund is what remains of a judgment fund provided to us in exchange for land taken from our Tribe. We have pledged to our membership that we will jealously guard and preserve the principal, and endeavor to reinvest as much as possible of its earnings in order to not have the value of the principal erode due to inflation. It is not the purpose of the Trust Fund to use the interest it has earned to make up for sudden losses created by the United States. The choice we faced at the end of 1996 was either to shutdown all of the vital services we provide our membership, shutter our offices, layoff employees, and pay for early termination of contracts, or to dip into our Trust Fund earnings to maintain operations. We chose to continue.

In 1997, BIA again notified us mid-way through our budget year that it would send us only 77% of our BIA-generated contract support funding requirements. This amounted to an actual under-recovery of $299,287, nearly one-fourth of our annual, BIA-approved budget. Again, we were forced to redirect our limited non-Federal funds so as to permit our operations to continue.

Halfway through 1998, BIA notified us our payment be only 80% of our contract support need. This amounted to an actual shortfall of $302,400.

And earlier this year, the BIA informed us that available funding permitted BIA to send us only 88% of the indirect costs associated with our operation of BIA-funded programs, creating a 1999 shortfall of $222,676. Again, we were forced to reallocate Trust Fund earnings to make up for the difference.

The $953,781 shortfall in BIA contract support funds due Tlingit Haida has placed a great deal of financial stress on our Tribe. It has forced Tlingit Haida to draw over $400,000 out of our original judgment Trust Fund, an amount that otherwise would have significantly boosted the Fund's growth during the recent expansion of the stock market. In addition, the use of these Trust Fund dollars to make up for under-recovery of BIA contract support funding has made it very difficult for Tlingit Haida to provide other critical membership services that Trust Fund dollars have been used for in the past.

In addition to the diversion of our Trust Fund earnings, the shortfall in BIA contract support funding has been felt throughout Tlingit Haida. As an immediate result of this shortfall, we have had to lay off employees who are also tribal members and in desperate need of employment. In a time when staff training is critical to handle the quickly changing advances in technology, the BIA shortfall has made it necessary for us to reduce and even eliminate many training opportunities. Unlike many of the federal agencies from whom we receive grants and contracts, the BIA shortfall has forced us to stop giving merit-based increases in compensation to our most valuable employees. The BIA shortfall has also caused end of year cash-flow management problems making it difficult for us to meet payroll and causing delayed payments on some accounts payable and quarterly retirement payments.

INDIRECT COSTS ARE FIXED COST REQUIREMENTS

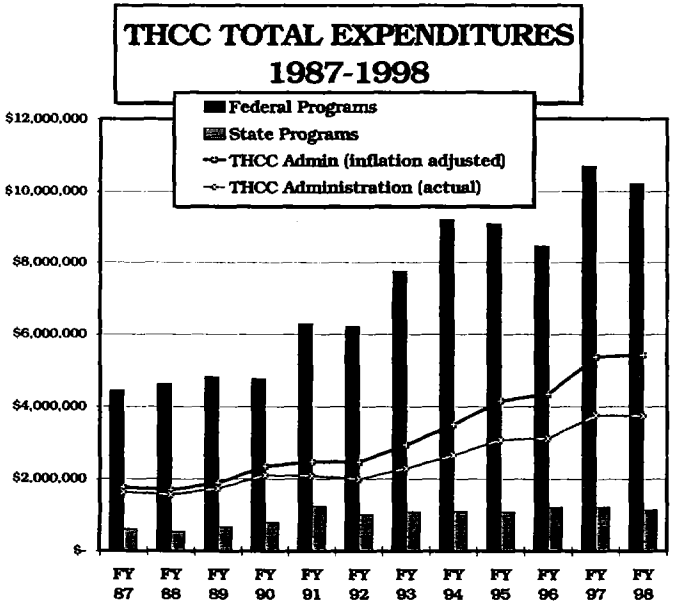
If indirect costs were not primarily "fixed" costs, the recurring problem of a shortfall in BIA contract support cost funding would, perhaps, be survivable. But most of our actual indirect costs are "fixed". For example, typically the most cost-effective way to acquire facility space or equipment is through a long-term lease with locked-in costs. Similarly, package deals for telephone and some forms of transportation offer significant cost savings over time. And obviously, the salary and benefit costs of accounting, administrative, and management staff must be treated as "fixed" or else we cannot hire or keep employees. If BIA does not send us 100% of the funds required by our rate, we have a shortfall associated with our operation of BIA programs.

We refer to tribal indirect cost funding as a "requirement", not a "need". They are requirements because they are derived from negotiations over rates that are used uniformly by federal agencies with all contractors, including universities and the defense industry. The rates use actual expenditures from prior years to project costs in the future year. Once set, the rates must be applied uniformly to all our programs.

Let me be clear about something. We would spiral into bankruptcy if we chose to not spend at the budgeted amounts. Failing to pay certain fixed costs would actually increase our costs (breaking leases, terminating employees, breaching contracts). Deferring certain costs to the following year aggravates the hardship of the shortfalls that cripple that year. And while to a limited extent, the P.L. 93-638 protections against theoretical under-recovery do work with respect to BIA funds; they still do not cushion our Tribe from the difficulties of dealing with shortfalls in non-BIA programs for which we must, by law, use the same indirect cost rate. If in year one we don't spend uniformly on all programs, BIA and non-BIA alike, this will lower the rate negotiated for the following year because the rate must be based on actual expenditures for the prior year. That lower rate is applied across the board to all programs, BIA included. When the BIA "requirement" is calculated by the rate, the BIA then applies an additional reduction to reflect the pro rata shortfall in appropriations earmarked for the contract support cost fund. The bottom line is that our bottom line gets smaller and smaller, year after year while our expenses remain steady or rise with inflation.

TLINGIT HAIDA'S ADMINISTRATIVE COSTS ARE KEPT TO A MINIMUM

I am proud to report that the Central Council has, year after year, restrained the pressures to increase its administrative spending. We have maintained increased below the national rate of inflation, despite the fact that our unemployment rates are exceedingly high and the resulting pressure from our membership is to make job creation the priority above all other program and service priorities. What follows is a chart we annually provide to our tribal membership that shows our revenue growth and administrative constraint:



TLINGIT HAIDA TARGETS ITS INDIRECT COST RATES TO SAVE FUNDS

Some time ago, Tlingit Haida determined that the use of multiple indirect cost rates would provide for better accuracy in the allocation of indirect costs throughout our organizational delivery system. Multiple rates reflect the actual administrative burden generated by various grants and contracts. This burden includes utilities, office space costs, executive direction, accounting and all other overhead costs that benefit all grants and contracts equally. We have used three classifications of direct expenditures made in our grants and contracts. Each of these

direct expenditure classifications requires a different level of administrative effort and cost; therefore, a different indirect cost rate is applied for each one.

The first of our three rates is called our "passthrough" rate and consists of direct funding that passes through Tlingit Haida to a separate and independent non-profit organization or government that both expends and accounts for the funding and most of their own overhead-type expenses. The administrative burden Tlingit Haida carries in this type of arrangement is sharply reduced, so our current passthrough indirect cost rate is only 7.1 percent.

The second of our three rates is called our "offsite" rate and is applied to direct funding accounted for by Tlingit Haida but expended at locations where some costs such as utilities and office space are funded through an independent tribal government and not by Tlingit Haida. In this case, Tlingit Haida has more administrative burden then with passthrough funding but not all indirect costs are covered by Tlingit Haida. Currently our indirect cost rate for offsite expenditures is 13.2 percent.

Our third indirect cost rate classification is called our "onsite" rate and is applied to direct expenditures that are both expended and accounted for by Tlingit Haida. Direct expenditures under this classification are fully supported by Tlingit Haida and include all utilities, office space, executive direction, accounting and all other overhead costs that benefit all grants and contracts equally. Since Tlingit Haida carries the full administrative burden for this classification of direct expenditures the indirect cost rate is at 38.5 percent.

It is our understanding that, when our three rates are blended together they result in a rate that is well within the average range of tribal indirect cost rates.

THE SOURCES OF THE BIA CSC SHORTFALL PROBLEM ARE OBVIOUS

There are several reasons why we have the present shortfall crisis in BIA contract support funding. The GAO study released in June of this year details them in adequate fashion. I wish to focus on three additional factors.

More than a decade ago, Congress and the Administration set up a separate appropriations account for indirect costs associated with the operation of tribal contracts under P.L. 93-638. However, no companion account was set up to identify the direct funds under tribal contracts, in large part because of bureaucratic pressure to obscure the relatively small amount of BIA funds being transferred into tribal contracts at that time. Consequently, annual budget requests for the contract support cost fund have lagged far below required levels, apparently because federal agency officials view as a threat to their job security and spheres of influence the devolution and transfer to tribes of federal programs, functions, services and activities under P.L. 93-638. In other words, direct and indirect funds were "de-linked" some time ago and no attention was paid to how out of proportion they were becoming. If there had been a separate account in the budget structure that contained the direct funds identified to tribal contracts and compacts, the shortfall problem would have been more apparent at an earlier stage of the process. Even at this late date, such an account would serve a useful purpose.

Another factor lies in the variation of tribal indirect cost rates approved by the United States. While the indirect cost rates are uniformly applied, the nature of the rates, and what costs they do and do not cover, varies widely from region to region and tribe to tribe. There is something to be said for the specific and unique factors that each tribe brings to the negotiation table that would allow for some variation. But the fact that some federal negotiators routinely classify certain costs as allowable indirect, and other costs as not, creates a crazy quilt practice throughout Indian Country which in part produces a wide range of very high and very low rates. Tribes who receive nearly all their revenue from BIA and IHS sources, and tribes who have non-federal resources from tribal revenues at their disposal, both have an incentive to classify more costs as indirect, thereby hiking their rates and obtaining higher shares of contract support funds even with the shortfalls. Tribes like Tlingit Haida who receive funding from a variety of sources in addition to the BIA, but have little or no tribal revenues, have no such incentive but also have no ability to make up the difference from the shortfall.

And finally, there has been some misinformation about the extent and future nature of the "problem". The GAO study I referred to earlier helps makes this clear. Between 1989 to 1998, the growth in actual funding of "indirect" costs by BIA and IHS was less (224%) than the growth in "direct" cost funds placed in contracts and compacts (238%). Moreover, the GAO report indicates that the actual amount of indirect costs funded comprised 22.1% of the total of "direct" costs that are in IHS and BIA contracts and compacts. That average tribal administrative cost "rate" should go down as more and more tribes take on more and more programs, since tribal operations already include accounting, payroll, procurement and management systems that could handle added workloads more efficiently. In other words, these systems are in place in most tribal government operations. If these tribes take on more work, the cost efficiencies of their management systems will increase, resulting in a reduction of overall indirect cost rates.

THE BIA CSC SHORTFALL IS A SOLVABLE PROBLEM

In recent years, the problems of shortfalls in BIA and in Indian Health Service (IHS) contract support cost funding have been lumped together and addressed as one. While BIA and IHS shortfalls are similar, the BIA portion of the problem is much smaller. The roots of the BIA problem are different from the IHS problem. And the path to resolution of BIA shortfalls may be easier than fixing the IHS shortfalls, given that there are fewer big BIA than IHS operations waiting in line to be placed in contracts or compacts. I would urge this Committee and the appropriations committees to address the IHS and BIA problems separately, and give priority attention to fixing the resolvable BIA problem first.

Relatively speaking, the bulk of the problem of the BIA contract support cost shortfall can be fixed for many Tribes without requiring huge outlays of additional funding. My Tribe's shortfalls are comparatively modest, about $250,000 per year. Within the overall Federal appropriations, this is a small drop in the bucket. For our tribal budget, however, our shortfalls can represent as much as three months worth of operational costs in any given year. Surely the Congress can find sufficient funds to remove this relatively small shortfall on a permanent basis in an era when the United States spends millions of dollars to painstakingly investigate whether this or that public official fudged the truth when other public officials think they should not have, when our Nation spends billions of dollars on peacekeeping operations surrounding the globe,

and when we spend hundreds of millions of dollars in emergencies relating to budget cap miscalculations as well as natural disasters at home and abroad. Our problem looms large for us. But it could be fixed with a relatively small reallocation of federal funds. All other federal contractors receive 100% of their allowable indirect costs under similar rates negotiated with the United States. Our appropriations should be adjusted to provide us with similar full funding treatment.

The present way of calculating indirect cost rates provides little incentive to some tribes to make their operations efficient. Whatever changes are made to contain the range of rates or to apportion limited funding should take into account the need to protect the most efficient tribal operations first before addressing what appear to be the less efficient ones. As you know, recent lawsuits have resulted in the Congress attempting to place a "cap" in the appropriations law on the amount that BIA is authorized to provide out of the lump sum appropriation regardless of the contract support cost requirements negotiated with the federal Inspector General's office. This inflexible "solution" provides no incentive for tribal administrative cost efficiency.

As you prioritize how you might begin to fix the problems, I would urge upon you several principles:

1. Give priority to fixing the resolvable problems at BIA first.
2. Fully fund allowable costs arising from negotiated rates.
3. If there are limited funds or rates are capped, prioritize the funding of tribal administrative efficiency.
4. Create a new appropriations account for direct funds in contracts or compacts, by which growth in contracting or compacting can be monitored and linked to the already established contract support cost fund.

THANK YOU

Thank you very much, Mr. Chairman and Members of the Committee, for the opportunity to present this testimony on behalf of Central Council of Tlingit and Haida Indian Tribes of Alaska and its citizens we serve. I commend you and this very distinguished committee for the valuable time you are dedicating to this very important issue. I wish you well as you do your work in this Congress and I hope my comments are useful as you consider these very important issues. The contract support cost problems can be resolved and I urge you to first address the BIA shortfalls as the most readily achievable of the solutions.

WRITTEN COMMENTS OF MARY V. THOMAS, GOVERNOR
GILA RIVER INDIAN COMMUNITY
BEFORE THE SENATE COMMITTEE ON INDIAN AFFAIRS

September 15, 1999 Oversight Hearing on Contract Support Costs

INTRODUCTION

My name is Mary Thomas, Governor of the Gila River Indian Community ("the Community"). I am submitting these comments to the Committee to provide for the hearing record the Community's views on the issue of federal funding for Contract Support Costs.

The Gila River Indian Community (the "Community") is located on 372,000 acres in south central Arizona. Our Community is composed of approximately 23,000 tribal members, 13,000 of whom live within the boundaries of the Reservation. The Community provides preventive health and primary care services through its Department of Public Health ("DPH") and the Gila River Health Care Corporation ("GRHCC" or "Corporation").

With minimal exceptions, the Community has operated all health service programs on the Reservation under Indian Self-Determination contracts with the Indian Health Service ("IHS") since fiscal year 1996. We also provide law enforcement, social services, irrigation system construction and rehabilitation, and other community services under self-determination contracts and self-governance agreements with the Bureau of Indian Affairs ("BIA") and the Bureau of Reclamation ("BOR").

We have a relatively young and rapidly growing population, which suffers disproportionate rates of debilitating chronic diseases such as diabetes and alcoholism. In fact, the World Health Organization has found that our population has the highest incidence of type 2 diabetes mellititus in the world. It will take working through at least one generation to move from the IHS model of treating acute health conditions to a Tribally-based health prevention and maintenance model.

We believe this change can only be made through the continued efforts of our Community-managed Department of Public Health and our Health Care Corporation under adequately funded self-determination contracts with the IHS. With respect to our BIA and BOR programs, we similarly believe meaningful improvements can best be made by continuing to operate these programs ourselves through our contracts and compacts with the BIA and BOR.

According to both national statistics and our own experience, Contract Support Costs can be expected to comprise approximately 25% of total program costs. In the area of health care, however, as of today, our Health Care Corporation, in its fourth year of operation, has received only approximately *56% of one year's* Contract Support Costs, and *no payment* for its Contract Support Costs for its first three years. With respect to the Community's ongoing self-determination and self-governance agreements with BIA, we receive less than 100% funding for indirect costs and far less in direct Contract Support Cost funding.

Our experience with contracting with the IHS illustrates the best and the worst of self-determination policy. The DPH has operated community service programs since as far back as 1985. In June of 1995, as the Community was preparing to contract with IHS to assume operation and management of the Community's Hospital and associated program and administrative functions, we submitted to IHS a contract support request of $4 million. Because of the IHS practice of utilizing its first-come first-served waiting list, or "queue", for new and expanded unfunded self-determination Contract Support Cost requests, our request was placed on the queue and we waited for funding. Under this system, the Corporation operated for three years with no contract support funding – waiting to reach the top of the queue.

Eventually our request made it close to the top of the IHS's queue. However, due to an estimated backlog of requests totaling approximately $60 million and litigation over contract support shortfalls, the contract support funding situation reached crisis proportions last year. Last year, certain Members of the Appropriations Committees supported allocating limited contract support appropriations on a pro rata basis among all tribes nationwide without regard to its effect on the underlying programs. In addition, language attempting to retroactively impose a " cap" on the amount of funds available for Contract Support Costs for previous years was enacted as an appropriations rider and a moratorium was imposed on any new contracting.

After a massive effort by tribal leaders and supporters in Congress, including various members of this Committee, $35 million in new funding was included in the FY99 IHS appropriation to begin to address the shortfall. The language requiring pro rata distribution was eliminated but the cap, moratorium, and limitation on past contract support payments remained in place. The Committee Report which accompanied the appropriation made clear that the Committee believed the "queue" system was inequitable and directed the IHS to work with tribes to find a sustainable solution for addressing the perceived inequity and the contract support needs of all tribes contracting with IHS.

At the same time, the General Accounting Office ("GAO") and National Congress of American Indians ("NCAI") initiated independent efforts to examine the shortfalls in contract support funding at the IHS and BIA, and to propose recommendations or alternatives to the current funding systems.

Distribution of IHS Contract Support Funding in FY99

For FY99, it was the Community's understanding that IHS would distribute FY99 contract support funding so as to bring all tribes' contract support funding up to a "floor" of approximately 71% of their total contract support need. It was our understanding that the $35 million increase was to be used to fund contract support requests on the queue to the extent a tribe's total contract support need – taking into consideration ongoing contract support need and payments and new or expanded contract support need – is below the "floor" of approximately 71%.

The Corporation's Contract Support Cost request for FY99 was approved by the IHS at approximately $3.7 million. Of this amount, $790,000 is for previously incurred preaward and

startup costs. The balance, approximately $2.8 million, represents direct costs (including indirect-type costs) which will be recognized by the IHS on a recurring basis so long as the Corporation continues to incur these costs each year. Under the IHS' distribution methodology for FY99, the Corporation was expecting to receive approximately 70% of its approved request, or approximately $2.52 million.

Recently, however, the Community learned that the IHS has made a decision, based on legal recommendations from its Office of General Counsel ("OGC"), not to pay preaward and startup costs incurred in prior fiscal years out of appropriated FY99 contract support cost funds. Instead, IHS has decided to distribute the full $35 million to tribes without payment of any preaward and startup costs[1].

The OGC opinion on this issue concludes that Section 314 of the FY99 Omnibus Appropriations Act prohibits use of any part of the $35 million increase for prior years' preaward and startup costs. As a result of the IHS decision, the Corporation will lose an additional $790,000 in unreimbursed preaward and startup costs. This is in addition to the $1.2 million the Corporation will not receive in FY99 under IHS's new distribution system.

These preaward and startup costs were included in the shortfall amounts communicated to Congress during the FY99 appropriations debates and in the calculations upon which the NCAI and IHS recommendations were based. It was clearly our (and other tribal representatives) expectation that 71% of all approved Contract Support Costs – including preaward and startup – would be paid in FY99. Congressman Hayworth and House Resources Committee Chairman Young sent letters to IHS Director Dr. Trujillo clarifying that it was congressional intent to pay tribes on the ISD queue at least 70% of their contract support costs need, including prior years' preaward and startup costs (see attached letters).

In addition to the preaward and startup costs, IHS is refusing to reimburse to us our unreimbursed Contract Support Costs from FY96 through FY99 that total over $10 million. While not directly involved, we are closely following the recently filed class action under which we may be able to recover these costs.

Proposed Distribution of IHS FY2000 Contract Support Funds

As an initial matter, the FY2000 House Interior Appropriations bill currently contains an additional $35 million in new Contract Support Cost funds. The full House rejected a proposal that these new funds be allocated on a pro rata basis on the ground that such a provision was a matter for consideration under the jurisdiction of the House Resources Committee and not the House Appropriations Committee. Currently, the Senate Interior Appropriations bill does not contain any new amounts for Contract Support Cost funding. We strongly encourage the

[1] If the system had continued without change and Congress appropriated $7.5 million in FY99 as it had in recent years, the Corporation would have received 100% of its FY99 contract support need plus reimbursement for pre-award and start-up costs incurred in prior years. We now estimate the Corporation's cumulative unreimbursed Contract Support Costs for FY96-98 at over $10 million. Each year we did not receive funding, we continued to track our Contract Support Costs and refine our Contract Support Cost request with the involvement and approval of IHS

Committee to push for the Senate's accession to the $35 million in new Contract Support Cost funding for FY2000 without any condition that the funds be allocated on a pro rata basis, in light of the fact that the full House has already rejected this proposal.

With respect to the allocation of new FY2000 Contract Support Cost funds, after working on distribution of the $35 million increase in FY99 contract support funds, the IHS Contract Support Workgroup began consideration of policy changes in response to the events of the FY99 appropriations debate and directives concerning contract support. The workgroup deliberations have resulted in a proposed revised circular. At the outset it is important to note that the proposed new circular accepts less than full funding and then proceeds to explain how the agency will distribute limited funds. It is not acceptable to us that the agency presumes these costs will be permanently underfunded.

The circular divides contract support funding into three pools: (1) an ISD pool for new or expanded contracts ("Pool 1"); (2) a pool for the Contract Support Cost needs of ongoing programs ("Pool 2"); and (3) a pool comprised of any additional funds available for shortfall (" Pool 3"). Perhaps the most significant aspect of the proposed change in policy is that the IHS will now look at a tribe's total contract support need and funding whereas in the past the IHS has considered only the tribe's contract support need associated with its new or expanded contract.

The ISD fund will be used to pay contract support needs associated with new or expanded contracts at a rate as close to full funding as possible. A tribe's *ongoing* shortfall will not be paid from ISD funds however. This method in essence seeks to bring tribes from the bottom up to as close to full funding as appropriations permit.

Other than IHS's refusal to pay our preaward and startup costs and with the threshold caveat that IHS can only do so much with less than full funding, we have not objected to most of IHS's proposed new contract support policy. Of the options discussed, and if one accepts contract support will not be fully funded, the new policy goes the farthest toward funding all tribes' Contract Support Cost needs and moving towards total equity while minimizing disruption to existing programs. We want to be assured, however, that once funded, our level of funding will ***not*** be reduced unless Congress fails to appropriate a recurring level of funds.

Another absolutely critical aspect will be timely information gathering and inclusion of tribes' true future needs in IHS's budget requests. We do, however, object to annual redistribution within IHS Areas as we believe this favors some areas over others and would like to see IHS return to timely national redistribution of contract support funds.

The success of the new policy will be largely dependent on adequate annual appropriations to fund tribes' true contract support needs. Most fundamentally, we reject the underlying premise of the IHS circular – that it is acceptable to have a regime in which a tribe contracts to operate federal programs for the federal government serving federal beneficiaries without the minimally necessary funding to administer those federal programs. This point is especially important when compared to direct services provided by IHS that have full "Contract Support Cost" funding.

NCAI and GAO Reports

Community representatives provided information to the GAO for its consideration in its report and followed closely the work of the NCAI Contract Support Workgroup. We believe each report makes a significant contribution to the ongoing debate and solution of contract support issues.

NCAI Report. The report confirms that the indirect cost rate negotiation system has proved the most workable in light of providing some uniformity for determining diverse tribal needs. The report further confirms the increases in contract support need are due to increased contracting and the associated increase in contract support needs.

We urge that the Administration and Congress further acknowledge that these increases are legitimate and necessary costs of the federal policy of tribal self-determination. It has been our experience that the benefits – in terms of increased access, improved services and improved health status that come with the devolution of federal authority to local tribal governments – more than compensate for any marginal increase in total program cost.

In addition, as noted in the NCAI report, we believe that further development of the idea of " benchmarking" should be made and that through such benchmarking, we may be able to achieve greater consistency while preserving sufficient discretion to allow for tribes' diverse needs and accounting systems.

GAO Report. We believe the ultimate value in the GAO report is that it confirms that the contract support dilemma for tribes is *real*, that is, the failure to fully fund Contract Support Costs adversely affects our local programs and our ability to efficiently administer them.

Also, importantly, the report validates the longstanding tribal position that increases in Contract Support Costs are attributable to increased contracting rather than uncontrollable increases in indirect cost pools and rates. In fact, the report concludes tribes' rates have remained relatively stable over the last ten years at approximately 25 percent.

The report also clarifies some of the common misperceptions about differing rates among tribes – an important point in dispelling the notion that some tribes manipulate their rates or operate inefficiently.

Contrary to the GAO report's reluctance to make predictions about future Contract Support Cost needs, however, we believe the stability in rates coupled with the agencies' hopefully improved data concerning tribes' contract support needs should enable the agencies to fairly accurately predict new contracts coming on line. In fact, we view it as a function of the agencies to know and guide tribes through the initial contracting processes – this should include working with tribes to include their future contract support needs in IHS budget requests.

The GAO report further confirms the effect of shortfalls on tribal programs. The documentation in the report mirrors our experience. Our Health Care Corporation's transition from federal to Tribal operation required extensive development of administrative – personnel, procurement,

finance, information - systems and training.

To function effectively and efficiently, change is still underway and more is necessary to upgrade antiquated medical records and information gathering systems which are absolutely critical in accessing information concerning the number of patient visits, reasons for patient visits, and the number of visits per diagnosis. The law requires, and we were promised, reimbursement for these items. After three, almost four, years of operating with almost none of our IHS-approved contract support need, the lack of contract support funding threatens the Corporation's financial stability.

We are faced with the unpalatable option of reducing services, as patient care dollars are used to cover administrative costs. Moreover, we are confronted with sharp limitations on our ability to expand into other areas of health care delivery. The GAO report is useful in confirming the effects of shortfalls on tribes. This information now needs to be taken seriously and used to support the need for full funding to avoid these detrimental effects on our programs, and to recognize that some initial investment in our infrastructure is necessary to realize increased administrative efficiencies such as more effective patient referrals and maximizing billing of third party resources.

And last, the GAO offers four alternatives for funding tribes' contract support needs. Of these alternatives, we favor options one and four. The first option is to fully fund Contract Support Costs. We believe this option, coupled with several of the recommendations in the NCAI report, would meet both tribal and federal interests on this issue. For instance, with the development of benchmarking and revisions to OMB circulars recognizing cost and audit issues unique to tribal operations, we believe a greater degree of consistency can be achieved so far as the allowable items included in tribes' indirect cost pools for operating similar programs.

We also support further development of option 4, which is to incorporate contract support into tribes' program budgets - essentially consolidating, "grandfathering", or "base budgeting" contract support and program funding. We strongly believe, however, for this option to be successful, the amount of contract support consolidated in the first year must be full funding of contract support need.

There also must be provision for annual increases in the consolidated amount tied to a nationally recognized inflationary index, and some provision for administrative increases tied to significant program increases. With these provisions, we believe option 4 offers considerable potential toward meeting tribal and federal concerns. Our Health Care Corporation is an ideal candidate to demonstrate the potential success of Option 4, and we would be pleased to continue to work with the Committee on such a demonstration.

SUMMARY

In summary, the following are the beliefs and recommendations of the Gila River Indian Community:

We believe that, as our own experience indicates, inadequate funding of Contract Support Costs results in funds being shifted from direct service provision to support.

We believe that the only permanent solution for the problem of Contract Support Costs shortfalls is for IHS and BIA programs to be funded at the 100% level.

We strongly recommend that the Committee support the Senate's accession to the $35 million in new Contract Support Cost funding currently contained in the FY2000 House Interior Appropriations bill, without any language conditioning allocation of the funds on a pro rata basis (based on the recent rejection of such language by the House). In addition, given the severity of the Contract Support Cost shortfall, we urge that serious consideration be given to increasing this amount, if possible.

We strongly believe that past attempts by IHS and BIA to equitably distribute partial Contract Support Costs have not worked and have in fact caused harm to the Gila River Indian Community contracted programs by reducing our Fiscal Year 1999 Contract Support Cost award by $790,000. We encourage the Committee to work with us and other affected tribes to include bill language this year directing the IHS to take into consideration prior year preaward and startup costs when distributing Contract Support Costs for FY2000.

We request that the Committee support the removal of a moratorium on BIA's execution of funding agreements covering new or expanded contract operations. The GAO report confirms that BIA, unlike IHS, has never experienced problems in fully and promptly funding new or expanded contract operations. Along with the removal of the BIA contracting moratorium, we also recommend that a fund of $5 million be set aside to fund anticipated new or expanded BIA agreements (as provided in the House Interior Appropriations bill).

We request that the Committee support Interior Appropriations conference report language that clearly instructs BIA not to carry out any proposal to remove a large number of BIA programs currently contracted under ISDEA from the self-determination process. No such changes should be made until the authorizing committees have had an opportunity to closely study the issues and after input from tribes.

We support GAO report recommendations 1 and 4: full funding for Contract Support Costs and incorporating these costs into contract program budgets. We would be willing to participate in a pilot program that implements a combination of GAO recommendations 1 and 4.

We believe that there must be a single, consistent federal policy dealing with Contract Support Costs that applies to any and all self-determination/self-governance contracting by tribes.

CONCLUSION

In conclusion, the Gila River Indian Community believes strongly that full Contract Support Cost funding is necessary to continue paving the road to self-determination that the Congress outlined and that we have been traveling for almost 25 years now.

In our health programs, we have directed the maximum amount of resources into direct patient care and specifically toward the worst health problems facing our Community. With our BOR program, we have made more progress toward a functioning water delivery system in the four years we have operated under a self-governance agreement than under past federal operation. In law enforcement, we have a more stable and reliable police department than when we relied upon the BIA to operate it.

We ask that you help us preserve and continue the success of our self-governance by committing to contract support policies that first acknowledge our contract support needs as legitimate and necessary and then fully fund these needs.

Statement of Jim Wells, Director,
Energy, Resources, and Science Issues
Resources, Community, and Economic
Development Division

Two months ago, the President of the United States visited the Oglala Sioux Tribe in South Dakota, stressing Native Americans' need for economic empowerment. This historic visit is another step—the first of which was taken in 1975 with the passage of the Indian Self-Determination and Education Assistance Act (the act)—toward recognizing the potential for tribes' self-determination through economic development. The act, as amended, provides that tribes shall have the opportunity to assume the management of federal Indian programs and that they shall receive contract support funds to cover their costs for contract management and administration.[1] However, during our review of contract support costs for tribal self-determination contracts, many tribal officials told us that they have diverted funds from economic development opportunities to cover shortfalls in federal funding.

For example, for fiscal year 1998, the Bureau of Indian Affairs (BIA) and the Indian Health Service (IHS) calculated that they owed the Oglala Sioux an additional $1.5 million in contract support funding that they were unable to provide because of limited appropriations. For all tribes with self-determination contracts, the shortfall in funding for allowable contract support costs totaled $95 million in fiscal year 1998.[2] Contract support costs are intended to cover the expenses tribes incur (e.g., for financial management and accounting, some training, and program startup costs) in managing contracted programs such as social services, hospitals and clinics, road maintenance, law enforcement, and forestry.

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, the tribes' costs that BIA and IHS determine are eligible for reimbursement), increases in the shortfall between these costs and the funding available for them, and litigation over such shortfalls. Because of a lack of progress in

[1]Throughout this testimony, the term "tribes" will refer to both tribes and tribal organizations eligible to contract for programs under the act. Also, the term "contracts" will refer to contracts, grants, self-governance agreements, cooperative agreements, or annual funding agreements that are entered into under the act, as amended, and receive contract support funds.

[2]Tribal contractors and IHS are currently engaged in litigation to determine whether, for Indian self-determination contracts, the funding for tribal contract support costs is limited to the amount appropriated.

resolving this issue during 1999, the Senate Committee on Appropriations has proposed extending the moratorium for another year.

Because of congressional concerns over ever-increasing contract support costs and shortfalls in funding these costs, the Subcommittee on Interior and Related Agencies, Senate Committee on Appropriations, and the Senate Committee on Indian Affairs asked us to review various aspects of these costs in our June 1999 report.[3] We testified last month on our report before the House Committee on Resources.[4] Our testimony today further discusses the issues surrounding Indian contract support costs. In particular, we will discuss (1) the different categories of contract support costs; (2) the extent of, and reasons for, increases in contract support costs over the last several years; and (3) four alternatives for funding these costs.[5]

In summary, BIA and IHS commonly refer to three categories of contract support costs: (1) indirect costs, (2) direct contract support costs, and (3) startup costs. Indirect costs are costs for a tribe's common support services, such as accounting. Direct contract support costs are costs for activities that are program-related but for which the tribe does not receive program funds, such as workers' compensation. Finally, startup costs are costs for one-time expenses incurred in beginning a program, such as the costs of computer hardware and software.

Tribes' allowable contract support costs tripled from 1989 through 1998, increasing from about $125 million to about $375 million.[6] This increase occurred for two principal reasons. First, the total costs of tribally contracted programs—upon which contract support costs are based—have increased. Second, the total cost to tribes of administering their self-determination contracts has increased. Although the amounts appropriated for contract support costs have increased over the past decade, they have not increased as fast as the support costs, resulting in funding shortfalls. For fiscal year 1998, for example, the shortfall between appropriations (almost $280 million) and allowable contract support costs (about $375 million) was about $95 million.

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[3]Indian Self-Determination Act: Shortfalls in Indian Contract Support Costs Need to Be Addressed (GAO/RCED-99-150, June 30, 1999).

[4]Indian Self-Determination Contracting: Shortfalls and Alternatives for Funding Contract Support Costs (GAO/T-RCED-99-271, August 3, 1999).

[5]The June 1999 report also addressed how the tribes have been affected by funding shortfalls for contract support costs and whether the act's provisions for contract support costs have been implemented consistently. The report contained two recommendations to make BIA's and IHS' payment of contract support costs more consistent.

[6]Dollar figures used throughout this testimony have been adjusted to constant 1998 values.

Projections of future contract support costs are difficult to calculate because the number of programs for which tribes will choose to contract in the future is uncertain, as is the amount of funding they will receive.

The impasse over whether to provide full funding for contract support costs or limit these costs continues in the Congress. To assist the Congress in its deliberations over how to resolve the impasse over contract support costs, we present four alternative funding approaches, each of which can be considered individually or combined with the others. 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 separately from and in addition to a program's direct costs and instead provide a single, consolidated contract amount. Each of the alternatives has advantages and disadvantages. Three of the four alternatives have the advantage of controlling future increases in contract support costs. A disadvantage of these same three alternatives is that they would require legislative changes to the act's funding provisions.

Background

Before 1975, Native Americans and Alaska Natives depended on the federal government to provide them with such services as law enforcement, social services, natural resource management, hospital care, and other health services like dental and mental health care. This began to change in 1975 when the government announced a policy of self-determination for tribal governments. The federal government's self-determination policy allows tribes to take over the management and administration of programs previously managed by the government on their behalf. As part of the government's policy, tribes receive funding for the programs they contract to manage as well as funding to cover the costs of their contract management and administration. These latter costs, referred to as contract support costs, are the necessary and reasonable costs tribes incur in establishing and maintaining the support systems needed to administer their contracts.

Tribes enter into self-determination contracts with two agencies: (1) BIA, which is the primary federal agency with responsibility for administering Indian policy and discharging the federal

government's trust responsibility for American Indians and Native Alaskan villages, and (2) IHS, which is responsible for delivering health services to American Indians and Alaska Natives. If a tribe chooses not to contract for a BIA or IHS program, the agencies continue to provide the service to the tribe. In fiscal year 1997, tribes contracted for programs worth about $546 million, excluding such programs as education and construction; BIA's budget that year totaled $1.7 billion. Tribes contracted for IHS programs worth $719 million in fiscal year 1998, and IHS' total budget for that same year was over $2 billion.

Categories of Contract Support Costs

BIA and IHS developed implementing guidelines that specified 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 defines and provides examples of these cost categories.

Table 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[a] and not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved.	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 training required to maintain the certification of direct program personnel, and costs related to direct program salaries, such as unemployment taxes, workers' compensation insurance, and retirement costs.
Startup costs	One-time costs incurred to plan, prepare for, and assume the 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.	Startup costs can include the costs of purchasing computer hardware and software, providing required training and staff development, establishing required administrative and management systems, and purchasing equipment and furniture to support the administrative unit.

[a]A cost objective is a grouping of costs for functions for which cost data are needed and costs are incurred.

[b]According to the Office of Management and Budget's Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, "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 may vary by tribe depending on each one's circumstances.

[c]As discussed in ch. 4 of our June 1999 report, the agencies have inconsistent policies on the payment of direct contract support costs.

Sources: Office of Management and Budget Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments; BIA; and IHS.

In 1996, BIA and IHS issued joint regulations for implementing the act, as amended, as it applies to self-determination contracts. These regulations describe the three types of costs identified in table 1 as costs for which tribes can request reimbursement in their contract proposals.

Tribes' indirect cost rates are negotiated using guidance published by the Office of Management and Budget. This is the same guidance used by other groups, such as state and local governments and nonprofit agencies. The Department of the Interior's Office of Inspector General negotiates the majority of these rates. The Department of Health and Human Services' Division of Cost Allocation also negotiates some rates, predominately for tribal organizations. A number of legal challenges have dealt with the rate-setting process and the funding for contract support costs. A 1997 court decision—Ramah Navajo Chapter v. Lujan—may require a change in

the Inspector General's method of calculating indirect cost rates; we do not address this issue in our testimony because the settlement discussion is ongoing.[7]

Past Increases in Contract Support Costs Likely to Continue

As tribes' funding for contracted programs has increased over the past decade, so has the funding for contract support costs. In the past decade, the total dollars that BIA and IHS have provided to tribes for self-determination contracts has more than doubled, from about $800 million in fiscal year 1989 to about $1.9 billion in fiscal year 1998.[8] 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 BIA and IHS. 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.

The exact amount of future contract support costs is difficult to predict but will likely increase beyond the $375 million calculated for fiscal year 1998. The extent of future increases will depend on the (1) amount of future appropriations BIA and IHS receive for contracted programs, (2) extent to which tribes choose to contract for new programs in the future, and (3) future changes in tribes' costs of administering contracts. Currently, tribes receive funding through self-determination contracts equal to about half of BIA's and IHS' total appropriations; the other half is being used by BIA and IHS themselves to provide services to tribes. If the half now being used by BIA and IHS were contracted by tribes in the future and if indirect cost rates were to stay about the same, then contract support costs could double—from the fiscal year 1998 amount of about $375 million to about $750 million.

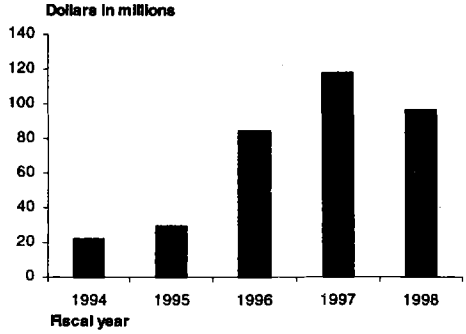
[7] 112 F. 3d 1455 (10th Cir. 1997).

[8] Because BIA could not provide us with fiscal year 1998 contracting data, this information is based on fiscal year 1997 contracting data expressed in constant 1998 dollars.

Alternatives for Funding Contract Support Costs

Shortfalls in contract support funding have persisted for the past decade, with the most dramatic shortfalls occurring in the last 5 years. Figure 1 shows that funding shortfalls grew from about $22 million in fiscal year 1994 to about $95 million in fiscal year 1998, peaking at about $120 million in fiscal year 1997.

Figure 1: Shortfalls in Contract Support Funding for BIA and IHS, Fiscal Years 1994-98



In response to the need for a permanent solution to the current funding impasse, we are presenting four alternatives for funding contract support costs. We discuss the advantages, disadvantages, and cost implications of each. In discussing the costs of each alternative, we address costs starting in fiscal year 1998. We do not address the additional funding that would be necessary if prior years' shortfalls were to be covered or BIA and IHS were to change their methods for determining direct contract support costs.[9] 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

[9]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 provision is currently being challenged by tribal contractors.

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). Under 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. The agencies would identify and request the funds necessary to support new contracts.

Advantages and Disadvantages

The first alternative has the advantage of fulfilling the provisions of the 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 potential for lawsuits stemming from such shortfalls. This alternative would be advantageous to tribes because it would help ensure that they receive the allowable support funds for the BIA and IHS programs they contract. As tribes contract for more programs, they may need to build up their administrative systems to properly administer and manage their contracts.

The primary disadvantage of this alternative is that its implementation would require the Congress to fully fund all allowable contract support costs, which would likely continue to increase each year. It is difficult to predict future contract support costs for several reasons, including the difficulty of determining how many tribes will enter into new contracts during a given year. As BIA and IHS transfer more and more programs to 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 would not provide tribes with incentives to limit the growth of contract support costs and, particularly, of indirect costs. Although tribes must justify their indirect cost rates through the standard rate negotiation process and, under the law, should not receive duplicate funding for the same task from program funding and contract support funding, the current method of funding indirect costs could encourage tribes to classify as many costs as possible as "indirect" to receive more funding.

Cost of the First Alternative

Because the need for contract support funding will, in all probability, continue to increase each year, the "full funding" alternative will involve ever-increasing amounts of funding. The cost of this alternative would be about $375 million the first year, including the fiscal year 1998 funding shortfall, and would increase by the amount paid for new and expanded contracts and an undetermined amount for changes to existing contracts due to changes in indirect cost rates or program funding.[10] The incremental cost of this alternative for the first year would be $95 million, the amount of the shortfall for fiscal year 1998.

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.[11] This alternative would eliminate the expectation of full funding as well as the potential for lawsuits stemming from funding shortfalls. Under this alternative, BIA and IHS would continue to identify tribes' allowable costs, using their indirect cost rates, in the agencies' budget requests.

Advantages and Disadvantages

This alternative has the advantage of limiting the growth of contract support funding; funding amounts would be established by the amount that the Congress appropriates each year. At the

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

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

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 would be available, when, in fact, appropriations and funding have been limited and shortfalls have occurred.

A disadvantage of this alternative is that it might 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 the Senate authorizing committee has explicitly stated, assuming responsibility for these programs was not intended to diminish tribes' program resources.[12]

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 produce shortfalls between the amounts provided and those identified as allowed for contract support. Appropriations could fluctuate from year to year, and this could negatively affect tribes' ability to plan and budget for administering their programs.

Cost of the Second Alternative

The cost of this alternative would depend on the annual appropriations provided by the Congress for contract support. For fiscal year 1998, $280 million was provided.

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

A third alternative would be to amend the act to limit the amount of funding tribes could receive for contract support by limiting the amount of indirect costs they 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.

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

Advantages and Disadvantages

Like the second alternative, this one has the advantage of imposing limits on the growth of funding for contract support costs and of eliminating the expectation created by the law's current language that such costs would be fully funded.[13] 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 it at the same rate.

However, a disadvantage of this alternative to tribes is that it would ignore differences among individual tribes' actual indirect costs, which make up the majority of contract support costs and vary widely among tribes. By ignoring these differences, this alternative could provide a windfall for tribes that have low indirect cost rates while placing those with high rates at a disadvantage, depending on the specific rate limit that would be applied. Currently, 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. For example, if a tribe had a 30-percent rate before this fixed rate was set, it would receive 5 percent less for indirect costs each year. On the other hand, a tribe that had a 15-percent rate before the establishment of a fixed 25-percent rate would receive 10 percent more each year than it would have done otherwise. While this alternative would provide an incentive for tribes with high indirect cost rates to lower their indirect costs, BIA and IHS would have to redistribute funding among tribes, which could cause financial and administrative disruption for those that would lose funding.

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. This amount would be higher or lower depending on the rate chosen by the Congress.

[13]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. See University Research: Effect of Indirect Cost Revisions and Options for Future Changes (GAO/RCED-96-74, Mar. 6, 1996).

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 direct funding for the program, 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. Upon consolidation into a single contract amount, these cost categories would lose their individual identities and would thereafter simply make up the contract total. This method was tried before but failed because of funding shortfalls. BIA tried to create a single contract amount in the mid-1980s.

Advantages and Disadvantages

An advantage of this alternative for both the government and tribes is that it would provide for the full recovery of indirect costs, although the amount of funding provided might not increase. At the same time, this alternative would remove 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 had been set, any increases in indirect costs would leave less money to spend for the program. Tribes would thus have an incentive 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 act, tribes would decide how much funding to spend on program costs and how much to spend on administrative, or indirect, activities. Under 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 automatically 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 program amounts.

Thus, tribes would bear the responsibility for managing indirect costs prudently, to retain as much funding as possible for program services.

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 but would not differ from the previous failed attempt by BIA. The incremental cost of consolidating the funding at this amount would be zero. 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. For fiscal year 1998 funding, the consolidated amount would be about $375 million, or $95 million more than the $280 million appropriated. As under the other alternatives, funding for contract support costs would continue to be needed for new contracts. But under this alternative, future increases in contract support costs would be slowed for existing contracts because the funding mechanism would no longer provide amounts for contract support over and above the amounts for program services. Thus, if the Congress decided to increase the funding for a particular program, this decision would not create a corollary obligation to increase the funding for contract support.

Mr. Chairman, this concludes my statement. We would be pleased to respond to any questions that you or other members of the Committee may have at this time.

Contact and Acknowledgments

For information about this testimony, please contact Chet Janik at (202) 512-6508. Individuals making key contributions to this testimony included Susan Iott and Jeff Malcolm.

(141387)

United States General Accounting Office
Washington, DC 20548

Resources, Community, and
Economic Development Division

September 29, 1999

The Honorable Ben Nighthorse Campbell
Chairman
Committee on Indian Affairs
United States Senate

Dear Mr. Chairman:

During your September 15th hearing on Indian contract support costs, at which we testified on our recently issued report Indian Self-Determination Act: Increases in Indian Contract Support Costs Need to Be Addressed (GAO/RCED-99-150, June 30, 1999), you asked us to provide a list of tribes that reported using their federal program resources to pay for shortfalls in contract support funding.

A total of 60 tribes and tribal organizations, or about two-thirds of the 94 tribes and tribal organizations we communicated with during our review, specifically mentioned using their federal program resources or tribal resources to pay for shortfalls in contract support funding. A list of the 60 tribes and tribal organizations is enclosed.

Our analysis of tribal responses presented in chapter 3 of the report does not differentiate between those tribes using federal program resources to cover their shortfalls in contract support funding and those using tribal resources. We decided to analyze the information in this manner because, at the tribal level, federal program resources and tribal resources are often commingled. Many tribes told us that they use their own resources to supplement the funding they receive from the federal government; therefore, when these commingled funds are used to pay for shortfalls in contract support funding, it is impossible to determine whether federal resources or tribal resources were used.

Our method for gathering information from tribes and tribal organizations was subject to certain limitations, discussed in chapter 3 and appendix IV of the report. Specifically, we did not use a standardized data collection instrument to gather the views of tribal officials. Most of the tribes' views were obtained through various open forums, two held during large Indian conferences and four others held during our visits to field offices. Not all of the tribal representatives who attended the forums spoke about the effects of shortfalls or the methods used to cope with shortfalls. 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 have identified 60 tribes and tribal organizations in response to your question, it is possible that the other 34 tribes and tribal organizations we communicated with during our review had similar experiences. A complete list of the 94 tribes and tribal organizations we communicated with during our review appears in appendix IV of the report.

Please contract Chet Janik at (202) 512-6508 or Jeff Malcolm at (303) 572-7374 if there is any other information on contract support costs that we might be able to provide.

Sincerely yours,

Jim Wells

Jim Wells,
Director, Energy, Resources
and Science Issues

Enclosure

Enclosure I

List of 60 Tribes and Tribal Organizations That Told Us They Have Used Federal Program Resources or Tribal Resources to Pay for Shortfalls in Contract Support Funding

Tribes (46)

Akiachak Native Community, Alaska
Apache Tribe of Oklahoma
Cherokee Nation of Oklahoma
Cheyenne-Arapaho Tribes of Oklahoma
Chickasaw Nation, Oklahoma
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
Ely Shoshone Tribe of Nevada
Fort Sill Apache Tribe of Oklahoma
Gila River Indian Community of the Gila River Indian Reservation, Arizona
Jamestown S'Klallam Tribe of Washington
Organized Village of Kake, Alaska
Karuk Tribe of California
Kaw Nation, Oklahoma
Kickapoo Tribe of Oklahoma
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
Muscogee (Creek) Nation, Oklahoma
Native Village of Barrow Inupiat Traditional Government, Alaska
Northern Cheyenne Tribe of the Northern Cheyenne Indian Reservation, Montana
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
Prarie Band of Potawatomi Indians, Kansas
Pueblo of Acoma, New Mexico
Pueblo of Jemez, New Mexico
Quinault Tribe of the Quinault Reservation, Washington
Ramah Navajo Chapter, New Mexico
Reno-Sparks Indian Colony, Nevada
Sac & Fox Nation, Oklahoma
Shoalwater Bay Tribe of the Shoalwater Bay Indian Reservation, Washington
Shoshone-Bannock Tribes of the Fort Hall Reservation, 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
Turtle Mountain Band of Chippewa Indians of North Dakota
Wichita and Affiliated Tribes (Wichita, Keechi, Waco & Tawakonie), Oklahoma
Zuni Tribe of the Zuni Reservation, New Mexico

Enclosure I

Tribal Organizations (14)

Alamo Navajo School Board, New Mexico
Alaska Native Tribal Health Consortium, Alaska
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
Gila River Health Care Corporation, Arizona
Great Lakes Indian Fish & Wildlife Commission, Wisconsin
Multi-County Youth Services, Oklahoma
Norton Sound Health Corporation, Alaska
Ramah Navajo School Board, Inc., New Mexico
Southeast Alaska Regional Health Consortium, Alaska
United Tribes Technical College, North Dakota
Yukon-Kuskokwim Health Corporation, Alaska

SOUTHERN INDIAN HEALTH COUNCIL, INC.
4058 Willows Road • Alpine, CA 91901-1620
Mailing: P.O. Box 2128 • Alpine, CA 91903-2128
(619) 445-1188 • FAX (619) 445-4131

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September 23, 1999

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Joseph E. Bulfer
CEO/CFO

Honorable Senator Ben Nighthorse Campbell, Chairman
Senate Committee on Indian Affairs
838 Hart Senate Office Building
Washington, D.C. 20510-0605

Testimony of the Southern Indian Health Council, Inc.
RE: Contract Support Cost Issues

Dear Honorable Senator Campbell;

Introduction:

We are writing this letter to provide written testimony on contract support cost issues addressed by the Committee at it's September 15, 1999, hearing.

The Southern Indian Health Council, Inc. (SIHC) provides services through contracts under P.L. 93-638 to approximately 8,000 Indians, at three different locations, in the remote reservation and rural areas of southern San Diego county. The SIHC represents health, and other related matters, of the seven reservations of the following Band of Mission Indians: Barona, Campo, Manzanita, Viejas, Ewiiaapaayp, La Posta, and Jamul.

There are many important issues affecting Indian country. We are addressing only one issue, the under-funding of contract support costs, at this time so that we may be effective in targeting it's importance in rendering the services to our people that are expected, as well as expected from our partner, the U.S. government.

We are thankful for Congressional participation and oversight in this process knowing that our concerns and rights, including Indian Self-Determination and Tribal Sovereignty, will receive utmost priority.

Accredited by
Accreditation Association
for Ambulatory Health Care, Inc.

Contract Support Cost Issues: Shortfall and the need to Fully-Fund

SIHC, as with other Tribal health clinics under the Indian Self-Determination Act, operates the most comprehensive outpatient health service program possible, given our allocation of federal funding through Fiscal Year appropriations. Only a limited amount of our needs are met with federal funding. The balance of funding requirements are supplied from third party insurance, or not provided at all.

In 1987, Congress labeled the U.S. government's failure to fully fund contract support costs as "the single most serious problem with implementation of the Indian Self-Determination policy". In June, 1999, the GAO stated that contract support costs are legitimate, essential and necessary to properly carry out federal Self-Determination contracts. Congress, by statute, has repeatedly determined that Tribes are "entitled" to be paid contract support costs, that these costs are "required to be paid", and that the federal agencies "shall add (these costs) to the contract" (see Section 106 of the Amendments to the Indian Self-Determination Act)..

Full CSC funding is required for Tribes to fully implement Self Determination and Self Governance. Without full funding, Tribes are forced to apply funds intended for direct services to cover indirect costs. Obviously, this reallocation lessens the effectiveness of the services that we can render to our people.

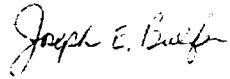
As Senator Inouye stated on October 7, 1998, before the Senate, full CSC funding was promised and is written in legislative language. It was never conditioned on appropriations, yet this promise remains broken as with other Treaty obligations to Indian people. Court cases have held that CSC must be paid as Congress intended.

The SIHC is requesting that the federal budget be increased by whatever amount will fully fund CSC. Congress is urged to recognize U.S. Treaty obligations to improve the current status of Indian health by appropriating an effective level of healthcare funding to enable our Tribal nations to exercise their full right to provide quality healthcare to their people, as provided in the Indian Self-Determination Act.

To the Senate Indian Affairs Committee:

Thank-You for allowing us to present this testimony and for your continuing assistance with these matters which are so vital to improving the health of the Indian people that we serve.

Sincerely,



Joseph E. Bulfer
Executive Director

NORTHWEST PORTLAND AREA INDIAN HEALTH BOARD

Burns-Paiute Tribe
Chehalis Tribe
Coeur d'Alene Tribe
Colville Tribe
Coos, Siuslaw & Lower Umpqua Tribe
Coquille Tribe
Cow Creek Tribe
Grand Ronde Tribe
Hoh Tribe
Jamestown S'Klallam Tribe
Kalispel Tribe
Klamath Tribe
Kootenai Tribe
Lower Elwha Tribe
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September 15, 1999

Honorable Ben Nighthorse Campbell and Daniel Inouye, Co-chairs
Senate Indian Affairs Committee
838 Hart Building
Washington, DC 20510

Dear Senators Campbell and Inouye,

The Northwest Portland Area Indian Health Board thanks the committee for the opportunity to submit this testimony for consideration at the Committee's September 15, 1999 hearing on Contract Support Costs.

- The Northwest Portland Area Indian Health Board requests that the Senate Committee on Indian Affairs initiate a process with the Senate Budget Committee to develop legislation to authorize the funding of contract support costs 'off-budget.' By taking the funding of contract support costs 'off-budget,' Congress will honor its commitment to self-determination.

Three reports, two funded in part by the Board, clearly demonstrate the legitimacy of contract support costs and clearly refute charges that contract support costs are escalating unnecessarily and are perhaps 'out of control.' The Board, together with the Affiliated Tribes of Northwest Indians (ATNI) published "Determining the True Cost of Contracting Federal Programs for Indian Tribes (1987)" and together with ATNI and the California Rural Indian Health Board (CRIHB) published a second edition of that report in May, 1997 (enclosed). These findings were supported in the Report of the National Congress of American Indians Contract Support Cost Workgroup (1999). The June, 1999 GAO report "Indian Self-Determination Act: Shortfalls in Indian Contract Support Costs Need to Be Addressed" corroborates the findings of the tribal reports: Contract support costs are justified, they are necessary to achieve the goals of self-determination, costs have increased because many tribes have chosen to contract and compact, not because tribes have been inefficient administrators of their programs. The Board supports the GAO report's Alternative 1 ('full funding') that, in our view, requires our recommendation to take contract support costs off-budget.

Contract support costs are justified and necessary to support the Indian Self-Determination Act (P.L. 93-638). The success of Self-Determination depends on full funding of contract support costs. The time to act is now while understanding of contract support costs is high. The time has come to take funding for contract support costs out of the annual appropriations process.

Sincerely,

Cheryle Kennedy, Executive Director

Intertribal Timber Council

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White Mountain Apache
Yakama Indian Nation
Yurok Tribe

October 4, 1999

The Honorable Ben Campbell, Chairman
Committee on Indian Affairs
SH-838 Hart Senate Office Building
U.S. Senate
Washington, D.C. 20510

Dear Chairman Campbell:

As President of the Intertribal Timber Council (I.T.C.), I am writing on the behalf of the I.T.C. Board of Directors to oppose S. 1589, the American Indian Trust Fund Management Reform Act Amendments. I ask that this correspondence be made a part of the Committee's official hearing record on S. 1589.

The I.T.C. is a twenty three year old organization of seventy forest owning tribes and Alaska Native organizations that collectively possess more than 90% of the 7.5 million timberland acres and a significant portion of the 9.4 million woodland acres that are under B.I.A. trust management. These lands are vitally important to their tribes. They provide habitat, cultural and spiritual sites, recreation and subsistence uses, and through commercial forestry, income for the tribes and jobs for their members. In Alaska, the forests of Native organizations and thousands of individual allotments are equally important to their owners. To all our membership, our forests and woodlands are essential to our physical, cultural, and economic well-being, and assuring their proper management is our foremost concern.

At the outset, I want to make clear that this letter does not purport to represent the views of our individual member tribes. Issues relating to satisfaction or dissatisfaction with the past and present trust activities of the Office of the Special Trustee, Interior Secretary Babbitt, and Assistant Secretary for Indian Affairs Kevin Gover, or whether current circumstances warrant a new review and recommendation of how and where the federal trust responsibility for Indian tribes and individual Indians should be conducted are more appropriately within the purview of tribal governments and individual land owners.

The Intertribal Timber Council Board has concerns about ambiguities and procedural shortcomings in the bill.

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First, in a bill of such serious consequence for tribal governments and the future of the government-to-government relationship, it is absolutely essential that this legislation make its intentions very clear, so tribes are fully aware of what is being proposed and can respond accordingly. The bill creates the impression that its Indian Trust Fund Reform Commission's scope will not include trust natural resources. Consider the following:
- Use of the words "Trust Fund" in the Commission's title;
- the description of the Commission's scope as "all phases of the trust business cycle," which is undefined but which, by use of the word "business," suggests a commercial or financial focus;
- the fact that many trust natural resources are not involved in what would normally be considered the "business cycle;"
- often repeated use of words such as "accounts," "accounting," "Indian account holders," "investment of trust accounts," and "financial resources" that re-emphasize the impression of a focus on trust funds; and
- not a single reference in the bill to "natural resources", either generally, under some other identifiable name, or for a specific natural resource, such as timber, land, or water.

However, some ambiguity remains in the legislation's language and we have been informed that the bill is intended to place the management of trust natural resources under the purview of the Trust Reform Commission. We believe that the Commission should be clearly limited in scope to the management of trust funds.

The I.T.C. Board believes that a thorough and satisfactory examination of and consultation on trust management alternatives with Indian tribes would require far more than six months. If the Commission's "consultation" with the beneficiaries of the trust is to be meaningful, the process of identifying options, examining them in depth, exploring their consequences, debating the issues, and then attempting to establish a broadly supported direction will be very complex and time consuming. To deny tribes the time necessary to do that would make the bill's consultation provision an empty promise.

The waiver of qualifications for service on the Commission by current members of the Special Trustee's Advisory Board is objectionable and should be deleted from the bill. The waiver effectively creates a preference for selection of Advisory Board members to serve on the Commission. There is no clear reason why Advisory Board members warrant such a preference. In fact, to the extent the waiver makes it easier for Advisory Board members to be appointed to the Commission, the more likely it will be that the Commission will simply regenerate the positions already espoused by the Advisory Board, thwarting the Commission's presumed goal of a fresh and even-handed examination of trust management. To the extent that trust natural resources do come within the Commission's purview, Advisory Board members would not have adequate expertise to deal with those issues.

We recommend that the legislation be clarified to require that the Commission's review address alternatives that include consideration of retention of trust management within the Interior Department. To specifically direct the Commission to examine removal of the trust management from Interior without any similar requirement for leaving the functions within Interior could prompt a bias in the Commission's report and recommendations.

The bill should also direct the Commission to consider the consequences on Self-Determination Act contracting and compacting if trust management activities are removed from the Interior Department. If removal were to occur without corresponding modifications to the Self-Determination Act, all 638 activities relating to the management of natural resource and financial trust assets could cease, with those functions being assumed by the new entity. That, of course, would unreel in a single instant all the progress made in almost thirty years of tribes assuming greater involvement and responsibility under the Self-Determination policy.

We would also urge that Indian tribes and individual Indians with trust interests be provided copies of the Commission's report and recommendations. Since they are the beneficiaries of the trust and will bear the consequence of any reforms, and since they are supposed to have been engaged, via consultation, in the conduct of the review, they ought to be provided copies of the Commission's final products.

Mr. Chairman, the I.T.C. Board is aware of your frustration with trust reform, and we appreciate your intentions to see that it moves promptly down the right course. At this time, as trust reform is under active debate, challenge, and change, Congressional oversight is helpful and appreciated. However, forcing a rushed decision will not necessarily produce a satisfactory answer or one that adequately considers the immense consequences for the beneficiaries of the trust. In the instance of S. 1589, we urge that the bill not be pursued in its current form.

Sincerely,

D. Fred Matt,
President

NORTHWEST PORTLAND AREA INDIAN HEALTH BOARD

Burns-Paiute Tribe
Chehalis Tribe
Coeur d'Alene Tribe
Colville Tribe
Coos, Suislaw & Lower Umpqua Tribe
Coquille Tribe
Cow Creek Tribe
Grand Ronde Tribe
Hoh Tribe
Jamestown S'Klallam Tribe
Kalispel Tribe
Klamath Tribe
Kootenai Tribe
Lower Elwha Tribe
Lummi Tribe
Makah Tribe
Muckleshoot Tribe
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Nooksack Tribe
NW Band of Shoshoni Tribe
Port Gamble S'Klallam Tribe
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Quinault Tribe
Samish Indian Nation
Sauk-Suiattle Tribe
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Umatilla Tribe
Upper Skagit Tribe
Warm Springs Tribe
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November 10, 1999

The Honorable Ben Nighthorse Campbell, Chairman
Senate Committee on Indian Affairs
United States Senate
Washington, D.C. 20510

RE: Contract Support Cost Publications

Dear Chairman Campbell:

On behalf of the Northwest Portland Area Indian Health Board (NPAIHB), I am writing to provide our support and approval to submit both editions of our report, *"Determining the True Cost of Contracting Federal Programs for Indian Tribes"* for the Congressional record. The first edition of this report (referred to as the "blue book") was jointly published in 1987 by NPAIHB and Affiliated Tribes of Northwest Indians to provide a better understanding of cost allocation and funding processes associated with contacting under the Indian Self-Determination Act.[1] The second edition (referred to as the "red book") was published in 1997.[2]

These publications identified problems and factors associated with the contract support shortfall; and provided guidance on the nuances of the indirect cost system particularly the theoretical over- and under-recovery problems. The publications also provided recommendations for solution to the contract support problem.

While there have been several past studies and initiatives by the Bureau of Indian Affairs, the Office of Inspector General and by various tribal groups throughout the years to provide remedies to this problem, we believe that these two documents provide important background information and recommendations, from a tribal perspective, for reform on contract support costs funding and policy issues. Further, these publications support the recently published National Congress of American Indians Final Report on Contract Support Costs completed in July 1999.

We appreciate the inclusion of these publications for the Congressional record. Please feel free to contact us if you have any questions. Thank you.

Sincerely,

Julia A. Davis

Julia A. Davis, NPAIHB Chairperson

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[1] "Determining the True Cost of Contracting Federal Programs for Indian Tribes";1987; Report of the Northwest Portland Area Indian Health Board and Affiliated Tribes of Northwest Indians. (May 1987).

[2] "Determining the True Cost of Contracting Federal Programs for Indian Tribes"; Second Edition - 1997; Report of the Northwest Portland Area Indian Health Board and Affiliated Tribes of Northwest Indians. (May 1997).

Determining the True Cost of Contracting Federal Programs for Indian Tribes

An analysis of indirect cost recovery by Indian Tribes contracting for the operation of Federal programs under the Indian Self-Determination and Education Assistance Act of 1975 (Public Law 93-638)

Published as a joint effort of the Northwest Portland Area Indian Health Board and the Affiliated Tribes of Northwest Indians

Written by:
Jim Sizemore and Bob Peterson

Assisted by:
William "Ron" Allen, Lloyd Coon and Ken Smith

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DEDICATION

This publication is dedicated to the memory of the late Harold Culpus. Harold was a member of the Warm Springs Tribe and served as a long time member of the Tribal Council of the Confederated Tribes of the Warm Springs Reservation of Oregon. He passed away on November 1, 1986, one day after his last official act on behalf of his Tribe. That act was to support the formation of the Task Force that produced this document. It was his desire that the Task Force conduct an objective study of the complicated issue of indirect costs and use the results as a tool with all interested parties.

Harold was an advocate for strong and capable administration and management foundations for Tribes. As such, he exemplified many Tribal leaders from across the country who have devoted their lives, with little or no compensation, to pursue the development of strong Tribal governments and solid economic bases for their communities.

It is the Task Force's hope that this publication will make a significant contribution to the realization of the visions of leaders like Harold Culpus.

EXECUTIVE SUMMARY

When Congress enacted the Indian Self-Determination and Education Assistance Act of 1975, it was intended that Tribes would develop strong Tribal governments which would be capable of administering quality programs for the benefit of Indian people.

To Congress and to the Tribes, contracting to operate federal programs meant that the Tribes would have the opportunity to take the funds the U. S. Government would have otherwise spent through the Bureau of Indian Affairs and the Indian Health Service and utilize them to provide services to their resuective communities. Section 106 (h) of the Act states that the amount of funds provided to Tribal contractors would not be "less than the appropriate Secretary would have otherwise provided for his operation of the programs or portions thereof for the period covered by the contract." This section assured the Tribes that the funds provided would be *at least as much* as the U.S. Government was spending for its operation.

Tribes generally embraced the spirit of self-determination and worked hard to establish and strengthen their administrative and management capabilities as the necessary foundation for effective Tribal government. As they viewed it, this Act would enable Tribes to address a multitude of needs, including economic development as a step towards self-sufficiency. Over these first eleven years of the Self-Determination Act

implementation, the Tribes have assumed responsibility for over 500 million dollars of BIA and IHS programs.

Despite the best intentions, and despite Tribes' eagerness to assume responsibility for determining their own fate and to achieve economic independence under Self-Determination, things generally did not proceed smoothly. Tribes, many of whom had little or no experience in administering federal programs, were introduced to a complicated set of contracting rules and regulations, including a method of recovering those portions of their costs known as "indirect costs," as determined by the Tribes' negotiated indirect cost rate.

While Tribes have struggled and in some cases met with very serious financial trouble in attempting to utilize indirect cost rates, the BIA and IHS, sister agencies charged with implementing the Self-Determination Act, have compounded the problem by requesting from Congress and allocating to Tribes less than the necessary funds required to operate programs in most budget years since 1975.

Little was understood about indirect costs by the high level bureaucrats in these agencies. While Tribes struggled to gain administrative expertise, these agencies (which employed in excess of 28,000 people) did little to support the Tribes in dealing with the complexities of indirect costs. To date, neither agency has provided even one full-time position to assist Tribes in addressing this critical technical issue. Rather than addressing this contractual problem in a direct and effective manner by advocating sufficient funding, the two agencies have attempted to bypass the problem by failing to request necessary operational funds and attempting to reduce or limit the recovery of legitimate indirect costs by Tribes.

In 1986, the BIA began advocating a shortsighted fifteen percent flat administrative fee in lieu of the existing negotiated indirect cost rates. If implemented, this policy would prevent Tribes from recovering their full costs for operating federal programs, severely crippling Tribes' capacity to administer programs, and unraveling much of the Tribal management and administrative capability developed during the first eleven years of Self-Determination.

While it seems ludicrous and ironic that the agency responsible for implementing the intent of the Self-Determination Act would not only fail to advocate it but would actually work to undermine the establishment of strong and effective Tribal

governments, it is nevertheless obvious that this simplistic cure poses a direct and potentially devastating threat to self-determination.

Recognizing the need for better understanding of current indirect cost problems and potential solutions among both Tribal and federal decision makers, The Northwest Tribes asked that a task force be established to address the issue. The first job of the task force was to publish an educational document that would examine the methods and uses of indirect costs as a cost recovery mechanism during the past eleven years. This report is the result of that effort.

The report takes the position that indirect costs or rates are really not the issue. The main issue is the recovery of costs incurred by operating federal programs and the equitable payment of total contract costs, both direct and indirect. Failure to provide full financial support places a Tribe in the position of being required to spend more than it can collect when operating contracted programs. For many Tribes, this creates economic hardship and inhibits the incentive to contract. The report further indicates that the provisions of Section 106 (h) of the Act have not been met. Neither the Secretary of the Interior nor the Secretary of Health and Human Services has developed a system that complies with that section of the law. That is to say, Tribes have been allocated less funds than the government would have spent for federal operation of the same program. One key feature of the law that must be addressed is how funds are budgeted and allocated, and then how total contract costs are recovered. Right now, this is not happening in any consistent or equitable way. A stable funding base is needed to enhance the development of strong Tribal governments.

It really comes down to this important point: To implement true self-determination, Congress and the BIA/IHS must budget and appropriate adequate funds to contract for federal Indian programs and services. To provide less than adequate funds, in many cases, causes financial hardship and prolongs dependence on the federal government. In short, to allow the BIA and IHS to underfund the P.L. 93-638 contracts is to plot a sure path to programmatic failure.

Tribes want true self-determination. That means being truly recognized as sovereigns and being assisted in develop-

ing an economic base that can lead to greater independence and self-sufficiency.

As this publication points out, the solutions to many problems that now block self-determination are neither very costly nor difficult. It will, however, take effective teamwork on the part of all concerned to make them work. It will also require that the Bureau of Indian Affairs and the Indian Health Service assume an advocacy role. Paying lip service to the concept of self-determination will not be enough. That commitment must be reinforced with fair and consistent enforcement of regulations that recognize variations in Tribes' managerial responsibilities, and with funding policies that enable Tribes to operate programs efficiently and effectively.

ABOUT THE PUBLICATION

This publication was developed in 1987 by a Task Force of the Affiliated Tribes of Northwest Indians in order to provide a better understanding of the whole matter of indirect costs, particularly as they relate to contracting for the operation of Federal programs under the Indian Self-Determination and Education Assistance Act of 1975. Members of the Task Force included

- William "Ron" Allen, Chairman, Jamestown Klallam Tribe
- Lloyd Coon, Deputy Director, Columbia River InterTribal Fish Commission
- Robert Peterson, Tribal Administrator, Suquamish Tribe
- Jim Sizemore, James M. Sizemore CPA
- Ken Smith, Ken Smith and Associates.

The Task Force has received assistance from many Tribal representatives of Northwest Tribes as well as other people associated with Tribes, Indian Health Service, the Bureau of Indian Affairs and other agencies.

Funding for research was provided, in part, by the Indian Health Service, Administration for Native Americans, the following Northwest Tribes, through the Northwest Portland Area Indian Health Board:

- Quinault Nation, WA
- Quileute Tribe, WA
- Squaxin Island Tribe, WA
- Makah Tribe, WA
- Jamestown Klallam Tribe, WA
- Lower Elwha Klallam Tribe, WA
- Port Gamble Klallam Tribe, WA
- Lummi Tribe, WA
- Nooksack Tribe, WA
- Puyallup Tribe, WA
- Suquamish Tribe, WA
- Swinomish Tribe, WA
- Tulalip Tribe, WA
- Upper Skagit Tribe, WA
- Yakima Tribe, WA
- Colville Confederated Tribes, WA
- Spokane Tribe, WA
- Chehalis Tribe, WA
- Stillaguamish Tribe, WA
- Coeur d'Alene Tribe, ID
- Nez Perce Tribe, ID
- Confederated Tribes of Grand Rhonde Community, OR
- Confederated Tribes of Warm Springs, OR
- Siletz Tribe, OR

and the following organizations:

- The Episcopal Church
- The Lutheran Church
- LeMaster and Daniels, CPAs
- Molatore Gerbert, P.C.
- Marceu, Karnopp, Petersen, Noteboom and Hubel, Attorneys at Law
- Native American Finance Officers Association

Research, coordinated by the Task Force, was accomplished by voluntary actions on the part of numerous individuals. Key contributions to the research effort were made by:

- Ron Cameron, Whitewolf Custom Services
- Bill Parkhurst, Quinault Nation
- Joe Tallakson, SENSE, Inc.
- Jim Thomas, Nooksack Tribe
- Don Smouse, Portland Area, BIA
- Nick Longley, Portland Area, BIA

-Doug Coster, Central Region, Department of the Interior Office of the Inspector General

-Dr. Tom Austin, Portland Area, Indian Health Service

-Jim Dunnick, Headquarters, Indian Health Service

-Joe Melland, Lummi Tribe

-Jim Willis, Molatore Gerbert, P.C.

-Ron Sells, LeMaster & Daniels, CPAs

Special thanks are due to the staff of Interwest Applied Research of Beaverton, Oregon, and in particular to editor Vicki Spandel, who assisted the Task Force in providing a nontechnical presentation of a very technical subject. Their assistance was vital to the effort.

On behalf of the Affiliated Tribes of Northwest Indians and the Northwest Portland Area Indian Health Board, we offer sincere appreciation to all who participated in this important effort.

Melvin R. Sampson
Chairman
Northwest Portland Area Indian Health Board

Allen V. Pinkham
Chairman
Affiliated Tribes of Northwest Indians

May 1987

AUTHORS' NOTE

The purpose of this document is to provide some basic educational background to those who are interested in the methods by which indirect costs are calculated and recovered. It is not the intent of the document to provide detailed technical information related to cost accounting; the document is directed to a general audience with a need for background in and understanding of the variables affecting achievement of self-determination for Tribes. The means by which indirect costs are determined and recovered have a very direct bearing on Indian Tribes' capability to achieve self-determination.

In attempting to provide this educational background, we make the assumption that those who share an interest in this document also share a common philosophical base, namely interest in and support of the intent and spirit of self-determination. Understanding the methodology by which indirect costs are calculated is one thing; implementing those methodologies in a manner that supports achievement of self-determination is another. The authors of the document share a belief that achievement of sufficient and stable funding bases is a realistic goal, and an essential one if Indian people are to realize the political and economic independence that will enable them to make the best use of the resources available to them.

The 36 Tribes participating in this study represent 36 sovereign nations, each having a unique and separate relation-

ship with the U.S. Government; and accordingly, each may develop independent views and conclusions on the numerous issues identified in this study. Therefore, the conclusions reached by this publication are those of the Task Force with general consensus from participating Tribes and do not necessarily represent the collective position of all members of the Affiliated Tribes of Northwest Indians.

As Task Force members who work for and represent Indian Tribes, we recognize our obvious bias in this matter. We intend this publication as an educational tool to be used to help create a common basis for teamwork among all concerned with the implementation of Public Law 93-638, recovery of costs and related issues. Part of the goal is to point out the problems associated with the existing system from a Tribal contractors' perspective, but not however to lay blame, and certainly not to offend.

We acknowledge that numerous of the federal agencies involved in this matter, and many devoted employees of those agencies, have made efforts to and have in fact improved the system in many ways since first implementation of the law. Very good teamwork currently exists between Tribes and the agencies in many, but not all, areas, and continues to improve.

CHAPTER 1

Indirect Costs and Indirect Cost Rates

The purposes of this study are (1) to examine the methods by which indirect costs associated with Tribal contracting are established, (2) to examine the problems associated with funding those costs, and (3) to offer some suggestions designed to result in more equitable and efficient budgeting and contracting procedures. Most of the information within this report was obtained from the 36 Northwest Tribes who participated in the analysis and provided information on their methods of categorizing and treating indirect costs. Contract schools, consortiums and other organizations which serve multiple Tribes under P.L. 93-638 contracts were not included in the research, although most do have negotiated indirect cost agreements.

Before examining specific procedures, let's consider how the government defines indirect costs. According to the Office of Management and Budget (OMB) Circular A-87, indirect costs are

> *"those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved."*

What this really means is that those costs incurred by a grantee or contractor which cannot be easily allocated among individual programs will be considered indirect costs.

Each Tribal organization must decide for itself, based on federal guidelines and as negotiated with the federal government, which costs are indirect and which are direct. Generally, direct costs are those associated with the personnel, materials and other costs required to fulfill a given contract. Indirect costs cover facilities and equipment, management and administration, and general expenses that facilitate—but are not directly assignable to—fulfillment of specific contracts.

Sometimes people substitute the term *overhead* or *administrative costs* for *indirect costs*; however, many overhead or administrative costs can be allocated to individual programs, and must therefore be considered direct rather than indirect costs. In short, the terms *overhead* and *administrative* should not be regarded as synonymous with *indirect*.

A Brief Scenario

To better illustrate the distinction between direct and indirect costs, imagine for a moment that you are in the business of making wooden boxes, and that these boxes are your only product. Let's say you have a small building on which you pay rent, and that you pay the utilities and purchase all the equipment (e.g., electric saws and drills) you need for box building. You also buy wood, nails, glue or any other materials that go into making the boxes. You have a manager and accountant, and you also retain a lawyer. And you purchase insurance of various kinds.

Since you manufacture just one kind of box (we'll keep our illustration simple), it's pretty easy to figure out what your production costs will be. You just add up all your costs and divide by the number of boxes you have made, and the result is your average cost per box.

Now, suppose that a customer—call him Mr. B—comes to you and asks you to build him some wooden piano crates instead of your standard boxes. The materials and procedures are essentially the same—with some minor differences—so you agree to take on the task. Mr. B agrees to pay you a profit of ten percent. But before you can know what to charge Mr. B for the crates, you'll have to figure out your manufacturing costs. How will you do that?

Well, the direct costs will be easy to calculate. You add up the costs for wood, nails, glue, wages of the designer and builder, and so forth—just as you would for the standard

wooden boxes. But the *indirect* costs will be a little more difficult to calculate. Indirect costs include such things as the rent, the utilities, phone, insurance, fees for the manager and accountant, and so forth; these costs support the making of both the boxes and the piano crates. The question is, what percentage of these various indirect costs supports the making of the boxes, and what percentage supports the making of the piano crates?

In order to reach a fair price for the piano crates, and to feel comfortable that he was not paying more than his fair share of the indirect costs, Mr. B would want to reach some agreement about how all costs were going to be allocated. That agreement would need to state (1) which costs would be directly charged to the piano crates, (2) which costs would be indirectly charged to the piano crates, and (3) on what basis these costs would be determined. Once you had determined these three things, you would call the resulting agreement a cost allocation plan. And when you billed Mr. B for his piano crates, that bill would cover direct costs, indirect costs and the ten percent profit.

Well, you might say, that sounds like a lot of trouble. Why not just charge three times as much for the piano crates, since they're about three times the size of the standard boxes, and be done with it? Because—with that arbitrary method, you'd have no way of knowing whether the price for the piano crates was in fact very fair, exorbitant, or so low that your company was incurring a loss on every crate you built. The point is, there are simply no shortcuts to fair cost allocation. Costs must be allocated appropriately if you are to know where your box company stands on its profits and losses, and Mr. B—even if he does not demand a full and detailed accounting of all your calculating steps and methods—still has a vital interest in knowing that those methods are sound. Moreover, life will be simpler for you if you can come up with an indirect cost rate that will apply to the manufacture of piano crates henceforth—or at least until there are substantial changes in your manufacturing methods or facilities.

Establishing a fixed rate isn't just a convenience, though; it's good business. If Mr. B does not agree with your pricing methods, you may need some means of demonstrating that you are operating fairly; otherwise, you risk losing Mr. B's future business, and perhaps anyone else's as well. Mr. B may

contend, for example, that there is no reason to include a portion of the rent in the price of the piano crate since you must pay rent monthly anyway, whether you're making piano crates or not. You can respond that while that may be true, you could not build piano crates without a facility in which to do it, and further, that if you were not building piano crates, the facility might then be used to support other activities. Chances are that if Mr. B is a reasonable sort, you'll come to an agreement fairly readily on the rent; but perhaps he'll be less willing to see things your way when it comes to phone bills or some other issue. Negotiations may then become complex, and you'll need some guidelines to get through them.

At the same time, however, let's make sure that we do not create some misunderstanding about the way in which "fixed indirect cost rates" are appropriately used. It might be very handy for you, if you continue in the wooden box business, to have a constant rate by which to calculate your indirect costs so that you do not have to reinvent that portion of your budget month by month. However, it would not be appropriate or useful for you to assign your rate to Mr. J down the street, who runs a dry cleaning franchise—nor even to Ms. D across town, who runs a competitive box building business. Their facilities, expenses, contractual agreements and circumstances are different from yours, and they must determine what is fair and equitable to fit those circumstances.

Admittedly, our example with Mr. B and the piano crates is highly simplified. But as you proceed through this chapter, you might keep our illustration in mind. While the government adds a lot of complicating factors, the same concepts regarding *direct* versus *indirect* costs and the need for guidelines to govern negotiations hold true. There is one big difference, however.

Your box and piano crate company is—we hope—operating for profit. When the federal government contracts with state and local governments and Indian Tribes for services, no profit is permitted. Basically, the government will reimburse Tribes $1.00 in cash for each $1.00 spent. Further, the government has established many rules for how and what it will pay. Many costs simply are not covered. For example, such costs as interest, penalties, lobbying, litigation and gifts are considered prohibited—some by statute and some by regulation.

The regulations governing Indian Tribes under P.L. 93-638 contracts are basically the same as for all other federal contractors with respect to methods for establishing cost allocation plans and recovering all contract costs, both direct and indirect. The government also gives guidance as to how contractors may determine which costs will be treated as direct, and which as indirect. Basically—to go back to our wooden box company scenario—the government wants to make sure that Mr. B isn't paying for any of the costs associated with building the standard wooden boxes and, by the same token, that he *is* in fact paying for the costs associated with building the piano crates he wanted. In addition, the government wants to ensure that the distinction between direct and indirect costs is sufficiently clearcut that no costs are covered twice.

One of the first steps Tribes face in contracting is the development of a cost allocation plan, which includes an indirect cost rate. Each Tribe must develop their own cost allocation plan because different Tribes operate a variety of different programs from a number of different agencies. But all plans must cover indirect costs. Thus, we must begin with some clarification about direct versus indirect costs.

What Things Are Covered Under Indirect Costs?

As a result of a review of the Tribal indirect cost rates (based on information provided by the 36 Northwest Tribes involved in the study), costs commonly referred to as indirect were separated into three major categories and twenty-two subcategories, as shown in Figure 1-A.

There are other types of indirect costs that tend to be institution-specific; for example, hospitals and educational in-

FACILITIES AND EQUIPMENT	MANAGEMENT AND ADMINISTRATION	GENERAL SERVICES AND EXPENSES
Building Rent/Lease Cost Recovery	Governing Body	Insurance and Bonding
Utilities	Management	Risk Management
Housekeeping/Janitorial	Planning	Malpractice Liability Insurance
Building and Grounds Maintenance	Financial Management	Legal Services
Security	Personnel Management	Audit
Equipment	Procurement/Materials Management	General Support Services
	Human Resource Management	Miscellaneous and Other
	Property Management	
	Records Management	
	Data Processing	
	Office Services	

Figure 1-A

stitutions incur indirect costs that are not included by other agencies. Those included in the preceding list are the indirect costs identified as most common to Indian Tribal governments, and the costs used in analyzing the indirect costs for Northwest Tribes.

Indirect cost rates for contracts and grants with the federal government are individually negotiated by states, counties, cities, universities, hospitals, defense contractors, Indian Tribes and others with one of the federal departments assigned that task by the Office of Management and Budget. The Department of Interior has been assigned the responsibility to negotiate indirect cost rates with Indian Tribes (OMB Circular A-87, as amended by Federal Register, February 1986). This responsibility has been delegated to Interior's Office of the Inspector General.

To establish an indirect cost rate, the Tribe categorizes all of its costs as direct, indirect, or unallowable. A fourth category called *directly funded indirect costs* comprises those specifically paid for by federal grant, and therefore not included in the indirect cost rate. Figure 1-B on the next page shows how a Tribe might distribute its costs in calculating an indirect cost rate. The cost categories listed are based on those *common* to the 36 Northwest Tribes on which the study was based; the programs are those *typically* operated by the 36 Tribes.

Once all costs have been categorized, the total indirect costs are divided by the total direct costs to determine the indirect cost rate, as follows:

INDIRECT COSTS ÷ DIRECT COSTS = INDIRECT COST RATE

That is, dividing the INDIRECT COSTS (also known as the indirect cost pool) by the DIRECT COSTS (also known as the direct cost base) gives the INDIRECT COST RATE

For example, assume we have direct costs of $2,330,000 and indirect costs of $870,000. Remember, indirect costs divided by direct costs gives the indirect cost rate. In this example

$870,000 ÷ $2,330,000 = .3734 or 37 34%

(Complicating factors, which we will discuss in some detail later, sometimes influence indirect costs; but essentially, this

COST CATEGORIES	Direct Costs	Indirect Cost Pool	Costs Not Allowed	Directly Funded Indirect Costs
Building Rent/Lease		$35,000		
Utilities		27,000		
Housekeeping/Janit.		37,000		
Building and Grounds Maintenance		18,000		
Security		5,000		
Equipment		16,000		
Governing Body		57,000	$57,000	
Management		75,000	25,000	$10,000
Planning		27,000		35,000
Financial Management		125,000		25,000
Personnel Management		50,000		12,000
Procurement/Materials Mgt.		35,000		
Human Resource Management	$10,000	27,000		
Property Management		12,000		5,000
Records Management		15,000		
Data Processing		35,000		10,000
Office Services	12,000	15,000		7,000
Insurance and Bonding		125,000		
Risk Management		12,000		
Malpractice Liability Ins.		0		
Legal Services		50,000	100,000	
Audit		28,000		5,000
General Support Services	28,000	32,000		
Miscellaneous and Other		12,000		3,000
Health Programs	450,000			
Education Programs	500,000			
Employment Programs	50,000			
Public Safety Programs	325,000			
Law Enforcement Programs	360,000			
Natural Resource Programs	290,000			
Economic Development Programs	55,000			
Public Works Programs	250,000			
Interest			62,000	
Litigation			75,000	
Lobbying			15,000	
Penalties			4,000	
Contributions			20,000	
Pass Through (i.e., welfare payments)			35,000	
Per Capita			50,000	
TOTAL	$2,330,000	$870,000	n/a	n/a

Figure 1-B

simple division process is the basis for determining the indirect cost rate.)

Once a Tribe has determined this rate, the Inspector General reviews the Tribe's calculation, determines that all the rules have been followed consistently, and ensures that the categorizing is fair and that the Tribe has included everything appropriately. Then the Inspector General negotiates

any differences with the Tribe and executes an indirect cost agreement with the Tribe on behalf of the United States Government.

Negotiated differences might influence whether a certain cost—particularly one not previously listed—is categorized as direct or indirect. Frequently, the amount allocated to the "Governing Body" category must be negotiated because the responsibility of this body differs from Tribe to Tribe. Governing responsibilities directly related to program operations are allowable under indirect costs, but those related to other activities—such as lobbying—are not.

Tribes use the established rate to recover indirect costs in proportion to direct costs. In other words, as direct costs go up, the budget for indirect costs (based on the established percentage rate) increases proportionately. As shown in Figure 1-D, the budget for a negotiated contract or grant generally combines total direct and indirect costs.

BUDGET

Direct salaries and Wages	$50,000
Fringe Benefits	5,000
Materials and Supplies	3,000
Travel	2,000
Vehicles	1,000
Other	1,000
Total Direct Costs	$62,000
Indirect Costs @ 37.34% (Direct Costs X Indirect Rate)	23,150
Total Budget	$85,150

Figure 1-C

Appendix B defines those budget items which are commonly categorized as indirect costs. These items can be covered under either direct or indirect costs, depending on the nature of the organization doing the categorizing. For example, health care providers or educational institutions might list some items under direct costs which most Indian Tribal governments would regard as indirect costs.

Conclusion

Establishing a cost allocation plan which includes an indirect cost rate works the same way for all who contract with the federal government—with the exception of those establishing fixed price contracts. Whether you are a small box manufacturer, a hospital administrator, another government leader, a school administrator or whatever, the concept is the same. The calculation is a bit more complicated for a government agency than for a box manufacturer, but the principles involved remain unchanged. *Costs are costs*, whether direct or indirect, and must be paid by someone. When the funding agency involved—in our case, the federal government—does not pay, problems result. Promoting understanding, as a first step toward resolving some of these problems, is what this report is all about.

CHAPTER 2

Background on Indirect Costs in P.L. 93-638 Contracting

When the Congress enacted the Indian Self-Determination Act in 1975, the use of indirect cost rates was an administrative matter that had not yet been considered by the legislation. Tribes had been operating grant programs, but few had been introduced to the concept or process of establishing indirect cost rates.

Further, the Bureau of Indian Affairs (BIA) had not had any experience with indirect cost rates. Contracting officers in the BIA had many problems understanding what indirect costs were, as did many other BIA employees. Some BIA officials saw the payment of indirect costs as a "carrot" to entice Tribes to contract, and advised Tribes to contract in order to increase their allocation of funds.

The Indian Health Service (IHS) had some experience with indirect costs and the Department (formerly HEW, now HHS) had a great deal. However, IHS employees at Tribal locations did not have any experience. Many felt that the indirect costs were not necessary and others felt that they were a "rip off." These negative feelings on the part of federal employees complicated matters—particularly when they attempted to avoid paying the indirect costs that Tribes were rightly owed, as provided by negotiated agreements.

Neither BIA nor IHS was sufficiently knowledgeable or experienced to accurately estimate how much money would be required to cover indirect costs. Further, the decision to contract—that is, to operate programs previously operated by the government—was an option belonging to Tribes, as intended by the Self-Determination Act, so neither agency could anticipate which services would be operated by the government and which would be contracted to Tribes.

Imagine not knowing whether you would be building boxes or buying them. You wouldn't know whether to rent space, buy equipment, hire employees, set up cost accounting systems and so forth, or just pay to have boxes delivered. That is exactly what happened to BIA and IHS. Both were set up with box building factories all over the country, but if a Tribe wanted to contract to build those boxes at a given point in time, then both agencies were required to buy the Tribe's boxes rather than build them out of their own factories. You can imagine the extra costs involved in being set up both to build boxes and buy them. And what is worse, of course, is the fact that we are not talking about wooden boxes here, really; we're talking about health programs, law enforcement, education, natural resources and other governmental services—the adequate provision of which profoundly affects not only those employed by such programs, but also those who depend on the services they provide. Some conclude that the BIA and IHS cannot be effective operating entities and contracting entities at the same time. This and later chapters point out that this is not the real problem, but a faulty conclusion based on superficial examination of indirect cost issues.

Indirect Costs: Someone Must Pay

The BIA and IHS indirect costs didn't go away when Tribes contracted to operate the programs that had previously been operated by the federal government, so additional funds were needed to pay for the Tribes' indirect costs. Both agencies established separate funds for payment of these costs.

Since both agencies had trouble estimating contracting levels, however, shortfalls resulted; the funds set aside to cover the indirect costs were never enough. As time went by, Tribes became more sophisticated and accurate in estimating and recovering all their legitimate costs—but they found their lives complicated by the imposition of a multitude of addition-

al federal requirements. As a result of these additional requirements and the failure of some agencies to pay their share, indirect costs continued to increase. Thus, the shortfalls continued.

In the Northwest, Tribes have become more knowledgeable in negotiating their indirect cost rates so that they included all their legitimate costs. And as a result, indirect cost rates rose steadily after the late seventies. From 1979 to 1986, the average rate rose from 23.16% to 36.31%. But our review indicates that most Tribes are still not recovering full indirect costs and that part of these costs are augmented by Core Management, Self-Determination and other grants (see Appendix A.)

Reasons Behind Increasing Indirect Rates

Tribes cite numerous reasons for these increases in indirect rates—among them, increasing administrative costs. For example, Public Law 93-638 regulations mandated that each Tribe maintain CPA certified bookkeeping systems. Congress implied this requirement in Section 102 of the Act, which stated:

> "... *the Secretary [of Interior] shall consider whether the Tribe or Tribal organization would be deficient in performance under the contract with respect to (A) equipment, (B) bookkeeping and accounting procedures, (C) substantive knowledge of the program to be contracted for, (D) community support for the contract, (E) adequately trained personnel, or (F) other necessary components of contract performance.*"

A like provision was inserted in Section 103 of the Act for the Secretary of Health, Education and Welfare (now HHS). These rules would pertain to the Indian Health Service.

The BIA and the IHS each published separate regulations which differed in areas of contract administration, reporting and other matters. Further, these agencies waived numerous requirements, such as Federal Procurement Regulations, which were adhered to by other federal agencies dealing with Indian Tribes. Thus, in order to assure adequate program delivery, Tribes were required to establish their own formal personnel systems and numerous other administrative sys-

tems—some of which would have been unnecessary had the Federal Procurement Regulations simply been followed.

Additional special and general requirements were attached to contracts in the form of *boilerplates*, which contained references to numerous federal laws and regulations. Considerable expertise was required to interpret these additional contract provisions and ensure that Tribes were in compliance with all contract requirements. Providing such expertise entailed further expense—as did spending the time and effort required to ensure and document compliance with all regulations.

OMB Circular A-102: An Attempt at Consistency

In 1981, the Office of Management and Budget (OMB) published revised OMB Circular A-102 and attachments. These attachments, which set out uniform requirements for federal grantees, called for consistency and standardization of requirements among all governmental contractors (such as states and Indian Tribes). They were designed to make contracting with the government more efficient, and to eliminate difficulties and differences resulting from the various federal agencies' imposing their own requirements upon grantees. Though the BIA and IHS did not immediately implement A-102, Tribes were required to follow it in order to comply with other federal agencies through which they received federal assistance grants.

Among other things, OMB Circular A-102 established standards for grantee administrative systems. These standards, which went beyond the existing requirements of BIA and IHS, included the following:

- ATTACHMENT G AND H: Standards for Grantee Financial Systems
- ATTACHMENT O: Standards for Grantee Procurement Systems
- ATTACHMENT C: Standards for Grantee Records Management Systems
- ATTACHMENT N: Standards for Grantee Property Management Systems

-ATTACHMENT P: Single Annual Audit Requirements (later replaced by OMB Circular A-128 which implements the Single Audit Act, P.L. 98-502)

In 1984 the BIA finally incorporated these uniform standards, as did IHS. By this time Tribes were well on their way to putting these requirements in place.

Program Administration: A Big Factor

Obviously, implementing required systems and the audit procedures that must accompany these systems is not free. Regulations—to be meaningful—must be adhered to and enforced. That costs money. And since administrative costs are normally *indirect* in nature, they boost Tribes' indirect cost rates. Such administrative systems also lend themselves to automation and computerization, which in turn augments costs even further. The upward trend of some administrative costs is detailed by the Interior Inspector General in a report issued in 1983. (*Trend Analysis.* Interior Inspector General, July 1983.)

Many Tribes have received federal recognition since 1975. Since the BIA and IHS had not formerly operated programs at their locations, it was necessary to establish facilities and equipment. In some cases Tribes were able to obtain grants to construct facilities. In other cases, facilities had to be rented or purchased. These expenses must also be covered under indirect costs.

Other Factors Affecting Indirect Costs

Several other factors have been significant in increasing indirect rates as well. First, the Employee Retirement Income Security Act (ERISA) and other pension reform laws added to the cost of administering pension plans for those Tribes fortunate enough to have such plans.

Second, additional federal requirements called for renovation or remodeling of buildings (e.g., redesign of entryways and restrooms) to meet the special needs of handicapped persons. Compliance with these requirements added substantially to the costs of providing program facilities.

Third, the Internal Revenue Service has added to information reporting requirements over the past several years, thereby further increasing administrative costs for Tribes.

Fourth, implementation and maintenance of new high tech systems added another cost factor.

Since 1980 most federal programs have dried up, been significantly reduced due to inflation and other economic influences, or at best, remained at existing levels—despite the fact that operating costs continue to mount. Overall, Tribes have experienced a significant reduction in available program dollars. So, even as costs are rising and available funds shrinking, federal administrative requirements continue to increase, placing an ever greater burden on already overstretched indirect dollars. By utilizing what we know from Chapter 1, we can see that if one shrinks the direct cost base, at the same time placing greater demands on the indirect cost pool, the inevitable mathematical result is a higher indirect cost rate—*even if the number of dollars actually involved remains the same or is slightly decreased.*

Whether you're building boxes or operating federal programs, if you don't identify and recover all of your costs, you'll wind up spending your own money to stay in business. And if you don't have your own money to spend, you'll be out of business very shortly. It's as simple as that. Many small Tribes—who have little or no money of their own—face a tough decision on how to spend what little they have: whether to subsidize federal programs or to build an economic base that might enable them to become less dependent on those federal programs. Without a stable funding base, it is difficult for these Tribes to achieve some measure of self-sufficiency.

In the past, Tribes have absorbed a lot of indirect costs themselves. In the Northwest, timber revenues were once plentiful for some Tribes and various types of grants were obtained by some to pay for systems development and operations. Self-Determination and Core Management grants were available from the BIA, and Tribal Management grants were available from the IHS. Many Tribes were able to utilize CETA dollars to pay for or subsidize administrative positions.

Figure 2-A shows what has happened to the BIA funding level for Self-Determination and Core Management Grants, a decline which further aggravates the problem.

BIA Grant Funding — 1977 to 1988:

FY	Self-Determination Grants	Core Management Grants	Proposed Tribal Gov't Assistance	Total Grants
1977	$16,500,000			$16,500,000
1978	19,488,000			19,488,000
1979	17,567,800			17,567,800
1980	17,569,000			17,569,000
1981	17,880,000			17,880,000
1982	17,084,000			17,084,000
1983	16,922,000	$2,500,000		19,422,000
1984	16,375,000	3,500,000		19,875,000
1985	15,820,000	4,900,000		20,720,000
1986	11,385,000	4,500,000		15,885,000
1987	7,761,000	2,821,000		10,582,000
1988	-0-	-0-	$6,800,000	[1]6,800,000

[1]$900,000 of this earmarked for a project

NOTE: The number of Tribes sharing in these grant programs has increased by over fifty. The number eligible for Core Management grants has almost doubled.

SOURCE: BIA budget justifications FY 78 to 88

Figure 2-A

Conclusion

Over the past several years, indirect costs could no longer be absorbed as timber and other revenues dropped away and as Core Management, Self-Determination and Tribal Management grants were dramatically reduced, even over the objections of small Tribes, who depend on these funds to support some of their necessary administrative costs. At the same time, Tribal staff have increased their efficiency and gained new capabilities. Yet that progress is offset by the funding erosion. Tribes point out that ultimately, systems erode as key staff look for employment opportunities that offer better compensation, more reasonable workloads relative to compensation, and greater job security. The decline in program efficiency continues as the number of Core Management, Self-Determination and Tribal Management grants decreases annually.

While the analysis indicates that many are still not recovering their full indirect costs, Tribes in the Northwest feel that they have become very capable of dealing with indirect costs over the eleven years of self-determination. Many believe that that capability is being eroded by design. And they have a right to ask why. What is to be achieved through a dwin-

dling of funds that makes Tribes' perpetual dependence on federal intervention an inevitability? And how can the federal government justify this trend, considering the intent of the Self-Determination Act?

Today most Tribes point out that they can no longer absorb nonreimbursed Federal costs and are nearing the point where programs must be retroceded back to BIA and IHS. When this occurs, many—if not most—of the gains anticipated by the Congress in Public Law 93-638 will have been lost. If Tribes lack the dollars to subsidize programs in the face of declining federal revenues, someone must go into debt in an effort to recover the loss. Further, the quality of services provided through programs necessarily suffers.

Clearly, the core of the problem is financial deficit. But the ramifications of the problem are far reaching and complex. After all, the underlying intent in providing Tribes the opportunity to contract for the operation of federal programs has been to enhance the development of strong Tribal governments and to provide Indians an effective voice in the planning, conduct and administration of programs and services deemed responsive to the needs of Indian communities. Eliminating or reducing that opportunity poses a direct threat to the future of self-determination. The legal responsibility of the federal government is twofold: first, to ensure the provision of programs and services that fulfill the unique federal obligation to Indian peoples and address the identified needs of Indian communities; and second, to provide Tribes a means of building skills and achieving greater independence through maximum involvement in the planning and administration of those programs and services. The erosion of federal funds is rapidly undermining these important goals.

CHAPTER 3

Indirect Cost Rates Differ Between Tribes

The BIA and IHS have generally held that funds cannot be equitably allocated on the basis of indirect cost rates because of the wide differences in those rates. Based on 1987 figures, negotiated indirect rates range, in the Northwest, from 11.1% to 147.0%.

Without knowing the reasons for these variances, a person who doesn't understand how indirect cost rates are established might naturally conclude that in the interest of fairness, everyone should get the same rate of recovery. There are, however, some very logical reasons why indirect rates need to differ from one Tribe to another. Let's consider several in detail.

1. Tribes pay for some of the indirect costs through direct grants.

In the Portland Area, in fiscal year 1985, Core Management and Self-Determination grants provided by the BIA paid directly for over $1,600,000 of indirect costs. In 1986 the amount dropped to $1,400,000. Amounts available in 1987 are much less, and the 1988 budget request asks for even less. Figure 3-A indicates by type the amounts of indirect costs funded by these grants.

CORE MANAGEMENT AND SELF-DETERMINATION GRANTS
Issued By The Bureau Of Indian Affairs, Portland Area

COST CATEGORIES	1985	1986
Building Rent/Lease	$5,414	$15,084
Utilities	120	1,305
Housekeeping/Janitorial	1,200	0
Building And Grounds Maintenance	10,200	0
Security	24,700	7,110
Equipment	80,669	84,061
Governing Body	55,130	0
Management	127,851	205,096
Planning	297,220	222,438
Financial Management	476,737	479,135
Personnel Management	70,042	25,742
Procurement/Materials Management	81,046	85,545
Human Resource Development	4,984	17,380
Property Management	13,989	8,248
Records Management	56,196	22,394
Data Processing	81,610	87,725
Office Services	83,251	16,902
Insurance and Bonding	750	435
Risk Management	0	0
Malpractice Liability Insurance	0	0
Legal Services	57,451	42,600
Audit	43,181	29,575
General Support Services	3,504	4,500
Miscellaneous and Other	89,021	50,075
TOTAL	$1,664,246	$1,405,350

Number of Tribes who had grants	1985	1986
BIA Core Management	24	23
BIA Self-Determination	32	28

Figure 3-A

Many other agencies have offered grants to assist Tribes in managing the kinds of indirect costs defined in Chapter 1. The Economic Development Administration has furnished planning grants to many Tribes. The Administration for Native Americans (ANA, within the Department of Health and Human Services) furnishes competitive grants for the development of systems. And the Indian Health Service has furnished Tribal Management grants, although many Tribes have not been aware of their availability.

Since costs funded by grants (directly funded indirect costs, that is) are not reflected in indirect cost rates, those rates are bound to differ from Tribe to Tribe. However, these differences also underscore another important point: Because indirect costs are necessary costs, and because the BIA through

grandfathering (allocation procedures) has limited and reduced the amount of funds available to cover indirect costs since Tribes began the grandfathering process, there have been insufficient funds to cover the increases in indirect cost rates. As Core Management and Self-Determination grants fall by the wayside, Tribes (particularly small Tribes) find themselves in a "Catch 22" position. They must find a way to provide the various services required to satisfy federal requirements governing program operations, but now there is insufficient money to pay for those services.

2. Many Tribes obtain grants to construct buildings.

The Economic Development Administration has provided many grants to construct buildings, as have other federal agencies. In such cases, the original cost of the buildings is not shown in the Tribes' indirect cost rates because the government has already paid for them once. Other Tribes have constructed their own buildings using their own or borrowed money. In that case, construction costs are covered by indirect rates under the headings of "depreciation" or "amortization." In still other cases, Tribes have had to rent buildings, and the rental fees are reflected as indirect costs. Often, all three situations are true for an individual Tribe. In still other cases Tribal programs may operate out of federal facilities, in which case the costs are borne by the federal government.

3. The structure and function of Tribal governing bodies differs.

Methods of operating and governing differ from Tribe to Tribe, as do compensation rates for the governing body. Some Tribal Councils meet only occasionally and are uncompensated while others are fulltime and salaried. Some also carry out key management functions. In some Tribes, each Council member is responsible for overseeing a different program area. Each Tribe must justify and negotiate the share of the governing body costs to be included in the indirect cost pool. That share must be limited to activities which support program operations covered by direct costs.

4. Management and administrative costs differ.

In most instances, administrative costs reflect some tradeoffs—often the result of attempting to achieve efficiency on the one hand by sacrificing something on the other. For example, efficiencies that might be gained by size of an organization can be lost because of geographic location or costly programs. Or a Tribe may pay a lower salary to a less qualified individual in a key management position, but lose efficiency or money in the long run because a less experienced manager may not know how to take advantage of available opportunities.

5. The number of different programs operated affects indirect costs.

The fewer the number of programs operated, the better the chance that some overhead costs can be directly charged to programs. However, this reduction in the number of indirect costs may be offset by the fact that small organizational size tends to boost indirect costs in relation to direct costs.

6. Many Tribes have very significant amounts of money tied up in federal training and employment programs.

To the extent that a Tribe can locate training positions within management and administrative structures, such positions may be funded all or in part by direct grants. For example, a bookkeeper position might be supported with JTPA funds. At the present time, there is no information available to indicate the extent to which this subsidization is occurring. Under the old CETA programs, many Tribes were able to capitalize on this opportunity. New regulations for JTPA programs, however, reduce the opportunities for subsidization of this type.

7. Insurance costs differ from Tribe to Tribe.

Some Tribes have been able to self-insure some costs and save money; however, paying staff to monitor this activity increases accounting costs. Overall, insurance costs have more than tripled for most Tribes during the past few years. And as a result, some Tribes have dropped certain types of coverage.

Several Tribes are considering tort claims laws in an effort to limit the liability of Tribal governments.

8. Audit costs differ from Tribe to Tribe.

Some Tribes have traditionally had all activities audited annually. Others have yet to comply with audit requirements. Those who have complied may be enjoying lower costs because of good ongoing monitoring of systems, while those who are new to the program are experiencing the relatively higher costs of setting up an auditing system. In some cases, the limited staff time that a Tribe can devote to recordkeeping may have resulted in incomplete records, which must then be reconstructed as part of the auditing process—a very expensive procedure.

9. Types of indirect cost rates negotiated differ from one Tribe to another.

Some Tribes negotiate indirect costs on the basis of "total direct costs less capital expenditures"-thereby including all costs associated with programs. Other Tribes negotiate indirect costs on the basis of "direct salaries and wages," a category which includes only salaries, wages and related costs. An indirect cost rate of fifty percent based on salaries and wages may equate to an indirect cost rate of thirty percent based on total direct costs. The rates look different, but the actual dollar recovery which would result could be the same.

10. Different representatives and different Inspector General's offices interpret rules differently and have adapted policies to personal biases.

Because of differences in interpretation, several Tribes have been unsuccessful in recovering depreciation or amortization within their indirect rates. Other Tribes have been unsuccessful in recovering the costs associated with the Tribe's governing body. Not all negotiators view negotiations as having the same goal: Some work to negotiate the lowest possible rate, others the fairest possible rate. Given these differing objectives, it is small wonder that the resulting rates differ.

Conclusion

This report lists only ten possible reasons that indirect costs differ from Tribe to Tribe. Indepth analysis would likely reveal many others. Methods used by Portland Area Tribes to determine potential indirect costs, based on the categories listed in Chapter 1, were analyzed to determine the extent of the differences involved. Appendix A indicates how different Tribes in the Northwest define indirect costs.

Despite differences among Tribes, this analysis does point out that most Tribes incur most of these costs and include them in their indirect cost pool. However, the analysis also points out that the indirect cost pools of many Tribes were artificially reduced through the supplement of grant funds. Now, with grant funds less available and no way to replace them through additional funds for indirect costs, there is no way to pay for these costs.

Further, the types of programs operated by individual Tribes differ; some Tribes operate more natural resource programs, others more human service programs. The assumption that differing rates result in inequity is not accurate. As a result, comparing one Tribe to another with respect to indirect cost rates is like comparing a wooden box factory to a picture framing gallery. True, both use wood, nails and glue to get the job done, but there the similarity ends. Their products are not the same, nor are their methods of doing business, nor—logically enough—are their indirect cost rates. And that, if each business is to operate at maximum efficiency, is as it should be.

CHAPTER 4

Problems Experienced with Indirect Cost Recovery

Once Tribes have negotiated their indirect cost rate, they then find themselves facing a new challenge – the challenge of collecting the indirect costs to which their negotiated rate entitles them. In fact, many federal programs have limitations on "administrative" costs which they apply to indirect cost rates. In some cases, the Congress establishes the limitations legislatively (e.g., for Department of Labor programs, CETA and JTPA). If a Tribe understands the concepts of indirect cost rates and multiple indirect cost rates, and is lucky enough to be assigned the right federal negotiator, then they can avoid some serious problems these limitations bring with them. Our review of the Northwest Tribes pointed out, however, that many haven't avoided the problems.

The Problem of Nonrecovery

In some cases the difficulty stems from the fact that once the Tribes negotiated their rate with the Inspector General for the Department of Interior, other agencies like the Department of Labor wouldn't recognize that rate, even though the Inspector General had executed the rate agreement with the phrase "on behalf of the United States Government." One Tribe points to substantial legal costs incurred in upholding

their right to charge indirect costs on the basis of the negotiated rate, within the confines of legislative limitations. As they put it, "This was only one instance in which Tribes had to bear the cost of correcting federal employees' misunderstanding of the federal requirements."

This problem has been further compounded by the BIA's failing to request sufficient funds for indirect costs and therefore not having funds to pay full indirect costs. What this amounts to is "nonrecovery." In other words, the Tribe is entitled to recover its full indirect costs but the federal agency cannot or will not pay.

Let's return to our wooden box scenario from Chapter 1. Remember that you had taken Mr. B's order for piano crates. But let's add a few new wrinkles. Now Mr. B doesn't want to pay a profit, but just wants to pay you at your cost. (Such is in fact the case for contracts with the government under P.L. 93-638.) And let's say that Mr. B says to you, "OK, I'll acknowledge your indirect cost rate but I'm only going to pay you a certain percentage [less than your real cost] of your rate." And according to what Mr. B is willing to pay, it turns out that you can collect only 97 cents for each dollar you spend. Would you take Mr. B's order? That is precisely the kind of order that has been placed with Tribal contractors in recent years by the BIA.

This problem of nonrecovery was described fairly clearly in a letter of November 3, 1983 when the Inspector General for the Department of Interior appealed to the Office of Management and Budget to remedy this situation. An excerpt from that letter follows:

[From]
United States Department of the Interior
Office of Inspector General
Washington, D.C. 20240

November 3, 1983

[To]
Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Room 252, Old Executive Office Building
Washington, D.C. 20503

Dear Mr. Wright:

The heavy and inconsistent requirements of the federal bureaucracy are jeopardizing the ability of Indian Tribes to handle federal programs, particularly those Tribes with limited resources of their own. The problem involves all Government agencies which award contracts and grants to Indian Tribes. Interior, Indian Health Service, other components of HHS, Education, Labor, HUD and Agriculture are the most involved.

Indian Tribes are treated the same as state and local governments when it comes to reimbursement for administrative costs incurred in handling federal programs. In a political sense, Tribes can reasonably be considered as state and local governments. However, in a financial sense, they are worlds apart. State and local governments have their own tax base; Indian Tribes do not. While some Tribes with valuable natural resources or large trust fund balances are reasonably well off, most are basically dependent on the federal government. About half are over 90 percent dependent.

The indirect cost guidelines (OASC-10) require an allocation of all 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.

Sincerely,

Richard Mulberry, Inspector General

This letter goes on to point out numerous other problems which are also discussed in this chapter.

The Problems of Overrecovery and Underrecovery

Again, let's return to our wooden box factory. This time Mr. B comes to you and says, "OK, I'll agree to your 30% indirect cost rate, but I want to look at all your costs at the end of the year, and to the extent you really didn't spend 30 cents of indirect costs for each dollar of direct costs, you will owe me the difference and must pay it back two years from now. If in fact you have spent more than 30 cents of indirect costs for every dollar of direct costs, I will owe you the difference and pay *you* two years from now. We can pay and collect through an adjustment in the indirect cost rate when we figure it out two years from now."

Now being a good business man, would you enter into that agreement? Probably not. But suppose you did. Would you expect to spend *exactly* 30 cents of indirect costs for every dollar of direct costs? Not really. Realistically, the actual rate would probably range from 25 cents to 35 cents.

If you collect 30 cents and actually spend only 25 cents, this is called "overrecovery." If, on the other hand, you collect 30 cents and actually spend 35 cents, that's known as "underrecovery."

In dealing with a "fixed with carry-forward rate"—which most Tribes have had to do—you'd need to negotiate over- and underrecoveries all the time. Over- and underrecoveries are adjusted into the rate two years down the road through what is called a "carry-forward adjustment."

The obvious question is: "Why not just agree on 30 cents and leave it at that? If we spend more we lose, and if we spend less we gain." For Tribes with resources, this would make sense; but to the many Tribes without resources, to lose money spells financial disaster.

Perhaps you think the situation is already growing complicated, and you're right. But it doesn't end here. In order to complete the analogy, we've got to add yet another wrinkle to the deal.

Let's say that you and Mr. B have made your agreement and you are going to collect indirect costs on the basis of a 30% rate. Mr. B comes to you and says, "Look, I know we agreed on 30%, but I'm a little short on money, so I'm only going to be able to pay you 27%." At this point you are be-

coming a little exasperated with Mr. B and wondering why you ever took his order in the first place, but you've stocked a lot of raw materials and several members of your family are working in your plant. If you don't build the piano crates, you'll be stuck with the materials and your loved ones will be out of work. So you say, "I guess I'll go in the hole three cents for every dollar of direct costs." This is an example of "nonrecovery." Figure 4-A shows examples of overrecovery, underrecovery and nonrecovery.

	Example of Overrecovery	Example of Underrecovery	Example of Nonrecovery
Negotiated rate	30%	30%	30%
Actually spent	25%	35%	30%
Actually recovered	30%	30%	27%
Overrecovery	5%		
Underrecovery		5%	
Nonrecovery			3%
Hypothetical recovery			30%

Figure 4-A

Quite a while after year's end, Mr. B comes to your factory and sits down to look at your costs. You have tried to curtail costs so you wouldn't lose money. And so, you've let the maintenance on the building fall behind (which really only defers the cost) and you've let your accountant's assistant go, and the accountant is being required to work extra hours. When he finally gets the books closed, you're almost through the next year. Quite frankly, you're not sure where you stand financially any more. Nevertheless, Mr. B looks over your books and discovers that you only spent 28 cents of indirect costs for each dollar of direct costs. He promptly announces to you that you owe him two cents. You say, "Now hold on there, Mr. B—you only paid me 27 cents; the truth is, you owe me one cent." Mr. B counters, "No—according to your rate you were *entitled* to 30 cents and so hypothetically you have been paid 30 cents." This is called "hypothetical overrecovery."

Well, he's stuck you again; only now you're over halfway through the next year and have the supply room stocked. You still have your employees—particularly your family members—to think of, so you look for another way to save. Next year,

Mr. B will agree to your 28% rate, but since you already owe him two cents now, he's only going to pay you 26 cents of indirect cost for every dollar of direct cost. So you defer some more maintenance, you cut the accountant's hours and start doing some of the labor yourself. The dilemma deepens because now you have to spend 28 cents to collect 26 cents or you'll owe Mr. B again. By this time, he's got you in such a financial mess, you've begun what we call an uncontrollable downward rate spiral to financial disaster.

On the other hand, let's say you figure Mr. B is a man of his word, so you keep your maintenance up and keep your accountant's assistant on. You actually spend 31 cents of indirect costs for every one dollar of direct costs. Mr. B is going to pay you that extra one cent through an adjustment to your rate next year, right? Not necessarily. By the time you're ready to enter into your negotiations, Mr. B informs you that he is no longer buying piano crates—and you have invested a great deal of time, money, energy and other resources in preparing a product for which there is no longer any market.

When a Tribe contracts with the federal government under P.L. 93-638, Mr. B is represented by many different people; and the hypothetical examples given above are quite real. In many cases Tribes have to contract to operate programs, or their communities simply don't receive the services that those programs provide. The Office of Management and Budget establishes the rules governing indirect costs; and OASC 10, published by the Department of Health, Education and Welfare (now the Department of Health and Human Services) provides guidelines for developing the rate. Other rules related to audit are set by the General Accounting Office. The Inspector General for the Department of Interior negotiates the indirect cost rates, although up until now many Tribes have been negotiating with the Department of Health and Human Services—others with the Department of Labor. The Tribes actually contract with the BIA and IHS, who pay the contract costs (or fail to). The Congress appropriates the money. And many other federal agencies and departments and offices—several of which are discussed elsewhere in this document—also enter into the act.

With all these people involved, it's no wonder that Mr. B behaves a little inconsistently, and that Tribes as a result are treated a little unfairly.

That is not to say that some of these agencies haven't worked to improve the situation. OMB has continually tried to increase the fairness and clarity of its regulations, bringing about greater uniformity and consistency. In 1986, the OMB made the Department of Interior responsible for all Indian Tribes—a fact which can help gain consistent treatment. The Department of Interior Office of the Inspector General in many cases has advocated for Tribes and attempted to make their life easier. Contracting officers in IHS and BIA have become more knowledgeable about the problem, and in many cases have done what they can to help.

Conclusion

Underrecovery, overrecovery and nonrecovery have been major problems for many Tribes. It is difficult to collect underrecovery in subsequent years when some of the programs from which full recovery was not made no longer exist. The lack of a stable funding base compounds this problem. Many of the problems Tribes report result from federal agencies' not following, and in many cases not understanding, the federal rules and procedures on indirect costs which Tribes are required to follow.

While the BIA and IHS were charged with the responsibility to implement P.L. 93-638, and while indirect costs were of vital importance to Tribes in contracting under P.L. 93-638, neither agency has devoted as much as one full-time position to providing technical assistance to Tribes in this matter. Problems related to indirect cost recovery are generally experienced by all Tribes which operate P.L. 93-638 contracts. There certainly are other problems relating to contracting for new Tribes and for new programs, contracting for operating schools, defining allowable versus unallowable costs, and dealing with economies of scale: i.e., small-Tribe problems versus large-Tribe problems. In all cases, however, problems with indirect cost recovery translate into lost dollars or recovering less than one dollar for each dollar spent.

The solutions to many of these problems rest with the OMB and don't necessarily require legal changes. OMB can instruct the Department of Interior to provide Tribes with al-

ternatives, and to ensure that they are treated fairly and consistently. Other solutions, however, rest with Congress and do require legal changes.

CHAPTER 5

Federal Appropriations for Indirect Costs

After the U.S. Congress enacted the Indian Self-Determination and Education Assistance Act in 1975, the BIA and IHS moved to include a new item called "Contract Support" in their respective budgets. Because of the lead time necessary to amend a federal budget, this item was not actually included until 1977.

BIA contract support funds and IHS P.L. 93-638 implementation funds were used to pay for the specific initial costs involved in preparing Tribes to contract for program management, covering the federal employee displacement costs that result from transferring program administration to Tribes, and covering the indirect costs associated with the contracts. Unfortunately, the funds available were not sufficient to cover these three costs. So, in fiscal year 1976, Tribes went to Congress to obtain supplemental appropriations.

Shortfalls in the Bureau of Indian Affairs

Shortfalls—the difference between what was needed to support programs and what could be obtained—occurred again and again, year after year in the BIA. Some years, supplemental appropriations were obtained to offset these shortfalls. In other years, Congress instructed the BIA to reprogram other

funds. And often, unfortunately, the Tribes never recovered their full negotiated indirect costs.

Why did shortfalls occur? Sometimes, they were attributable in part to increasing Tribal indirect cost rates, and in part to the fact that contract levels were underestimated. For several years, OMB reduced the BIA estimate in the budget formulation process.

The repeated occurrence of this same problem attracted questions and concerns from some members of Congress, who perceived that the shortfalls were placing a heavy burden on Tribes. Not only were they short the money needed to fund program operations, but often—even when funding was available—they received no assurance of that funding until the last month of the fiscal year. Such timing made planning and program administration a nightmare. No one could know for certain which programs might exist from one year to the next, or even whether certain positions within those programs should be filled or left vacant. Further, it is difficult to attract well qualified personnel to an atmosphere troubled by such uncertainty.

The BIA frequently testified that shortfalls were a reflection of increasing Tribal indirect cost rates over which the BIA had no control. Testimony by BIA officials, however, failed to provide support for that hypothesis. In some testimony, officials provided information that criticized the Inspector General for negotiating higher rates, and in other testimony, some isolated cases of abuse (e.g., high executive salaries and fringe benefits, high Tribal Council salaries) were cited as causing increases in indirect cost rates (see the Senate Appropriations Committee Report and the Bureau of Indian Affairs Budget Justifications for fiscal year 1987). As a result, Tribes generally seemed to be penalized because of several isolated instances and lack of understanding by BIA officials.

In the BIA, the Congressional Conference Committee Report on the fiscal year 1983 budget submission indicated that

> "... *Contract Support Funds shall be allocated to program accounts with only funds required for new contracts included in the Contract Support Line Item.*"

In 1983, the BIA proposed a new method of handling indirect cost rates based on a study of indirect costs conducted

by the American Indian Law Center, Inc. After many meetings across the country with Indian leaders and in accordance with Congress, the BIA changed its original proposal and allocated funds for indirect costs into the programs in a way that *separated allocation of funds from cost recovery methods.* It was BIA's intent to limit funding requests strictly to new contracts from that point forward.

An ad hoc committee was appointed in 1984 to recommend the best methods of implementing this plan. Tribal representatives requested that the BIA not lose track of the dollars involved because it appeared that the 1985 budget request was deficient by somewhere between $3 and $4 million.

In fact, when the Contract Support funds were distributed in 1985, only $37,749,000 was available to fill an entitlement of $40,777,500—resulting in a shortfall of $3,028,500. The BIA grandfathered Tribes at 92.5% of their indirect costs and did not request additional funds. When all the facts were in for FY 85, an additional need of $1,408,000 had been identified. Still later, an additional $883,000 need was identified, bringing the total shortfall at that point to over $5,250,000. The shortfall has been continued and has increased for new contracts in fiscal years 1985, 1986 and 1987.

In estimating new contract needs, the BIA has used a median estimated indirect cost rate of 15.5% based on the 1983 study, which has been neither updated nor validated. The budget request for FY 1987 included 92.5% of the identified additional need for 1984 and new contracts for 1985, 1986 and 1987. (As of this writing, the BIA is projecting that funding available for new post-1984 contracts will cover only about 70% of indirect costs.)

The Senate Appropriations Subcommittee was not satisfied with the data the BIA submitted to support the 1987 request, and appropriated an amount that did not include the additional 1984 requirements. When these amounts were questioned by Congressional committees during hearings on the fiscal year 1987 budget, the BIA proposed to "ungrandfather" previously allocated amounts and replace them with a flat fifteen percent administrative fee. In other words, allocations would no longer be program-specific, but would all come out of a general, central fund. This approach would enable the government to establish a strict ceiling on allocations and to say to

Tribes, in effect, "Here is the amount you will receive, *irrespective of what it costs.*"

The BIA attempted to implement this approach in 1987, but was required by Congress to go through the regulatory process.

As of this writing, the following steps have been taken:

- The BIA has ungrandfathered allocations in its fiscal year 1988 budget submission, in preparation for implementation of a flat administrative fee.
- BIA officials are moving towards publication of federal regulations implementing a flat fee.
- The FY 88 budget request does not reflect the real need for indirect cost allocations.
- The Office of the Inspector General in the Department of the Interior is conducting an impact study and a report is expected later in FY 87.
- Tribes have asked the BIA to consult with them and have attempted to point out the problems which will be created if BIA goes ahead with the plan, but to no avail.
- Several Tribes have pointed out that they will be forced to retrocede their contracts if the BIA goes through with its plan. Others anticipate severe crippling of their operations.

Figure 5-A the top of the next page shows the appropriations available to the BIA for contract support since 1976.

Shortfalls in the Indian Health Service

In the Indian Health Service, negotiations for the payment of indirect costs have gone somewhat better than in the BIA. The IHS established a large budget called "Public Law 93-638 implementation funds" in 1977. This budget was initially funded at $18,453,000—$10 million for projects, $849,500 for training and technical assistance, $1,950,500 for personnel, and $5,653,000 for indirect costs. This amount was included in the recurring base for the IHS budget so that as additional indirect costs were needed, the other items within the total amount were reduced to make additional funds available. This helped preclude shortfalls in the indirect funds available for several years.

P.L. 93-638 CONTRACT SUPPORT FUNDS
PROVIDED BY BIA
(Dollars in Thousands)

FY	Original BIA Request to OMB	Original BIA Request to Congress	Appropriations (incl. Sup. and Reprogrammed)	Less Estimated Displacement Cost	Available for Indirects	Estimated Need for Indirects
1976	0	11,200	10,700	Not avail.	10,700	Not avail.
1977	21,690	11,130	9,777	Not avail.	9,700	Not avail.
1978	15,900	9,700	8,742	Not avail.	12,200	Not avail.
1979	17,200	10,941	23,577	Not avail.	23,577	Not avail.
1980	25,093	23,577	23,770	Not avail.	23,770	23,328
1981	25,577	25,873	28,073	Not avail.	28,073	27,559
1982	25,873	28,460	27,322	Not avail.	27,322	34,153
1983	31,908	30,338	37,338	Not avail.	37,338	37,788
1984	36,788	34,788	37,788	(300)	37,488	43,069
1985	42,288	39,588	38,698	(300)	38,398[d]	45,856
1986[a]	2,850	1,440	4,600	(400)	4,200	5,649
1987[b]	7,086	7,586	6,768	(200)	6,568	9,032
1988[c]	9,586	42,787		(400)		53,719

[a] Includes new FY 85 and 86 contracts
[b] Includes new 4th quarter 1984 contracts, new 1985, 1986 and 1987 contracts
[c] All contracts include ungrandfathered amounts
[d] $38,308 grandfathered to pre-1985 contracts

SOURCE: BIA budget justifications, internal BIA documents and correspondence

NOTE: Estimated need has not been adjusted by major reductions to housing construction and Johnson O'Malley programs. The amount of these reductions has not been confirmed but are estimated at approximately $3 million.

Figure 5-A

For the first several years, the IHS funded indirect costs on a contract-by-contract basis from the Central Office. Contracts were negotiated in the area office and forwarded to the Central Office for the application of indirect cost funds. Tribes indicate that with a few exceptions, the IHS funded full indirect costs.

As alcohol and drug program funds were transferred to the IHS from the NIAAA, these transferred funds were seen as including indirect costs, so the IHS would not make what it termed *additional* indirect funds available. This caused a problem for most Tribes as rates increased and there was no mechanism to apply for additional needed funds.

Tribes also expressed dissatisfaction over IHS officials' unilateral decisions about what they would and would not consider in calculating indirect costs. In some cases, officials would disallow items that should have been used as a basis for

calculating indirect costs, thereby reducing the amount recoverable to something less than what the Tribe was entitled to. In most cases, fortunately, the differences were not terribly significant. And some Tribes indicate that they were able to prevail in the negotiations by educating IHS officials on how their indirect cost rate was typically negotiated.

In some cases, the IHS has set limits on what it would pay for certain classes of costs, based on its own experience. For example, limitations on the costs of fringe benefits were established in this way. Tribes without their own resources to fall back on face problems with this method of negotiation; even when small amounts of nonreimbursed costs occur—as they frequently do—Tribes simply lack the funds to make up the difference. Numerous small shortfalls quickly add up to large deficits.

Contracted programs have included both clinical (direct, full medical service) and nonclinical (e.g., social service, mental health) programs—and even, in some cases, hospitals. Tribes frequently contract for nonclinical programs and leave clinic operations to IHS. Nonclinical programs include alcohol and drug programs, community health, mental health, maternal and child health. Size ranges from very small contract programs at remote locations to large-scale hospital operations. This range in turn accounts for a wide variance in both direct and indirect costs, as well as—obviously—resultant indirect cost rates.

In order to comply with Congressional demand and as a result of a lawsuit, the IHS has developed a methodology to provide for equitable distribution of health resources. In doing so, the IHS had proposed to allocate funds based on standard formulas for all cost categories, and to negotiate with Tribes on a line item-by-line item basis, rather than utilizing indirect cost rates. This threatened problems for Tribes.

Tribes pointed out that IHS's proposed method, with its inherent item-by-item negotiation approach, would entail much greater time and effort during planning, negotiations and recordkeeping—thereby automatically increasing expense. In addition, this method would put Tribes in a position of noncompliance with OMB published regulations, upon which audits are based.

At a special meeting held in Tulsa, Oklahoma in October of 1986, the Northwest Tribes presented a compromise solu-

tion which would permit IHS to base funding allocations on standard cost categories, yet allow Tribes to continue using their indirect cost rates for the purpose of cost recovery. In effect, Tribes would provide information about actual costs; and the IHS would use that information in its formulas to calculate total needs.

The IHS indicated favorable disposition to this proposal, and took further steps to determine its feasibility, later incorporating it into policy in early 1987. Continued consultation and joint efforts with Tribes are continuing as of this writing.

While it has not always provided enough funds within its budget to fund indirect costs, the IHS has, fortunately, been able to utilize other available funds to supplement needs in years when additional appropriations were not made.

Figure 5-B indicates that Congressional add-ons have been available to supplement the need. IHS testimony in presenting the FY 87 budget to Congress indicates a deficiency of $10 million with a report due in 1987. The FY 88 Budget submittal does not appear to include a request for this additional need. Little precise information has been given within the budget submittal for several years as indirect cost funds appear to be hidden within the hospital and clinic line item.

INDIAN HEALTH SERVICE HISTORY OF INDIRECT COSTS
(Dollars in Thousands)

	Original IHS Budget Request	President's Budget	Appropriation	Supplemental	Gramm-Rudman Reduction	Total Available	Actual Obligations
1976	0	0	0	0	0	0	0
1977	0	0	0	6,000	0	6,000	N/A
1978	6,000[a]	0	6,000	0	0	6,000[a]	N/A
1979	6,000	0	6,362	0	0	6,362[a]	N/A
1980	6,725	6,725	6,725	0	0	6,725[a]	9,075
1981	16,528[b]	16,528	16,528	0	0	16,528	13,458
1982	16,528	16,528	16,528	0	0	16,528	14,549
1983	16,528	16,528	16,528	0	0	16,528	14,683
1984	16,528	16,528	16,528	0	0	16,528	17,546
1985	16,528	16,528	16,528	0	0	16,528	16,285
1986	26,528	16,528	19,028	0	30	19,028	21,125
1987	29,028	19,028	19,028	0	0	19,028	21,500 est.
1988	29,028	19,028	N/A	0	0	N/A	21,500[c]

[a] These resources were in the Tribal Health Program Support activity and were used to support direct management costs of tribal contracts.
[b] During restructuring of Indian Health Service budget, it was determined that approximately $10 million was used for indirect costs for Tribal contracts under Tribal Health Program Support activity. Amount of $16.528 million transferred to hospitals and clinics.
[c] Reflective of information available from accounting records, not full amount actually spent.

NOTE: IHS officials indicate the original IHS budget request includes best IHS estimates of unmet need.

Figure 5-B

Conclusion

The problems of shortfalls in funds available to pay for indirect costs can be attributed to two things: first, the reduction in budget requests by offices above the BIA and IHS level, and second, the lack of accurate information being provided to Congress. The record shows that the Congress has in most cases appropriated needed funds when presented with the facts.

Efforts to find a simple shortcut for determining indirect costs have typically been counterproductive. Other agencies have considered the flat fee approach and discarded it. The fact is, different Tribes incur different kinds of costs, and at different levels, depending on the nature of the programs for which they contract. Taking a flat rate approach would *seem* on the surface to solve many problems: to simplify negotiations, and to ensure equitable distribution of funds. But in reality, the opposite occurs. A flat rate approach ensures that numerous programs will be dramatically underfunded. And in their efforts to circumvent that reality, Tribes must spend additional time and effort negotiating even minimal funding levels.

What seems to be needed, rather than a "quick fix" formula, is an educational process by which all those involved—Tribes and government representatives alike—analyze and agree upon the methods by which real indirect costs are established. Unless this process is thoroughly understood, the government will find itself once again assuming a dominant role in program administration. Such a consequence would be unfortunate indeed, not only because Tribes stand to lose some measure of the independence and autonomy they have gained over the past few years, but also because retrocession of programs squanders precious resources: time, money, and personnel. Let's face it, from a business perspective, the choice is clear: It's immeasurably easier (and cheaper) to subsidize an up-and-running program than to rejuvenate one that has fallen apart due to lack of funds.

CHAPTER 6

The Funding Issue

Section 106 h of the Indian Self-Determination and Education Assistance Act provides that each Secretary (Interior and HEW) will not spend "less than the appropriate Secretary would have otherwise provided for his direct operation of the program or portions thereof for the period covered by the contract" (25USC §450j (h)).

Tribes believe Congress intended that the BIA and IHS would include all costs associated with operating the program in funding allocations. However, there were two problems not foreseen by the language of the Act.

First, program funding allocations at the reservation level did not cover all costs associated with the program—nor were they representative of all the money spent to finance the program. In fact, program costs were spread throughout the government at all levels. Without a detailed analysis of what the government was actually spending, the Tribe which contracted to operate the program could wind up with less than program parity—in other words, with less money to operate the program than the federal government had been spending to provide the same services. However, because of misleading, underrepresentative figures at the reservation funding level, the Tribe would *appear* to have parity.

Next, both agencies can unilaterally withdraw funding allocations from funding requests to Congress at any level after contracts have been entered into and still fall within the lan-

guage of the Act, since all contracts are written "subject to the availability of funds."

While neither the funding parity nor the funding withdrawal issue has immediate direct impact on indirect costs, both issues affect whether such funds are adequate to ensure completion of the task at hand.

Let's return for a moment to the first issue—funding parity. An analysis of government spending was conducted to determine how and where the government actually accounted for the costs of operating programs in the Northwest. Because the BIA has claimed an eight percent overhead rate, a typical BIA program was used for the analysis. (BIA's eight percent claim is examined in Appendix D.)

Figure 6-A at the top of the next page presents the same indirect cost categories used in analyzing Tribal rates to indicate where and how those costs are accounted for under government administration of the same programs. Note that other costs which would normally be considered direct costs by Tribes are not even included within the Tribe/Agency program budget (e.g., unemployment tax and workers' compensation insurance are paid for from the Central Office level).

What Figure 6-A points out to the Tribe contracting this program is that even if it included all of the indirect cost items in its indirect cost rate and *obtained full recovery*, full cost of the program still would not be recovered *in parity with the government's operation of the program*—particularly since the BIA often retains a part of the available funds to "monitor the program."

Were the government to conduct an analysis of its real program operating costs, those costs would be equal to if not greater than the Tribes' real costs. Apparently, the President of the United States agrees because, by executive order and OMB Circular A-76, he has directed the government to contract out more functions. Further, Senate Bill S.265, which was introduced in 1987 and is currently pending, indicates that some members of Congress agree.

The second issue, that of agencies tampering with funding allocations, is not as easily dealt with, because it is not covered under the law. Many Tribes have feared contracting under P.L. 93-638 because they felt that as soon as they assumed operational control of a program, the funding would

DISTRIBUTION OF THE COSTS OF BIA OPERATING A PROGRAM

This chart indicates budgets and locations from which expenditures in support of a BIA-operated program would be made.

	BIA Tribe/Agency Program Budget(a)	BIA Tribe/Agency Other Budgets	BIA Area Office Budgets	BIA Field and Central Office Budgets	Other Agencies and Departments
Direct Program Costs					
Program Personnel	X				
Fringe Benefits	X				
Worker's Compensation Ins.				X	
Unemployment Tax				X	
Travel/Vehicles	X				
Materials and Supplies	X				
Contractual Services	X				
Other Direct Costs	X				
Indirect Costs					
Facilities and Equipment					
Building Rent/Lease Cost				X	
Utilities				X	
Housekeeping/Janitorial				X	
Building and Grounds Maint.				X	
Security				X	
Equipment	X	X	X	X	X
Management and Administration					
Governing Body					X
Management		X	X	X	X
Planning		X	X	X	X
Financial Management		X	X	X	X
Personnel Management			X	X	
Human Resource Development	X	X	X	X	X
Procurement/Materials Mngmt.		X	X	X	GSA
Property Management		X	X	X	
Records Management			X	X	X
Data Processing		X	X	X	
Office Services	X	X	X	X	
General Services and Expenses					
Insurance and Bonding					Self/Ins
Legal Services					Justice
Audit					OIG/GAO
General Support Services		X	X	X	
Misc. and Other		X	X	X	X

[a] The Tribe/Agency Program Budget is the amount of funds which would be made available to Tribes prior to an addition for indirect costs.

Figure 6-A

dry up. Unfortunately, many of these fears have been confirmed.

While each Tribe has an individual relationship with the United States Government and operates as a sovereign, the

budget process by which the United States provides services to Indians in effect lumps them all together and deals with them as a group.

In 1975, the BIA was using a budget planning system called "band analysis." This was changed a little in the late 70s when "zero base budgeting" was developed. Zero base budgeting eventually evolved into what is now called the "Indian Priority System." In each case, Tribal input was sought and Tribes had the opportunity to request shifts of funding from one program to another within the base funding at their location. Further, the Tribes were able to set priorities to determine which programs would be affected by overall funding reductions or increases. This approach was intended to allow Tribes to base priorities on needs within their individual communities.

Under all three approaches, as Tribal Councils have been asked to participate in the planning process, BIA officials have assured Tribes that their priorities would be honored. However, each year the BIA at the Central Office level finds new ways to tamper with it. For example, in the FY 88 budget request, the Assistant Secretary of Indian Affairs eliminated Self-Determination grants and cut the forestry budget by $7.5 million. In proposing the FY 89 budget planning, roads maintenance and credit and financing are being unilaterally withdrawn. Area offices dip into allocations to fund new Tribes. Field programs, such as the Bureau's electronic data processing function, allocate charges to Tribe/Agency programs. When across-the-board cuts are made to budgets for executive direction and administration, even at the Tribe/Agency level, then funds which would have supported key BIA management and administrative salaries and travel are lost. These necessary salaries or travel must then be allocated against programs.

To be sure, in the following year's planning, part of the budget will need to be shifted from programs to replace the previous year's reductions in administrative and management functions—with the hope that those particular budgets won't be arbitrarily targeted again. Tribes point out that participating in this process is much like playing Russian roulette. Tribes try to outguess the BIA and shift funds to the program that will *not* be unilaterally withdrawn; but if they guess wrong, their funding base will be permanently reduced by the amount of the withdrawal.

In an effort to maintain a more stable level of funding at the program level, the IHS uses a system called a "recurring base." Under this system, the Congress has made "equity funds" available to provide adjustments in regional base allowances. The "resource allocation methodology" currently being developed appears to provide some means of identifying and making allowance for all Tribal costs associated with contracting. However, in reviewing the 1987 budget, Congress solicited information from IHS that indicated a $10 million shortfall in indirect funds. A report due in mid-1987 may provide some clarification, but the fact remains that the 1988 budget does not cure this shortfall. Once again, the difference between need and allocation—in this case an anticipated substantial difference—could lead to the same problems which occurred in the BIA when amounts available to "grandfather" in 1985 were insufficient, except that this shortfall will be hidden by the new "resource allocation methodology."

Conclusion

The intent of the Self-Determination Act was to provide a mechanism for Tribes to contract and administer BIA and IHS programs and services that are operated for the benefit of the Tribes' members. Implementing this law has been complicated by the fact that Congress and the federal agencies (BIA and IHS) have not had an accurate way of determining the actual cost of transferring program planning and administration responsibilities to Tribes.

Neither agency (BIA nor IHS) has developed a method for determining what it is spending on the programs it operates. Ostensibly, parity could be achieved if Tribes were funded at the same indirect rate that had been employed by the federal government. But in practice, this approach does not work. First, the government agencies do not have an accurate way of determining their indirect rate. And second, as Tribes point out, part of the program allocation is often retained by the government to cover the costs of monitoring the program.

Tribes feel that at the heart of the real funding issue is the question of parity—together with need for stability. Tribes need assurance that as the transition is made from federal to Tribal program operation, programs will be funded at a level on par with what the federal government would have spent.

They also need stability to allow improved program planning and delivery. In the final analysis, funding of all indirect costs is less an issue than is the funding of all contract costs both direct and indirect. How can government agencies reasonably expect Tribes to operate programs for less money than they themselves would have spent in providing the same services, particularly when Tribes must comply with federal regulations that demand more quality and accountability? The issue is more than one of logic or fairness, however. Under the Indian Self-Determination and Education Assistance Act, parity is mandated. Therefore, the issue is also one of legal compliance. And clearly, neither agency has developed a system to comply with the law.

CHAPTER 7

Contracting Regulations and Indirect Cost Recovery

As one looks at the issues surrounding indirect cost recovery on P.L. 93-638 contracts with the Bureau of Indian Affairs and the Indian Health Service, it is natural to wonder how other federal agencies handle their indirect cost recovery with contractors.

There are several components to contracting, involving government procurement and its historical perspective and background, cost accounting requirements, audits, and the many rules and regulations that make up the procurement process. The following discussion is intended to help readers better understand how the original P.L. 93-638 contract regulations merged into the general federal contracting sphere, and to gain a clearer picture of how P.L. 93-638 contracting with the Indian Health Service and Bureau of Indian Affairs compares to procedures used by other agencies and their contractors.

Procurement

According to Frank M. Alston, *et al.* in their highly informative book, *Contracting with the Federal Government,* the experiences of World War II had shown that competitive bidding was not the best means of producing required goods and

services under emergency conditions. Thus, new rules and regulations were developed during this time, and most competitive procurement requirements were dropped for a while, but ultimately, because of some complications, government procurement reverted to competitive bidding.

Prior to WW II, contracting among different agencies had been handled somewhat differently—meaning that regulations varied somewhat, and also that different agencies reported to different contracting authorities. Over the past several decades, however, the trend has definitely been toward consistency in the way contracting regulations are established and enforced across agencies. By 1984, the original Federal Procurement Regulations which had been developed during the war years were totally replaced by the Federal Acquisition Regulations (FAR). Gradually, BIA and IHS P.L. 93-638 contracting—as but another component of civilian contracting—quietly but surely came under the auspices of the Federal Acquisition Regulations, as did all other federal procurement contracting.

The implications are clear. Despite disparities among agencies with respect to products, services, or even methods of doing business, the federal government recognized a need for fairness and equitability in the ways in which contracts were established and monitored. Such consistency would extend, of course, to regulations governing budgeting and the way in which direct and indirect costs were established within contracts. Such, at least, was the intent of FAR.

Over the years, various agencies occasionally applied for waivers from standard rules or regulations, but by and large, the concept of applying consistent regulations to such different kinds of agencies as the Postal Service and the Department of Defense still seemed to work. There seemed no compelling reason to treat agencies differently, or to suppose that contracts for different agencies should be set up or enforced in different ways—even though the content of those contracts might differ substantially. This is analogous to saying that certain laws governing the way in which business is conducted shall hold equally true and applicable for the local grocery, the department store chain, and the high tech conglomerate.

Of course, although there is much uniformity in the way that acceptable costs are established under government contracts, agency differences do exist. For instance, the Agency

for International Development (AID) has its own principles for compensation and the Environmental Protection Agency (EPA) has its own cost principles for some types of grant awards to nonprofit organizations. And numerous other differences could be noted. But the differences are less important than the fact that over the years—and particularly within the last several years—the definite trend has been toward consistency.

Organization for Procurement

Today, about thirteen departments and sixty agencies in the executive branch are responsible for awarding numerous large contracts (Alston, p.15). Several key policy groups are involved in handling this large-scale contract management—most notably the Office of Federal Procurement Policy (OFPP), the Office of Management and Budget (OMB), the General Accounting Office (GAO), and the Office of the Inspector General (OIG).

The OFPP is responsible for issuing the Federal Acquisition Regulations in the first place. And, it is worth noting that in 1979, the Office of Federal Procurement Policy established government-wide uniformity as a major objective within its procedures for awarding contracts and grants.

The Office of Management and Budget (OMB), in addition to overseeing OFPP, also plays a significant role within the procurement process through the issuance of circulars that help define for agencies the principles and policies governing the setting of costs and indirect cost rates, auditing procedures, and so forth.

The General Accounting Office (GAO) has widespread oversight and authority over federal funds. The GAO audits, inspects and reviews virtually every governmental activity.

The Office of the Inspector General has currently been established for sixteen federal departments and agencies. The broad responsibilities and authority of this Office include conducting audits and inspections relating to policies, practices and operations covering all aspects of departmental operations.

All indirect cost agreements are negotiated with a cognizant agency. For example, the Department of Health and Human Services, the Department of Defense, the Department of the Interior and the Energy Research and Development

Administration have all been assigned cognizance (i.e., responsibility) for various institutions. Federal management circulars assign institutions to each of these federal departments. Indian Tribes have as their cognizant agency the Department of the Interior (DOI) as provided by OMB Circular A-87, as amended in the Federal Register in 1986. The DOI responsibility is further delegated to the Office of the Inspector General.

BIA and IHS P.L. 93-638 Contracting Regulations

Because the Bureau of Indian Affairs, under the Department of Interior, and Indian Health Service, under the Department of Health and Human Services, are among the many government entities that do contract for services, it is useful to follow the line of regulations that govern BIA and IHS procurement specifically. It is also interesting to see how P.L. 93-638 Self-Determination contracts have now come under the Federal Acquisition Regulations. In other words, the way in which costs are established or negotiated for Tribes should in no way differ from the way in which similar costs (direct or indirect) are negotiated for any other agency governed by the Federal Acquisition Regulations.

Yet, in practice, this has not been the case. In fact, as Tribes contract to assume management of programs formerly operated by the federal government, it becomes increasingly clear that because of budgeting and accounting difficulties, and because of the lack of parity in program allocations (i.e., between what the government spends and what the Tribe finally receives), contracting procedures are not being applied to Tribes in the same way that they're being applied to other government agencies or private contractors. In effect, this difference is discriminatory.

Conclusion

Our primary question in this chapter has been, How do rules for determining Tribal indirect costs for BIA and IHS P.L. 93-638 contracts compare with those for other agencies? And the answer is clear: They are the same.

The next question then becomes, How does funding of indirect costs for BIA and IHS P.L. 93-638 contracts compare

with the funding of indirect costs for other agencies? That answer is clear also: They are very different.

There seems no compelling reason that Indian Tribal contractors should be treated differently from other federal contractors with relation to indirect costs or cost recovery in general. Additionally, the indirect rates of P.L. 93-638 contractors are not out of line with those of other federal contractors (See Appendix E); in fact, P.L. 93-638 contracts tend to have rates similar to those achieved by most contractors for other agencies. Again, note that the uniformity of the procurement regulations, cost accounting standards, audit requirements and review assures that these comparisons of rates is truly a comparison of "apples with apples."

With comparable indirect recovery rates, and without—in most cases—the benefit of expensive accounting advice and funds to cover unallowable costs, Tribal governments have demonstrated extraordinary adaptability and success in operating programs. Rules and regulations, in the broadest and best sense, are intended to simplify life, not to make it more difficult. They're also intended to promote fairness, not render it unachievable. Tribes have generally accepted the idea that they should live up to the same set of rules and standards as everyone else. If the federal agencies involved could make true comparability a reality, that single step would go a long way toward enhancing the achievement of self-determination.

CHAPTER 8

Conclusions and Observations

Following are the general conclusions based on the evidence and arguments presented in Chapters 1 through 7.

1. Indirect costs are not unique to P.L. 93-638 contractors.

Contracting of federal programs is not unique to P.L. 93-638. As indicated in Chapter 7, the evolution of laws governing federal contracts has been a long and involved process. In fact, it is clear that P.L. 93-638 contractors, being dependent domestic sovereign governments, were forced into sets of regulations not easily implemented within the short period of the Self-Determination policy. Tribes clearly come under the same rules that apply to all other federal contractors, even if those rules are not equitably enforced. Further, Tribes have generally accepted the expectation that they would meet the same standards of accountability as all other federal contractors, an assumption which has strengthened Tribal government capability in the long run. Tribes come under OMB Circular A-87, which also covers state and local governments in dealing with indirect costs.

2. The federal government attempts to recognize and recover its indirect costs.

The federal government itself has consistently recognized the need to identify, measure and recover indirect costs. OMB Circular A-76 (to name one source) documents the intent of the government to measure and account for indirect costs.

Senate Bill S265, submitted to Congress in January 1987, seeks to establish the provision that the federal government will not operate services that it can buy from the private sector unless significant economic advantage accrues to the government through the operation of such services. In making the determination about what constitutes "significant economic advantage," a government official must take into consideration

> "... *all direct and indirect costs of starting or conducting such activity in the executive agency; and in consultation with certified public accountants employed in the private sector, prescribe in the regulations generally accepted accounting principles and simple procedures for each head of an executive agency to apply in making a determination* ... "

Further, there is clear intent that the government will recover its indirect costs, as indicated in numerous reports issued by the General Accounting Office. One such report (GAO OFMD-82-10, 2/2/82) indicates that recovery of indirect costs is *required* by the Defense Department:

"The Arms Export Control Act of 1976 gives the Department of Defense authority to sell Defense articles and services to foreign countries at no cost to the U.S. Government. To recover the indirect costs of these sales, the Act requires that foreign customers be charged an appropriate amount, calculated on an average percentage basis, to recover the full estimated costs of administrative services. The legislative purpose of this charge is to ensure that all sales include 'a fair share of all indirect cost so that there are no longer any elements of subsidy in the sales program'."

3. Tribes see the problem as going far beyond the use of indirect cost rates.

Tribes feel that the problems associated with indirect cost recovery symbolize a failure of the government to adequately fund Tribal programs, and a failure of federal agencies to properly recognize the Tribes' efforts. Most feel that they have become competent in establishing fair, responsible indirect rates since they began contracting. The failure of the BIA and IHS to appropriately recognize indirect costs and fund them has caused many Tribes severe financial difficulty, and has also caused them to ask for what purpose they have developed their budgeting capabilities. In many cases, their outstanding performance in complying with regulations and holding costs to a fair rate has been for nothing. The government's unwillingness to fund the very programs for which it imposes high quality performance standards spells certain disaster and utter frustration for Tribal administrative efforts.

4. Requiring or encouraging Tribes to contract before they were ready to assume administrative responsibilities has placed many Tribes under severe financial hardship.

Many Tribes have had substantial costs disallowed, and because of that now owe the government money. In many cases, inadequate recordkeeping has made it difficult for Tribes to determine the allowability of various costs. Abuse or misuse of funds within Tribes is rare; more often, Tribes face governmental debts resulting from legitimate expenditures which could not be supported because records were incomplete. Generally, Tribes lack the financial capability to repay these debts.

5. Measures anticipated by the BIA appear designed to undermine the progress Tribes have made toward achieving self-determination.

Many Tribal leaders feel that future procedures anticipated by the BIA with respect to establishing indirect costs pose a real threat to Tribes' efforts at achieving self-determination. The imposition of a flat fee would severely damage the infrastructure that the Tribes have developed to successfully operate programs under P.L. 93-638. Without systems the

process of contracting for programs under P.L. 93-638 is doomed to failure—whether through ignorance or design.

6. The funding of total contracting costs in compliance with P.L. 93-638 has not been achieved.

What the federal government actually spends to operate programs through the Bureau of Indian Affairs and the Indian Health Service has yet to be carefully analyzed or documented. Although the BIA claims that its overhead rate is eight percent, our analysis, based on the best information available, indicates that this estimate is inaccurate. It is clear that a thorough analysis, based on the approach outlined in Chapter 6, would yield a much higher rate. Tribal indirect cost rates reflect the most accurate statement of what it takes to do the job, yet the government tends to question this rate, while seeming willing to accept a rate presented by agencies who have never thoroughly analyzed their true costs. This seems not only discriminatory, but from a business perspective, ludicrous and indefensible. It is clear, based on the evidence available, that the BIA and IHS have not requested or received adequate funds during the period since implementation of the Self-Determination Act.

7. Tribes have no assurance of a stable funding base for contracted programs, particularly through the BIA.

While the IHS has had what is called a recurring base budget, it has targeted several contracted programs, such as community health representatives, for elimination from the budget. Only repeated challenge by Tribes and the support of Congress have kept these programs alive. In the BIA, Tribes are asked to set priorities through the Indian Priority System. Yet the BIA continually adds programs to and removes programs from the system. How can priorities be equitably set when the list of characters is continually changing?

Several programs are targeted for reduction in the FY 88 budget. So even though Tribes may prevail in getting the government to recognize indirect costs, the ability of the BIA and IHS to unilaterally withdraw funding once a program has been contracted will continue to undermine the process. How disheartening to finally negotiate an agreed-upon fair indirect

cost rate only to have the program itself pulled from under you because of "insufficient funds."

How can Tribes be expected to have confidence in a system to prioritize the uses of funds when the BIA Central Office continually ignores Tribal input?

8. There are many logical and justified reasons for differences in indirect cost rates among Tribes.

Clearly, an across-the-board rate, though ostensibly an appealing, simple resolution to a complex issue, will do nothing but augment existing inequities. A better solution consists of providing education and assistance to Tribes in identifying and recovering all valid costs, both direct and indirect. Any system implemented should ensure that each Tribe receives a dollar for each dollar spent, under the parameters established by Congress in carrying out federal programs.

9. Tribal rates will necessarily increase as a result of factors outside Tribal control.

As indicated in Chapters 2 and 3, countless regulations and requirements over which Tribes have no control whatever influence their indirect costs. Further, as grant funds available to offset portions of these costs become increasingly scarce or vanish altogether, the need grows at an ever greater rate. In addition, the cost of some items and services which Tribes must purchase—insurance, for example—grows every year. Another subtle factor outside Tribes' control is inflation; yet the influence of this factor upon indirect costs is not even considered in P.L. 93-638 pay cost adjustments.

10. Numerous Tribes have experienced financial hardship as a result of nonrecovery of full indirect costs.

Tribes who do not have the ability to absorb unfunded federal costs (by spending their own money) have found themselves in increasingly difficult financial positions. Some are perpetuating the problem by deferring costs into the future—with no guarantee whatever that funds will ever be available to repay those costs. Sooner or later, however, someone must pay. If funds cannot be obtained, programs must be aban-

doned. And the costs in lost revenues and resources (to say nothing of human potential) are all but incalculable.

In many cases, theoretical over- or underrecovery represents only theoretical dollars, which Tribes are expected to repay in real dollars (that many do not have). The bottom line is that Tribes are forced to utilize their scarce resources to subsidize federal programs rather than to pursue and establish economic foundations leading to true self-sufficiency and self-determination.

11. The current BIA proposal to allow a fifteen percent flat fee in place of indirect costs is discriminatory and will severely damage Tribes if implemented.

The federal government and every contractor doing business with it must answer to the same laws and regulations governing those contracting procedures. The idea of limiting recovery of costs to fifteen percent is very discriminatory, particularly in light of the fact that the BIA is supposed to be supporting the development of Tribal capability and independence. If implemented, this flat fee will substantially reduce the contract support funds available to Tribes who operate federal programs, and diminish their capability to become efficient and accountable.

12. The budgets for the BIA and IHS for FY 88 are short by over $22 million because of limited funds to cover indirect costs, and another $15 million for grants due to ongoing reductions.

As indicated in Chapter 5, the proposed FY 88 budget now before Congress does not provide an accurate assessment of need, and is deficient for both agencies. The government has attempted to base funding on tradition, on a fixed rate, and even on a comparison with incomplete government figures (many expenditures are hidden when the federal government administers a program). Why not fund on the basis that makes sense—on the basis of identified need? Most Tribes have the data to support their needs. Those that do not could develop it with a little help. They have the skill to negotiate costs fairly. We have only to take unfair (and unnecessary) obstacles out of the way, and let them do their job. Small Tribes have artificially low indirect cost rates due to subsidiz-

ing these costs with grants. The restoration of grant funds is needed to cover necessary indirect costs.

CHAPTER 9

Some Possible Solutions

A number of potential solutions to this problem exist; however, the regulations being proposed by the Bureau of Indian Affairs are not among them. The flat fee concept has been examined by other agencies and rejected by other contractors. Tribes should not be subjected to an arbitrary flat fee approach when all other federal contractors are permitted to recover full indirect costs. Perhaps the first step in solving the problem would be for the BIA to discard its present paternalistic position and to work with Tribes in the same spirit that IHS has shown with respect to the indirect cost matter—in other words, to grant Tribes the freedom and opportunity to achieve self-determination.

Indirect cost agreements are designed to *allocate and account for costs*. That is a separate issue from allocating funding. Allocating funding was addressed in P.L. 93-638 in Section 106 (h). However, the language—while seemingly intended to achieve program parity for contracted programs—doesn't clearly set parity as a goal. If program parity *were* the goal, then both IHS and BIA would be duty bound to examine what is really being spent in support of programs at the service level when those programs are operated by the government. An analysis which provided good expenditure information (of the kind shown in Chapter 6) should be done and that information made available to the Tribes and to Congress.

The initial allocation when a Tribe contracts should include sufficient funds to provide for all identified costs, and after that allocation, that particular program budget should be insulated from tampering by being set apart in the budget process. This could be accomplished with a little fine tuning of the Indian Priority System in the BIA and the Resource Allocation Methodology in the IHS. Tribes should then recover both direct and indirect costs from that total allocation.

This would accomplish the *separation of funding (allocation) from cost recovery (including indirect costs).* It would also provide more stability in funding levels, which would not only enhance planning, but would also go a long way towards lessening over- and underrecovery problems.

Following establishment of such a system, the Department of the Interior's Office of the Inspector General—as part of the indirect cost negotiation and audit review process—should support ongoing information gathering about costs Tribes are presently incurring. In this way, Congress could receive accurate information on trends, such as the recent insurance cost increases, along with the financial impact of those trends on Tribes.

A New Initiative Is Needed for Small Tribes

The original intent of the Core Management Grant Program was to provide a dependable and stable base of funds through which small Tribes could take care of key management and financial functions and audits, without dependence on indirect cost recovery.

The initial goal was to provide upwards of $75,000 to $100,000 to small Tribes with few or no resources of their own. Lower funding levels coupled with the fact that additional Tribes have been made eligible has reduced these grants to less than $10,000, which won't even maintain a good property system. Then, because of a shortage of funds, these grants were made competitive. This generally meant that the Tribe without the expertise to compete (probably the Tribe needing the most help) could not get a grant.

A strong and stable government which is adequately funded is the very first step in true self-determination. Surely the cost of such a program would be extremely small when compared to the total Indian budget.

Self-Determination grants were a Congressional initiative with a formula base. Core Management grants were a later BIA initiative. The present initiative seeks to take away both and replace them with a new program called "Small Tribes Assistance" (with about a third as much funding). By the BIA's estimate, the average eligible Tribe will receive $16,208. This falls a long way short of any amount which could really serve a useful purpose (See Figure 2-A).

What is really needed is a new Congressional initiative designed to provide the type of support of Tribal government that was originally envisioned by the Core Management grant program. Such a program should have a definite life longer than five years so that Tribes would not get into trouble by depending on funding and not including such costs within indirect cost rates. Further, to ensure that they were not locked in with lower numbers as a result of such grants, contracted program allocations should not be considered in the allocation process.

Stable Funding Is a Must

Improvements are needed to the law requiring the BIA and IHS to account for all funds flowing to Tribes, along with a budget system which honors Tribal priorities and forbids bureaucratic tampering. We recognize that there are a broad range of possible solutions to these problems. This chapter outlines only a few. The key criteria in judging any viable solution are that it

a) support the development and maintenance of strong administrative and management skills within Tribes.

b) provide a means of reimbursing Tribal costs at a rate of one dollar for each dollar spent.

c) appear fair and equitable to those involved, and provide Tribes more flexibility.

d) be developed with the aid of Tribal input.

These criteria are not unrealistic. They are readily achievable. And if they are met, true self-determination can become a reality—not just on paper, but in the lives of the million and a half persons whom this legislation affects.

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APPENDIX A

Northwest Tribal Indirect Cost Rates — Objectives Of The Analysis

As part of the analysis of indirect cost issues, the Task Force was particularly interested in revealing what costs make up indirect costs. Lack of understanding of indirect costs often leads those who don't understand them to see them as something less than a true representation of the cost of doing business, or something less than true and legitimate costs.

The Task Force also wanted to measure the upward trend of indirect cost rates and to determine what the Northwest Tribes included in their indirect cost rates.

Additional information on the extent to which indirect costs were directly funded by grants, particularly Core Management and Self-Determination grants, was desired.

Finally the task force wished to obtain an insight into whether Tribes were in fact recovering their true and legitimate indirect costs.

The data obtained was also to be utilized to develop an analysis of the potential impact of the implementation of the BIA's proposed flat administrative fee.

The Analysis

To assist with the analysis, each of 36 Northwest Tribes who were contracting with the Portland Area Bureau of In-

dian Affairs and had indirect cost rates were asked to distribute their fiscal year 1985 indirect cost pool between the 22 categories listed in Chapter 1 and in this appendix. (These categories are defined in Appendix B; results appear in Figures A-1 and A-2 later in this appendix.)

Next, Tribes were asked to indicate whether all, part or none of their costs for each category were included in their indirect cost pool in negotiating their 1985 rate. (Results appear in Figure A-3 later in this appendix.)

Finally, the Tribes were asked to provide information on any direct federal funding for costs which would have otherwise been included in the indirect cost pool. Each Core Management and Self-Determination grant for 1985 and 1986 was analyzed by the Task Force in order to show the impact of the reductions to those grants at the national level. (Results appear in Figure A-4 later in this appendix.)

The Task Force was provided information from the indirect cost agreements for the 36 Tribes for years 1979 to 1987.

Of the 36 Tribes, 25 (representing ninety percent of the total dollars involved) provided full information. Partial information, including the total dollar amount of indirect cost pools, was obtained from indirect cost agreements of the remaining eleven.

A further analysis was made of the indirect cost rates under fifteen percent and over one hundred percent to determine the reason for the lows and highs.

Additional information was obtained from several Tribes regarding their financial status.

Results of the Analysis

The Task Force did not expect to receive exact information. Amounts provided were based on negotiated agreements and total contracts. Spending patterns obviously differ from total budgets. However the information gained, while not one hundred percent precise, does support numerous conclusions and observations.

1. Average indirect cost rates trended consistently upward since 1979. Numeric averages were

1979 – 23.16 %	1984 – 34.98 %
1980 – 24.13 %	1985 – 36.25 %
1981 – 30.39 %	1986 – 36.31 %
1982 – 34.72 %	1987 – 39.61 %
1983 – 35.02 %	

The weighted average based on total dollars for 1985 was 38.2%. True rates average in excess of 40%.

2. Only five Tribes had rates of less than fifteen percent in any of the past three years. Three of these were only for one year and were due to overrecovery adjustments. Two have had rates consistently under fifteen percent. Further analysis indicated that neither was recovering all legitimate indirect costs. (Some technical assistance would result in all 36 Tribes having rates in excess of fifteen percent and therefore all 36 Tribes would lose under the BIA proposal.)

3. Many Tribes were failing to recover all legitimate indirect costs. For example, numerous Tribes indicated they were not recovering depreciation on buildings they had constructed. Several were not including or recovering insurance.

4. Over sixty percent of the Tribes are receiving direct funding for some of the indirect cost categories from other federal agencies. More common sources of support are EDA planning grants and ANA assistance.

5. Indirect cost pools for 1985 totaled $21,761,166. The BIA share of this was $7,162,700, of which the BIA "grandfathered" $6,438,400 (89.9%). The BIA proposed flat administrative fee would take away about $3,307,000 – meaning that Tribes would receive less than half of their indirect cost funding needs.

6. There are 45 contractors (including the 36 Tribes) receiving indirect costs from the BIA in the Portland Area in 1987. The allocation, including the grandfathered allocation for pre-1985 contracts, represents $8,099,784 – which is less than ninety percent of entitlement, based on rates. The imposition of a flat fee by the BIA would remove more than half

of the allocation. At least 43 of the 45 contractors would have net funding reductions and be forced to lose money on their contracts. (Due to inclusion of the allocations within the Indian Priority System and BIA's tampering with it since 1985, the exact amount of the allocation still remaining is unknown.)

7. Several Tribes are currently caught in the downward rate spiral (spoken of in Chapter 4) due to overrecovery adjustments.

8. Several Tribes are delaying maintenance, have financial records falling behind, and are suffering other financial problems. Several point out wage freezes since 1980.

9. BIA Core Management and Self-Determination grants were paying for 6.8% of reported indirect costs in 1985.

Figure A-1 points out the relative portion of indirect cost pools which are applied to each of the categories. Information provided by Tribes (particularly small Tribes) indicated that in many cases, multiple functions, such as procurement, property management, etc., were supported under one category such as management and financial management and were not broken out.

Figure A-2 points out that 1985 BIA contracts (not including new 1985 contracts) provided 21.3 cents of each total contract dollar for indirects. Due to the grandfathered shortfall, the BIA reimbursed 97.8 cents for each dollar spent.

DISTRIBUTION OF NORTHWEST TRIBAL
INDIRECT COST POOLS

	Costs	Percentage
FACILITIES AND EQUIPMENT		
Building Rent/Lease Cost Recovery	$316,950	1.46
Utilities	1,831,062	8.41
Housekeeping/Janitorial	867,357	3.99
Building and Grounds Maintenance	1,162,807	5.34
Security	95,646	.44
Equipment	677,980	3.07
Subtotal	4,941,802	22.71
MANAGEMENT AND ADMINISTRATION		
Governing Body	1,574,279	7.23
Management	2,419,746	11.12
Planning	790,441	3.63
Financial Management	2,676,235	12.30
Personnel Management	703,181	3.23
Procurement/Materials Management	578,100	2.66
Human Resource Management	412,763	1.90
Property Management	654,445	3.01
Records Management	210,022	.97
Data Processing	1,050,721	4.83
Office Services	1,663,015	7.64
Subtotal	12,732,948	58.52
GENERAL SERVICES AND EXPENSES		
Insurance and Bonding	936,480	4.30
Legal Services	1,034,702	4.75
Audit	735,850	3.38
General Support Services	866,376	3.98
Miscellaneous and Other	513,008	2.36
Subtotal	4,086,416	18.77
TOTAL	$21,761,166	100.00

Figure A-1

ANALYSIS OF TOTAL BIA CONTRACT COSTS
36 PORTLAND AREA TRIBES
FISCAL YEAR 1985

		Total Dollars	Proportionate Share of the Contract Dollars
DIRECT PROGRAM COSTS ELIGIBLE FOR INDIRECTS		$20,875,400	62.3¢
DIRECT PROGRAM COSTS NOT ELIGIBLE FOR INDIRECTS (i.e., pass through funds)		$5,493,700	16.4¢
Indirect Costs (Entitlement Based Actual Rates)			
FACILITIES AND EQUIPMENT		$1,626,700	4.8¢
Building Rent/Lease Cost Recovery	.3¢		
Utilities	1.8¢		
Janitorial	.8¢		
Building/Grounds Maintenance	1.1¢		
Security	.1¢		
Equipment	.7¢		
MANAGEMENT AND ADMINISTRATION		$4,191,600	12.5¢
Governing Body	1.5¢		
Management	2.4¢		
Planning	.8¢		
Financial Management	2.6¢		
Personnel Management	.7¢		
Procurement/Materials Management	.6¢		
Human Resource Management	.4¢		
Property Management	.7¢		
Records Management	.2¢		
Data Processing	1.0¢		
Office Services	1.6¢		
GENERAL EXPENSE		$1,344,400	4.0¢
Insurance and Bonding	.9¢		
Legal Services	1.0¢		
Audit	.7¢		
General Support Services	.8¢		
Miscellaneous and Other	.5¢		
TOTAL		$33,531,800	$1.00

Figure A-2

HOW TRIBES TREATED COSTS

% Of Tribes Reporting Costs As	Part In Pool	All In Pool	None In Pool
FACILITIES AND EQUIPMENT			
Building Rent/Lease Cost Recovery	16	32	52
Utilities	32	68	
Housekeeping/Janitorial	28	56	16
Building and Grounds Maintenance	28	52	20
Security	12	8	80
Equipment	20	36	44
MANAGEMENT AND ADMINISTRATION			
Governing Body	44	12	44
Management	24	64	12
Planning	20	36	44
Financial Management	16	76	8
Personnel Management	16	48	36
Procurement/Materials Management	20	48	32
Human Resource Management	8	32	60
Property Management	8	48	44
Records Management	12	52	36
Data Processing	8	56	36
Office Services	32	56	12
GENERAL SERVICES AND EXPENSES			
Insurance and Bonding	40	56	4
Legal Services	36	16	48
Audit	28	56	16
General Support Services	36	36	28
Miscellaneous and Other	16	20	64

NOTE: Further analysis of the "none" column indicates that it represents four possible occurrences or combinations thereof:

1) the Tribe is not incurring the costs;
2) the Tribe is incurring but not recovering the costs;
3) the costs are incurred but reported under another category; or
4) the Tribe is incurring the costs but recovering through direct grant or direct charges to contracts.

Figure A-3

ANALYSIS OF INDIRECT COSTS FOR 36 PORTLAND AREA TRIBES

Cost Categories	Indirect Pools	Core Management	Self-Determination	Other Fed. Funds	Total	Percent
Bldg. Rent/Lease	316,950	1,500	3,914	60,677	383,041	1.56
Utilities	1,831,062	0	120	120,098	1,951,280	7.95
Housekeep./Janitrl.	867,357	0	1,200	17,991	886,548	3.61
Bldg./Ground Maint.	1,162,807	0	10,200	15,392	1,188,399	4.84
Security	95,646	0	24,700	155,148	275,494	1.12
Equipment	667,980	32,942	47,727	3,679	752,328	3.07
Governing Body	1,574,279	10,800	44,330	0	1,629,409	6.64
Management	2,419,746	34,719	93,132	38,013	2,585,610	10.54
Planning	790,441	76,813	220,407	297,623	1,385,284	5.64
Financial Mgmt.	2,676,235	287,715	189,022	43,320	3,196,292	13.02
Personnel Mgmt.	703,181	39,364	30,678	58,949	832,172	3.39
Procure./Mat'ls.	578,100	72,779	8,267	0	659,146	2.69
Human Resources	412,763	4,964	0	2,661	420,388	1.71
Property Mgmt.	654,445	13,989	0	128,574	797,008	3.25
Records Mgmt.	210,022	10,840	45,356	0	266,218	1.08
Data Processing	1,050,721	30,148	51,462	18,772	1,151,103	4.69
Office Services	1,663,015	15,686	67,565	45,747	1,792,013	7.30
Insurance/Bonding	936,480	0	750	44,750	981,980	4.00
Legal Services	1,034,702	0	57,451	40,000	1,132,153	4.61
Audit	735,850	37,236	5,945	6,137	785,168	3.20
Gen. Support Servs.	966,376	1,200	2,304	18,103	887,983	3.62
Other/Undefined	513,008	28,305	60,716	0	602,029	2.45
TOTALS	21,761,166	699,000	965,246	1,115,634	24,541,046	100.00

NOTE: These amounts do not represent the total Tribal expenditures within each of the 22 categories. Our analysis revealed that many Tribes were not recovering all legitimate expenditures in these categories. Further, executive direction and governing bodies are most frequently negotiated as a percentage of total costs. The amounts included in indirect cost pools are normally fifty percent of total costs.

Figure A-4

APPENDIX B

Indirect Costs Defined

This appendix defines those cost categories which are commonly categorized as indirect costs. These items can be covered under either direct or indirect costs, depending on the organization doing the categorizing. For example, health care providers or educational institutions might list some of these items under direct costs. Most Indian Tribal governments, however, will regard them as indirect costs.

Facilities And Equipment

-*Building Rent/Lease Cost Recovery*—Includes the costs of buildings which house programs and related support services. Includes rent or lease payments associated with providing the space, or if the buildings are owned, amortization or depreciation over the projected useful life of the building. Major renovations may also be amortized over their anticipated useful life. Property taxes are included where applicable. Note: The costs of Tribally owned buildings which have been paid for with federal funds cannot be included, as this would result in a duplication of costs to the federal government.

-*Utilities*—Includes the costs of electricity, fuel, water, sewage and refuse removal necessary to the operation of buildings.

-Housekeeping and Janitorial—Includes the costs of routine care and cleaning of buildings.

-*Building and Grounds Maintenance*—Includes long-term care and repair of buildings, preventive maintenance, grounds keeping and snow removal.

-*Security*—Includes the costs of burglar and fire alarms, guards, surveillance and other security measures.

-*Equipment*—Includes purchase, replacement and cost recovery of capital equipment. Generally, the cost of equipment not directly related to contract work (e.g., equipment used for snow removal or janitorial services) can be recovered through indirect charges. Note: Most Tribal indirect cost rates apply to "total direct cost less capital expenditures," meaning that the indirect cost rate is based on total direct costs *minus* the cost of equipment. For example, if a computer is purchased in association with direct costs, in order to perform work associated with a contract, the cost of that computer must be deducted from total direct costs *before* the indirect cost rate can be computed.

Management And Administration

-*Governing Body*—Includes Tribal councils, executive boards or other bodies which are considered the governing body of Tribes while acting in their role in support of programs. Includes advisory committees to councils where applicable. Note: Most Tribes negotiate a portion of Tribal council costs into their indirect rates while leaving out that portion which might relate to such activities as lobbying, litigation, legislation or any activities not directly related to program operations. Some councils operate in more of a management capacity than others, depending on the size and organization of the Tribal structure; generally, including fifty percent of Tribal council costs under indirect cost rates is a common practice.

-*Management*—Includes executive direction, general management and related policy planning and compliance

functions. May include mid-management costs, depending on size and complexity of organization.

–*Planning* – Includes planning offices and management staff involved in long- and short-term planning, as well as costs associated with developing formal plans and strategies.

–*Financial Management* – Includes all accounting, bookkeeping, comptrolling, internal auditing, overall financial management, budget planning and related activities (e.g., setting up accounts payable and receivable, coordinating payroll, banking, managing cash flow and financial reporting). Also covers staff involved in processing compliance measures and letters of credit, managing and processing grants and contracts, reporting and recordkeeping. Note: Tribes are required to establish and maintain a financial management system which conforms to OMB Circular A-102, attachments G and H. Financial reports are expected to conform to generally accepted governmental accounting methods.

–*Personnel Management* – Includes recruitment and staffing, personnel classification, recordkeeping, benefits management, performance evaluation and EEO (Equal Employment Opportunity) Indian preference management. Also includes employment counseling, assurance of personnel compliance and other special functions related to staff management. (Staff development, however, falls under Human Resource Management.) Note: To be eligible to contract under Public Law 93-638, Tribes are required to establish and maintain personnel management systems.

–*Human Resource Management* – Includes employee training and career development activities, including general skill training.

–*Procurement/Materials Management* – Includes purchasing, receiving, inventorying, warehousing and distributing materials. Contract and subcontracting, as appropriate, are included. Note: Tribes are required to establish and maintain property management systems which conform to OMB Circular A-102, Attachment N.

-*Records Management*—Includes activities involving the management of current and cumulative records and filing systems. Includes retention scheduling, storage, microfilm library management, etc. Note: Tribes are required to establish and maintain records management systems which conform to OMB Circular A-102, Attachment C.

-*Data Processing*—Includes central information support, including system analysis, programming costs, the cost of employing computer operators, etc.

-*Office Services*—Includes general clerical supplies and personnel required for typing, copying, reception, telephone answering services, mail management and general office management.

General Services And Expenses

-*Insurance and Bonding*—Includes all types of insurance, such as fire, hazard, theft, general liability, director's liability, employee fidelity bonds, auto liability and comprehensive insurance. Also includes insurance management functions such as managing insurance costs, administering claims if self-insured, handling claims and exposure analysis, and malpractice liability coverage for functions related to providing health care, counseling, emergency medical care, etc.

-*Legal Services*—Includes reasonable expenses to retain legal counsel for activities related to the operation of programs. Includes policy, contract and other review. Basically administrative in nature. May involve employee relations, grievances, etc.

-*Audit*—Includes anticipated activities to provide required audits under provisions of OMB Circular A-128, which implements Public Law 98-502. Audits include review of compliance with grants and contracts, examination of financial statements and systems, provision of systems certifications required by the federal government, independent review of indirect cost proposals and general assistance in developing and improving financial systems.

–*General Support Services* – Includes costs for outside services, including photocopying, transportation costs or communications costs not otherwise allocated.

–*Miscellaneous* – Includes costs not categorized above, but not allocatable to individual programs.

APPENDIX C

Glossary Of Acronyms and Terms

Acronyms

25-CFR	Title 25 – Code Of Federal Regulations
41-CFR	Title 41 – Code Of Federal Regulations
A-128	Office Of Management And Budget – Circular A-128
AID	Agency For International Development
BIA	Bureau Of Indian Affairs
CAS	Cost Accounting Standards
CASB	Cost Accounting Standards Board
CETA	Comprehensive Employment And Training Act
CSF	Contract Support Funds
DAR	Defense Acquisition Regulations
DCAA	Defense Contract Audit Agency
DOD	Department Of Defense
DOI	Department Of The Interior
EDA	Economic Development Administration
EPA	Evironmental Protection Agency
ERISA	Employee Retirement Income Security Act
FAR	Federal Acquisition Regulations
FPR	Federal Procurement Regulations

GAO	General Accounting Office
GSA	General Services Administration
GSAR	General Services Administration Regulations
IHS	Indian Health Service
JTPA	Job Training Partnership Act
NASA	National Aeronautics And Space Administration
NIAAA	National Institute on Alcoholism and Alcohol Abuse
OASC-10	Cost principles and procedures for establishing cost allocation plans and indirect cost rates for grants and contracts with the federal government.
OFPP	Office Of Federal Procurement Policy
OIG	Office Of The Inspector General
OMB	Office Of Management And Budget
P.L. 93-638	Public Law 93-638, the Indian Self Determination and Education Assistance Act of 1975
PCM	Postal Contracting Manual

Terms

-CENTRAL OFFICE: Means headquarters offices of the Bureau of Indian Affairs or Indian Health Service, located in Washington, D.C. and Rockville, MD, respectively.

-COST ALLOCATION PLAN: The documentation identifying, accumulating and distributing allowable costs under grants and contracts together with the allocation methods used. (A-87)

-COST OBJECTIVE: a pool, center, or area established for the accumulation of cost. Such areas include organizational units, functions, objects or items of expense, as well as ultimate cost objectives including grants, contracts, projects and other activities. (A-87)

-COST: costs as determined on a cash, accrual, or other basis acceptable to the federal grantor agency as a discharge of the grantee's accountability for Federal funds. (A-87)

-DIRECT COSTS: Generally, those costs that can be identified specifically with a particular cost objective. These costs may be

charged directly to grants, contracts, or to other programs against which cost are finally lodged. Direct costs may also be charged to cost objectives used for the accumulation of costs pending distribution in due course to grants and other ultimate cost objectives. (Note – consult A-87 for examples of direct costs.)

-EQUITY FUNDS: Special appropriations provided by Congress to the Indian Health Service to adjust recurring budget allocations to those regions which have major deficiencies after allocation of recurring base funding. Targeted to make services more equitable across the country.

-INDIAN PRIORITY SYSTEM: The budget planning system utilized by the Bureau of Indian Affairs to permit Tribes to prioritize funding for some of the programs operated by the BIA at their locations.

-INDIRECT COSTS: Generally those 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. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services and facilities to the grantee department. (A-87)

-MULTIPLE RATES: Indirect cost rate agreements having different indirect costs rates for different agencies, different operational units or for specific grant operations.

-NONRECOVERY: Means that amounts a grantee or contractor was entitled to on the basis of a negotiated indirect cost rate were not fully received. Result – the grantee does not recover all costs of operating the grant or contract program.

-OVERRECOVERY: Means recovery on the basis of negotiated indirect cost rate exceeds that which would have occurred on the basis of actual costs, which are not known until after the fact.

-PARITY: As used herein, means that a Tribe, when contracting a program under P.L. 93-638, is able to (is provided sufficient funds to) provide services equal to those provided, or that would have been provided by the government.

-PROGRAMS: As used in this publication, means programs operated by Indian Tribes for the benefit of their members,

including Federal contract and grant programs, or programs operated by the Federal Government for the benefit of Indians.

-RECURRING BASE: Established budget bases used within the Indian Health Service to distribute part of available funds by geographic location (regions and service units) at a reasonably consistent level from year to year.

-SHORTFALLS: Means lack of available budgeted funds to pay legitimate indirect costs Tribes were entitled to based on negotiated indirect cost rates.

-UNALLOWABLE COSTS: Costs which are not allowed to be charged to grants or contracts. Consult A-87 Attachment B, Section D for examples.

-UNDERRECOVERY: Means recovery on the basis of negotiated indirect cost rate is less than that which would have occurred on the basis of actual costs, which are not known until after the fact.

APPENDIX D

The Bureau Of Indian Affairs' Asserted 8% Overhead Rate

In proposing a fifteen percent flat administrative fee, the Bureau of Indian Affairs indicated that the BIA's overhead rate was about eight percent. Knowing what we all now know from Chapter 6, the Task Force felt that this was not a fair statement. A Freedom of Information Act Request was submitted to the BIA for evidence which verifies the eight percent. Figures D-1 and D-2 show the response provided.

Note that the calculation uses Program Management and Administrative Funds divided by Total Funds to be Managed,

BUREAU OF INDIAN AFFAIRS
PROGRAM MANAGEMENT/ADMINISTRATION VS. PROGRAM FUNDS
AT RESERVATION LEVEL [1]

	Total Funds to be Managed	Prog. Management/Administration Funds	Percent (%) Program Mgmt./ Administration
FY 1984 Actual	$956,693,000	$80,288,000	8.39
FY 1985 Estimate	$991,288,000	$78,818,000	7.95
FY 1986 Estimate	$927,417,000	$75,047,000	8.10

[1]See attached sheets for detail behind each year.

Figure D-1

BUREAU OF INDIAN AFFAIRS
DISTRIBUTION OF FEDERAL FUNDS – FY 1984-1986 (a)
(In thousands of dollars)

	FY 1984	FY 1985	FY 1986
I. Federal Program Management/Administration	80,282	78,818	75,047
Central Office Staff Costs	25,809	25,654	24,543
Middle Management Staff Costs:			
Education Program – Area/Agency	8,431	8,293	7,756
Area Office Direct Operations	28,252	26,831	25,000
Agency Office Administrative Staff	17,790	18,040	17,748
II. Direct Program Operations	791,781	814,598	792,640
Direct Payments to Tribes/Individuals:			
Tribal "638" Contract Operations	282,788	288,698	(b) 270,565
Grants to Tribal Governments	19,875	21,383	20,861
Economic Development Grants	5,000	9,800	9,800
Other Grants to Tribes & Individuals (est.)	(c) 67,890	88,817	94,509
(Subtotal)	(375,553)	(408,698)	(395,535)
Federal Operations:			
Direct Services to Non-contracting Tribes (d)	381,457	370,294	360,351
GSA Space Rentals (Bureau-wide)	8,918	10,300	10,300
Intra-Gov't Assessments	5,972	5,073	6,975
ADP – Area IMC's and NCC	6,235	4,732	4,725
ADP – Costs of Applications	13,691	14,501	14,754
(Subtotal)	(416,228)	(405,900)	(397,105)
III Construction Programs (e)	84,256	97,872	58,245
IV. Loan Programs	–	–	1,485
TOTAL FEDERAL FUNDS, BIA (f)	956,319	991,288	927,417

[a] FY 1984 Final Appropriations; FY 1985 Appropriations-to-Date; FY 1986 President's Request to Congress.
[b] 1986 amount adjusted for elimination of Johnson O'Malley program ($-24,183K) and anticipated new contracts in other programs ($+6,050K).
[c] Excludes $40,700K in grants made to State of Alaska for rehabilitation of former BIA schools which were financed by funds appropriated in prior years.
[d] These services are provided by Federal employees rather than through contract at the option of the tribe being served. The services are basically the same programs as shown under Tribal "638" Contract Operations.
[e] Excludes the portion of the Housing construction program which is included in Tribal "638" Contract Operations (FY 1984: $15,290K; FY 1985: $15,500K est.; FY 1986: $12,000K est.). Also excludes the contract authority from the Highway Trust Fund ($100 million in each fiscal year).
[f] Excludes one time Federal appropriations such as Eastern Indian Land Claims (FY 1984 – $900K), Payment to Utah Paiute Trust Fund (FY 1985 – $2,450K); budget authority relating to accounts financed by collections (Miscellaneous Permanent Appropriations) or receipts on trust property (Tribal Trust Funds); and Highway Trust Fund contract authority.

Figure D-2

which includes the Program Management and Administrative Funds. Using what we know from Chapter 1 we know (if one is discussing an indirect cost rate) that the ratio used is incorrect. It should be Program Management and Administrative Funds divided by total funds other than Program Management and Administrative Funds. By simply doing this, the overhead rate would be higher.)

In looking at these BIA numbers from the perspective of indirect cost rates as we know them, and from the reservation program level, we have shown what the Indirect Cost Rate would be if just the numbers provided were utilized to calcu-

Indirect Costs at FY88 Rate

Cost Items	Total Costs	Direct Costs	Indirect Costs	Not Allowed
Central Office Staff	$24,543		$24,543	
Middle Management Staff				
–Education Program	7,756		7,756	
–Area Office	25,000		25,000	
Agency Office Admin. Staff	17,748		17,748	
Tribal 638 Contracts	270,565			$270,565[1]
Grants to Tribal Gov'ts	20,661			20,661[1]
Economic Development Grants	9,800			9,800[1]
Other Grants to Tribes/Individuals	94,509			94,509[1]
Direct Services to Non-Contracting Tribes	360,351	$360,351		
GSA Space Rentals	10,300		10,300	
Intra Gov't Assessments	6,975		6,975	
ADP – Area IMC's and NCC	4,725		4,725	
ADP – Costs of Applications	14,754		14,754	
Construction Programs	58,245			58,245[1]
Loan Programs	1,485			1,485[1]
Total	$927,417	$360,351	$111,801	$455,265[1]

[1] Under proposed BIA regulations these would represent pass through funds as the BIA does not directly operate these programs. Much of the Construction would likely represent directly funded indirect costs which would fall into the indirect cost column and increase the resulting rate.

Figure D-3

late a rate for FY88. (Remember, not all the BIA costs are in the BIA budget!)

Now, using what we know from Chapter 1, we can easily calculate an indirect cost rate for the BIA.

Indirect Costs ($111,801) ÷ Direct Costs ($360,351) = Indirect Cost Rate (31.03%)

We do not assert that the BIA's indirect cost rate is 31.03%. As we know from Chapter 6, many of the BIA's costs are not within the BIA budget but fall within other parts of the federal government. Further, we know that the BIA administers some funds not provided within its budget. The calculation of the true indirect cost rate for a BIA program would be much more complicated.

What we do assert is this: First, the comparison of an eight percent overhead rate in discussing Tribal indirect cost rates is both unfair and irrelevant. Further, if the BIA was required to live with the fifteen percent administrative fee proposed for Tribes, it would result in a large reduction in administrative budgets for the BIA.

APPENDIX E

Selected Readings from General Accounting Office Reports

The Task Force, in analyzing information to develop this report, requested all GAO reports which dealt with the subject of indirect costs. The reports listed below indicate that the subject of indirect costs is not unique to Indians or even to government contractors. Some of the reports point out that the idea of using a flat fee, rather than negotiated indirect cost rates, has been examined by other agencies and rejected by other contractors. (The references are listed in alphabetical order within category by document title.)

Readings

-AFMD-82-10 February 2, 1982
SUBJECT: The Arms Export Control Act of 1976 gives the Department of Defense authority to sell Defense articles and services to foreign countries at no cost to the U.S. government. To recover the indirect costs of these sales, the act requires that foreign customers be charged an appropriate amount, calculated on an average percentage basis to recover the full estimated costs of administrative services. The legislative purpose of this charge is to ensure that all sales include "a fair share of all indirect costs so that there are no longer any elements of subsidy in the sales program."

-GAO-089577 January 6, 1976
SUBJECT: Letter to Department of Health, Education and Welfare from GAO Assistant Director, Robert E. Iffert surveying inappropriate indirect cost reimbursements to Trustees of Health and Hospital of The City of Boston, Inc. The report states that "trustees may have been allowed excess indirect costs for fiscal years 1973 through 1975 on its Drug Abuse Services Project grant. Trustees claimed costs based on a provisional indirect cost rate of 45.63 percent for Trustees administered research at BCH (the on-site rate) when most of the effort under this grant was performed at locations other than BCH."

-GAO-76-44 July 28, 1976
TITLE: A Comparative Analysis of Subsidized Housing Costs. "This paper presents a comprehensive discussion of the subsidy costs involved in the three major multifamily housing programs administered by the Department of Housing and Urban Development for low- and moderate-income families . . ."
"In addition, the long-term costs of various subsidy strategies may differ markedly so that comparisons based on first year costs alone may be misleading. Thus, carefully estimating the future costs of a particular strategy and expressing these costs in terms of present value provide a basis for legitimate comparison." The report also states that "Indirect subsidy costs range from about 20% of direct cost for section 236 with limited dividend sponsorship to about 70% of the direct cost in the case of public housing."

-GAO-B-164031(1) January 9, 1978
TITLE: Determination of Costs Relating to the Environmental Education Act. The report states that the "estimated costs incurred by the Government in administering the Act is believed to be 50% of the 3 million grant funds."

-GAO-B-199886 August 14, 1980
SUBJECT: Letter to Senator Melcher from GAO Director Henry Eschwege about Financial Management Practices at the Flathead National Forest. The reports states that "the Forest Service has interpreted 'Estimated Cost' to mean all necessary costs, including overhead costs. Included in overhead costs are the costs of personnel and activities not directly related to specific programs or projects."

-GAO-B-207000 September 6, 1983
SUBJECT: Letter to Department of Energy from GAO acting

director W. D. Campbell answering the question of whether the method used by Decision Planing Council to compute overhead resulted in the government's bearing a disproportionate share of indirect costs. Conclusion: "In reviewing DPC's vouchers for payment, the technical representative compares the number of hours charged, travel expenses, equipment, overhead, and fee charges with the cost reports. In addition, before payment is approved, a contract specialist relates cost charges to the estimated cost negotiated in the contract to ensure that the amounts charged are reasonable, overhead rates are not higher than the negotiated rate, and the labor rate and fee charges are correct."

"Because of the Subcommittee's concern we also looked into an incident of possible overbilling by DPC. A DOE analyst at one of the project sites had questioned the hours charged for a task in the second contract and raised the issue with the DOE official responsible for monitoring that contract. We found that further information provided by DPC had satisfied both the DOE contract monitor and the analyst that the charges were proper." Report also notes that the "DPC subsequently revised its initial proposal to reflect a 41 percent field overhead rate, which applied only to its DOE Chicago work, and a 27.4 percent general-and-administrative rate."

-GAO-B-218788 May 7, 1985
SUBJECT: Letter to Caspar W. Weinberger, entitled Procedures to Prevent Reimbursement of Unallowable Costs on Department of Defense Contracts. On the average,overhead (indirect) represents 66% of production costs.

-GAO-CED-78-102 April 11, 1978
SUBJECT: Letter of EPA from Henry Eschwege, Director, reviewing aspects of the EPA's efforts to implement the industrial cost recovery F.W.P.C.A. The letter states that "Public Law 95-217 revised this requirement and permits grantees to use all of its 50% retained share of industrial cost recovery payments to administer the program."

-GAO-CED-78-166 October 31, 1978
SUBJECT: Federal management weaknesses cry out for alternatives to deliver programs and services to indians to improve their quality of life. The reports states that the "BIA reduced funds for Indian programs by 7.6 million in years 1977 and '78 rather than reduce its administration costs as directed by congressional committees."

-GAO-CED-79-29 March 21,1979
TITLE: National Bureau of Standards: Information and Observations On Its Administration. NBS three overhead levels--bureau, Laboratories/Institute, and center--may be causing an inequitable distribution of overhead costs to projects. Fiscal year 1978 overhead costs were about $46.1 million, or 35 percent, of total funds available to NBS. Bureau overhead is applied on a predetermined percent to all labor costs including laboratories, institute and center overhead labor and the individual scientific/technical projects. Laboratories, institute and center overhead is applied to the respective centers' overhead and to project labor. Center overhead is applied to all scientific/technical project labor costs within the center.

"Each overhead level must estimate the total labor cost over which its overhead will be distributed and its overhead costs in order to arrive at a predetermined percentage to be charged to the cost centers bi-weekly. The percentages may be adjusted for proposed changes and variations in actual costs from prior estimates." The report also states that "for fiscal year 1979, Commerce and the Office of Management and Budget looked more favorably on the Bureaus' budget request and the Bureau received more funds than requested."

-GAO-FGMSD-7847 July 25, 1978
TITLE: Inadequate Methods Still Used to Account for and Recover Personnel Costs of the Foreign Military Sales Program. The report states that "Defense has no assurance that a 3% charge added to the sales price of equipment and services sold under the program is sufficient to recover, as intended by law, the full costs of administering the program."

-GAO-GGD-28-71 November 29,1977
TITLE: Overview of Activities Funded by the Law Enforcement Assistance Administration. The report states that "the determination of the activities to be included in an administrative cost rate is a very complex matter."

-GAO-GGD-77-87 February 14, 1970
SUBJECT: The federal government should know but does not know the cost of administering its assistance programs. The report states that "without this information, the administrative efficiency of programs cannot be evaluated systematically . . ." and further, that "administrative costs were found to vary considerably."

-GAO-GGD-83-71 June 22, 1983
TITLE: Guidance Needed If Better Freedom of Information Act Cost Reports are Desired. "A precise determination of direct and indirect costs of implementing the Freedom of Information Act is not possible because agencies generally lack detailed supporting records. Costs of over $61 million were identified mainly from agencies' 1981 annual reports. The reports vary widely in the ways costs are categorized and measured but provide an indicator of total cost. Inquiries at four agencies that have over 50 percent of the reported costs show they are attempting to capture most personnel costs, the largest category of costs incurred." "Because available cost information is both incomplete and inconsistent, it has limited usefulness for decisionmakers. Previous studies by GAO, the Congressional Research Service, and the Department of Justice identified weaknesses in the reported costs and cited the lack of government-wide reporting guidance as a contributing factor. The Office of Management and Budget is considering requiring agencies to report the costs of administering the act and providing them with detailed reporting guidance. If the proposal is implemented, the quality and value of future cost reports could improve."

-GAO-GGD-85-69 July 29, 1985
TITLE: Fiscal Management of the Combined Federal Campaign. "The Combined Federal Campaign, the government's annual charity drive, raises millions of dollars in employee contributions. The Office of Personnel Management has overall responsibility for managing the charity drive. In 1984, over 500 separate local campaigns served different geographic areas where federal personnel live and work . . ." The report states that "the charities that manage each local campaign have begun to charge for indirect services they previously had provided without charge."

-GAO-HRD-79-67 July 27, 1979
TITLE: Indirect Costs of Health Research: How They Are Computed. "The Congress has expressed concern that indirect costs of health research have been escalating rapidly. This report describes the system used to compute these costs and shows why they are increasing rapidly. Further, the document explains why indirect cost rates cannot be meaningfully compared among grantees, and demonstrates inconsistencies in principles and practices used to make indirect cost determinations." The study also demonstrates that the indirect costs of Indian Tribes are not

the only indirect problem. The report is quite old with no real hard numbers. Page 3 has an interesting graph.

-GAO-HRD-84-3 March 1984
TITLE: Assuring Reasonableness of Rising Indirect Cost on NIH Research Grants. "National Institutes of Health reimbursements to its grantees for indirect costs increased from $166 million in 1972 to $690 million in 1982. Moreover, indirect costs consumed an increasing proportion of the federal research dollar--rising from about 21 to 30 percent during the same period."
"GAO believes that indirect cost rates have been established with grantees despite (1) difficulties involved in verifying the largest category of indirect costs (departmental administration expenses), (2) relatively few indirect cost audits, and (3) inadequate written explanations for significant year-to-year increases in indirect costs."
"GAO recommends that the Office of Management and Budget (OMB) revise its Circular A-21 to establish a fixed allowance for large institutions' departmental administration expenses to replace the cost reimbursement method now used. This simplified means of establishing reimbursable departmental administration expense allowances should not require reliance on grantees' personnel activity reporting systems. It should also minimize difficulties encountered in independently verifying such expenses."
See page 2 of reports for examples of rising indirect rates from year 1972 to 1982. See page iii: "Imposition of a uniform indirect cost rate on all universities would be both unsound and inequitable. Appendix I has individual indirect rates for universities.

-GAO-HRD-84-42 March 12, 1984
TITLE: Information of the Senior Community Service Employment Program and the Proposed Transfer to the Department of Health and Human Services. The reports states that "while most national sponsors and state agencies have reported that they have remained within the 15% limitation, it appears that one reason they have been able to do so is by using other sources of funds and contributions to supplement a portion of actual administrative costs."

-GAO-HRD-86-93 August 1986
TITLE: Alternatives for Paying Hospital Capital Costs. The report states that the "prospective capital payment, however, has certain disadvantages and risks. For example, the prospective payment proposals would generally result in hospitals receiving less than actual costs during the first years of an asset's useful life and more

than actual cost in later years. As a result, hospitals must accumulate large amounts in the later years of an assets useful life to be able to finance replacement assets. This ability may not exist, particularly for hospitals with large amounts of uncompensated care."

-GAO-HRD-86-94 May 1986
TITLE: How Funds Reserved for State Efforts in California and Washington Are Used. GAO reported that they "were unable to estimate the amount of block grant funds used for administration due to the absence of standard definitions of administration and the different way the two states accounted for funds."

Determining the True Cost Of Contracting Federal Programs for Indian Tribes

Second Edition - 1997

An analysis of cost recovery by Indian Tribes
contracting for the operation of Federal programs
under the Indian Self-Determination and
Education Assistance Act (Public Law 93-638, as amended)

Published as a joint effort of the Northwest
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EXECUTIVE SUMMARY

Following 200 years of failed Indian policy, the United States embarked on the Self-Determination Policy, now in its third decade - and working fairly well. The policy, first discussed by President Johnson, announced by President Nixon and signed into law by President Ford, has been supported by every President and Congress since. The policy, which as been bipartisan, is intended to end the federal domination of tribal communities and support the development of tribal governing capacities to operate programs and to develop the economies of their respective communities. The policy also provides for an orderly transfer of the responsibilities and the resources associated with operating programs provided by the federal government for Indians to tribal governments.

Congress has recognized that implementation of the Indian Self-Determination Act requires additional appropriations as would implementation of any major federal policy. Currently, however, additional appropriations are not being provided consistent with the amount needed to implement the policy. This publication is about the history and issues related to financing of the implementation of the Act. It particularly relates to financing the incremental costs associated with the transfer of the operation of programs, functions, services and activities to tribal governments as they exercise their option to assume the responsibility for their operation.

The option to contract to operate federal programs means the relationships change. The federal government changes from delivering services to delivering resources. Tribal governments

assume the responsibility to deliver services, with reliance on the federal resources. Indian people come to rely on their own tribal government for services, instead of the federal government.

Originally, the Act provided a contract as the mechanism to transfer the responsibility and the funds the U.S. Government would have otherwise spent through the Bureau of Indian Affairs (BIA) and the Indian Health Service (IHS) to tribal governments to be utilized to provide services to their respective communities. The funding provisions of the Act required that the amount of funds provided to tribal contractors would not be "less than the appropriate Secretary would have otherwise provided for his operation of the programs or portions thereof for the period covered by the contract." This section assured the tribes that the funds provided would be at least as much as the U.S. Government was spending when it operated the program.

Tribes generally embraced the spirit of self-determination and worked hard to establish and strengthen their administration and management capabilities as the necessary foundation for effective tribal government. As they viewed it, this Act would enable tribal governments to address a multitude of needs, including economic development as a step towards self-sufficiency. Between 1975 and 1986 tribes assumed responsibility for over 500 million dollars of BIA and IHS programs.

Despite the best intentions, and despite tribes' eagerness to assume responsibility for determining their own fate and to achieve economic independence under Self-Determination, things generally didn't proceed smoothly. Tribes, many of whom had little or no experience in administering federal programs, were introduced to a complicated set of contracting rules and regulations; the federal cost reimbursement system and indirect costs rates.

Tribes struggled and in some cases met with very serious financial trouble in attempting to utilize indirect cost rates. Meanwhile, BIA and IHS, the sister agencies charged with implementing the Self-Determination Act, compounded the problem for numerous years by requesting from Congress and allocating to tribes less than the necessary funds required to operate programs.

While the indirect cost rate system had been utilized for many years by other agencies of the federal government in their financial dealings with states and local governments and others, little was understood by the high level bureaucrats in the BIA and IHS. As tribes struggled to gain administrative expertise, these agencies (which employed in excess of 28,000 people) did little to support the tribes in dealing with the complexities of indirect costs. Neither agency provided even one full-time position to assist tribes in addressing this critical technical issue. Because indirect costs were not well understood by those who didn't work with them, the two agencies failed to request necessary appropriations and attempted to reduce or limit the recovery of legitimate indirect costs by tribes.

In 1986, the BIA began advocating a shortsighted fifteen percent flat administrative fee in lieu of the existing negotiated indirect cost rates. If implemented, this policy would have prevented tribes from recovery of their full costs for operating federal programs, and undermined and unraveled much of the tribal management and administrative capability developed during the first decade of self-determination.

Recognizing the need for better understanding of indirect costs, funding problems and potential solutions among both tribal and federal decision makers, the first edition of this publication was issued in 1987. It was used to assist in the dialogue as Congress reviewed the issues.

The original publication observed that indirect costs or rates were really not the issue. The main issue was the recovery of costs incurred by operating federal programs and the allocation of adequate funds for payment of total contract costs, both direct and indirect. Failure to provide full financial support required that tribes either reduce services or spend more than they collect when operating contracted programs. For many tribes, this creates economic hardship and inhibited the incentive to contract. The report further indicated that the provisions of Section 106 (h) of the Act had not been met. Neither the Secretary of the Interior nor the Secretary of Health and Human Services could identify what the government would have spent for federal operation of the same program. One key feature of the law that needed to be addressed was how funds were budgeted and allocated, and then how total contract costs were recovered. Clearly, this was not happening in any consistent or dependable way. A stable funding base was

needed to enhance the development of strong tribal governments. To implement the Self-Determination Act adequate funds needed to be budgeted and appropriated, or else the process would fail.

In 1987 tribal leaders from across the nation approached Congress with these problems. Congress made substantial changes to the Act in 1988 to correct the deficiencies. "Contract Support" was defined as the amount to be added to contracts to ensure that all necessary tribal costs were met. And when the agencies found ambiguities and failed to publish regulations, Congress enacted another round of substantial amendments in 1994 to clarify the intent of the federal policy of Self-Determination. As the Senate Committee on Indian Affairs pointed out in its report accompanying the amendments of 1994...

> *"Throughout this section the Committee's objective has been to assure that there is no diminution in program resources when programs, services, functions or activities are transferred to tribal operation. In the absence of section 106(a)(2)* [the contract support funding provisions] *as amended, a tribe would be compelled to divert program funds to prudently manage the contract, a result Congress has consistently sought to avoid."* (Report to accompany S. 2036).

Much has improved since the 1988 amendments. Tribal interest in operating programs has escalated rapidly. A Self-Governance Demonstration Project streamlined the transfer of responsibility and resources, and a new streamlined standard contract was included in the Act in 1994. The Indian Health Service, working closely with tribes, adopted formal policy for implementing the new funding provisions of the Act. BIA began to pay full indirect costs, although it hasn't developed procedures or budgeted to fund other contract support costs. Today, after considering amounts needed for inherently federal functions, tribes are managing nearly half of the contractible operations of both agencies. Tribes have improved their capacity, and embarked on efforts to develop more non-federal resources.

In recent years information provided by the agencies in support of appropriations has been inadequate and untimely. Appropriations have been inadequate to finance the implementation of the Act. Today budgets for both BIA and IHS are deficient and many tribes

are waiting in line for contract support funding so that they can take over programs of the two agencies. Tribes are being required to divert program funds to pay contract support costs. Meanwhile the Congressional reports that have accompanied the appropriations for the past few years raise concern with the growth in the need for contract support funds. There appears to be confusion regarding how much of the increase is related to increased tribal assumption of program operations and how much is related to increases in indirect cost rates.

> *"The Committee again expects IHS to work with the tribes, the BIA and the Inspector General at the Department of the Interior to contain the cost escalation in contract support costs. In today's constrained budget climate the contract support cost activity must receive its fair share of administrative streamlining and procurement reform funding reductions as well as the lower inflation allowances provided for all other programs within IHS."* (House of Representatives, Report on FY 1997 Appropriations).

Analysis of Northwest tribal indirect cost rates (Appendix A) indicates that indirect rates have actually trended downward as tribal operations have grown. But absent this publication, that trend would be unreported.

The needs of the parties haven't changed very much from a decade ago. Tribes need the federal government to honor its unique ongoing obligation to them. They need to be assured that they won't have to reduce program services in order to take over more programs. Stable financing is important to maintaining the services and the capacity they've built. The BIA and IHS need adequate information to plan and budget, and assistance in reporting and justifying appropriations. Congress needs good information about the financing needs and the progress of implementation of the Act. It also needs to be assured that the resources are allocated consistent with the Act and used wisely. As Congress works to close the gap on the federal deficit, increases to the budget must be very well justified to be considered. Currently the necessary information is not getting to Congress as it deliberates the budget.

The federal policy of self-determination is working. Tribes have worked hard to develop their governing capacity. They have assumed a large portion of the federal operations and improved the

health, education and economic status of many of their communities. Additional appropriations provided to implement the Act have been partially offset by savings elsewhere in BIA and IHS, and in other federal agencies as well, even though such savings go unaccounted for and unreported. Certainly the improvement in tribal economies provides benefits to the federal government in terms of added tax receipts and employment. It would be a shame to bankrupt the policy now.

Tribes want true self-determination. That means being truly recognized as sovereigns and being assisted in developing an economic base that can lead to greater independence and self-sufficiency.

This updated publication points out that a lot of progress has been made, but problems still exist. The solutions to many of them have been legislated by Congress, but have yet to be implemented. It will continue to take effective teamwork on the part of all concerned to implement them. Most importantly, the process of transferring the operation of federal programs to tribes requires additional appropriations. With adequate appropriations, the self-determination process will be able to move forward at the tribes' pace, which is as intended.

ABOUT THE PUBLICATION

The first edition of "Determining the True Cost of Contracting Federal Programs for Indian tribes" was published in 1987 to provide a better understanding of the whole matter of cost allocation and funding processes associated with the implementation of the Indian Self-Determination and Education Assistance Act. The need for this second edition has become apparent because many things have changed since the first was written. Congress has passed two major amendments to the Act and a number of minor ones. Many of the obstacles to implementing the Act, discussed in the first edition, have been removed. Yet, some of the key issues addressed in 1987 still need attention.

A key development in the implementation of the Self-Determination Policy has been the development of Self-Governance Compacts. These instruments were created to provide a more efficient method of transfer of responsibility and resources to the tribes. Compacts delegate more authority for budget allocation and program design than do contracts. Many Northwest tribes have opted to compact rather than to contract. Much of what has been learned from compacting was transferred to the contracting portion (Title I) of the Act in 1994. A standard "Self-Determination Agreement" is now prescribed by the Act. Both processes rely on the same provisions of Title I for funding. Since this publication is specifically about funding, for ease of presentation in this publication, the word "contracting" is used to refer to both types of instruments.

It is hoped that this report will be of assistance to our member tribes as they pursue Self-Determination, and in their dialogue with the Congress and the Administration on issues related to cost allocation and funding.

On behalf of the Northwest Portland Area Indian Health Board and The Affiliated Tribes of Northwest Indians, we offer sincere appreciation to all who participated in this important effort. We give special thanks to those who have helped to shape and gather information for it, especially; Don Berry, Rick Gay, Karen Harvey, Nick Longley, Pat Mercier, Bill Parkhurst, Gina Seidl, Terry Smith, Don Smouse, Doni Wilder, and Jim Willis.

Julia Davis, Chair
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May 1997

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AUTHOR'S NOTE

The purpose of this document is to provide some basic educational background to those who are interested in cost and funding allocation associated with the Indian Self-Determination Act. It is not the intent of the document to provide detailed technical information related to cost accounting; the document is directed to a general audience with a need for background in and understanding of the funding issues affecting achievement of self-determination for tribes. The means by which costs are determined and recovered have a very direct bearing on Indian tribes' capability to achieve self-determination.

In attempting to provide this educational background, the assumption is made that those who share an interest in this document also share a common philosophical base, namely interest in and support of the intent and spirit of self-determination. Understanding the funding provisions of the Act is one thing; implementing those provisions in a manner that supports achievement of self-determination is another. The author believes that achievement of sufficient and stable funding bases is a realistic goal, and an essential one if Indian people are to realize the political and economic independence that will enable them to attract and make the best use of the resources available to them.

Having observed the implementation of the Act from the outset, it is impossible not to develop bias regarding what has worked well, what hasn't, who has contributed to the problems and who has contributed to their solutions. Every effort has been made to keep this publication factual. It is intended as an educational tool to be used to help create a common basis for teamwork among all

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concerned with the implementation of Self-Determination, recovery of costs and related funding issues. Part of the goal is to point out the problems associated with the existing system, however not to lay blame, and certainly not to offend.

The tribes participating in this study represent sovereign nations, each having a unique and separate relationship with the U.S. Government; and accordingly, each may develop independent views and conclusions on the numerous issues identified in this study. Therefore, the conclusions reached by this publication are those of the author, with general consensus from representatives of participating tribes and do not necessarily represent the collective position of all members of the Northwest Portland Area Indian Health Board or the Affiliated Tribes of Northwest Indians.

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James M. "Jim" Sizemore, CPA is a shareholder and principal in Strategic Wealth Management, Inc., a financial and investment management consulting firm with offices in Kirkland, Washington and Portland, Oregon.

Jim has worked exclusively with and for Indian Tribes in the area of financial management since 1975 – eleven as a Tribal finance officer and the past eleven consulting with Tribal clients. He has extensive background regarding the funding provisions of the Indian Self-Determination Act, having been involved at the tribal, regional and national level throughout the evolution of the processes. At the tribal level Jim has been intimately involved in development of fiscal management systems, including technical assistance and education regarding cost allocation and indirect cost rates. At the regional and national levels he has served on numerous working and advisory groups, working with tribal organizations, Congressional Committees, BIA and the IHS regarding the drafting and implementation of the funding provisions and other related efforts.

CHAPTER 1

Contract Support Funding

The purpose of this study is to (1) examine the methods by which costs associated with tribal contracting are determined, (2) examine the history, procedures and problems associated with funding those costs, and (3) offer some suggestions for improving the overall system for reporting and financing necessary costs. Most of the information about tribal costs and experiences contained within this report was obtained from Northwest tribes who participated in the analysis and provided information on their cost experience and methods of categorizing and treating costs.

Before examining the specifics of costs and funding, it is necessary to look at the relationship between the tribes and the federal government with respect to the Indian Self-Determination Act. The Act recognized that the federal government was delivering a variety of governmental services to Indians in response to an ongoing federal obligation. It also recognized that tribal governments may be better able, over the long term, to deliver these services in a manner more appropriate to their respective communities. The Act authorized tribal governments to assume the responsibility to deliver a whole variety of services, such as health care, resource management and law enforcement as each tribal government felt it was ready. The option to implement the Act (or not) with respect to any given program, and the timing, was up to each tribal government. As tribes exercised their options, their

relationship with the federal government changed. Now, in a government-to-government relationship, they had responsibility to deliver the services. Their relationship to their respective communities changed as well. Now their communities looked to tribal government for the services, as opposed to the federal government. The success of this change certainly rested with the tribal government desiring to take on the additional responsibilities, and their ability to carry them out. A critical element of the transition was the transfer of resources from the federal to the tribal governments to carry out the programs. There would be little incentive for a tribal government to accept responsibility for delivery of services, if the resources, and particularly the financial resources, weren't available to carry them out. Imagine yourself as a tribal leader facing your constituents – trying to explain why services were reduced or not available.

When enacted in 1975, the Indian Self-Determination Act made provisions to transfer the funds available for the operation of programs operated by the federal government to Indian tribes as they exercised their option to operate programs. Determination of the amount of funds to be transferred to operate a program was discussed in the funding provisions of the Act, which read...

> *"The amount of funds provided under the terms of self-determination contracts entered into pursuant to this Act shall not be less than the appropriate Secretary would have otherwise provided for his direct operation of the program or portions thereof for the period covered by the contract."* (25USC § 450j (h)).

Congress intended that tribes would have enough to operate the programs with at least the same level of services that the federal agencies were providing. Again, there would be little incentive for a tribal government to assume operation of a program if it meant immediately reducing services. As tribes began assuming the operation of BIA and IHS programs in 1975, they did so with the belief that all of the costs associated with operating the program would be covered by the funding allocations available from the agencies. However, there were two problems not foreseen by the language of the Act.

First, program funding allocations at the tribal level did not cover all costs associated with the program - nor were they representative of all the money spent to finance the program. In

fact, program costs were spread throughout the government at all levels. Without a detailed analysis of what the government was actually spending, the tribe that contracted to operate the program could wind up with less than program parity - in other words, with less money to operate the program than the federal government had been spending to provide the same services. However, because of misleading, underrepresentative figures at the tribal funding level, the tribe would *appear* to have parity.

In the early years of Self-Determination contracting, Congress recognized that the amount of funds being provided did not consider tribal indirect costs. Funds were added to the budget for both BIA and IHS to finance tribal indirect or administrative costs. However, appropriations never seemed to be adequate to finance all tribal indirect costs associated with the contracts. Since the option to contract belonged to the tribes, neither agency could predict the level of contracting. Both agencies frequently challenged tribal indirect costs and were continually unable to finance them. At one point the BIA proposed to stop funding tribal indirect costs, in favor of a flat 15% administrative fee. IHS was considering other directions as well. Tribes argued to Congress that their indirect rates were justified and that their costs were not being met.

Next, both agencies could unilaterally withdraw funding allocations from funding requests to Congress at any level after contracts had been entered into and still fall within the language of the Act, since all contracts were written "subject to the availability of funds." Obtaining stable funding, which was and remains a major issue, is addressed in Chapter 4.

While neither the funding parity nor the funding withdrawal issue has immediate direct impact on indirect costs, both issues affect whether such funds are adequate to ensure that tribes would not be forced to diminish services as a result of contracting.

Return for a moment to the first issue - funding parity. An analysis of government spending was conducted to determine how and where the government actually accounted for the costs of operating programs in the Northwest. A typical BIA program was utilized for the analysis. Figure 1-A on the next page presents the *typical indirect cost categories* used in analyzing tribal rates *(see Chapter 2)* and indicates where and how those costs are accounted for under government administration of the same programs. Note that other costs which would normally be considered direct costs by tribes are not even included within the local program budget (e.g., unemployment tax and workers' compensation insurance are paid

DISTRIBUTION OF THE COSTS OF BIA OPERATING A PROGRAM

This chart indicates budgets and locations from which expenditures in support of a BIA-operated program would be made.

	BIA Tribe / Agency Program Budget *	BIA Tribe / Agency Other Budgets	BIA Area Office Budgets	BIA Field and Central Office Budgets	Other Agencies and Departments
Direct Program Costs					
Program Personnel	X				
Fringe Benefits	X				
Worker's Compensation Ins.				X	
Unemployment Tax				X	
Travel/Vehicles	X				
Materials and Supplies	X				
Contractual Services	X				
Other Direct Costs	X				
Typical Indirect Costs					
Facilities and Equipment					
Building Rent/Lease Cost				X	
Utilities				X	
Housekeeping/Janitorial				X	
Building and Grounds Maint.				X	
Security				X	
Equipment	X	X	X	X	X
Management & Administration					
Governing Body					X
Management		X	X	X	X
Planning		X	X	X	X
Financial Management		X	X	X	X
Personnel Management			X	X	X
Human Resource Development	X	X	X	X	X
Procurement/Materials Mgmt.		X	X	X	GSA
Property Management		X	X	X	
Records Management			X	X	X
Data Processing		X	X	X	
Office Services	X	X	X	X	
General Services & Expenses					
Insurance and Bonding					Self/Ins
Legal Services					Justice
Audit					OIG/GAO
General Support Services		X	X	X	
Misc. and Other		X	X	X	X

* The Tribe/Agency Program Budget is the amount of funds which would be made available to Tribes prior to an addition for indirect costs.

Figure 1-A

for from the Central Office level). The BIA has always budgeted Facility Operations and Maintenance only for federal facilities. So a tribe that didn't include facilities costs in its indirect costs would not get any additional funds to pay for the costs of operating them. Also note that many of the costs of the federal operation are not in the "Secretary's" budget, but found elsewhere in the federal system.

Figure 1-A points out that a tribe, even if it included all of the typical indirect cost items in its rate and *obtained full recovery*, would not recover full costs of operating the program *in parity with the government's operation of the program.* To make matters worse, the tribes pointed out that they were required to finance costs that the federal government didn't pay at all. For example, liability insurance was a legal requirement of contracts, but the federal government doesn't insure. Property and casualty insurance, director's liability and other types of coverage were certainly necessary to protect the interests of the tribe and were appropriate costs of managing programs, but the federal government didn't insure for those purposes either. Much of the federal employee retirement compensation was not included within the BIA or IHS budgets.

Clearly the tribes were at a disadvantage. They were not being paid for all of their indirect costs, and many of their direct costs were not considered in the funding being made available to finance the program. The result was diminished programs and services, clearly a disincentive to contracting.

Congress revisited the funding provisions in its 1988 amendments to the Act. These amendments identified "contract support" as an amount to be added to ensure that the tribe would have the amount needed to operate the program. The amount to be made available to the tribe was identified as follows:

> *"(1) The amount of funds provided under the terms of self-determination contracts entered into pursuant to this Act 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.*
>
> *(2) There shall be added to the amount required by paragraph (1) contract support costs, which shall consist of 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."* (Section 106 (a) as amended of the Indian Self-Determination Act, 1988).

This language clearly indicated that tribes were not to be forced to reduce program services when they contracted. The law now focused, for the first time, on tribal costs rather than what the Secretary was spending. Since indirect costs were an effective measure of necessary and reasonable tribal costs, and were negotiated with the federal government, Congress recognized the need to consider them in financing "contract support."

> *"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 agreement."*

Observing these changes in the law, IHS adopted formal policy and procedures to identify and finance both indirect and "direct" contract support costs. Where negotiated indirect cost rates were not in place, alternative methods were established to determine an amount of funding to finance indirect types of costs. The key provision of these procedures was ensuring that the program funds identified could be used to finance program activities and not to finance contract support costs. BIA became more committed to financing indirect costs, although it did not implement formal policy or finance direct contract support costs. Neither agency was able to fully implement the reporting requirements *(discussed in Chapter 5)* necessary to fully advise Congress regarding the amount of contract support funds needed.

In 1994 the Congress again visited the Indian Self-Determination Act and further clarified the funding provisions. Congress recognized that many of the programs, functions, services and activities operated or controlled from Area and Headquarters offices should be available for tribes to assume. It was also recognized that some of the programs, functions, services and activities, which were operated or controlled from Areas and Headquarters, were considered within tribal indirect cost rates. Congress made it clear the programs were contractible, but that contract support costs were not to duplicate amounts made available under the program funding provisions. Clarification was also added to ensure that the BIA and IHS would provide funding for certain "start-up" costs associated with new contracts. The Senate Committee on Indian Affairs report on the 1994 amendments reiterates Congress's intent...

"Throughout this section the Committee's objective has been to assure that there is no diminution in program resources when programs, services, functions and activities are transferred to tribal operations. In the absence of Section 106(a)(2) as amended, a tribe would be compelled to divert program funds to prudently manage a contract, a result Congress has consistently sought to avoid." (Report to accompany S. 2036, U.S. Senate, Committee on Indian Affairs).

Accordingly, the funding provisions (Section 106) were amended to read...

"(1) The amount of funds provided under the terms of self-determination contracts entered into pursuant to this Act 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 contractible, 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 Act 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 section 106(a)(1).

(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 Act, 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."

After the Act was amended in 1994 the IHS, which was already administering contract support consistent with the intent of the Act, reviewed and revised its policy and procedures to conform to the new provisions within Indian Health Service Circular 96-04 *(See Appendix F)*. Meanwhile, BIA continues to finance only indirect costs and has not implemented other portions of the amended funding provisions.

Conclusion

Congress has clearly understood the funding issues and provided clarity within the funding provisions of the Act to ensure that there is no diminution of program resources when programs, functions, services and activities are transferred to tribal operations. The funding provisions anticipate the need for additional appropriations as tribes assume the operation of programs.

The IHS has adopted formal policy to implement the full funding provisions of the Act. Consequently, as they assume IHS programs, tribes can obtain adequate contract support resources to ensure that there is no diminution of program resources.

The BIA continues to finance only indirect costs. Consequently, there will be a diminution of program resources when a tribe assumes BIA programs. The amount of the diminution may differ on a program by program basis, and tribes must determine for themselves whether they can live with the result.

Under either system, the availability of adequate appropriations will determine the extent to which each respective agency can meet its obligation to pay contract support. *(Appropriations are discussed in Chapters 6 and 7).*

CHAPTER 2

Indirect Costs and Indirect Cost Rates

Chapter 1 established that contract support funding is to be added to self-determination contracts to ensure that the programs, functions, services and activities to be operated by the tribes do not have to be reduced to cover contract support costs. Chapter 1 pointed out that indirect costs make up a significant portion of contract support, and that the BIA and IHS rely on negotiated indirect cost rates to determine the amount of contract support funding to be provided. Also it's been established that the lack of understanding of indirect costs has contributed to a lack of support for providing the necessary appropriations to fund them. So, what are indirect costs, and how are indirect cost rates established?

Before examining specific procedures associated with indirect costs, consider how the government defines indirect costs. According to the Office of Management and Budget, indirect costs are...

> *"those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved."*

What this really means is that those costs incurred by a grantee or contractor, which cannot be easily allocated among individual programs, will be considered indirect costs.

The federal guidelines for establishing indirect cost rates are found in the Office of Management and Budget (OMB) Circular A-87, *"Cost Principles for State, Local and Indian tribal Governments,"* last published in May of 1995. The circular calls for each government to establish its own internal cost allocation policy or plan which provides direction for the allocation of direct and indirect cost on a fair and uniform basis.

Tribes are bound to the same set of rules as states and local governments, and each tribal organization must decide for itself, based on the circular and negotiation with the federal government, which costs are indirect and which are direct. Generally, direct costs are those associated with the personnel, materials and other costs required to fulfill a given program. Based on analysis of Northwest tribes' indirect cost agreements, tribal indirect costs cover facilities and equipment, management and administration, and general expenses that facilitate - but are not directly assignable to - fulfillment of specific programs.

Sometimes people substitute the term overhead or administrative costs for indirect costs; however, many overhead or administrative costs can be allocated to individual programs, and must therefore be considered direct rather than indirect costs. In short, the terms *overhead* and *administrative* should not be regarded as synonymous with indirect.

A Brief Scenario

To better illustrate the distinction between direct and indirect costs, imagine for a moment that you are in the business of making wooden boxes, and that these boxes are your only products. Let's say you have a small building on which you pay rent, and that you pay the utilities and purchase all the equipment (e.g. electric saws and drills) you need for box building. You also buy wood, nails, glue or any other materials that go into making the boxes. You have a manager and accountant and you also retain a lawyer. And you purchase insurance of various kinds.

Since you manufacture just one kind of box (we'll keep our illustration simple), it's pretty easy to figure out what your production costs will be. You just add up all your costs and divide by the number of boxes you have made, and the result is your average cost per box.

Now, suppose that a customer - call him Mr. B - comes to you and asks you to build him some wooden piano crates instead of your standard boxes. The materials and procedures are essentially the same – with some minor differences – so you agree to take on the task. Mr. B agrees to pay you a profit of ten percent. But before you can know what to charge Mr. B for the crates, you'll have to figure out your manufacturing costs. How will you do that?

Well, the direct costs will be easy to calculate. You add up the costs for wood, nails, glue, wages of the designer and builder, and so forth – just as you would for the standard wooden boxes. But the *indirect* costs will be a little more difficult to calculate. Indirect costs include such things as the rent, the utilities, phone, insurance, fees for the manager and accountant, and so forth; these costs support the making of both the boxes and the piano crates. The question is, what percentage of these various indirect costs supports the making of the boxes, and what percentage supports the making of the piano crates?

In order to reach a fair price for the piano crates, and to feel comfortable that he was not paying more than his fair share of the indirect costs, Mr. B would want to reach some agreement about how all costs were going to be allocated. That agreement would need to state (1) which costs would be directly charged to the piano crates, (2) which costs would be indirectly charged to the piano crates, and (3) on what basis these costs would be determined. Once you had determined these three things, you would call the resulting agreement a cost allocation plan. And when you billed Mr. B for his piano crates, that bill would cover direct costs, indirect costs and the ten percent profit.

Well, you might say, that sounds like a lot of trouble. Why not just charge three times as much for the piano crates, since they're about three times the size of standard boxes, and be done with it? Because – with that arbitrary method, you'd have no way of knowing whether the price for the piano crates was in fact very fair, exorbitant, or so low that your company was incurring a loss on every crate you built. The point is, there are simply no shortcuts to

fair cost allocation. Costs must be allocated appropriately if you are to know where your box company stands on its profits and losses, and Mr. B – even if he does not demand a full and detailed accounting of all your calculating steps and methods – still has a vital interest in knowing that those methods are sound. Moreover, life will be simpler for you if you can come up with an indirect cost rate that will apply to the manufacture of piano crates henceforth – or at least until there are substantial changes in your manufacturing methods or facilities.

Establishing a fixed rate isn't just a convenience, though; it's good business. If Mr. B does not agree with your pricing methods, you may need some means of demonstrating that you are operating fairly; otherwise, you risk losing Mr. B's future business, and perhaps anyone else's as well. Mr. B may contend, for example, that there is no reason to include a portion of the rent in the price of the piano crate since you must pay rent monthly anyway, whether you're making piano crates or not. You can respond that while that may be true, you could not build piano crates without a facility in which to do it, and further, that if you were not building piano crates, the facility might then be used to support other activities. Chances are that if Mr. B is a reasonable sort, you'll come to an agreement fairly readily on the rent; but perhaps he'll be less willing to see things your way when it comes to phone bills or some other issue. Negotiations may then become complex, and you'll need some guidelines to get through them.

At the same time, however, let's make sure that we do not create some misunderstanding about the way in which "fixed indirect cost rates" are appropriately used. It might be very handy for you, if you continue in the wooden box business, to have a constant rate by which to calculate your indirect costs so that you do not have to reinvent that portion of your budget month by month. However, it would not be appropriate or useful for you to assign your rate to Mr. J down the street, who runs a dry cleaning franchise – nor even to Ms. D across town, who runs a competitive box building business. Their facilities, expenses, contractual agreements and circumstances are different from yours, and they must determine what is fair and equitable to fit those circumstances.

Admittedly, our example with Mr. B and the piano crates is highly simplified. But as you proceed through this chapter, you might keep our illustration in mind. While the government adds a

lot of complicating factors, the same concepts regarding *direct* versus *indirect* costs and the need for guidelines to govern negotiations hold true. There is one big difference, however.

Your box and piano crate company is – we hope – operating for profit. When the federal government contracts with state and local governments and Indian tribes for services, no profit is permitted. Basically, the government will reimburse tribes $1.00 in cash for each $1.00 spent. Further, the government has established many rules for how and what it will pay. Many costs simply are not covered. For example, such costs as penalties, lobbying, litigation and gifts are considered prohibited – some by statute and some by regulation. OMB Circular A-87 provides a long list of allowable and unallowable costs, and establishes boundaries and documentation requirements for them.

The rules governing state, local governments and Indian tribes are basically the same as for all other federal contractors with respect to methods for establishing cost allocation plans, determining what are direct and indirect costs, and recovering all contract costs, both direct and indirect. OMB has other circulars covering education institutions, defense contractors, non-profits and others. The basic guidance and principals are the same. Basically - to go back to our wooden box company scenario - the government wants to make sure that Mr. B isn't paying for any of the costs associated with building the standard wooden boxes and, by the same token, that he *is* in fact paying for the costs associated with building piano crates he wanted. In addition, the government wants to ensure that the distinction between direct and indirect costs is sufficiently clearcut, that no costs are covered twice.

One of the first steps tribes face in administering contracts and grants is the development of a cost allocation plan or policy, which provides the basis for negotiation of an indirect cost rate. Each tribe must develop their own cost allocation plan because different tribes operate a variety of different programs from a number of different agencies. But all plans must cover indirect costs. Thus, we must begin with some clarification about direct versus indirect costs.

What Things Are Covered Under Indirect Costs?

Based on a review of the Northwest tribal indirect cost rates, costs commonly referred to as indirect were separated into three major categories and twenty-two subcategories, as shown on the next page in Figure 2-A.

There are other types of indirect costs that tend to be institution-specific; for example, educational institutions incur indirect costs, such as library costs, that are not a material cost for tribes.

Those included in the preceding list are the indirect costs identified as most common to Indian tribal governments, and the costs used in analyzing the indirect costs for Northwest tribes. *(See Appendix B for definitions of those items of cost listed.)*

As mentioned above, indirect cost rates for contracts and grants with the federal government **are individually negotiated by states, counties, cities, universities, hospitals, defense contractors, Indian tribes and others** with one of the federal departments assigned that task by the Office of Management and Budget. The Department of Interior (DOI) has been assigned the responsibility to negotiate indirect cost rates with Indian tribes. Within DOI this responsibility has been delegated to Interior's Office of the Inspector General. So, for tribes, the Inspector General is the federal government negotiator. (In the case of tribal health organizations, the Department of Health and Human Services – Division of Cost Allocation may be the negotiator.)

To establish an indirect cost rate, a tribe categorizes all of its costs as direct, indirect, or *excluded* based on its cost allocation policy. Costs may be excluded either because they are not allowed as indirect costs, or because the rate does not apply to them. Examples of items to which the rates might not apply are capital acquisition, major subcontracts and pass-through funds (e.g.: welfare or scholarship payments). Another type of costs that are excluded are called *directly funded indirect costs,* comprising those costs specifically paid for by federal grant, and therefore not included in either indirect or direct costs.

FACILITIES AND EQUIPMENT

Building Rent/Lease Cost Recovery
Utilities
Housekeeping/Janitorial
Building and Grounds Maintenance
Security
Equipment

MANAGEMENT AND ADMINISTRATION

Governing Body
Management
Planning
Financial Management
Personnel Management
Procurement/Material Management
Human Resource Management
Property Management
Records Management
Data Processing
Office Services

GENERAL SERVICES AND EXPENSES

Insurance and Bonding
Risk Management
Malpractice Liability Insurance
Legal Services
Audit
General Support Services
Miscellaneous and Other

Figure 2-A

Figure 2-B on the next page shows how a tribe might distribute its costs in calculating an indirect cost rate. The cost categories listed are based on those *common* to the Northwest tribes on which the study contained in Appendix A was based; the programs categories are those typically operated by tribes, and would each generally include a number of programs from a variety of sources. They are grouped here for ease of illustration. Complicating factors, which we will discuss in some detail later, sometimes influence indirect costs; but essentially, a simple division process is the basis for determining the indirect cost rate.

Once all costs have been categorized, the total indirect costs are divided by the total direct costs to determine the indirect cost rate, as follows:

INDIRECT COSTS ÷ DIRECT COSTS = INDIRECT COST RATE

That is, dividing the INDIRECT COSTS (also known as the indirect cost pool) by the DIRECT COSTS (also known as the direct cost base) gives the INDIRECT COST RATE.

For example, assume we have direct costs of $2,330,000 and indirect costs of $870,000. Remember, indirect costs divided by direct costs gives the indirect cost rate. In this example:

$870,000 ÷ $2,330,000 = .3734 or 37.34%

Once a tribe has determined this rate, the Inspector General reviews the tribe's calculation and ensures that, all the rules have been followed consistently, the categorizing is fair, costs are reasonable, and that the tribe has included everything appropriately. Then the Inspector General negotiates any differences with the tribe and executes an indirect cost agreement with the tribe on behalf of the United States Government.

Negotiated differences might influence whether a certain cost – particularly one not previously listed – is categorized as direct or indirect. Frequently, the amount allocated to the "Governing Body" category must be negotiated because the responsibility of this body differs from tribe to tribe. The Inspector General currently negotiates to allow half of the cost of governing bodies without

Cost Categories	Direct Costs	Indirect Costs	Excluded Costs
Building Rent/Lease Cost		$35,000	
Utilities		27,000	
Housekeeping/Janitorial		37,000	
Building and Grounds Maint.		18,000	
Security		5,000	
Equipment		16,000	
Governing Body		57,000	$57,000
Management		75,000	35,000
Planning		27,000	35,000
Financial Management		125,000	25,000
Personnel Management		50,000	12,000
Procurement/Materials Mgmt.		35,000	
Human Resource Management	$10,000	27,000	
Property Management		12,000	5,000
Records Management		15,000	
Data Processing		35,000	10,000
Office Services	12,000	15,000	7,000
Insurance and Bonding		125,000	
Risk Management		12,000	
Malpractice Liability Insurance		0	
Legal Services		50,000	100,000
Audit		28,000	5,000
General Support Services	28,000	32,000	
Miscellaneous and Other		12,000	3,000
Health Programs	450,000		
Education Programs	500,000		
Employment Programs	50,000		
Public Safety Programs	325,000		
Law Enforcement Programs	360,000		
Natural Resource Programs	290,000		
Economic Develop. Programs	55,000		
Public Works Programs	250,000		
Litigation			75,000
Lobbying			15,000
Penalties			4,000
Contributions			20,000
Pass Through (i.e., welfare payments)			35,000
Per Capita			50,000
TOTAL	$2,330,000	$870,000	N/A

Figure 2-B

special documentation. The Inspector General also reviews compensation for key management and administrative officials being recovered through indirect charges to ensure that they are reasonable and consistent with compensation for like jobs elsewhere. Actual costs are reconciled to tribal audited financial statements to ensure that all costs are considered in the equation.

Tribes then use the established rate to recover indirect costs in proportion to direct costs. In other words, as direct costs go up, the budget for indirect costs (based on the established percentage rate) increases proportionately. As shown in Figure 2-C, the budget for a negotiated contract or grant generally includes both direct and indirect costs.

BUDGET	
Direct Salaries and Wages	$50,000
Fringe Benefits	5,000
Materials and Supplies	3,000
Travel	2,000
Vehicles	1,000
Other	1,000
Total Direct Costs	62,000
Indirect Costs @ 37.34% (Direct Costs x Indirect Rate)	23,150
Total Budget	$85,150

Figure 2-C

Appendix B defines those budget items which are commonly categorized as indirect costs. These items can be covered under either direct or indirect costs, depending on the nature of the organization doing the categorizing. For example, health care providers or educational institutions might list some items under direct costs which most Indian tribal governments would regard as indirect costs.

Conclusion

Establishing a cost allocation plan which includes an indirect cost rate works the same way for all who contract with the federal government – with the exception of those establishing fixed price contracts. Whether you are a small box manufacturer, a hospital administrator, another government leader, a school administrator, or whatever, the concept is the same (as are the rules). The calculation is a bit more complicated for a government agency than for a box manufacturer, but the principles involved remain unchanged. *Costs are costs,* whether direct or indirect, and must be paid by someone. When the funding agency involved – in our case, the federal government – does not recognize or pay these costs, problems result. Promoting understanding, as a first step toward resolving some of these problems, is what this report is all about.

CHAPTER 3

Indirect Cost Rate Trends and Differences

Reasons Behind Increasing Indirect Rates

Analysis provided in Appendix A indicates that Northwest tribal indirect costs trended upward until the past few years. There are numerous reasons for these increases in indirect rates. Chief among them are the administrative costs necessary to meet federal standards for personnel, financial, procurement, property management and other administrative systems. These systems require funds to implement and maintain. Tribes have been developing and improving these systems for two decades. OMB Circular A-102, *Uniform Administration of Grants and Cooperative Agreements with State and Local Governments,* has established government wide standards for financial management, procurement, property management and records systems. The *Single Audit Act of 1984* sets forth requirements of single audits for all states, local governments and Indian tribes who have any material federal funding. Internal Revenue Service reporting requirements have increased during this period as well. Added employment at the tribal level demanded expanded personnel management systems,

including compensation policies, pension administration and human resource development functions. Health, pension and other fringe benefit costs increase as tribes attempt to bring compensation in line with other employers. The Employee Retirement Income Security Act (ERISA) and other pension reform laws added to the cost of administering pension plans for those tribes fortunate enough to have such plans. Additional special and general requirements were attached to contracts in the form of *boilerplates*, which contained references to numerous federal laws and regulations. Considerable expertise was required to interpret these additional contract provisions and ensure that tribes were in compliance with all contract requirements. Providing such expertise entailed further expense – as did spending the time and effort required to ensure and document compliance with all regulations.

Obviously, implementing required systems and the audit procedures that must accompany these systems is not free. Regulations – to be meaningful – must be adhered to and enforced. That costs money. And since administrative costs are normally *indirect* in nature, they boost tribes' indirect cost rates. Such administrative systems also lend themselves to automation and computerization, which in turn augments costs even further.

Several facility related factors have been significant in increasing indirect rates as well. Many tribes have received federal recognition since 1975. Since the BIA and IHS had not formerly operated programs at their locations, it was necessary to establish facilities and equipment. In some cases tribes were able to obtain grants to construct facilities. In other cases, facilities had to be rented, or financed. These expenses must also be covered under indirect costs. New requirements under the Americans with Disabilities Act called for renovation or remodeling of buildings (e.g., redesign of entryways and restrooms) to meet the special needs of handicapped persons. Occupational Health and Safety (OSHA) also comes into play. Compliance with these requirements adds substantially to the costs of providing program facilities. Tribes are recognizing the need to employ professionals to address facility maintenance and safety issues. Facility investments are also needed for health facilities to meet recognized accreditation standards.

Since 1980 many federal grant programs which supported tribal capacity building have dried up, been significantly reduced due to inflation and other economic influences, or at best, remained at existing levels. Economic Development Administration planning

grants, Administration for Native Americans development grants and HUD community development block grants all have helped to defray the cost of building administrative capacity and financing administrative facilities. BIA Core Management and Self-Determination Grants, in excess of $20 million in 1985, were specifically designed to assist in financing the development of administrative capacity. Today they no longer exist. With these programs operating at flat or reduced levels, or even eliminated, their help in defraying administrative costs no longer serves to hold rates down. The costs must be financed from indirect rates.

Since the 1988 Self-Determination Amendments, a portion of indirect costs not recovered from other federal grants is forgiven as "theoretical recovery" which also results in rate increases.

Indirect Cost Rates Differ Between Tribes

Some of the suggestions from BIA and IHS over the years have centered on developing formulas or flat fees to finance contract support costs. Without an understanding of why rates differ between tribes it is easy to jump to the conclusion that fairness and equity demand such consideration. In fact, there are many reasons why rates differ.

Tribes pay for some of the indirect costs through direct grants. Since these are competitive, not all tribes enjoy them.

Facilities costs are a major component of tribal indirect costs. Various federal agencies have provided grants to construct administrative and other buildings. Those tribes who are able to obtain them can greatly reduce future indirect costs. Because of differences in interpretation, or because of poor records, several tribes have been unsuccessful in recovering depreciation or amortization within their indirect rates. Reservation based tribes have frequently been able to take over federal facilities, thereby reducing future rent costs. Tribes in more urban areas, and particularly newly recognized or restored tribes, have no such facilities available and must build or rent. This difference can be expected to level out as old federal facilities reach the end of their useful life and must be replaced, particularly since the federal government isn't building many new facilities in Indian country.

Tribal organization structures and operating methods differ, as do the management and administrative costs associated with them. In most instances, administrative costs reflect some tradeoffs - often the result of attempting to achieve efficiency on the one hand by

sacrificing something on the other. A tribe may pay a lower salary to a less qualified individual in a key management position, but lose efficiency or money in the long run because a less experienced manager may not know how to take advantage of available opportunities. The lack of current audits is usually a pretty good indication that extra financial management help is needed. Geographic isolation may increase the price to be paid to attract qualified professionals.

The number of different programs operated affects indirect costs as well. The fewer the number of programs operated, the better the chance that some overhead costs can be directly charged to programs. Relative size of an organization impacts on the rate too. Smaller organizations don't enjoy the economies of scale that large ones do in supporting administrative systems. For example, for all the tribes in the country for which BIA reported 1993 and 1994 rates, those that had indirect rates in excess of 50% had an average direct cost base of just over $1 million. Those tribes with rates less than 50% had an average direct cost base of nearly $4.5 million.

Types of indirect cost rates negotiated differ from one tribe to another. Some tribes negotiate indirect costs on the basis of "total direct costs less capital expenditures" thereby including all costs associated with programs. Certain costs may be treated as "pass-through" by one tribe, so the rate does not apply to them. Another tribe may include them in their base and apply their rate to them. Still other tribes negotiate indirect costs on the basis of "direct salaries and wages," a category which includes only salaries, wages and related costs. An indirect cost rate of fifty percent based on salaries and wages may equate to an indirect cost rate of thirty percent based on total direct costs. The rates look different, but the resulting actual overall dollar recovery may be the same.

The system of rate negotiations may also have a lot to do with differing rates. Different representatives and different Inspector General's offices have interpreted rules differently and have adapted policies to personal biases. Until recently, three different regional offices negotiated tribal indirect cost rates across the country. There were significant differences in their interpretation of the federal rules. Not all federal negotiators view negotiations as having the same goal. Some work to negotiate the lowest possible rate - others the fairest possible rate. Tribes' understanding of the rules differ. Some tribes have been at the business for over two decades now. For them, the process has become almost automatic. Others are relatively new to the process.

Tribal objectives differ in negotiating rates. Some start from the level of quality they expect from their systems and budget accordingly. The indirect rate in this case is a reflection of their objectives. Other tribes start with a rate that they believe they can live with and work backwards. Their budgets for systems reflect what they can afford. In this case their systems may not perform adequately. Some tribes with their own resources don't even try to recover all of their costs, instead trying to hold their rates down.

Rates are a reflection of costs, negotiated according to federal rules on the basis of what is reasonable, necessary, allowable and allocable. There are many reasons why they differ and they must be viewed over the long term, even though they typically are negotiated for one year at a time. Like any other government, tribes must set their internal standards on systems and facilities. Set too high, they may not be affordable. Set too low, and the problems created may cost more in the long run. Ultimately, "*...compliance with the terms of the contract and prudent management...*" is the standard that Congress understood and included in the funding provisions when it defined contract support. Cost allocation plans and resulting indirect cost rates are a reflection of these standards, and also reflect longer term financing plans and strategies, and multi-year commitments.

A Review of Colleges and Universities

Perhaps the most compelling argument in support of rate differences would be to compare those of the colleges and universities who will spend around $14 billion in federal funds this year on research, of which something over $4 billion is indirect costs. For 1994-95, the Council on Government Relations reported rates ranging from 38 to 79 per cent on research volume at any single university ranging between $3 million and $350 million.

According to a recent GAO report, college and university rates average 50%, with about half of the total indirect costs being used to finance facilities. Johns Hopkins University, with over $350 million of federal research volume, reported a rate of 66.5% for 1993-94 – 41.5% for facilities and 25% for administrative costs. That university alone probably accounts for as much in indirect costs as the whole BIA contract support budget.

In 1991 the Office of Management and Budget revised its Circular A-21, "Cost Principles for Educational Institutions", separating indirect costs into two parts - Facilities and Administrative Costs. Administrative Costs were capped at 26%. Facilities costs were not capped. The General Accounting Office estimates that the cap saves the Federal government about $100 million per year, by our estimate about 2½% of overall indirect costs paid.

Universities have expressed some concern about how the administrative cost cap will impact research capacity over the long term. They also cite many of the reasons listed in this chapter for differences between institutions. Meanwhile, the Office of Management and Budget and the Office of Science and Technology Policy both agree that facility rates should not be capped. They have, in fact, risen as a percentage of direct costs since the Circular was amended, more than administrative costs have dropped. (Appendix A contains a trend analysis of College and University Rates for the past ten years.)

The ongoing dialogue surrounding college and university rates is important reading for anyone concerned with indirect cost rates. These learned institutions have had their facilities and administrative systems in place for many more years than have tribes, who really just entered the game about twenty years ago. In fact, many recently restored tribes are just now getting started. But whether you are interested in finding solutions to science and technology questions, or solutions to the many compelling issues in Indian country, quality facilities and administrative systems are a must.

Conclusion

Tribal rate increases result from a number of factors, including the development of necessary facilities and administrative systems, many of which are required to meet federal requirements. However, as systems mature and more programs are operated, rates among Northwest tribes have leveled off.

A portion of the increase in rates is directly attributable to other federal agencies not paying their respective share of indirect costs.

Rate differences occur for a variety of very legitimate reasons and the variations occur not only among tribes, but also others who do business with the government.

The federal government continues to review rates in other sectors and to seek ways to ensure efficient use of federal appropriations. The ongoing dialogue around college and university rates is fertile ground to look for trends and ideas.

CHAPTER 4

Tribal Experiences and Legislative Solutions

When the Congress enacted the Indian Self-Determination Act in 1975, the use of indirect cost rates was an administrative matter that had not yet been considered by the legislation. Tribes had been operating grant programs, but few had been introduced to the concept of the process of establishing indirect cost rates. Sometimes the BIA and IHS were of little help for reasons described earlier. The process of negotiation with the Inspector General was new, and most tribes didn't have the type of accounting records and budget systems that would lend themselves to full identification and recovery of costs. For that reason, early rates were low and failed to recover full costs. In addition, tribes were just developing their capacity and didn't have, and couldn't afford, many of the administrative systems considered necessary to prudent management.

As tribes became more knowledgeable in negotiating their indirect cost rates, they included more of their legitimate costs. And as a result, indirect cost rates rose steadily after the late seventies. From 1979 to 1986, Northwest tribes' average rates rose from 23.16% to 36.31%. But review at that time indicated that most tribes were still not recovering full indirect costs and that part of these costs were being augmented by Core Management, Self-Determination and other grants.

Since both agencies had trouble estimating contracting levels, however, shortfalls resulted; the funds set aside to cover the indirect costs were never enough. As time went by, and tribes became more sophisticated and accurate in estimating and recovering all their legitimate costs – they found their lives complicated by the imposition of a multitude of additional federal requirements. As a result of these additional requirements and the failure of some agencies to pay their share, indirect costs continued to increase. Thus, the shortfalls continued.

Problems Experienced with Indirect Cost Recovery

Once tribes have negotiated their indirect cost rate, they then find themselves facing a new challenge - the challenge of collecting the indirect costs to which their negotiated rate entitles them. In fact, many federal programs have limitations on "administrative" costs which they apply to indirect cost rates. In some cases, the Congress establishes the limitations legislatively (e.g., JTPA and Headstart programs). In still other cases the federal agency has authority to pay indirect costs, but a federal employee having grant authority simply chooses not to. If a tribe understands the concepts of indirect cost rates and multiple indirect cost rates, and is lucky enough to be assigned the right federal negotiator, then they can avoid some serious problems these limitations bring with them. Our earlier review of the experience of Northwest tribes pointed out, however, that many hadn't avoided the problems. In fact, many tribes were and still are forced to commit significant tribal resources to programs that don't pay their fair share of costs.

When tribes negotiate their indirect cost rate with the Inspector General, the agreement includes the phrase over the Inspector General's signature "on behalf of the United States Government." The difficulty stems from the fact that other agencies don't recognize that rate. In fact, federal agency employees sometimes misinterpret the agreements and how the rates apply. In this case tribes must expend funds to correct the misinterpretation, or they just don't get paid what they should. The problem has been further compounded by the BIA and IHS failing to request sufficient funds for indirect costs and therefore not having funds to pay full indirect costs. What this amounts to is "nonrecovery." In other words, the tribe is entitled to recover its full indirect costs but the federal agency cannot or will not pay.

Let's return to our wooden box scenario from Chapter 2. Remember that you had taken Mr. B's order for piano crates. But let's add a few new wrinkles. Now Mr. B doesn't want to pay a profit, but just wants to pay you at your cost. (Such is in fact the case for contracts with the federal government under P.L. 93-638.) And let's say that Mr. B says to you, "Okay, I'll acknowledge your indirect cost rate but I'm only going to pay you a certain percentage [less than your real cost] of your rate." And according to what Mr. B is willing to pay, it turns out that you can collect only 97 cents for each dollar you spend. Would you take Mr. B's order? That is precisely the kind of order that has been placed with tribal contractors for years by the government. This problem of nonrecovery was described fairly clearly in a letter of November 3, 1983 when the Inspector General for the Department of Interior appealed to the Office of Management and Budget to remedy this situation. An excerpt from that letter follows:

[From]
"United States Department of the Interior
Office of Inspector General, Washington, D.C. 20240
November3, 1983

[To]
Honorable Joseph R. Wright, Jr., Deputy Director
Office of Management and Budget
Room 252, Old Executive Office Building
Washington, D.C. 20503

Dear Mr. Wright:

The heavy and inconsistent requirements of the federal bureaucracy are jeopardizing the ability of Indian tribes to handle federal programs, particularly those tribes with limited resources of their own. The problem involves all Government agencies which award contracts and grants to Indian tribes. Interior, Indian Health Service, other components of HHS, Education, Labor, HUD and Agriculture are the most involved.

Indian tribes are treated the same as state and local governments when it comes to reimbursement for administrative costs incurred in handling federal programs. In a political sense, tribes can reasonably be considered as state and local governments. However, in a financial sense, they are worlds

apart. State and local governments have their own tax base; Indian tribes do not. While some tribes with valuable natural resources or large trust fund balances are reasonably well off, most are basically dependent on the federal government. About half are over 90 percent dependent.

The indirect cost guidelines (OASC-10) 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...

...Sincerely,

Richard Mulberry, Inspector General"

This letter went on to point out numerous other problems, which are also discussed in this chapter. Even though it was written over fourteen years ago, it still goes right to the heart of the matter.

The Problems of Overrecovery and Underrecovery

Again, let's return to our wooden box factory. This time Mr.B comes to you and says, "Okay, I'll agree to your 30% indirect cost rate, but I want to look at all your costs at the end of the year, and to the extent you really didn't spend 30 cents of indirect costs for each dollar of direct costs, you will owe me the difference and must pay it back two years from now. If in fact you have spent more than 30 cents of indirect costs for every dollar of direct costs, I will owe you the difference and pay you two years from now. We can pay and collect through an adjustment in the indirect cost rate when we figure it out two years from now."

Now being a good business man, would you enter into that agreement? Probably not. But suppose you did. Would you expect to spend exactly 30 cents of indirect costs for every dollar of direct costs? Not really. Realistically, the actual rate would probably range from 25 cents to 35 cents.

If you collect 30 cents and actually spend only 25 cents, this is called "overrecovery." If, on the other hand, you collect 30 cents and actually spend 35 cents, that's known as "underrecovery."

In dealing with a "fixed with carry-forward rate" – which most tribes have had to do - you'd need to negotiate over and underrecoveries all the time. Over and underrecoveries are adjusted into the rate two years down the road through what is called a "carry-forward adjustment."

The obvious question is: "Why not just agree on 30 cents and leave it at that? If we spend more we lose, and if we spend less we gain." For tribes with resources, this would make sense; but to the many tribes without resources, to lose money spells financial disaster.

Perhaps you think the situation is already growing complicated, and you're right. But it doesn't end here. In order to complete the analogy, we've got to add yet another wrinkle to the deal.

Let's say that you and Mr. B have made your agreement and you are going to collect indirect costs on the basis of a 30% rate. Mr. B comes to you and says, "Look, I know we agreed on 30%, but I'm a little short on money, so I'm only going to be able to pay you 27%." At this point you are becoming a little exasperated with Mr. B and wondering why you ever took his order in the first place, but you've stocked a lot of raw materials and several members of your family are working in your plant. If you don't build the piano crates, you'll be stuck with the materials and your loved ones will be out of work. So you say, "I guess I'll go in the hole three cents for every dollar of direct costs." This is an example of "nonrecovery." Figure 4-A provides examples of overrecovery, underrecovery and nonrecovery.

	Example of Overrecovery	Example of Underrecovery	Example of Nonrecovery
Negotiated Rate	30%	30%	30%
Actually Spend	25%	35%	30%
Actually Recovered	30%	30%	27%
Overrecovery	5%		
Underrecovery		5%	
Nonrecovery			3%
Theoretical Recovery			30%

Figure 4-A

Quite a while after year's end, Mr. B comes to your factory and sits down to look at your costs. You have tried to curtail costs so you wouldn't lose money. And so, you've let the maintenance on the building fall behind (which really only defers the cost) and you've let your accountant's assistant go, and the accountant is being required to work extra hours. When he finally gets the books closed, you're almost through the next year. Quite frankly, you're not sure where you stand financially any more. Nevertheless, Mr. B looks over your books and discovers that you only spent 28 cents of indirect costs for each dollar of direct costs. He promptly announces to you that you owe him two cents. You say, "Now hold on there, Mr. B - you only paid me 27 cents; the truth is, you owe me one cent." Mr. B counters, "No - according to your rate you were entitled to 30 cents and so hypothetically you have been paid 30 cents." This is called "theoretical" overrecovery.

Well, he's stuck you again; only now you're over halfway through the next year and have the supply room stocked. You still have your employees - particularly your family members - to think of, so you look for another way to save. Next year, Mr. B will agree to your 28 cent rate, but since you already owe him two cents now, he's only going to pay you 26 cents of indirect cost for every dollar of direct cost. So you defer some more maintenance, you cut the accountant's hours and start doing some of the labor yourself. The dilemma deepens because now you have to spend 28 cents to collect 26 cents or you'll owe Mr. B again. By this time, he's got you in such a financial mess, you've begun what we call an uncontrollable downward rate spiral to financial disaster.

On the other hand, let's say you figure Mr. B is a man of his word, so you keep your maintenance up and keep your accountant's assistant on. You actually spend 31 cents of indirect costs for every one dollar of direct costs. Mr. B is going to pay you that extra one cent through an adjustment to your rate next year, right? Not necessarily. By the time you're ready to enter into your negotiations, Mr. B informs you that he is no longer buying piano crates - and you have invested a great deal of time, money, energy and other resources in preparing a product for which there is no longer any market.

When a tribe contracts with the federal government under P.L. 93-638, Mr. B is represented by many different people; and the hypothetical examples given above are quite real. In many cases tribes have to contract to operate programs, or their communities simply don't receive the services that those programs provide. The

Office of Management and Budget establishes the rules governing indirect costs; and OASC 10, published by the Department of Health, Education and Welfare (now the Department of Health and Human Services) provides guidelines for developing the rate. Other rules related to audit are set by the General Accounting Office. The Inspector General for the Department of Interior or another federal office negotiates the indirect cost rates. The tribes actually contract with the BIA and IHS, who pay the contract costs (or fail to). Departments of Interior and Health and Human Services review their budgets and tell them what they can submit to Congress. The Office of Management and Budget review what the Departments submit and may make changes. Then Congress appropriates the money based on whatever information is available. In today's budget climate, Congress has a real challenge to find enough money to appropriate.

With all these people involved, it's no wonder that Mr. B behaves a little inconsistently, and that tribes as a result are treated a little unfairly. That is not to say that some of these agencies haven't worked to improve the situation. OMB has continually tried to increase the fairness and clarity of its regulations, bringing about greater uniformity and consistency. In 1986, the OMB made the Department of Interior responsible for all Indian tribes - a fact which can help gain consistent treatment. The Department of Interior Office of the Inspector General in many cases has advocated for tribes and attempted to make their life easier. In recent years the Office of the Inspector General has consolidated rate negotiation for all tribes in a single office. Contracting officers in IHS and BIA have become more knowledgeable about the problem, and in many cases have done what they can to help. Congress has recognized all of these problems and attempted to correct them through legislation.

Funding Stability

As mentioned in earlier Chapters, funding stability was a major issue. Tribes felt that once they contracted a program, the funds would dry up. It did little good to negotiate and manage an indirect cost rate if the programs that were contracted on which the rate was based no longer existed. In the early years of Self-Determination, both BIA and IHS had a great deal of discretion regarding the level

of funding made available to a contract. This undermined the process and was a key element of tribal decisions not to contract programs.

Legislative Solutions

Congress made it clear through the 1988 amendments to the Indian Self-Determination Act that it expected the tribes to be treated fairly. A number of provisions were added to Section 106 of Title 1 of the Act.

First, Congress made it clear that the tribes were not to be held liable for "theoretical" recoveries of indirect costs.

> *"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."* (Title 1, Section 106(d)(1)).

This language, implemented correctly, would ensure that tribes were not counted as having received reimbursements of indirect costs that they actually never received. However, due to a strict reading of the law, implementation has been only partially successful. A tribe must have an overrecovery, giving rise to a downward rate adjustment in a future year to have such "theoretical" recovery forgiven. A tribe with an underrecovery has no downward adjustment forward, so the fact that they never collected the reimbursements is ignored. They essentially lose twice. This issue has been the subject of litigation over the past several years, and a recent ruling may correct this problem. (Ramah Navajo Chapter vs. Manuel Lujan, et al.)

A forgiveness for theoretical recoveries actually increases rates down the road as the liability for financing indirect costs not recovered falls to future years. Future rates will be slightly higher as a result.

Next the Congress made it clear that the BIA and IHS were to pay full indirect costs.

> *"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."* (Section 106 (d)(2)).

This compelled the agencies to try harder with respect to indirect costs, however, all contracts are subject to the availability of funds. If Congress doesn't appropriate enough, then the agencies seem to be off the hook. However, certain court cases brought by tribes have resulted in demands on the agencies to pay.

Congress also noted the financial distress that some tribes were in when the 1988 amendments were enacted. The following language was added to forgive debts associated with the recovery issues (except real overrecoveries) and the Act was later amended to extend the period for which the forgiveness would occur through 1992.

> *"Indian tribes and tribal organizations shall not be held liable for amounts of indebtedness attributable to theoretical or actual under-recoveries or theoretical over-recoveries of indirect costs, as defined in Office of Management and Budget Circular A-87, incurred for fiscal years prior to fiscal year 1992."* (Section 106 (e)).

Finally, Congress recognized the need to do something to stabilize funding for both direct program funding and contract support funding. Language was added in 1988 to the funding provisions to address the issue of funding stability.

> *"The amount of funds required by subsection (a)--*
>
> *(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 Act or as provided in section 105(c).

Notwithstanding any other provision in this Act, the provision of funds under this Act 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 Act." (Section 106 (b)).

This language, combined with other efforts led to more stability in financing from year to year as recurring budgets were established for each tribal location. Today, a much larger percentage of the budget for both agencies is identified with recurring funding base budgets at each tribal location.

With the BIA and IHS expected to pay their share of indirect costs, and theoretical recoveries removed from the equation, Congress thought that fairness would be brought to the process. However, as indicated in Chapters 6 and 7 the shortfalls continue, and as indicated above, only in certain cases are theoretical recoveries adjusted for. Tribes are able to use their overall funding to balance between indirect and direct costs under self-determination agreements, but in reality, this means shifting program services to cover contract support costs, a result that Congress intended to avoid.

Conclusion

Whether you're building boxes or operating federal programs, if you don't identify and recover all of your costs, you'll wind up spending your own money to stay in business. And if you don't have your own money to spend, you'll be out of business very shortly. It's as simple as that. Many tribes, who have little or no

money of their own, face a tough decision on how to spend what little they have: whether to subsidize federal programs or to build an economic base that might enable them to become less dependent on those federal programs. Without a stable funding base, it has been difficult for these tribes to achieve some measure of self-sufficiency. The situation has improved some since the 1988 amendments, but many of the problems they sought to correct are still present.

Congress has recognized a number of the obstacles that inhibited tribal contracting and added specific provisions within the Self-Determination Act to remove them.

Underrecovery, overrecovery, theoretical recovery, and nonrecovery continue to be major problems for many tribes, despite legislation intended to correct the issue. Precious tribal resources are still being diverted to cover unpaid federal costs.

Tribes are still being required to divert services dollars to pay indirect costs due to shortfalls in contract support funds in both BIA and IHS. This remains a disincentive to many tribes to contracting more programs.

Changes in budget practices in both BIA and IHS have resulted in more of the resources of both agencies being identified with recurring funding bases at the tribal level, thereby providing improved stability for tribal programs and capacity.

CHAPTER 5

Contract Support Reporting Requirements

If we review the history of implementation of the funding provisions, and all of the written material, including budget justifications and appropriations reports it is clear that lack of information and understanding have been major contributors to some of the problems experienced. When Congress addressed the contract support funding provisions in 1988, there were clearly some ongoing issues which needed to be addressed. The first was to make sure that Congress had the information needed when considering appropriations. Clearly the BIA and IHS were not able to give Congress correct information regarding the amount of contract support needed. The record at that time showed that the amounts included within the President's budget were frequently not the amount the respective agencies originally submitted. Congress did not have a formal way through the budget process to obtain the needed information.

Since the bulk of the discussion at that time centered around indirect costs, provisions were added to the Act which required separate reports to be submitted to advise Congress of the funding needs. In 1994, to conform to the contract support funding provisions, the report provisions were expanded to cover all

contract support requirements. The report deadline was changed from March 15 to May 15, still intending that Congress would have it available each year before it made budget decisions. Section 106 (c) of the Act addressed a number of report requirements, the first being an accurate reporting of amounts under contract and the related contract support funding requirements.

> *"The Secretary shall provide an annual report in writing on or before May 15 of each year to the Congress on the implementation of this Act. Such report shall include--*
>
> *(1) an accounting of the total amount of funds provided for each program and budget activity for direct program costs and contract support costs of tribal organizations under self-determination contracts during the previous fiscal year;*
>
> *(2) an accounting of any deficiency of funds needed to provide required contract support costs to all contractors for the current fiscal year;*

Next, there was a need to better report on what indirect costs were so that Congress would be aware of what was being paid for and could watch trends in the types of costs that rates provided for.

> *(3) the indirect costs rate and type of rate for each tribal organization negotiated with the appropriate Secretary;*
>
> *(4) the direct cost base and type of base from which the indirect cost rate is determined for each tribal organization;*
>
> *(5) the indirect cost pool amounts and the types of costs included in the indirect cost pools; and*

Finally, the Congress wanted to know about funding deficiencies related to the maintenance of services to tribes. Additionally, to give the tribes the option of converting their contract funding period to a Calendar Year, provisions were made to ensure that the amount needed to accomplish this was reported.

> *(6) an accounting of any deficiency of funds needed to maintain the preexisting level of services to any tribes affected by contracting activities under this Act, and a statement of the amount of funds needed for transitional purposes to enable contractors to convert from a Federal fiscal year accounting cycle to a different accounting cycle, as authorized by section 105(d)."*

Taken as a whole, if these reports were delivered completely and timely to Congress, the Appropriating Committees would have the information needed to make informed decisions on budget. Unfortunately, neither agency has made the reports available. To do so would require that good information be maintained on each contract and contractor. Analysis of the type done on Northwest tribal rates would need to be completed each year. The agencies would have to request information regarding tribal desires to convert to a calendar year.

As of this writing, BIA has not yet submitted a report for fiscal years 95 and 96. BIA reports have addressed only the first few items required by law, have not addressed direct contract support requirements, and have never discussed the makeup of tribal indirect costs. The Indian Health Service has not submitted its report for fiscal year 96 through Departmental channels yet, so it may not be to Congress on time. IHS reports have typically addressed unmet need, although it is believed that in some years the amount of need reflected in the report changed and was reduced as the report made its way through Departmental clearance. The Indian Health Service has commented on the types of costs included in tribal rates, although it has not performed an analysis of rates. However, IHS continues to work in partnership with tribes to improve its information.

There may be an inherent conflict in the reporting requirements that has not been addressed. Given the current competition for appropriations, there may be pressure within the two departments to hold down the reported needs. Further, the agency heads are required to support the President's budget, and if the President's budget reflects less than the actual needs, then can a report reflect a need greater than the President's budget and still support the President's budget? How does Congress assure itself that it gets the accurate picture? Of course accuracy is not such a big issue if the reports arrive too late to be of any use.

While the failure of the agencies to fully meet the reporting requirements inhibits the Self-Determination process and Congress's ability to monitor it, in fairness to the agencies, no staff positions have been assigned to this task. A portion of the information is available and could be compiled by the Office of the Inspector General (or Division of Cost Allocation in HHS). Some of the information would need to be gathered from and in cooperation with tribes. Mandated reductions in headquarters staffs at both agencies have not considered the need to meet these legal

reporting requirements. So while Congress appropriates over $250 million each year on contract support, not one federal employee in either federal agency has it as his/her full time job to meet these reporting requirements. The trend appears to be to further shrink the agencies and Headquarters structures without regard to statutory obligations. This being the case, it is not likely that the reporting requirements will be staffed in the foreseeable future.

Conclusion

Congress set forth the necessary reporting requirements to ensure that accurate information would be available to support appropriation decisions and to monitor the progress of the Self-Determination process, the trends in tribal indirect costs and other related issues.

Neither BIA nor IHS has met the full report requirements. Both are required to submit their reports through their respective Departments for clearance before going to Congress.

Over $250 million is spent by the two agencies for contract support, but neither has a single full time position dedicated to gathering the information needed to meet reporting requirements. Additional staff is not likely in today's budget climate.

Congress is being asked to increase appropriations for contract support (in a very tough budget climate) without being provided the full information called for by the Act.

CHAPTER 6

BIA Implementation of Contract Support

When the Congress enacted the Indian Self-Determination Act in 1975, the negotiation and use of indirect cost rates was an administrative matter that had not yet been considered by the legislation. Tribes had been operating grant programs, but few had been introduced to the concept or the process of establishing indirect cost rates. They soon realized that there was a major problem in meeting the financial needs of the programs they were contracting. Tribal leaders were soon in front of Congress requesting that funds be appropriated to ensure that funds were available to pay their indirect costs. They had not yet been afforded the full cost analysis discussed in Chapter 1. Congress responded with appropriations for indirect costs. These funds came to be called "contract support" in the Bureau of Indian Affairs budget, but they financed only indirect costs.

The BIA had little experience with indirect cost rates. Contracting officers in the BIA had many problems understanding what indirect costs were, as did many other employees. Some BIA officials saw the payment of indirect costs as a "carrot" to entice tribes to contract, and advised tribes to contract in order to increase their allocation of funds. Many federal employees felt that the indirect costs were not necessary and others felt that they were a

"government rip-off." These negative feelings on the part of federal employees complicated matters-particularly when they attempted to avoid paying the indirect costs that tribes were rightly owed.

The BIA had neither the systems nor the experience to support accurate estimates of how much contract support funding would be required to cover indirect costs. Under the Act, the decision to contract to operate programs was an option belonging to tribes, so BIA couldn't anticipate which services would be operated by the government and which would be contracted to tribes.

Imagine not knowing whether you would be building boxes or buying them. You wouldn't know whether to rent space, buy equipment, hire employees, set up cost accounting systems and so forth, or just pay to have boxes delivered. That is exactly what happened to the BIA. It was set up with box building factories all over the country, but if a tribe wanted to contract to build those boxes at a given point in time, then BIA was required to buy the tribe's boxes rather than build them out of its own factories. You can imagine the extra costs involved in being set up both to build boxes and buy them. And what is worse, of course, is the fact that we are not talking about wooden boxes here. Really, we're talking about social programs, law enforcement, health services, education, natural resources and other governmental services – the adequate provision of which profoundly affects not only those employed by such programs, but also those who depend on the services they provide.

Shortfalls in the Bureau of Indian Affairs

The BIA's indirect costs didn't go away when tribes contracted to operate the programs that had previously been operated by the federal government, so additional funds were needed to pay for the tribes' indirect costs. BIA established separate "contract support" funds for payment of these costs.

Since BIA had trouble estimating contracting levels, shortfalls resulted; the funds set aside to cover the indirect costs were never enough. As time went by, tribes became more sophisticated and accurate in estimating and recovering more of their legitimate indirect costs – but they found their lives complicated by the imposition of a multitude of additional federal requirements. As a result of these additional requirements and the failure of some agencies to pay their share, indirect costs continued to increase. Thus, the shortfalls continued.

Shortfalls - the difference between what was needed to support programs and what could be obtained – occurred again and again, year after year in the BIA. Some years, supplemental appropriations were obtained to offset these shortfalls. In other years, Congress instructed the BIA to reprogram other funds. And often, unfortunately, the tribes never recovered their full negotiated indirect costs.

Why did shortfalls occur? Sometimes, they were attributable in part to increasing tribal indirect cost rates, and in part to the fact that contract levels were underestimated. For several years, OMB reduced the BIA estimates during the budget formulation process. Sometimes Congress didn't provide what the BIA's proposed budget recommended.

The repeated occurrence of this same problem attracted questions and concerns from some members of Congress, who perceived that the shortfalls were placing a heavy burden on tribes. Not only were they short the money needed to fund program operations, but often - even when funding was available - they received no assurance of that funding until the last month of the fiscal year. Such timing made planning and program administration a nightmare. No one could know for certain which programs might exist from one year to the next, or even whether certain positions within those programs should be filled or left vacant. Further, it is difficult to attract well qualified personnel to an atmosphere troubled by such uncertainty.

The BIA frequently testified that shortfalls were a reflection of increasing tribal indirect cost rates over which the BIA had no control. Testimony by BIA officials, however, failed to provide support for that hypothesis. In some testimony, officials provided information that criticized the Inspector General for negotiating higher rates, and in other testimony, some isolated cases of abuse (e.g., high executive salaries and fringe benefits, high tribal council salaries) were cited as causing increases in indirect cost rates. As a result, tribes generally seemed to be penalized because of several isolated instances and lack of understanding by BIA officials.

In 1983, the BIA proposed a new method of handling indirect cost rates based on a study of indirect costs conducted by the American Indian Law Center, Inc. After many meetings across the country with Indian leaders and in accordance with Congress, the BIA changed its original proposal and allocated funds for indirect costs into the programs in a way that *separated allocation of funds from cost recovery methods.* This was referred to as

"*grandfathering*" as it locked in the annual allocation for future years, without regard to negotiated rates or what was needed. It was BIA's intent to limit funding requests strictly to new contracts from that point forward. The Appropriations Committee directed BIA to implement this plan for FY 1985. Unfortunately, when it was implemented for FY 1985, the budget was deficient by over $5 million, so the amount grandfathered was less than full costs, and was locked in for future years. For a number of reasons, this process failed and had to be reversed in 1987.

Figure 6-A below shows the appropriations available to the BIA for contract support from 1976 to 1997.

P.L. 93-638 CONTRACT SUPPORT FUNDS
PROVIDED BY BIA
(DOLLARS IN THOUSANDS)

Fiscal Year	Original BIA Request To OMB	Original BIA Request To Congress	Appropriations (Incl. Sup. and Reprogrammed)	Reprogramed & ISD Fund	Available For Indirects	Estimated Need For Indirects
1976	0	11,200	10,700		10,700	*
1977	21,690	11,130	9,777		9,777	*
1978	15,900	9,700	8,742		8,742	*
1979	17,200	10,941	23,577		23,577	*
1980	25,093	23,577	23,770		23,770	23,328
1981	25,577	25,873	26,073		26,073	27,559
1982	25,873	28,460	27,322		27,322	34,153
1983	31,906	30,338	37,338		37,338	37,788
1984	36,788	34,788	37,188		37,188	43,069
1985	42,288	39,588	38,098		38,098	45,866
1986	41,158	39,748	42,508		42,508	51,515
1987	45,394	45,894	44,876		44,876	54,898
1988	47,894	42,787	46,987		46,987	53,719
1989	*	45,866	52,966	1,018 1	53,984	*
1990	48,946	48,948	54,753		54,753	*
1991	*	43,946	52,231		52,231	*
1992	63,946	55,000	56,282	8,500 1	64,782	67,617
1993	*	56,282	65,223	10,100 1	75,323	83,900
1994	66,282	83,808	84,808		84,808	90,845
1995	*	95,823	95,640	5,486 2	101,126	111,250
1996	103,823	116,628	90,829	5,000 2	95,829	109,528
1997	*	115,608	90,829	5,000 2	95,829	112,695
1998	*	110,829				116,547

1985: $38,308 grandfathered to pre-1985 contracts
1993: Shortfall in OIP was funded from 1994 funds in the sum of $11,088,043
1994: Funding appropriated was reduced by $11,088,043 to finance 1993 shortfalls. Requirements were funded at 81.21%
1995: Requirements were funded at 81.74%, with additional unfunded requirements reported later
1996: Requirements were funded at 88.9%: Request includes $7 million for ISD Fund
1997: Requirements are expected to be funded at 84.3%: Request includes $6 million for ISD Fund
1998: Requirements are expected to be funded at 98%: Request includes $6 million for ISD Fund

1 Amounts reprogrammed to fund indirect costs
2 Amounts appropriated for Indian Self-Determination Fund
* Information not available

SOURCE: BIA budget justifications, internal BIA documents and correspondence

Figure 6-A

BIA's Attempt at a Flat Fee

Faced with insufficient funds in the FY 1987 budget, the BIA proposed to "ungrandfather" previously allocated amounts and replace them with a flat fifteen percent administrative fee. This approach would enable the government to establish a strict ceiling on allocations and to say to tribes, in effect, "Here is the amount you will receive, *irrespective of what it costs.*"

At this point the BIA and tribes were very much at odds and the tribes took their case to the legislative committees of the Congress. Congress responded with the 1988 amendments and "contract support" funding provisions discussed in Chapter 1.

The BIA's Implementation of the 1988 Amendments

With the amendments in place, the BIA seemed more committed to fully funding tribal indirect costs. However, it seemed that BIA still had a problem with tribal indirect cost rates. The 1989 BIA Budget proposed that the negotiation of tribal indirect cost rates would be removed from the Office of the Inspector General to some other office in the Department of Interior. The budget justifications indicated that *"...the concept of "reasonable" costs in addition to "allowable" costs will become the basis for rate determination"*, intimating that they were not already. In fact, OMB Circular A-87 already provided guidance, requiring that *"To be allowable...costs must...be necessary and reasonable for the proper and efficient administration of the grant programs..."*

Tribes again went to Congress, pointing out that the Inspector General was the only office in the Department that had adequate independence to ensure that negotiations were "fairness" and not "budget" driven. Congress ultimately agreed and negotiation responsibility remained with the Office of the Inspector General.

Contract Support Shortfalls Continue

Now faced with a legal requirement to finance contract support costs, the BIA continued financing only indirect costs. No system was established to determine how much contract support was required to pay direct contract support costs or indirect costs associated with new contracts. As shortfalls continued BIA could

not identify how much of the requirements were associated with new contracts, and how much was needed to finance requirements of existing ongoing contracts. As shortfalls continued to occur, BIA began reprogramming other funds (such as *Housing Improvement* and *Indian Child Welfare Funds).* This helped to pay the indirect cost liability, but left the requirements unmet for the programs that lost the funds. Reprogramming required Congressional approval, and when approval was denied for FY 1993 a large liability remained for unpaid indirect costs. The Appropriations Committee then inserted language to limit the BIA's liability to the contract support appropriation and BIA was forced to ration contract support. A new process was instituted, which involved obligating part of the total amount available early in the fiscal year and then waiting until the end of the fiscal year, until all the requirements were known, to allocate the balance, ensuring that everyone share equitably in any shortfall. This meant that the tribes didn't know until well through their funding cycle how much they would have available to spend or what the shortfall would be. Since BIA had not implemented the contract support funding provisions, contract support was limited to those tribes who had current rates or formal applications pending with the Inspector General. Due to late submission of rates, some tribes received no contract support at all. Recently, this issue has been litigated and BIA has been forced to adjust its practices. Funds are now allocated based on other criteria if current rates aren't in place. For the past several years the BIA has announced its annual process for distribution of contract support in the Federal Register.

Tribes Accelerate Self-Determination

With the 1988 amendments to the Act and the Self-Governance process in place, the pace at which tribes assumed operation of programs accelerated. The pace is moving even faster since the 1994 amendments to the Act. Figure 6-B on the following page reflects the increase in the portion of the Portland Area BIA "Operation of Indian Programs" resources under tribal operation from 1988 to 1996. By comparison, the overall BIA programs operated by tribes nationally rose to 37% in 1994, the last year for which reports have been made.

Federal vs Tribal Operations
Portland Area Bureau of Indian Affairs

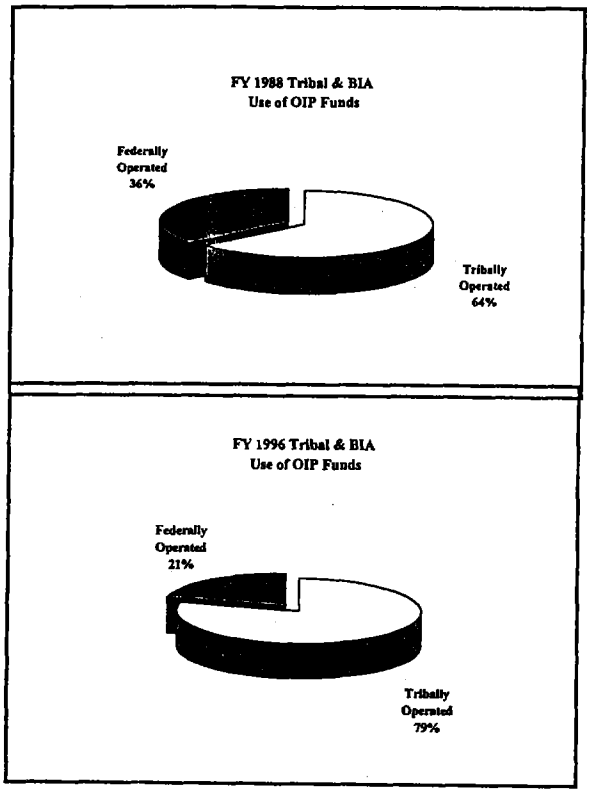


Figure 6-B

Congress Establishes an Indian Self-Determination Fund

Tribes recognized that part of the problem with indirect shortfalls was the manner in which BIA lumped all contract support funding into one budget item. Information was not available regarding how much of the requirement was associated with new contracts and how much was associated with existing ongoing contracts. Adding new contracts to an already limited pool of funds was distorting the picture. Congress was not able to tell if progress was being made in transferring more of the federal operations to tribes, or if indirect cost rates were just going up. In FY 1995, the Appropriations Committees added an "Indian Self-Determination Fund" (ISD Fund) to the budget to finance the contract support associated with new contracts. BIA was instructed to implement the fund consistent with the process IHS was using. This, for the first time, separated out new contracts and was aimed at stabilizing the amounts available for existing ongoing contracts.

Under this arrangement, Congress would expect to transfer the ISD amount to the contract support fund each year to annualize the increase associated with the prior year's new contracts. A new amount would be budgeted the following year to finance more new contracts. As of the date of this publication, no funds have been distributed for new FY 1997 assumptions. Tribes who have assumed new programs are forced to "bet on the come" and hope that their request is funded. *(See Chapter 7 for more on how this works in the IHS).*

Given the current budget climate, new funding will be difficult to obtain. The ISD fund was initially funded at $5 million. The increase was not annualized for FY 1996 when the overall BIA budget was cut dramatically. The ISD fund amount was not annualized in FY 1997 either. This has caused an additional $5 million shortfall in paying for indirect costs on existing ongoing contracts for FY 1997. The FY 1998 budget contains a new $5 million for the ISD fund, and $10 million aimed at reducing the annual shortfall. This is expected to finance about 90% of total indirect cost requirements associated with ongoing contracts.

BIA Budget Savings and Contract Support Requirements

While there is not a one-for-one ratio between reductions in BIA's costs and tribal contract support costs as tribes take more programs over, there certainly is a relationship. For example, as tribes take over BIA facilities, the Facilities Operations and Maintenance budget requirements should go down and the savings should be transferred to the contract support budget. But that doesn't happen. BIA administrative budgets have been arbitrarily slashed in the past few years. So instead of budget savings accruing to contract support, the funds have been lost to the BIA.

There are numerous costs in the BIA and the Department of Interior which should be reduced when tribes assume a program. Employee Worker's Compensation and Unemployment, FTS costs and others are budgeted in the budget category "Special Programs and Pooled Overhead" and are relieved of costs when contracting occurs. However, since no analysis is available, there is no savings reported to offset the increased need for contract support.

For the first time, the FY 1998 budget proposes to transfer Central Office administrative savings to create an overall increase in Tribal Priority Allocations. So instead of these savings financing contract support, they may actually create a greater unfunded demand for it.

Staffing to Implement Contract Support

Timely and accurate information on contract support, indirect costs and contracting in general has never been available to inform the Congress, tribes or the policy makers in BIA and the Department. There is a lack of staff to focus on the issues surrounding contract support. Recent budget reductions to the Central Office further eroded the number of positions available to work on contract support related issues. Only a few positions remain, and those positions have responsibility for other duties as well. There is no single position dedicated to tracking, understanding and reporting on contract support needs and uses. As of this writing, the required reports for 1995 and 1996 have not been submitted. BIA does not have immediate access to all of the information required for the annual report to Congress. In fact, the

Inspector General and tribes have a great deal of this information, but there is no organized partnership with BIA for sharing it.

Conclusion

BIA has continued to finance indirect costs only, despite the guidance provided by the 1988 and 1994 amendments to the Indian Self-Determination Act. No funds have been requested or recommended to finance "direct" contract support. No analysis has been provided to indicate how much would be needed to implement the Act in this regard.

Shortfalls are resulting in the need to ration contract support and pay tribes only a portion of what they are entitled to. The portion of the requirements financed over the past several years have ranged from 81-92% with the amount not yet known for 1997. BIA estimates that the FY 1998 budget, if approved, is expected to finance approximately 95% of indirect costs associated with ongoing contracts.

Under the current system, tribes don't know until late in the fiscal year what portion of their requirements will be funded.

Congress created an Indian Self-Determination Fund beginning in 1995 to budget funds needed to provide indirect costs for new (and expanded) contracts. Unfortunately, the fund has not had the opportunity to work yet. Increases for new contracts from 1995 were lost in the severe 1996 budget cuts, and the increase for 1996 new contracts was not annualized in 1997. As a result, contract support for existing contracts absorbed $10 million in new requirements over the 1995 budget. BIA has requested an increase of this amount for 1998 to restore the level of funding available for ongoing programs. If the fund is continued, and annualized each year as originally planned, it should provide some measure of stability for ongoing programs, and perhaps allow BIA to distribute more of the funds early in the fiscal year.

CHAPTER 7

IHS Implementation of Contract Support

In 1975, the IHS had some experience with indirect costs and the Department (formerly HEW, now HHS) had a great deal through its dealings with hospitals and universities. This contributed to a better experience with the IHS than the tribes had with the BIA.

The IHS established a separate budget called *"Public Law 93-638 implementation funds"* in 1977. While it was included within the Hospitals and Clinics portion of the budget and was not easily tracked, it contributed to the implementation of contracts and stability of their funding. As contracts were entered into at the Area level, the Headquarters would transfer funds for indirect costs to the Area office on a *recurring* basis. Unused funds were used by Headquarters and the Area offices for non-recurring projects so that the budget for the following year was available to finance indirect costs as tribes assumed more programs. This ensured that the Area would have the funds in the following years to finance the ongoing costs of the contracts. For the most part, IHS funded full indirect costs during the first several years, but began to fall behind in the early 1980's.

Tribes expressed some dissatisfaction over IHS officials' unilateral decisions about what they would and would not consider in calculating indirect costs. In some cases, officials would disallow items that should have been used as a basis for calculating indirect costs, thereby reducing the amount recoverable to something less than what the tribe was entitled to. In most cases, fortunately, the differences were not terribly significant. And some tribes indicate that they were able to prevail in the negotiations by educating IHS officials on how their indirect cost rate was typically negotiated.

Shortfalls in Contract Support

While not always providing enough funds within its budget to fund indirect costs, the IHS has fortunately been able to utilize other available funds to supplement needs in years when additional appropriations were not made.

Figure 7-A on the next page indicates the Congressional appropriations made available for indirect and contract support costs each year since 1977. While difficult to interpret in the earlier years, immediately following the 1988 amendments the IHS began breaking out the contract support funding within its annual budget justifications. Amounts being shown as available within the budget justification crosswalk tables were overstated for a number of years. However, in more recent years the IHS has correctly stated the amount of contract support in the budget and has reconciled its recurring allocations to its annual appropriation. Today, recurring allocations to the Area level can be reconciled to the total budget being submitted to Congress.

Implementing Contract Support

When Congress enacted the Indian Self-Determination Amendments of 1988, IHS had already established ongoing dialogue with tribes on the contract support issue and was well positioned to implement the new funding provisions. In fact, understanding the cost of doing business and having experience with indirect costs with other organizations, the Department of Health and Human Services made individuals available to assist IHS in implementation. A federal/tribal work group on contract support was formed, informally at first, to address the need to improve the administration of contract support. Written instructions

IHS CONTRACT SUPPORT APPROPRIATIONS
(DOLLARS IN THOUSANDS)

Fiscal Year	President's Budget	Appropriations: For Ongoing Programs	Appropriations: For ISD Fund	Appropriations: Total Available
1977	*	6,000		6,000
1978	*	6,000		6,000
1979	*	6,362		6,362
1980	6,725	6,725		6,725
1981	16,528	16,528		16,528
1982	16,528	16,528		16,528
1983	16,528	16,528		16,528
1984	16,528	16,528		16,528
1985	16,528	16,528		16,528
1986	16,528	19,028	2,500	19,028
1987	19,028	19,028		19,028
1988	19,028	19,028		19,028
1889	49,600	23,701 [1]		23,701
1990	49,497	46,414 [2]	2,469	48,883
1991	83,171	79,511 [3]	2,500	82,011
1992	121,793	87,369	2,500	89,869
1993	103,910	93,058	7,500	98,605
1994	110,686	128,686 [4]	7,500	136,186
1995	143,433	137,960	7,500	145,460
1996	161,174	147,340	7,500	154,840
1997	200,955	153,220	7,500	160,720
1998	172,720			

1 The amount reflected in the budget request was overstated substantially, later the amount shown as appropriated was reported to Congress as available and obligated within Tribal contracts for 1989, became Area base amount.

2 Includes $22.7 million for Indirect Shortfall, of which $1.7 million was used to fund new contracts.

3 Includes $22.4 million for direct contract support costs to adjust base for pre-1988 ongoing contracts, of which $18.2 million was allocated as recurring direct contract support. The balance was used to fund indirect costs associated therewith and about $1 million of new and expanded contracts.

4 Includes $23 million for indirect cost shortfall.

* Information not available.

Figure 7-A

were developed and the Indian Health Service immediately implemented the new contract support funding provisions.

With an Indian Self-Determination Fund in place, tribes were now able to request both direct and indirect contract support funding when they were ready to take over an additional program. This provided the necessary funding to make contracting a viable option for many tribes, and the contracting activity began to expand.

The implementation policy within IHS provided that tribes would be served on a first come-first serve basis until each year's ISD fund was exhausted. Soon tribes recognized the need to plan ahead and to prepare their applications for new programs a year or more in advance. They began to submit their applications early to contract. The Appropriations Committees began requesting information about the waiting list when making appropriation decisions, adding more to the ISD fund to ensure that new contracts could move forward.

In addition to the ISD fund, IHS also recognized that those tribes who had contracted prior to 1988 had been at a disadvantage. They had received no funds for the direct contract support costs that the law now required. Working with tribes, IHS documented and justified $44 million in direct contract support costs. OMB agreed to add $22.8 million to the IHS budget to make a recurring increase to the programs under contract that were assumed prior to 1988. Congress appropriated the increase and it was distributed in 1991. Congress also added funds as shortfalls were identified and reported to meet indirect cost requirements.

The formal policy that IHS utilizes to guide the administration of contract support has been updated several times. It was most recently published as Indian Health Service Circular 96-04 *(see Appendix E)*. One of the most vital characteristics of the IHS policy is stability. Funds for ongoing contract support costs are considered part of the Area funding base. This means that the Area offices can always count on at least what they received last year, unless Congress trims the budget. Tribes, likewise are always entitled to what they received the previous year unless their rate dictates a lesser amount. While there may be shortfalls, a tribe can depend on a certain amount of funds, but the tribe may not be immediately rewarded with more funds if its indirect cost rate increases. Mandatory increases (for inflation) provided for at the national level are utilized first to balance out the funding needs between Area offices to keep overall requirements funded on an equitable basis nationally. This may be augmented if Congress provides shortfall funds. The system has been in place since 1988 and is stable and predictable. The IHS/Tribal Contract Support Work Group is convened routinely to review how the system is working. Policy recommendations are crafted to facilitate tribal consultation as the process evolves.

Self-Determination Activity Increases

When Congress amended the Indian Self-Determination Act in 1994, changes were also made to Title III, to permit ten more tribes per year to enter into the Self-Governance Demonstration Project. Title 1 of the Act, which covered contracting, was changed to incorporate a new standard agreement. The new provisions made it clear that the contract was a "government-to-government" agreement in which the government was to transfer the funds and responsibility for program operations to tribes, and they were to have maximum flexibility in the design and operation of programs. Tribal authority for rebudgeting and other issues were expanded and many previous reporting requirements were removed. Self-governance compacts transferred even more flexibility and authority to the tribes.

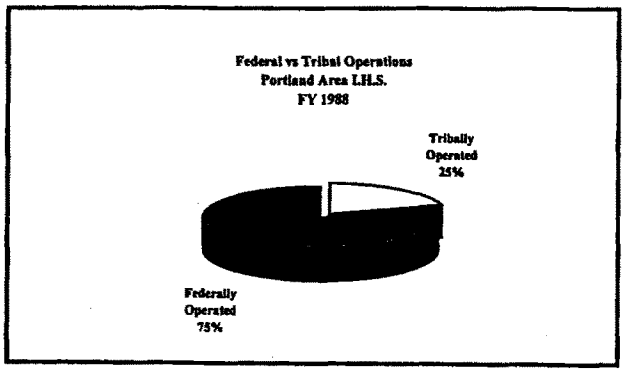
With the flexibility and authority available to redesign programs to better meet the needs in their communities, and with an effective system in place for determining and financing contract support costs, many more tribes decided to assume the operation of programs under both contracts and compacts. The list of tribes waiting for the ISD fund grew rapidly. Now being funded at $7.5 million per year, the ISD fund could no longer keep up with the demand. By January of 1997 the contract support requests awaiting funding for new (or expanded) contracts and compacts had grown to $36 million, after exhausting available funds for FY 1997. Meanwhile, the IHS budget for 1998 contains only $12 million. In a letter to the Senate Committee on Indian Affairs written in April of 1997, the Director of the Indian Health Service pointed out that $75 million was actually needed. $60 million would be needed to finance the existing waiting list and those other new agreements anticipated for the balance of 1997 and 1998. $15 million was attributable to a shortfall in contract support for indirect costs associated with ongoing contracts and compacts.

Today a very significant portion of the total Indian Health Services appropriation passes into tribal self-determination contracts and self-governance compacts. According to Indian Health Service budget justifications, just under 23% of the total non-construction appropriations were obligated under self-determination contracts in 1988. Estimates for 1998 indicate that over 40% of the non-construction appropriations will be obligated to self-determination and self-governance agreements.

Recent Appropriations Concerns

Congressional language within the appropriations report accompanying the 1997 budget indicate a misunderstanding regarding the increases which have been provided and which are needed for contract support. The language leads to the impression that indirect cost rates are thought to be driving the increased requirements for contract support and that tribes may not be streamlining administratively. In fact, as IHS has recently reported to the Committees, the bulk of contract support increases is due to new programs being assumed. There are also a number of reasonable explanations for the additional amounts needed to finance indirect costs associated with ongoing contracts and compacts. For one, mandatory increases for contract support haven't matched increases in other programs. Additionally, many indirect costs are fixed and the tribes don't have full control, such as rent and utilities. A review of tribal rates for the Northwest indicates that they have actually gone down in aggregate. However, the volume of overall programs being operated by tribes has increased dramatically. Figure 7-B on the next page reflects the portion of the Portland Area resources being operated under self-determination agreements and self-governance compacts in 1988, the year of the amendments, and in 1996.

Federal vs Tribal Operations
Portland Area Indian Health Service



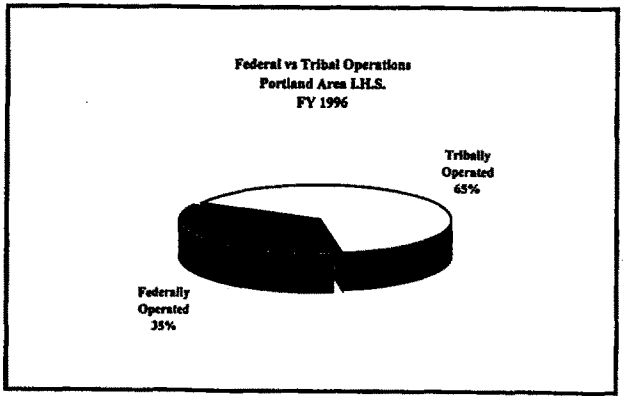


Figure 7-B

Conclusion

The IHS has developed and adopted written policy to guide implementation of the funding provisions of the Self-Determination Act. The policy has been updated to be consistent with the most recent amendments to the Act. It has supported a system for stability of financing for ongoing contracts and compacts. It has also provided an understandable system for financing contract support for tribes wishing to enter into agreements.

Contract Support requirements associated with new program assumptions under contracts and compacts have accelerated, creating a demand for new contract support funds in excess of amounts made available through appropriations.

An increase of approximately $75 million is needed in 1998 to finance contract support requirements, of which the vast majority is associated with new and expanded contracts and compacts. Only $12 million of this need is reflected in the President's budget currently being reviewed by Congress.

CHAPTER 8

Addressing the Future

This is an educational publication, so a review of what has been learned in the first seven chapters is appropriate:

- Indian Self-Determination has been a bipartisan policy, which has proven successful in the development of tribal government capacity, following two centuries of failed Indian policy.
- A major part of the Indian Self-Determination Policy supports the transfer of the responsibility for operation of federal Indian programs, services, functions and activities to tribes as they are ready to assume them.
- Congress has recognized, within the Indian Self-Determination Act, that additional funds to finance contract support costs are needed to implement the transfer from federal to tribal operations. Also, that there are unreported savings elsewhere in the federal system as these transfers occur.
- Tribes negotiate indirect cost rates which are used, in part, to determine the amount of contract support costs required as they accept the transfer of the responsibility for the operation of programs and the funds associated with them.

- Indirect cost rates are used by states, local governments, universities, hospitals, defense contractors and others, and Indian tribes under a system of cost allocation that has been in place since long before the Indian Self-Determination Policy.
- Many have questioned this indirect cost system and struggled with it, but no replacement system has been found.
- Indian tribes are the latest players in the game, and are required to play by the same rules as everyone else.
- There are other contract support costs referred to as "direct contract support" costs that have been identified and funded by the IHS. BIA has neither identified them nor recommended appropriations for them.
- Despite the funding problems experienced by tribes in implementing the Act, many have chosen to operate all or part of BIA and IHS programs. As Congress has corrected some of the funding problems and removed other obstacles there has been increased assumption of programs by tribes, and they continue to assume more each year. Accordingly, the funding needed for contract support increases.
- Lack of current and accurate information has contributed to poor results in terms of budgeting and appropriating needed funds for contract support.
- The Appropriations Committees are facing tight budget ceilings. Yet there are a number of tribes, representing a large amount of new contract support funding requirements, with applications pending to assume additional programs. Future cost projections aren't available.
- Absent adequate funding, there is little incentive for tribal governments to assume the responsibility to deliver services. Particularly if services must be reduced in order to do so. Politically speaking, it wouldn't make sense.

The above points summarize the history and current issues, but don't solve any problems. Congress is still faced with a funding dilemma without the information needed to address it. One thing seems certain – the system of the future must be credible and

informed, or else it's going to be difficult for Congress to fund it. So what are some possible solutions?

Start With Better Information

Whether it is to support appropriations or to help craft improvements to the system, the parties need improved information. The BIA and IHS have neither the positions nor the systems to collect and report the information needed. The Inspector General has some of the data, but tribes must be relied on for som of it too. How can it be gathered?

Appropriations Committee Reports have, for several years, suggested that the two agencies need to get together with the tribes and the Inspector General to work on the issues surrounding indirect and contract support costs. Recently, at the invitation of the Indian Health Service, some contact has been established between all parties. Both agencies are thinly staffed, and the Office of the Inspector General is typically behind in negotiating rates, due to the sheer number of them and a limited staff. But reproducing the analysis that is presented in Appendix A would be as simple as asking each tribe to provide the extra information each year when they negotiate their rate. A national database could easily be constructed to capture and report the information. Tribes will need to take the lead in this situation if they are to see their needs served.

Some of the issues to be explored might be: 1) How can assurance be provided that the system is fair and that costs are justified cyclically so that Congress can be assured regarding the use of appropriations? 2) What can be done to improve the cost projections for both ongoing and new and expanded agreements, so that accurate multi-year estimates can be provided? 3) What can be done to measure some of the offsetting budget savings and other benefits that accrue to the federal government as tribes assume more programs?

Improve the Credibility of Indirect Costs

Two things are clear. First, the legitimacy of indirect cost rates has been questioned and is a difficult concept for people to understand. Second, concern and lack of understanding have contributed to some of the problems experienced in implementing Self-Determination. If all the parties to this process could agree

Unfortunately, BIA's suggested alternatives, published in the Federal Register, involved a wholesale unilateral base transfer, whether tribes were ready or not. Tribal responses were not very friendly to the approach. Written BIA material represents the responses as being against moving contract support to TPA. Meanwhile a number of tribes supported the process recommended by the Task Force and would like to exercise their option. It is not likely, however, that the movement to implement this option will come from the BIA at this point.

A similar initiative in IHS, the concept of "stable base funding" is being explored within the Self-Governance Demonstration Projects where tribes have assumed the vast majority of IHS programs. In this effort an amount of contract support is negotiated to be included within the tribes' self-governance funding base. This process is still being considered exploratory, but it would achieve the same end as was anticipated in the BIA, a single base of funds within which a tribe will manage its allocations between programs and between direct and indirect costs.

While these may not be the ultimate solutions or the only ones, they provide the tribes with the option and the initiative. This being an evolving process, they provide a starting point.

Reconcile Cost and Fund Allocation

When states and local governments, universities, hospitals, and even defense contractors negotiate, all of their costs are on the table and the funding source is a single one. The federal agencies finance costs from single budget lines. They don't have the equivalent of contract support. Contract support is a unique and necessary part of the Self-Determination Policy.

In all the other cases the federal government is either negotiating to buy goods or services, or providing assistance grants. There is no federal program being transferred to another government to operate, no need to ensure that the level of program services isn't diminished in the process, and no offsetting unreported savings in the federal system because the federal government no longer operates the program services.

Funds for self-determination agreements are allocated from two budget line items because of their unique nature. Contract support is one of the line items, and the program line item involved is the other. Contract support costs are to finance those costs not financed by the program allocation. If contract support funds weren't

that indirect costs are legitimate, that problem would be easier to dispense with. But, how do we know that the costs being negotiated by the Inspector General are reasonable and necessary? Certainly the rules say they are supposed to be. The tribes think they are. Shouldn't an independent third party be asked to review this issue? A recent GAO study of colleges and universities *(GAO/RCED-95-74, March 1995)* provides an example of what such a review might look like. Such a study should be broad and answer a number of questions. How do tribal indirect costs stack up against those of other organizations? How does the quality of tribal facilities and systems stack up against others? Most importantly, how does the financing of these costs impact on the development of tribal capacity, a key element of the intent of the Self-Determination Policy?

Review the Fund Allocation System

Earlier chapters point out that the notion of separating funding allocation from cost allocation has been attempted in the past and hasn't worked. But the reason it hasn't worked is because the attempted fix was quick, arbitrary, unilateral and potentially disruptive. The Self-Determination process is supposed to be government-to-government, evolving, bilateral and non-disruptive. One objective is strong and stable tribal governments. The beginnings of a solution have been under way in both the BIA and IHS for ongoing programs.

In the BIA an effort was made to move contract support funding to the Tribal Priority Allocations (TPA) portion of the budget. That's the portion that is supposed to be identified specifically with tribes. A process laid out by the Joint Tribal/DOI/BIA Task Force on Bureau of Indian Affairs Reorganization would permit tribes, as they were ready, to accept their contract support costs into their base TPA budget and no longer be involved in annual allocations based on indirect cost rates. Essentially, they would have a single lump sum base of funds and budget both their indirect and direct costs themselves within it. This would be most appropriate for tribes who have contracted the majority of programs and have stable rates. Then several years' averages could be negotiated as a funding base.

This solution wouldn't be practical yet for tribes who are relatively new to contracting or haven't seen their rates stabilized yet. BIA began to implement this process in 1995 and 1996.

allocated on the basis of indirect costs, then rates might not be as big of an issue. But they are, and no one has come up with a better system. The appropriate task is to make sure the allocation on the basis of these rates is fair and reasonable. How can that be done? For one, make sure that the system fully implements the contract support funding provisions that prohibit any duplication. The system was designed based on how the agencies budget and allocate funds. A change in allocation processes may change how the system works. For example, if a tribe includes all facilities costs in its indirect costs, then an agency begins allocating funds for facilities directly, someone needs to make sure that those funds are applied toward the indirect costs thereby reducing requirements, instead of creating even larger requirements. This requires looking at each tribe's rate to see how the funds should be handled. Though subtle this difference could add up to real dollars.

When the Inspector General negotiates, he/she has no knowledge of funding allocations. The agencies have little specific information on the cost allocations. In the current system the agencies and the Inspector General can't see everything on the other side of the agreement. It's like playing checkers but only seeing half the board. The IHS policy addresses this issue, but real coordination will be needed with the Inspector General. Tribes can help by making sure that they document and display how their funding allocations are applied.

Design Solutions in Partnership

The history of funding the implementation of the Self-Determination policy is available for review to those with an interest. Chronologically, from the Presidential and Congressional intent at the outset, through budget submissions, regulations, testimony, appropriations and amendments to the Act, and their respective reports, they are all a matter of public record. Appropriations report language provided in Appendix C and D highlight the dialogue on contract support. A few things stand out. Congress requires and is most responsive to good information. Arbitrary unilateral solutions haven't helped the process. Federal/tribal partnership seems to get results, and the current day realities faced by all the parties call for partnership efforts. This publication seeks to provide a common basis of understanding to help in the dialogue.

APPENDIX A

Northwest Tribal Indirect Cost Rates

Lack of understanding and misconceptions about indirect cost rates has had a negative impact on the willingness to fund them over the years. As pointed out earlier, described simply as indirect costs, they seem somewhat nebulous. One objective of this report is to provide a better understanding of what makes up indirect costs. Another is to measure trends in the indirect cost rates and the components of cost that they represent. To support preparation of both editions of this report, an analysis of Northwest tribal indirect cost rates was completed. Analysis of a similar nature was completed recently by the Department of Health and Human Services on the indirect cost rates of Colleges and Universities. Part of the results of that analysis is also presented for comparison with Northwest tribal indirect cost rates.

The Analysis

The analysis prepared in 1987 was repeated for all tribes served by the Portland Area Indian Health Service and Bureau of Indian Affairs. Originally tribes were asked to distribute their fiscal year 1985 indirect cost pool between the 22 categories listed in this appendix. (These categories are defined in Appendix B). Tribes

were asked to update this information for 1993-1996. In addition, they were asked to provide information showing their total indirect cost pools, total direct cost base and the source of their funding.

Information was gathered from the indirect cost agreements for 42 tribes for years 1979 to 1996. Of the 42 tribes, 27 (representing 82 percent of the total dollars involved) provided full information. Partial information, including the total dollar amount of indirect cost pools and source and total amount of direct cost bases, was obtained from indirect cost agreements of the remaining tribes.

Results of the Analysis

Exact information was not expected. Amounts provided were based on negotiated agreements and total contracts, which are based on projected funding and budgets. Actual spending obviously differs from projected budgets. However the information gained, while not one hundred percent precise, does support numerous conclusions and observations.

- Average indirect cost rates trended consistently upward from 1979 to 1992 and then began to level off and drop slightly. Figure A-1 on the next page presents the rate averages since 1979.

- Fifteen new tribes were added from 1979 to 1993. These tribes achieved federal recognition, or restoration of their status in the case of previously terminated tribes. Most have little or no land and had no federal facilities available to occupy.

- The presence of stable rates among larger and more established tribes, with larger amounts of funds involved, accounts for the weighted averages being lower than the numeric averages.

Northwest Tribal Indirect Cost Rates
1979-1996

Year	Number of Tribes	Numeric Average %	Weighted Average %	Average Indirect Cost Pool $ in 000's	Average Direct Cost Base $ in 000's
1979	27	23.2			
1980	28	26.7			
1981	31	30.4			
1982	33	34.7			
1983	32	35.0			
1984	33	35.0			
1985	35	36.2	38.2		
1986	35	36.3			
1987	35	34.0			
1988	38	37.2			
1989	39	38.7			
1990	40	40.6			
1991	42	42.8			
1992	41	43.2			
1993	42	39.5	32.7	1,336	4,097
1994	42	39.0	32.2	1,526	4,744
1995	42	38.2	31.5	1,744	5,545
1996	42	38.7	33.8	1,981	5,892

Figure A-1

- Rates for 1987 ranged from a low of 10.2% to a high of 82.3%. For 1996 they ranged from a low of 11.6% to a high of 62.9%. A small increase was noted in both numeric and weighted rates for 1996 which is likely a reflection of reduction in the BIA budget for that year. Many indirect costs are fixed and therefore don't reduce proportionate to direct costs. Only 24 tribes report having established rates for 1997. Both increases and decreases are reported, and the number is insufficient to establish what the trend will be for the current year.

- Figure A-2 points out the relative portion of indirect cost pools which are applied to each of the categories. Some tribes (particularly small tribes) combined multiple functions, such as procurement and property management, under a single category like financial management. In that regard, the information is not precise.

DISTRIBUTION OF NORTHWEST TRIBAL INDIRECT COST POOLS

	Percentage of Indirect Pool 1995	1996
FACILITIES AND EQUIPMENT		
Building Rent/Lease Cost Recovery	1.46	5.09
Utilities	6.41	6.04
Housekeeping/Janitorial	3.99	4.20
Building and Grounds Maintenance	5.34	6.19
Security	0.44	0.97
Equipment	3.07	1.58
Subtotal	22.71	24.07
MANAGEMENT AND ADMINISTRATION		
Governing Body	7.23	6.32
Management	11.12	14.90
Planning	3.63	4.91
Financial Management	12.30	12.74
Personnel Management	3.23	3.89
Procurement/Materials Management	2.66	1.81
Human Resource Management	1.90	2.00
Property Management	3.01	1.03
Records Management	0.97	0.90
Data Processing	4.83	5.24
Office Services	7.64	6.52
Subtotal	58.52	60.26
GENERAL SERVICES AND EXPENSES		
Insurance and Bonding	4.30	3.49
Legal Services	4.75	3.82
Audit	3.38	1.87
General Support Services	3.88	3.82
Miscellaneous and Other	2.36	2.67
Subtotal	18.77	15.67
TOTAL	100.00	100.00

Figure A-2

- Figure A-3 reflects the weighted average of the tribal indirect costs for facilities and administration. This compares favorably with a recent Department of Health and Human Services analysis of 118 colleges and universities which accounted for over $14 billion per year in federal research grants, presented in Figure A-4.

WEIGHTED AVERAGE INDIRECT COST RATES
FOR 42 NORTHWEST TRIBES

	Fiscal Year				
Rate Category	1985	1993	1994	1995	1996
Facilities *	7.5	6.9	6.8	6.6	7.6
Use Allowance and depreciation including rents and leases	0.6	1.2	1.3	1.3	1.7
Operations and maintenance	6.9	5.7	5.5	5.3	5.9
Administration **	29.8	24.9	24.2	24.2	25.3
Other ***	0.9	0.9	1.2	0.8	0.9
Total Average rate	38.2	32.7	32.2	31.5	33.8

* Includes all Facilities and Equipment Items from Figure A-2 except Equipment.
** Includes all Items except Facilities and Miscellaneous and Other from Figure A-2.
*** Includes Miscellaneous and Other from Figure A-2.

Figure A-3

- For colleges and universities, OMB Circular A-21 broke the indirect cost rates in to two parts beginning in 1991. A facilities rate and an administrative rate are now utilized. The administrative rate for universities is capped at 26%.

WEIGHTED AVERAGE INDIRECT COST RATES
FOR 118 MAJOR RESEARCH UNIVERSITIES

	Fiscal Year				
Rate Category	1988	1992	1993	1994	1995
Facilities	19.4	22.4	23.6	23.7	23.7
Use Allowance and depreciation	5.0	7.1	8.1	8.2	8.3
Operations and maintenance	14.4	15.3	15.5	15.5	15.4
Administration	26.4	26.4	24.7	24.6	24.8
Library	2.2	1.9	1.9	1.8	1.8
Other *	0.8	0.4	0.2	0.3	0.2
Total Average rate	48.8	51.1	50.4	50.4	50.5

* Includes carry forward of costs from prior years, costs of special service centers, and other unspecified costs.

Source: U.S. Department of Health and Human Services

Figure A-4

- The comparison of tribal rates with university rates is not an exact apples to apples comparison because the tribal analysis did not break out the facilities costs included within the categories for insurance, procurement, etc. However, the comparison is useful in considering the reasonableness of tribal costs.
- Low tribal cost of *facility use allowance* are likely a reflection of federally constructed facilities, failure to recover costs and poor facilities needing replacement.
- Economies of scale were reviewed to see if there is a pattern. There are significant differences in the amounts of funds administered by Northwest tribes. The amounts within their 1996 direct cost bases ranged from a low of $550,000 to a high of $30 million. Figure A-5 provides a comparison of indirect cost rates based on the relative size of the direct cost base. Note that due to the relatively small number of tribes involved, a major shift in rate for a single tribe, usually as a result of a carryover adjustment, can impact the overall averages noticeably.

AVERAGE INDIRECT COST RATES BY SIZE OF DIRECT COST BASE
FOR 42 NORTHWEST TRIBES

Size of Direct Cost Base		Fiscal Year			
		1993	1994	1995	1996
Less than $1 million	#	15	11	7	7
	Avg	41.5	42.6	45.2	38.5
More than $1 million, but less than $5 million	#	17	17	18	17
	Avg	41.4	44.0	41.8	44.3
More than $5 million, but less than $10 million	#	6	9	12	12
	Avg	32.6	33.0	32.8	36.2
More than $10 million	#	4	5	5	6
	Avg	26.0	27.5	25.1	30.3
Overall Numeric Average Rate	#	42	42	42	42
	Avg	38.5	39.0	38.2	38.7

Figure A-5

- Another trend of interest is the relationship of the amounts from different funding sources. As the tribes have taken over more of the Indian Health Service operations and added more of their own resources to the equation, the Bureau of Indian Affairs funding has become a smaller portion of their overall funding, as have other federal and state sources. Figure A-6 shows the proportionate percentage of tribal direct cost bases coming from each source.

PROPORTIONATE SOURCE OF DIRECT COST BASE
FOR 42 NORTHWEST TRIBES

	Fiscal Year				
Size of Direct Cost Base	1985	1993	1994	1995	1996
	%	%	%	%	%
Bureau of Indian Affairs	36.6	37.2	33.9	32.5	28.9
Indian Health Service	*	19.0	21.4	25.2	28.4
Other Federal and State Sources	*	18.8	18.9	17.3	16.1
Tribal Resources	*	25.0	25.9	25.1	26.6
Total		100.0	100.1	100.1	100.0
Total $ in direct cost base, in millions	$57	$172	$199	$233	$247

* Information not available for this year

Figure A-6

APPENDIX B

Indirect Costs Defined

This appendix defines those cost categories which are commonly categorized as indirect costs. These items can be covered under either direct or indirect costs, depending on the organization doing the categorizing. For example, health care providers or educational institutions might list some of these items under direct costs. Most Indian tribal governments, however, will regard them as indirect costs.

Facilities and Equipment

-*Building Rent/Lease Cost Recovery* - Includes the costs of buildings which house programs and related support services. Includes rent or lease payments associated with providing the space, or if the buildings are owned, amortization or depreciation over the projected useful life of the building. Major renovations may also be amortized over their anticipated useful life. Property taxes are included where applicable. Note: The costs of tribally owned buildings which have been paid for with federal funds cannot be included, as this would result in a duplication of costs to the federal government.

-*Utilities* - Includes the costs of electricity, fuel, water, sewage and refuse removal necessary to the operation of buildings.

-*Housekeeping and Janitorial* - Includes the costs of routine care and cleaning of buildings.

-*Building and Grounds Maintenance* - Includes long-term care and repair of buildings, preventive maintenance, grounds keeping and snow removal.

-*Security* - Includes the costs of burglar and fire alarms, guards, surveillance and other security measures.

-*Equipment* - Includes purchase, replacement and cost recovery of capital equipment. Generally, the cost of equipment not directly related to contract work (e.g., equipment used for snow removal or janitorial services) can be recovered through indirect charges. Note: Most tribal indirect cost rates apply to "total direct cost less capital expenditures," meaning that the indirect cost rate is based on total direct costs *minus* the cost of equipment. For example, if a computer is purchased in association with direct costs, in order to perform work associated with a contract, the cost of that computer must be deducted from total direct costs *before* the indirect cost rate can be computed.

Management and Administration

-*Governing Body* - Includes tribal councils, executive boards or other bodies which are considered the governing body of tribes while acting in their role in support of programs. Includes advisory committees to councils where applicable. Note: Most tribes negotiate a portion of tribal council costs into their indirect rates while leaving out that portion which might relate to such activities as lobbying, litigation, legislation or any activities not directly related to program operations. Some councils operate in more of a management capacity than others, depending on the size and organization of the tribal structure; generally, including fifty percent of tribal council costs under indirect cost rates is a common practice.

-*Management* - Includes executive direction, general management and related policy planning and compliance functions. May include mid-management costs, depending on size and complexity of organization.

-*Planning* - Includes planning offices and management staff involved in long and short-term planning, as well as costs associated with developing formal plans and strategies.

-*Financial Management* - Includes all accounting, bookkeeping, comptrolling, internal auditing, overall financial management, budget planning and related activities (e.g., setting up accounts payable and receivable, coordinating payroll, banking, managing cash flow and financial reporting). Also covers staff involved in processing compliance measures and letters of credit, managing and processing grants and contracts, reporting and recordkeeping. Note: tribes are required to establish and maintain a financial management system which conforms to OMB Circular A-102, attachments G and H. Financial reports are expected to conform to generally accepted governmental accounting methods.

-*Personnel Management* - Includes recruitment and staffing, personnel classification, recordkeeping, benefits management, performance evaluation and EEO (Equal Employment Opportunity) Indian preference management. Also includes employment counseling, assurance of personnel compliance and other special functions related to staff management. (Staff development, however, falls under Human Resource Management.) Note: to be eligible to contract under Public Law 93-63S, tribes are required to establish and maintain personnel management systems.

-*Human Resource Management* - Includes employee training and career development activities, including general skill training.

-*Procurement/Materials Management* - Includes purchasing, receiving, inventorying, warehousing and distributing materials. Contract and subcontracting, as appropriate, are included. Note: tribes are required to establish and maintain property management systems which conform to OMB Circular A-102, Attachment N.

-*Records Management* - Includes activities involving the management of current and cumulative records and filing systems. Includes retention scheduling, storage, micro film library management, etc. Note: tribes are required to establish and maintain records management systems which conform to OMB Circular A-102, Attachment C.

-*Data Processing* - Includes central information support, including system analysis, programming costs, the cost of employing computer operators, etc.

-*Office Services* - Includes general clerical supplies and personnel required for typing, copying, reception, telephone answering services, mail management and general office management.

General Services and Expenses

-*Insurance and Bonding* - Includes all types of insurance, such as fire, hazard, theft, general liability, director's liability, employee fidelity bonds, auto liability and comprehensive insurance. Also includes insurance management functions such as managing insurance costs, administering claims if self-insured, handling claims and exposure analysis, and malpractice liability coverage for functions related to providing health care, counseling, emergency medical care, etc.

-*Legal Services* - Includes reasonable expenses to retain legal counsel for activities related to the operation of programs. Includes policy, contract and other review. Basically, administrative in nature. May involve employee relations, grievances, etc.

-*Audit* - Includes anticipated activities to provide required audits under provisions of OMB Circular A-128, which implements Public Law 98-502. Audits include review of compliance with grants and contracts, examination of financial statements and systems, provision of systems certifications required by the federal government, independent review of indirect cost proposals and general assistance in developing and improving financial systems.

-*General Support Services* - Includes costs for outside services, including photocopying, transportation costs or communications costs not otherwise allocated.

-*Miscellaneous* - Includes costs not categorized above, but not allocatable to individual programs.

APPENDIX C

Appropriations Committee Direction to BIA

Reports on Appropriations for FY 1987

U.S. House of Representatives
Supplemental Appropriations Bill

"Bill language has also been included prohibiting BIA from proceeding to implement any proposed initiatives which have not yet been reviewed or approved by the Congress. The examples of such initiatives cited in the language are the implementation of a flat fifteen per cent administrative fee on P.L. 93-638 tribal contractors... ".

U.S. Senate
Supplemental Appropriations Bill

"The House also included bill language prohibiting the BIA from proceeding to implement any proposed initiatives which have not yet been reviewed or approved by the Congress, such as implementation of a flat 15 percent administrative fee on Public Law 93-638 tribal contractors. The Committee is somewhat encouraged by recent

testimony indicating that the BIA has dropped the flat 15 percent administrative fee for some as yet unspecified alternative proposal."

"While the Committee has retained the bill language proposed by the House, the Bureau may continue preparatory work during the remainder of the current fiscal year, such as briefing interested parties and the Congress, consulting with Indian tribes, and preparing, but not publishing, draft or proposed regulations. No implementation of the initiatives may occur until Congress has made a final determination on the proposed initiatives during consideration of the fiscal year 1988 regular appropriation bill."

Reports on Appropriations for FY 1988

U.S. House of Representatives

"A decrease of $1,000,000 is recommended for self-determination services. Included is an increase of $2,000,000 for contract support of which $500,000 is for the expected shortfall in fiscal year 1987. It is likely this is the minimum amount that will be needed as a result of the Bureau's decision not to implement a flat 15 percent administrative fee on tribal contracts, on which the budget request was based. Bill language has also been included prohibiting the implementation of any changes in the method of funding tribal contractor indirect costs, including imposition of a flat rate during fiscal year 1988. If the amount provided for contract support is not adequate, the Bureau is directed to submit a request for the additional amount required, through supplemental appropriation or reprogramming, as soon as the shortfall is known."

U.S. Senate

"For self-determination services, in order to further encourage tribal capacity to contract for the operation of BIA programs, the Committee recommends an additional $2,000,000 over the President's request for contract support funds."

"While the Committee appreciates the Bureau's concern over the inequity and inadequacies of the current method of funding contract support in accordance with the guidelines provided in OMB Circular A-87, the proposed flat administrative rate is not supported. The Bureau is encouraged to further study other possible ways of funding the administrative support costs of tribal Public Law 93-638 self-determination contracts in order to avoid the financial losses incurred

by tribes in the cost recovery determinations, including a lump sum approach. A report to the Committee on such alternative methods which may be considered should be made prior to implementing changes."

Committee on Conference

"Bill language has been included providing that not less than $47,787,000 shall remain available until expended for contract support for contracts entered into under Public Law 93-638."

"The managers have provided sufficient funds, based on current BIA estimates, to provide full contract support costs for all P.L. 93-638 contractors based on negotiated indirect cost rates. If it appears there will be a shortfall during the year, the Bureau should promptly notify the Appropriations Committees, along with a proposal to meet the funding shortfall."

Reports on Appropriations for FY 1989

U.S. House of Representatives

"There is an increase of $10,000,000 for contract support. This will restore the program to the 1988 level (+$1,500,000), fund the currently identified shortfall of $5,500,000, and will allow an increase of $3,000,000 related to program increases recommended in this bill. The Committee has provided funds under the Office of the Secretary to allow that office to continue to prepare for the transfer of indirect cost negotiations from the Inspector General in fiscal year 1990. It is expected the IG will continue to be responsible for this activity during fiscal year 1989, and that the Office of the Secretary will provide for consultation and will work with the tribes in preparing to take over this function in fiscal year 1990."

U.S. Senate

"As in previous years, the Committee remains concerned about the Bureau's commitment to self-determination, as evidenced in the inadequate request for contract support costs. Full funding for these costs is a key factor in providing tribes with sufficient opportunity to offer services to their members. Delays in making appropriated funds available to the area offices, and therefore the tribes, further plague the contracting process. The delay in distributing contract support

funds results in tribes being forced to use their revenues to cover expenses that should be paid from their indirect cost pool. This causes cash flow and financial management problems for tribal governments which could be avoided. These delays in turn affect both the tribes' ability to pay for annual audits and submit and negotiate new cost rate proposals.

The Bureau is aware of a contract support shortfall in fiscal year 1988, but has failed to notify the Committee, as directed in the fiscal year 1988 report, of a proposal for addressing the funding shortfall. To address fiscal year 1989 contract support needs, the Committee recommends an appropriation of $57,866,000, an increase of $12,000,000 over the request. None of this increase is intended for contract monitoring."

Committee on Conference

"The managers expect the Office of the Secretary to consult and work with tribes in preparing to take over the function of indirect cost negotiations beginning in fiscal year 1990."

Reports on Appropriations for FY 1990

U.S. House of Representatives

"For self-determination services, there is an increase of $7,000,000, which restores contract support to the 1989 level, and adds $3,000,000 more for the increased levels of contracting that will result from recommendations in this bill."

"Additional Items. - The Committee has included $77,000,000 in budget authority only, which is the estimate of funds needed by the Bureau to carry out the requirements of section 204 of Public Law 100-472, the Indian Self-Determination and Education Assistance Act Amendments of 1988. Under this section, the Secretary is required to use the calendar year as the basis for contracts and agreements with Indian tribes, which will require additional budget authority in fiscal year 1990 to cover the extra quarter year for all such contracts. Bill language has also been included to provide these funds for this purpose."

U.S. Senate

"The Committee has not included funds, as proposed by the House, to initiate conversion of tribal contracts to a calendar year basis. The Committee directs the Bureau to report back, by March 1, 1990, regarding the logistical and accounting needs for such a conversion. It is the Committee's understanding that only existing contracts would be converted, and every time a new contract is issued, additional conversion would be necessary. Thus, the Bureau report should also address the option, and costs, of converting the entire Bureau budget to a calendar year basis."

Committee on Conference

"With respect to contract support funds provided to the Bureau of Indian Affairs, the managers direct the Bureau and the Inspector General to take steps to notify tribes that indirect cost rates may be negotiated to include the administrative costs of operation of tribal departments of education."

"For tribal contract conversion funds, the managers have provided $54,000,000 in budget authority. It is the intent of the managers that these funds not be expended until the Bureau reports, by March 1, 1990, regarding the logistical and accounting needs of this conversion. Potential future conversion costs should also be analyzed.

Reports on Appropriations for FY 1991

Department of the Interior and Related Agencies

"The Committee is very concerned with the failure of the current Indian Priority System to meet the needs of the Tribes in preparing adequate budget requests to be submitted to the Congress. Therefore, the Committee directs the Department to establish a Task Force to review and improve the Tribal budgeting and priority setting process of the Bureau. The members of the Task Force should include Tribal as well as Bureau and Departmental representatives, and should be asked to submit their recommendations for a new system to the Congress by April 1, 1991.

It is also apparent from the magnitude of requests from Tribes to the Committee that the historical allocations of funds in the Bureau budget is not based in many cases on any rational standard of need, such as population, land base, resource requirements, etc. Therefore, the Bureau is directed to undertake a needs assessment and equity study of the 80 percent of funds which the Bureau claims is made available from every Bureau budget at the local level, in order to determine what the level of unmet need at each location is, and to establish a basis from determining the equitable allocation of any increases in funds which may be made available in the future. This report should be submitted to the Committee by March 1, 1991."

U.S. House of Representatives

"The Committee recommends an increase of $9,000,000 for contract support. A portion of this, approximately $5,000,000, represents the amount of shortfall expected in this account in 1990, which will continue into 1991, and the balance is due to the increased program levels included in the Committee's recommendations, which will result in increased P.L. 93-638 contracting."

U.S. Senate

"Under self-determination services, the Committee recommends an increase of $9,000,000 in contract support funds. This level includes $5,000,000 to address the shortfall experienced in fiscal year 1990 that would continue in fiscal year 1991, and $4,000,000 associated with additional contract programs included in the Committee's recommendations."

Reports on Appropriations for FY 1992

U.S. House of Representatives

"Under self-determination services, there is a net decrease of $4,000,000. Included is an increase of $2,000,000 for contract support costs, and a decrease of $1,000,000 for employee displacement costs. There is also a decrease of $5,000,000 for self-determination grants. The Committee supports the efforts of the Bureau to reinstate this program, but could not agree to the entire increase of $9,000,000 due to the budget constraints with which it is faced. The amount of increase allowed will double the size of this important grant program, which will

enable more tribes to plan and build tribal capacity to design and administer their own programs."

U.S. Senate

"The recommendation for self-determination services includes a decrease of $9,000,000 for self-determination technical assistance grants, an increase of $2,000,000 for contract support costs, and a decrease of $1,000,000 for employee displacement costs. The Committee is unable to provide for the requested increase for self-determination technical assistance grants due to budget constraints at this time. The Committee has opted to focus its limited increase in funds to direct programs operated by the tribes."

Reports on Appropriations for FY 1993

U.S. House of Representatives

"Non-Recurring program.-An increase of $10,050,000 is included under tribal government. Of this amount, $10,000,000 is for contract support, to meet the shortfall identified in fiscal year 1992 by the Bureau. The Committee is concerned that the Bureau has not yet reported this shortfall to the Congress, as required under the amendments to Public Law 93-638, and has yet to submit its plan to make up this shortfall in the current year. If the increased funds are not provided, the shortfall will continue into 1993, contrary to the requirements of the law."

Reports on Appropriations for FY 1994

U.S. House of Representatives

"The budget estimate includes an increase of $25,000,000 to make up a shortfall in contract support funds, currently estimated to be $17,000,000; and to provide additional contract support funds for the additional program funding included in the budget. The Committee has agreed to this increase, but recognizes that this amount does not include specific funds for new contracts. Such funds are provided under the Indian Health Service through a self-determination fund, and the Committee believes the Bureau should establish such a fund in fiscal year 1994, if sufficient funds are available, or in its fiscal year 1995 budget request."

U.S. Senate

"Within tribal government, an increase of $4,171,000 is recommended. The Committee recommends an increase of $1,000,000 for contract support, which represents a net increase of $26,000,000, or 30 percent, above the fiscal year 1993 enacted level. This is partially offset by a transfer of $6,415,000 in contract support funds to tribal priority allocations for the self-governance tribes. The additional $26,000,000 should cover the fiscal year 1994 equivalent of the additional needs which were identified in fiscal year 1993, as well as an increase to cover additional contracting requirements which result from programmatic increases in fiscal year 1994.

The Committee is concerned by the significant shortfall which occurred for contract support in fiscal year 1993. Despite the BIA's efforts to adequately budget for contract support and the Committee's efforts to provide sufficient funding based on the information it receives, shortfalls continue to occur. With the increases the Committee recommends, the Committee believes the program should be adequately funded to avoid shortfalls in fiscal year 1994. The Committee is aware that the tribes have the flexibility to contract for programs which the Bureau operates and that they may enter into these contracts during the course of the fiscal year. The Committee urges the BIA to work closely with the tribes to determine the level of new programs the tribes plan to contract for in fiscal year 1995 prior to submission of the budget in order to improve the BIA's ability to adequately budget for contract support costs. The BIA also should work closely with the tribes on the advisability of establishing advance notification requirements for new contracting by the tribes to improve the reliability of projections for contracting costs."

Reports on Appropriations for FY 1995

U.S. House of Representatives

"For contract support, the Committee's recommendation will result in a total of $103,323,000, of which $95,823,000 will be available for the contract support requirements associated with ongoing self-determination and self-governance awards for programs contracted during fiscal year 1994. The Bureau is expected to manage the $95,823,000 in such a way that all fiscal year 1995 awards related to self-determination agreements first entered into prior to fiscal year 1995 are funded first, before making use of these funds for any other purpose. Further, should this amount prove insufficient, the procedures

should ensure that each contractor receives a proportionate share of their fiscal year 1995 contract support costs.

Should the amount provided for existing contracts prove insufficient, a Tribe or group of Tribes may wish to reprogram funds to priority programs to make up deficiencies made necessary to recover full indirect costs. The Bureau may therefore reprogram, at the request of a Tribe or Tribes, between activities during 1995 if all Tribes affected by such reprogramming approve such action. This flexibility is in no way intended to be misconstrued as to authorize or require the Bureau to return to the practice of reprogramming at the national level to meet contract support shortfalls. Consistent with the requirements of P.L. 100-472, the Bureau is expected to report any deficiency to the Congress, should the amount available not meet the full requirements. Award agreements should limit the amount of the Bureau's obligation under the award to the amounts available for each agreement from the $95,823,000. This will ensure that adjustments are made within overall resources at the local level and will not result in future claims. The use of these procedures will support the transition process being developed by the Task Force to permit transfer of contract support into each Tribe's base funding within Tribal priority allocations. Taken as a whole, these procedures should ensure stability of funding and result in accurate information regarding the amounts required to meet the funding provisions of P.L. 100-472.

The balance of $7,500,000 is provided to establish an Indian Self-Determination Fund for new contracts first entered into in fiscal year 1995. New awards shall include recurring base amounts for new or expanded programs under self-determination awards, including new program assumptions under self-governance compacts. The Bureau is expected to implement procedures for administering this fund consistent with those of the Indian Health Service. Recurring base amounts in the fund utilized for new ongoing awards should be combined with contract support for existing awards in subsequent years, and the Bureau should estimate the amount of additional resources needed to provide for future new awards in each subsequent year. The Bureau should fund new contracts at the 100 percent level.

Bill language to establish the Indian Self-Determination Fund is included, but the language included in the 1994 Act which placed a cap on the total amount of funds available for contract support is not continued. Instead, the Bureau is expected to manage the $95,823,000 in such a way that all fiscal year 1995 awards related to self-determination agreements first entered into before fiscal year 1995 are

funded first, before making use of these funds for any other purpose, including prior year claims. With regard to the shortfalls in contract support funds in 1994, budgetary constraints make it impossible to include adequate funds to repay these amounts, which will be at least $15,000,000. These shortfalls should be treated as one-time occurrences, and should not have any impact on determining future indirect cost rates.

The Committee notes that the Bureau has not implemented the amended funding provisions of the Self-Determination Act amendments to provide full contract support costs, and has limited payment to tribal indirect costs alone. No allowance has been made for direct contract support costs such as workers' compensation and unemployment taxes associated with direct cost personnel. The Bureau should examine this issue and report to the Committee the financial impact of these types of costs on tribal contractors. Many Tribes have expressed their concerns to the Committee that the failure to finance fully contract support undermines the self-determination process and tribal government capacity. The Bureau should take a lead role in working with the Inspector General, the Indian Health Service, other agencies and Tribes in seeking to improve the response of the Federal system on these issues."

U.S. Senate

"For tribal government, the Committee recommends an increase of $7,500,000 for contract support, which will provide a total of $103,323,000 for contract support for fiscal year 1995, an increase of $18,515,000. The Committee notes that this increase allows a rate of growth of 22 percent above the current level and 58 percent above the fiscal year 1993 level. The Committee has included the additional $7,500,000 to establish a self-determination fund for new contracts first entered into in fiscal year 1995.

The Committee supports the concept of self-governance and self-determination by the tribes, which permits tribes to compact and contract to provide program delivery which would otherwise be provided by the Bureau. The Committee also supports the ability of the tribes to elect to have the Bureau continue to provide program services directly and is concerned that the Bureau is not adequately protecting the interests of these tribes. In order to protect the Bureau's ability to provide services to those tribes who do not elect to contract for a part or all of their programs, the Committee has retained bill language which establishes a limit of the amount of funding to be available for contract support. The Committee expects the Bureau to continue efforts with the

tribes to identify anticipated contractual activity prior to the submission of the budget. The Bureau should ensure that contract support funding is allocated in such a way that all tribes will be treated the same if there is a shortfall in contract support funds by the end of the year.

The Committee is aware that significant shortfalls exist for fiscal year 1994 contract support funding. Unfortunately, budget constraints preclude the Committee from including sufficient funds to repay these shortfalls. These shortfalls should be treated as one-time occurrences and should not have any impact on determining future indirect cost rates."

Committee on Conference

"Amendment No. 43: Modified language proposed by the Senate to place a cap on the amount of funding to be made available for fiscal year 1995 and to separate the amount of contract support for ongoing self-determination agreements entered into prior to fiscal year 1995 from that provided for new awards first entered into during fiscal year 1995. The House had no similar provision. The purpose of separating the amount available for ongoing agreements from that for new and expanded agreements is to stabilize the fund for ongoing awards and still provide contract support funding for new and expanded contracts. The Bureau is expected to implement procedures for administering the new Indian Self-Determination Fund, for which $7,500,000 is provided, consistent with those of the Indian Health Service. The Bureau should fund new contracts at the 100 percent level.

The Bureau is expected to begin developing procedures for eventual transfer of contract support into each tribe's tribal priority allocation. Once this has been accomplished, the tribes will be able to manage their total program costs within their overall funding allocation.

The cap is not intended to limit the flexibility of tribes to reprogram within tribal priority allocations to obtain full recovery of indirect costs, if a shortfall in contract support were to occur. Accordingly, the managers anticipate that tribes, individually or in agreement with other tribes, may reprogram within tribal priority allocations without regard to the contract support ceiling. Reprogramming on a Bureau-wide basis is not authorized for this purpose."

Reports on Appropriations for FY 1996

Committee on Conference

"Amendment No. 55: Earmarks $104,626,000 for contract support costs as proposed by the Senate instead of $106,126,000 as proposed by the House and adds language earmarking $100,255,000 for welfare assistance.

Amendment No. 56: Earmarks up to $5,000,000 for the Indian Self-Determination fund as proposed by the Senate instead of $5,000,000 as proposed by the House."

APPENDIX D

Appropriations Committee Direction to IHS

Reports on Appropriations for FY 1988

U.S. Senate

"The Committee has also included $3,000,000 for tribal contractor indirect costs shortfall. The Committee expects that $500,000 of the funds provided for indirect costs of tribal contractors will be added to the base level of funding available to the Mount Edgecumbe service unit and $190,000 for the Annette Island service unit. The Committee has also agreed to proposed bill language, to establish an Indian self-determination fund for the transitional costs of initial or expanded tribal contracts and has provided an increase of $2,500,000 for this purpose."

Committee on Conference

"The net decrease from the amount proposed by the House consists of increases of ...

...and decreases of $2,500,000 in tribal contractor indirect costs; ..."

Reports on Appropriations for FY 1989

U.S. House of Representatives

"Finally, there is an increase of $10,000,000, for an additional amount for tribal contractor indirect cost funds, to be added to the base amount available for that purpose in fiscal year 1988. This will fund part of the identified shortfall of $12-18,000,000. The IHS should identify the total amount included for tribal contractor indirect costs in the fiscal year 1990 budget justification, including any proposed changes to the base amount as a result of the budget request."

Reports on Appropriations for FY 1990

U.S. House of Representatives

"The Committee has not agreed to proposed bill language which would have provided two separate accounts, one for tribal health administration and one for Federal health administration. The Committee believes this would create a cumbersome funding mechanism which is not necessary in order to support and encourage more tribal contracting of IHS programs, as the Committee always has. The Committee continues to believe that the best way to encourage more tribal contracting is to provide adequate funding, including funds for contract indirect costs, and has therefore provided increased funds aimed at accomplishing this purpose."

"Finally, there is an increase of $23,000,000 which is required to fully fund tribal contractor indirect costs in fiscal year 1990. The budget has proposed meeting these costs by using insurance reimbursements. However, fiscal year 1990 will be the first year such reimbursements will be collected, under authorization provided in Public Law 100-713, and it is unlikely the amount estimated will be available. It is also the Committee's understanding that the use of these funds to offset the required contract indirect costs is not authorized."

"Tribal contract conversion. –The Committee recommends an increase of $23,000,000, along with bill language, to carry out the requirements of section 204(d)(1) of Public Law 100-472, the Indian Self-Determination and Education Assistance Act Amendments of 1988. This section requires the Secretary, no later than 1990, to begin using the calendar year as the basis for tribal contracts and agreements, unless the Secretary and tribe agree on a different period. This is the

amount of budget authority which IHS estimates will be needed to accomplish this requirement in fiscal year 1990. No outlays are associated with the conversion."

U.S. Senate

"The Committee concurs in the House recommendation to fund directly through appropriated funds the indirect costs associated with the fiscal year 1990 budget request, rather than to rely on third party collections. As such, an increase of $23,000,000 is provided.

Contract Conversion.-The Committee has not included funds, as proposed by the House, to covert tribal contracts to a calendar year basis beginning January 1, 1990. The Committee is concerned about the actions necessary to achieve conversion and whether conversion funds will be needed annually due to newly executed contracts. The IHS should report to the committees, by March 1, 1990, with BIA, regarding the logistical and accounting needs for such a conversion. This report should address the option, and costs, of converting the entire Bureau budget to a calendar year basis."

Reports on Appropriations for FY 1991

U.S. House of Representatives

"The Committee has not agreed to proposed bill language which would provide two separate accounts for tribal health administration and Federal health administration. The Committee continues to believe the best way to encourage more tribal contracting is to provide adequate funding for tribal contracts. Indeed, the Committee expects the IHS to comply fully with its statutory responsibility to fund self-determination contracts at the same level as IHS health care delivery programs. Creating a more-cumbersome accounting system to provide for separate appropriations does nothing to make sorely needed additional funding available. The administrative costs associated with separate accounting may well decrease the funds available for health services."

U.S. Senate

"The Committee has not concurred in proposed bill language that would establish separate appropriation accounts for tribal and Federal health administration. The Committee remains unpersuaded that separate appropriation accounts will foster more tribal

contracting, and concurs with the House that sufficient funds to enable tribes to manage their health programs will do more to fulfill the objectives of self-determination. Administrative actions to pursue this separation of programs will not be tolerated by the Committee. The Committee wishes to express its rejection of sentiment expressed informally by IHS that tribal decisions to engage in Public Law 93-638 contracts for the operation of health programs somehow represent a willingness on the part of the tribe to tolerate a less than acceptable level of health care for its members in exchange for fiscal control. The Committee maintains that tribal self-determination and the highest possible standard of health care are not mutually exclusive elements."

Reports on Appropriations for FY 1993

U.S. House of Representatives

"The Committee recommends...;$3,500,000 for the Indian self-determination fund, for a total funding level of $6,000,000 in fiscal year 1993;..."

U.S. Senate

"The Committee expects IHS to identify clearly in future budget requests the contract support costs associated with the programs operated by tribal contractors. The total funding provided herein should be allocated in such a manner as to fund fully contract support costs as required by law.

The Committee recommends deleting bill language regarding payment of contract support costs out of funds otherwise available for new, continuation, and expanded grants, contracts, or cooperative agreements. The Committee expects IHS, in future budget justifications, to identify contract support costs as a separate line item so that these costs can be tracked more carefully."

Committee on Conference

"The managers agree that:

2. Contract support costs associated with tribally-operated programs should be included as a separate line item in the budget beginning in fiscal year 1994 and these costs should be fully budgeted;

3. The total funding provided in fiscal year 1993 should be allocated to fund fully contract support costs as required by law;"

Reports on Appropriations for FY 1994

U.S. House of Representatives

"The Committee believes that staffing reductions, in both the services and facilities accounts, should be achieved through the increased use of tribal contracting which should be facilitated by the Committee's recommendation to fund fully contract support costs. The Committee notes that tribal contracting is determined by the tribes and not by the IHS so that a definitive reduction in Federal staffing linked to prospective tribal contracting cannot be established. As self-governance compacts are negotiated with the tribes, further reductions in IHS administrative and health professional positions should be realized."

"Contract Support Costs.-The Committee recommends an increase of $26,000,000 to fund fully contract support costs as required by law. The increase recommended by the Committee should encourage continued contracting by the tribes which, in combination with self-governance compacts, should enable Federal staffing reductions in IHS."

"Bill Language.-Bill language has been recommended to provide $8,000,000 for the Indian Self-Determination Fund rather than the $5,000,000 proposed by IHS. The increase recommended by the Committee is included as part of the $26,000,000 contract support cost funding increase referenced above. The IHS should ensure that at least $8,000,000 is added as part of the base budget in each subsequent fiscal year for the Indian Self-Determination Fund to ensure shortfalls do not develop in the future."

U.S. Senate

"In addition, the Committee has placed a priority on addressing the shortfall in contract support, and expects IHS to keep the Committee regularly informed about the costs of this program. The Committee would note that the current projections for domestic discretionary spending will become even more constrained over the next 5 years. It is estimated that it will be fiscal year 1998 before domestic discretionary spending is restored to the same level as was provided in fiscal year 1993."

"Contract support.-The Committee recommends an increase of $22,000,000 for contract support. This provides 85 percent of the estimated shortfall, which is the same percentage as is provided in the allocation of staffing resources for new facilities. The Committee is very concerned about the escalating costs of the contract support program and encourages the tribes and the IHS to carefully review contract support costs so that the increases in contract support costs do not soon overwhelm the Committee's ability to provide program increases."

"The Committee has amended the language proposed by the House with respect to the funding for the Indian self-determination fund. The Committee recommendation includes $7,000,000 for this purpose, as part of the $22,000,000 contract support increase."

Committee on Conference

"...; and $500,000 in contract support costs for new and expanded contracts funded through the Indian self-determination fund."

"Amendment No. 98: Earmarks $7,500,000 for the self-determination fund instead of $8,000,000 as proposed by the House and $7,000,000 as proposed by the Senate."

Reports on Appropriations for FY 1995

U.S. House of Representatives

"The Committee continues to be concerned that some tribes are experiencing problems because of contracts that are issued on a fiscal year basis and expects the IHS to review the need for changing contracts to a calendar year cycle. The funding requirements for such adjustments should be included in the fiscal year 1996 budget justification. This direction appears to have been ignored for fiscal year 1995."

"Contract Support Costs.-The Committee recommends an increase of $2,305,000 for contract support costs including $1,900,000 to partially offset inflation and $405,000 for operations at the new Kotzebue, Alaska hospital.

The Committee expects the IHS to work with the tribes, the BIA and the Inspector General at the Department of the Interior to contain the cost escalation in contract support costs. In today's constrained

budget climate the contract support cost activity must receive its fair share of administrative streamlining and procurement reform funding reductions as well as the lower inflation allowances provided for all other programs within IHS.

The IHS should report to the Committee by December 1, 1994, on funding for existing Public Law 93-638 contracts, including the program costs and the contract support costs associated with each contract."

U.S. Senate

"Contract support costs.-The Committee recommends an increase of $1,900,000 for inflation and $405,000 for operational costs associated with the Kotzebue, AK, hospital. The Committee concurs with the House recommendation regarding escalating contract support costs. This program has received a 45-percent increase in funding between fiscal years 1993 and 1995. Such growth will be impossible to continue over the course of the 5 years covered by the fiscal year 1995 budget resolution, which will require $13,000,000,000 in outlay reductions over the period."

Reports on Appropriations for FY 1996

U.S. House of Representatives

"Contract Support Costs.-The Committee recommends $153,040,000 for contract support costs including decreases of $11,864,000 for pay and fixed costs and $3,770,000 for support cost shortfalls. The Committee recommends an increase of $80,000 for staffing and operations of new facilities, same as the budget request.

The Committee has provided $7,500,000 for the Indian Self-Determination Fund. These funds are to be used for new and expanded contracts. The IHS should not use ISD funds to accommodate existing or new self-governance compacts.

The Committee again expects IHS to work with the tribes, the BIA and the Inspector General at the Department of the Interior to contain the cost escalation in contract support costs. In today's constrained budget climate the contract support cost activity must receive its fair share of administrative streamlining and procurement reform funding reductions as well as the lower inflation allowances provided for all other programs within IHS."

U.S. Senate

"Contract support costs.-The Committee recommends $153,040,000 for contract support, the same as the House and the fiscal year 1995 level. This amount includes decreases of $11,864,000 for pay and fixed costs and $3,770,000 for support cost shortfalls. The requested increase of $80,000 is included for the staffing and operations of new facilities.

The Committee has provided $7,500,000 for the Indian self-determination fund, the same as the House."

Committee on Conference

"The managers agree that the Indian Self Determination Fund is to be used only for new and expanded contracts and that this fund may be used for self -governance compacts only to the extent that a compact assumes new or additional responsibilities that had been performed by the IHS."

Reports on Appropriations for FY 1997

U.S. House of Representatives

"Contract Support Costs.-The Committee recommends $153,100,000 for contract support including and increase of $60,000 above the fiscal year 1996 enacted level.

The Committee has provided $7,500,000 for the Indian Self Determination fund. These funds are to be used for new and expanded contracts.

The Committee again expects IHS to work with the tribes, the BIA and the Inspector General at the Department of the Interior to contain the cost escalation in contract support costs. In today's constrained budget climate the contract support cost activity must receive its fair share of administrative streamlining and procurement reform funding reductions as well as the lower inflation allowances provided for all other programs within IHS."

U.S. Senate

"Contract support costs.-The Committee recommends $160,660,000 for contract support. This amount includes increases over the fiscal year 1996 enacted level of $120,000 for the staffing of new facilities and $7,500,000 for the Indian self-determination fund. The Committee agrees with the House regarding the need for IHS to continue to work with tribes to contain growth of contract support costs. The Committee hopes that the revised contract support guidelines recently issued by the IHS are helpful in this regard."

APPENDIX E

Funding Provisions of the Indian Self-Determination Act

Sec. 106 Contract Funding Provisions

(a) (1) The amount of funds provided under the terms of self-determination contracts entered into pursuant to this Act 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 Act 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 section 106(a)(1).

(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 Act, 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 8.

(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) The amount of funds required by subsection (a)–

(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 Act or as provided in section 105(c).

Notwithstanding any other provision in this Act, the provision of funds under this Act 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 Act.

(c) The Secretary shall provide an annual report in writing on or before May 15 of each year to the Congress on the implementation of this Act. Such report shall include--

(1) an accounting of the total amount of funds provided for each program and budget activity for direct program costs and contract support costs of tribal organizations under self-determination contracts during the previous fiscal year;

(2) an accounting of any deficiency of funds needed to provide required contract support costs to all contractors for the current fiscal year;

(3) the indirect costs rate and type of rate for each tribal organization negotiated with the appropriate Secretary;

(4) the direct cost base and type of base from which the indirect cost rate is determined for each tribal organization;

(5) the indirect cost pool amounts and the types of costs included in the indirect cost pools; and

(6) an accounting of any deficiency of funds needed to maintain the preexisting level of services to any tribes affected by contracting activities under this Act, and a statement of the amount of funds needed for transitional purposes to enable contractors to convert from a Federal fiscal year accounting cycle to a different accounting cycle, as authorized by section 105(d).

(d) (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.

(e) Indian tribes and tribal organizations shall not be held liable for amounts of indebtedness attributable to theoretical or actual under-recoveries or theoretical over-recoveries of indirect costs, as defined in Office of Management and Budget Circular A-87, incurred for fiscal years prior to fiscal year 1992.

(f) Any right of action or other remedy (other than those relating to a criminal offense) relating to any disallowance of costs shall be barred unless the Secretary has given notice of any such disallowance within three hundred and sixty-five days of receiving any required annual single agency audit report or, for any period covered by law or regulation in force prior to enactment of the Single Agency Audit Act of 1984 (chapter 75 of Title 31, United States Code), any other required final audit report. Such notice shall set forth the right of appeal and hearing to the board of contract appeals pursuant to section 110. For the purpose of determining the 365-day period specified in this paragraph, an audit report shall be deemed to have been received on the date of actual receipt by the Secretary, if, within 60 days after receiving the report, the Secretary does not give notice of a determination by the Secretary to reject the single-agency report as insufficient due to noncompliance with chapter 75 of title 31, United States Code, or noncompliance with any other applicable law. Nothing in this subsection shall be deemed to enlarge the rights of the Secretary with respect to section 16 of the Indian Reorganization Act of June 18, 1934 (48 Stat. 984; 25 U.S.C. 476).

(g) 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 section 106(a), subject to adjustments for each subsequent year that such tribe or tribal organization administers a Federal program, function, service, or activity under such contract.

(h) In calculating the indirect costs associated with a self-determination contract for a construction program, the Secretary shall take into consideration only those costs associated with the administration of the contract and shall not take into consideration those moneys actually passed on by the tribal organization to construction contractors and subcontractors.

(i) On an annual basis, the Secretary shall consult with, and solicit the participation of, Indian tribes and tribal organizations in the development of the budget for the Indian Health Service and the Bureau of Indian Affairs (including participation of Indian tribes and tribal organizations in formulating annual budget requests that

the Secretary submits to the President for submission to Congress pursuant to section 1105 of title 31, United States Code); and

(j) Notwithstanding any other provision of law, a tribal organization may use funds provided under a self-determination contract to meet matching or cost participation requirements under other Federal and non-Federal programs.

(k) Without intending any limitation, a tribal organization may, without the approval of the Secretary, expend funds provided under a self-determination contract for the following purposes, to the extent that the expenditure of the funds is supportive of a contracted program:

(1) Depreciation and use allowances not otherwise specifically prohibited by law, including the depreciation of facilities owned by the tribe or tribal organization.

(2) Publication and printing costs.

(3) Building, realty, and facilities costs, including rental costs or mortgage expenses.

(4) Automated data processing and similar equipment or services.

(5) Costs for capital assets and repairs.

(6) Management studies.

(7) Professional services, other than services provided in connection with judicial proceedings by or against the United States.

(8) Insurance and indemnification, including insurance covering the risk of loss of or damage to property used in connection with the contract without regard to the ownership of such property.

(9) Costs incurred to raise funds or contributions from non-Federal sources for the purpose of furthering the goals and objectives of the self-determination contract.

(10) Interest expenses paid on capital expenditures such as buildings, building renovation, or acquisition or fabrication of capital equipment, and interest expenses on loans necessitated due to delays by the Secretary in providing funds under a contract.

(11) Expenses of a governing body of a tribal organization that are attributable to the management or operation of programs under this Act.

(12) Costs associated with the management of pension funds, self-insurance funds, and other funds of the tribal organization that provide for participation by the Federal Government.

(l) The Secretary may only suspend, withhold, or delay the payment of funds for a period of 30 days beginning on the date the Secretary makes a determination under this paragraph to a tribal organization under a self-determination contract, if the Secretary determines that the tribal organization has failed to substantially carry out the contract without good cause. In any such case, the Secretary shall provide the tribal organization with reasonable advance written notice, technical assistance (subject to available resources) to assist the tribal organization, a hearing on the record not later than 10 days after the date of such determination or such later date as the tribal organization shall approve, and promptly release any funds withheld upon subsequent compliance.

(1) with respect to any hearing or appeal conducted pursuant to this subsection, the Secretary shall have the burden of proof to establish by clearly demonstrating the validity of the grounds for suspending, withholding, or delaying payment of funds.

(m) The program income earned by a tribal organization in the course of carrying out a self-determination contract-

(1) shall be used by the tribal organization to further the general purposes of the contract; and

(2) shall not be a basis for reducing the amount of funds otherwise obligated to the contract.

(n) To the extent that programs, functions, services, or activities carried out by tribal organizations pursuant to contracts entered into under this Act reduce the administrative or other responsibilities of the Secretary with respect to the operation of Indian programs and result in savings that have not otherwise been included in the amount of contract funds determined under subsection (a), the Secretary shall make such savings available for the provision of additional services to program beneficiaries, either directly or through contractors, in a manner equitable to both direct and contracted programs.

(o) Notwithstanding any other provision of law (including any regulation), a tribal organization that carries out a self-determination contract may, with respect to allocations within the approved budget of the contract, rebudget to meet contract requirements, if such rebudgeting would not have an adverse effect on the performance of the contract.

APPENDIX F

IHS Circular 96-04
"Contract Support Costs"

Indian Health Service (IHS) Circular No. 96-04, "Contract Support Costs," superceded Indian Self-Determination Memorandum No. 92-2, "Contract Support Costs Policy," as the written policies or instructions for the administrative and allocation of contract support funds.

The Circular provides instructional guidance to IHS staff as they work with tribes and tribal organizations to determine amounts of start-up, direct, and indirect costs associated with contracts and compacts under the authority of Public Law (P.L.) 93-638, as amended. The instructions provide guidance to IHS personnel in negotiating and allocating contract support cost (CSC) amounts while allowing IHS personnel to apply judgment and prudence in individual circumstances.

The Circular was developed with extensive tribal consultation and the participation of numerous tribal representatives.

DEPARTMENT OF HEALTH AND HUMAN SERVICES
PUBLIC HEALTH SERVICE
INDIAN HEALTH SERVICE
ROCKVILLE, MARYLAND 20857

REFER TO: OAM

INDIAN HEALTH SERVICE CIRCULAR NO. 96-04

CONTRACT SUPPORT COSTS

Sec.
1. Purpose
2. Authorizing Legislation
3. Definitions
4. Process
5. Supersedure
6. Effective Date

Circular Exhibit 96-04-A: Section 106, Indian Self-Determination and Education Assistance Act, as Amended (See Appendix E).

Circular Exhibit 96-04-B: Contract Support Costs Calculated Using the 80/20 Method

Circular Exhibit 96-04-C: Contract Support Costs Calculation Based on a Detailed Analysis

1. PURPOSE. The purpose of this circular is to provide instructional guidance on:

- Determining amounts of start-up, direct, and indirect contract support costs (CSC)
- Allocating pools of Indian Health Service (IHS) funding available for CSC
- Prioritizing tribal requests for funding of CSC
- Reporting by the IHS to all tribes and to the Congress

These instructions are not regulations establishing program requirements and are not intended to bind agency personnel. These instructions are intended to provide guidance to IHS personnel to determine and allocate CSC, while allowing judgment and prudence in individual circumstances.

2. AUTHORIZING LEGISLATION. This circular is authorized pursuant to the Transfer Act, Title 42 United States Code (USC) §2001and implementing regulations in Title 42 of the Code of Federal Regulations §36.3. The development of this circular has involved the active participation of representatives from Indian tribes. Since 1992, the procedures discussed in this circular have been applied to contracts awarded pursuant to Title I of the Indian Self-Determination and Education Assistance Act, Public Law (P.L.) 93-638, as amended. The CSC process has also been applied to compacts awarded to tribes that have been selected to participate in the Tribal Self-Governance Demonstration Project (SGDP) pursuant to Title III of P.L. 93-638, as amended. Section 106 of P.L. 93-638, as amended, authorizes funding for all Indian Self-Determination (ISD) and Self-Governance agreements under the Act. Section 106 is provided as Exhibit 96-04-A to this circular, and is cross-referenced to the pertinent sections where instructions or examples have been provided.

3. DEFINITIONS.

   A. Award. An agreement authorized under Title I (contract) or Title III (compact) of P.L. 93-638, as amended.

   B. Awardee. A recipient (tribe or tribal organization) of an award as defined above.

   C. Contract Proposal. Refer to the regulations implementing P.L. 93-638, as amended, and Title 25, USC.

   D. Recurring Funds. Contract or compact funds that do not require rejustification each year to the Secretary. Annual increases are provided through congressional mandatory increases or other resource allocation methodologies applicable to the respective funding category of the award.

E. Non-Recurring Funds. Funds that require a rejustification annually, and are awarded based upon an annual resource allocation methodology that considers or is dependent upon other factors (e.g., an indirect cost rate applied to a direct program base that may change the amount to be reimbursed from a single agency as the programs under contract continue to increase).

F. Programs, Functions, Services, and Activities (PFSA). The PFSA including those administrative activities supportive of, but not included as part of, service delivery programs that are otherwise contractible, without regard to the organizational level within the department that carries out such functions, as authorized under P.L. 93-638, as amended.

G. Tribal Shares. A term that refers to a tribe's equitable share of Area office and Headquarters resources only. This definition was originally adopted and utilized in negotiating and awarding Annual Funding Agreements (AFA) under Title III, P.L. 93-638, as amended, and is being consistently applied to Title I contracts as authorized under P.L. 93-638, as amended. This term does not refer to a tribe's equitable share of a service unit or program base, which may also be included in a negotiated funding agreement.

H. Self-Governance Request.

(1) Tribes entering the SGDP (Title III) the first year:

The tribe's application to the IHS for a Negotiation Grant, which is subsequently approved for the tribe's participation in the SGDP. The application must include evidence of having completed a sufficient planning activity as described in the Negotiation Grant application instruction.

(2) Tribes joining an existing compact:

The tribe's written notice to the IHS, which is subsequently approved, that it intends to join an existing compact.

(3) Tribes negotiating for new or expanded programs in a subsequent year's AFA:

The tribe's written notice to the IHS that it intends to negotiate for additional programs.

To be considered a valid request for purposes of establishing placement on the ISD priority list, H1, 2, or 3 above must include a clear description of the programs to be negotiated, date that the program operations are to be assumed, or estimate of the amount of program funding required, and the amount of contract support funding required.

4. PROCESS.

A. Determining Amounts of Start-Up, Direct, and Indirect CSC.

(1) Determining the Amount of the Award. Section 106 (a)(l) and 106 (a)(2) of the P.L. 93-638, as amended, provides for funding of contract and compact awards for program costs and CSC respectively. Section 106(a)(1) provides the awardee the right to the funding the Secretary would have otherwise provided for the PFSA awarded. In addition, section 106(a)(2) authorizes funding that represents costs associated with tribal expenses or PFSAs either not experienced by the Secretary or provided to the Secretary from resources not available to the awardee.

(2) Providing for Cost Reimbursement. Throughout the operation of the program by the awardee, total contract costs, including CSC, are eligible to be reimbursed as either direct or indirect costs. Since tribes often operate more than one program, many of the costs incurred by the awardee are reimbursed through an indirect cost allocation process, usually negotiated by the cognizant agency. Section 106(a)(3) provides authority for tribes to recover costs in this manner, whether they are indirect in nature (benefiting multiple programs) or additional costs associated with operating a single program.

Since some, but not all, of the funds provided in section 106(a)(2) represent costs that are eligible to be reimbursed through this indirect cost recovery method, the procedures below are intended to ensure that needs are accurately identified but avoid a duplication of funding.

For service unit assumptions, or partial service unit assumptions, the costs historically incurred by the IHS will be reviewed to identify types of costs that are similar in nature to those costs that are included in the awardee's indirect cost pool. Those costs that are in the awardee's indirect cost pool that are similar in nature to the costs incurred by the IHS will be considered as duplicative for purposes of funding for administrative "overhead" purposes (section 106(a)(3)(A)(ii)). In determining whether such costs are similar in nature, the review will consider both the cost category label (travel, supplies, etc.) and how the funds were spent by the IHS.

a. Start Up Costs. Section 106(a)(5) states, "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 onetime basis pursuant to the contract necessary:

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

(ii) To ensure compliance with the terms of the contract and prudent management.

Examples include:

- Purchase of computer hardware and software
- Required training and staff development
- Systems development (establishing required administrative and other health management systems)
- Equipment and furniture to support the administrative unit

b. Direct CSC. Requirements for these costs will be determined by negotiation between the awardee and the Secretary. Costs for activities that are not contained in either the indirect cost pool (or indirect cost type budget) or the amount computed pursuant to section 106(a)(1) can be funded as a direct CSC. These funds shall be awarded on a recurring basis.

Examples include, but are not restricted to:

- Unemployment taxes on direct program salaries
- Workers compensation insurance on direct program salaries
- Cost of retirement for direct program salaries
- Long distance telephone charges
- Postage
- Training required to maintain certification of direct program personnel

Items listed above as examples of startup costs and direct CSC must be justified as such and negotiated with the Area office. Items not included as examples above, but requested and justified by awardees shall be submitted by the Area office to IHS Headquarters, Office of Administration and Management (OAM), for approval. This will contribute to greater consistency from Area-to-Area.

c. Indirect or Indirect Types of Costs. Guidelines for the Principles Involved in Negotiating Indirect Costs:

A plan for allocation of indirect costs will be required to support the distribution of any indirect costs related to the awardee's program. All

indirect costs included in the plan will be supported by accounting records that will substantiate the propriety of the indirect costs. The allocation plan should cover all indirect costs of the awardee, and contain, but not necessarily be limited to: (1) the nature and extent of services provided and their relevance to the awardee's program; (2) the item of expenses to be included in the indirect cost pool, and (3) the methods to be used in distributing cost.

The Office of Management and Budget (OMB) circulars establish principles and standards for determining indirect costs applicable to the awardee. Public Law 103-413 has made modifications to the OMB cost principles otherwise applicable to tribes and tribal organizations.

(i) Awardee with Negotiated Indirect Cost Rates. The amount of indirect costs expected to be incurred under awards by tribes or tribal organizations with rates that have been negotiated or are being negotiated with the cognizant Federal agency, will be determined by applying the negotiated rate(s) to the direct cost base amount for this purpose. The amount to be reimbursed will be consistent with the individual awardee rate agreement, reflecting any exclusions required by the agreement.

(ii) Awardee without Negotiated Indirect Cost Rates (Guidelines for Agency Negotiators). A lump sum amount for "indirect types of costs" may be computed for awardees who do not have formally negotiated agreements with their cognizant agency for reimbursement under an indirect cost rate. This annual lump sum amount may be calculated by negotiating a

fixed amount for "indirect types of costs." Categories of costs often considered "overhead" or "indirect-type" are generally in the categories of Management and Administration, Facilities and Equipment, General Services, and Expenses. Examples of indirect costs are:

Examples of "Overhead" or "Indirect-type" Costs

Management & Administration	Facilities & Equipment	General Services & Expenses
Governing Body	Building	Insurance &
Management & Planning	Utilities	Legal Services
Financial Management	Housekeeping/Janitorial	Audit
Personnel Management	Building & Grounds	General
Procurement / Material	Repairs & Maintenance	Interest
Human Resources	Equipment	Depreciation/
Property Management		Use Allowance
Records Management		
Data Processing		
Office Services		

(3) Alternative Methods for Calculating Amount of Section 106(a)(1) Funds in Area Office and Headquarters "Tribal Shares". With respect to amounts to be considered as the direct program base (for the purpose of calculating indirect or indirect-type costs) from amounts of PFSAs transferred from Areas and Headquarters "Tribal Shares," at the option of the awardee, the IHS and the awardee will either:

a. Conduct a case-by-case detailed analysis of the "purpose for which the funds were utilized by the Secretary" in order to avoid a duplication in amounts funded.

In cases where a detailed analysis is performed, it will be conducted in the following manner:

Area/Headquarters tribal shares will be reviewed to identify types of costs that are similar in nature to those costs that are included in the awardee's indirect cost pool. Those costs that are in the awardee's indirect cost pool that are similar in nature to Area/Headquarters tribal shares will be considered as duplicative for purposes of funding for administrative or "overhead" purposes (Section 106(a)(3)(A)(ii)).

In determining whether such costs are similar in nature, the review will consider both the cost category label (travel, supplies, etc.) and how the funds were spent by the IHS.

b. Apply the following "split" of total Area and Headquarters tribal shares as specified below:

In the absence of a detailed analysis by the awardee and the IHS, 80 percent of Area/Headquarters tribal shares will be considered as direct program funds (section 106(a)(3)(A)(I)) and 20 percent of such tribal shares will be considered as funding for administrative or "overhead" purposes section 106(a)(3)(A)(ii)).

Once an amount is computed for a direct program or an indirect or overhead purpose under method a. or b. above, it will be used in accordance with the terms of the rate agreement or alternative method provided herein, for calculating the amount required for indirect or indirect type costs. The balance of the tribal shares not considered as direct program expenses (and therefore not used to calculate indirect cost funding requirements) will be considered as available for CSC for the respective awardee. Any such balance, if in excess of the CSC requirement, shall also remain with the awardee. Any excess CSC requirements not funded by the portion of the Area or Headquarters tribal shares

to be considered as available for CSC, will be eligible for payment from the ISD fund, and the processes specified in this circular for allocation of funding in this pool will apply.

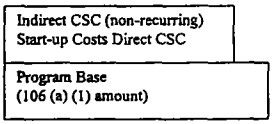
Exhibit 96-04-B illustrates how the 80/20 method would be calculated, and Exhibit 96-04-C illustrates how a detailed analysis would be calculated.

(4) Allocating Funding Available for CSC. Essentially three pools of funding are contained in the single IHS budget activity for CSC. The first pool represents an increase in the IHS appropriation for CSC for new and expanded awards. The second pool represents amounts awarded in the prior year that are made available to the IHS on a recurring basis. The third pool represents amounts provided for mandatory increases on the prior year "base" and shortfall funds, if appropriated. Each one has funding priorities and eligibility requirements for costs to be reimbursed.

a. Pool No. 1 – The Indian Self-Determination Fund. The ISD Fund will cover CSC when an award is:

(i) (1) An initial transfer of a program previously operated by the IHS to the tribe or tribal organization; or (2) to expand current tribal operations through the assumption of additional shares of PFSAs previously operated by the IHS, regardless of the organizational level at which it was operated; or (3) assumption of programs previously operated under awards to other tribes, tribal organizations, contractors, and for newly recognized tribes; or (4) new or expanded programs available because of new appropriations, excluding mandatory increases.

(ii) Initial Funding Period - First Come First Served. Funds for new and expanded programs will be allocated by IHS Headquarters as expeditiously as possible. Approved requests for CSC for new and expanded programs will be funded at 100 percent of the approved amount on a first come first served basis. Allocation will be based on a priority list until funding for the ISD funds is exhausted. If permitted by appropriations act, any funds that remain in the ISDF at the end of the year will be added to funds to be made available in the subsequent year. If funds are exhausted in any fiscal year (FY), tribes on the priority list will remain on the priority list and be considered in priority order when funding is made available by appropriation or reprogramming.



The ISD fund is the source of funds in the initial funding period

(iii) Priority Determined by Date of Request. A priority list for each FY will be developed for every tribe with a requested start date in the proposal (Title I) or request (Title III) in that FY. Tribes will be placed on the priority list within the FY based on:

(a) The date of receipt by the IHS Area office of a Title I contract proposal.

(b) The date of receipt by the IHS Area office of a request to negotiate a Title III award.

(iv) Roles and Responsibilities. Tribes will provide either (a) or (b) above to the Area office. The Area office will provide a copy to OAM, and in the case of Title III, an additional copy will be provided to the Office of Tribal Self-Governance (OTSG). In providing either (a) or (b) above, the tribe will include a clear estimate of the amount of CSC required.

The Area office will be responsible for negotiating the CSC and forwarding the recommendation to OAN. In the case of Title III, an additional copy will be forwarded to the OTSG. The Area office shall ensure that costs are reasonable, necessary, and not duplicative. To the extent that the Area office and the awardee cannot agree on an item(s) of cost, the disputed item(s) shall be submitted to the Director, IHS, through the Headquarters OAM.

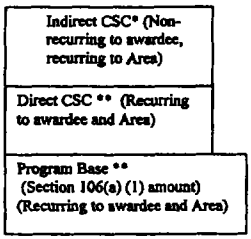
(v) Information and Documentation by IHS. The priority list will be maintained by OAM and distributed quarterly to Area offices. The list will include tribe or tribal organization, proposed start date, date of request or proposal, estimated amount of the program costs to be awarded, estimated amount of CSC approved and awarded, and remaining funds available. The OAM will revise estimated amounts of CSCs as additional data becomes available through negotiations.

(vi) Changes in Start Date. While awaiting award of ISD funding, tribes or tribal organizations may choose to delay their starting date, if necessary, because of the delay in the award of contract support funding. Such choice shall not change the

placement of the tribe or tribal organization on the priority list. The priority list shall be maintained by OAM and reviewed periodically to ensure the validity of start dates and the amounts needed.

If a tribe changes the FY start date for any reason other than solely the lack of CSC funding, it will be placed in the new FY by its original date.

(vii) Subsequent Funding Periods. Beginning in year 2, direct contract support and section 106(a)(1) funds will be considered part of the recurring base of the award. Mandatory funding increases will be provided based on congressional appropriation. The amount of direct contract support funds may be renegotiated annually at the option of the awardee. The amount of indirect contract support funds must be justified each year based on the awardee's indirect cost agreement or mutually negotiated amounts. Any shortfalls in funding are reported to the Headquarters OAM by Area offices and the OTSG for inclusion in required reports to the Congress, and other reporting to tribes.



* *Indirect CSC base amount in subsequent years is described below, Pool No. 2. Increases/decreases to indirect CSC base amount are governed by Pool No. 3, also described below.*

** *Treated as recurring i.e., not adjusted unless tribe request to renegotiate in subsequent years.*

b. Pool No. 2 Prior Year CSC Base (Ongoing Awards). The amount of indirect contract support funds representing the previous year's base will be distributed to Areas as "recurring" to fund each Area's indirect cost need. Each awardee's need for indirect CSC shall be determined by calculating changes, if any, in indirect cost rates, bases, and pools. If the funds available in the Area's indirect cost base are not adequate to meet all awardee's requirements, then the amount available shall be distributed according to each awardee's proportion of total need, except that prior year funds should not be reduced if justified as described below. These funds will be awarded to the contractor as non-recurring funds.

c. Pool No. 3 Mandatory Increases/ Shortfall Funds. Mandatory increases that represent a percentage of the Area's prior year recurring indirect cost base are distributed annually as available. Additional shortfall funds may also be made available to the IHS and allocated to Area offices

for this purpose. Since awardees are required to rejustify their needs for indirect CSC each year, amounts required for indirect CSC may exceed the amount available for this purpose. Mandatories should be allocated in such a manner as to provide increases to awards based on each awardee's proportion of total additional need. If additional need is proportionately greater for some awardee's, they will receive a greater percentage of CSC mandatories and shortfall funds.

Prior year funds provided for indirect CSC to each awardee, if justified in subsequent years, shall not be reduced by the IHS, except as authorized in section 106(b) of the ISDA. Awardee should expect to receive these funds continuously, only if they continue to be justified for at least the same amount or greater annual need. They are awarded as non-recurring funds to enable the Area to adjust amounts previously awarded if the amount of costs allocated to the IHS for reimbursement should decrease. If amounts previously awarded for indirect CSC are not justified by an awardee in a subsequent year, they will be made available for distribution to other awardees in the Area with unfunded CSC needs for this purpose.

Note: It is not intended for Areas to reduce contract amounts of indirect contract support funds allocated prior to FY 1992 (original date of ISDM No. 92-2, Contract Support Cost Policy was February 27, 1992) as recurring funds without approval of the contractor.

B. Requirements for Reporting and Documenting Amounts of CSC Funds Available, Needed, and Requested. Areas shall maintain an historical record of funds negotiated and awarded in each of the categories:

- Direct program funds
- Start-up costs

- Direct contract support funds
- Indirect cost funding
- Indirect-type cost funding
- Indirect cost rates
- Types of rates
- Types of bases
- Pass through/exclusions

5. SUPERSEDURE. Indian Self-Determination Memorandum No. 92-2, "Contract Support Costs Policy," dated February 27, 1992, and any policies or instructions previously issued regarding the allocation of contract support funds.

6. EFFECTIVE DATE. The policy and procedures contained in this circular are retroactive to April 1, 1996, upon signature by the Director, IHS.

(Signed)
Michael H. Trujillo, M.D., M.P.H
Assistant Surgeon General
Director, Indian Health Service

Circular Exhibit 96-04-B
(4/12/96)

Contract Support Costs Calculated Using the 80/20 Method

Assumptions:

1. Tribe A has $100,000 in Area and Headquarters Tribal Shares
2. Indirect cost rate = 30%
3. New budgeted tribal wages = $48,000
4. Direct Contract Support = 15% of wages
5. No excluded items
6. Other Direct Contract Support Costs = $5,000

Expanded program base $100,000 tribal Shares x 80%	$80,000
DCSC fringe $48,000 wages x 15%	$7,200
Other DCSC	$5,000
Sub-total direct	$92,200
Less excluded items	$0
Total direct	$92,200
x 30% indirect cost rate	$27,660
TOTAL Direct and Indirect	$119,860

ISD Calculation

DCSC recurring	$12,200
ICSC non-recurring	$27,660
TOTAL CSC	$39,860
Less tribal shares Available for CSC	($20,000)
TOTAL ISD Request	$19,860

Tribe A would receive $100,000 from tribal shares and $19,860 would be requested from the ISD fund.

Circular Exhibit 96-04-C
(4/12/96)

Contract Support Costs Calculation Based on a Detailed Analysis

Assumptions:

1. Tribe B has $100,000 in Area and Headquarters tribal shares
2. Detailed analysis indicates that $10,000 of tribal shares are similar in nature to costs included in tribe B's indirect cot pool
3. Indirect cost rate = 30%
4. New budgeted tribal wages = $48,000
5. Direct contract support fringe = 15% of new wages
6. Other direct contract support = $5,000
7. No excluded items

Expanded program base $100,000 tribal $100,000 - $10,000	$90,000
DCSC fringe $48,000 wages x 15%	$7,200
Other DCSC	$5,000
Sub-total direct	$102,200
Less excluded items	$0
Total direct base	$102,200
x 30% indirect cost rate	$30,660
TOTAL Direct and Indirect	$132,860

ISD Calculation

DCSC recurring	$12,200
ICSC non-recurring	$307,660
TOTAL CSC	$42,860
Less tribal shares Available for CSC	($10,000)
TOTAL ISD Request	$32,860

Tribe B would receive $100,000 from tribal shares and $32,860 would be requested from the ISD fund.

APPENDIX G

Glossary of Acronyms and Terms

Acronyms

25-CFR	Title 25 - Code Of Federal Regulations
A-128	Office Of Management And Budget – Circular A-128
BIA	Bureau of Indian Affairs
CETA	Comprehensive Employment And Training Act
CSF	Contract Support Funds
DAR	Defense Acquisition Regulations
DCAA	Defense Contract Audit Agency
DOD	Department Of Defense
DOI	Department Of The Interior
EDA	Economic Development Administration
EPA	Environmental Protection Agency
ERISA	Employee Retirement Income Security Act
FAR	Federal Acquisition Regulations
FPR	Federal Procurement Regulations
GAO	General Accounting Office
GSA	General Services Administration
GSAR	General Services Administration Regulations

IHS	Indian Health Service
JTPA	Job Training Partnership Act
NASA	National Aeronautics And Space Administration
NIAAA	National Institute on Alcoholism and Alcohol Abuse
OASC-10	Cost Principles and procedures for establishing cost allocation plans and indirect cost rates for grants and contracts with the federal government
OFPP	Office of Federal Procurement Policy
OIG	Office of the Inspector General
OMB	Office of Management and Budget
P.L. 93-638	Public Law 93-638, the Indian Self Determination and Education Assistance Act of 1975

Terms

-ALLOWABLE COSTS: A number of costs are not allowed to be charged to grants or contracts. Consult OMB Circular A-87 Attachment A, Section C for the basic guidelines to follow to determine whether a cost is allowable or not.

-CENTRAL OFFICE: Means headquarters offices of the Bureau of Indian Affairs or Indian Health Service, located in Washington, D.C. and Rockville, MD, respectively.

-COST ALLOCATION PLAN: Means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. (OMB Circular A-87)

-COST OBJECTIVE: Means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred. (OMB Circular A-87)

-COST: Means an amount as determined on a cash, accrual, or other basis acceptable to the federal awarding or cognizant agency. It does not include transfers to a general or similar fund. (OMB Circular A-87)

-DIRECT COSTS: Generally, those costs that can be identified specifically with a particular cost objective. These costs may be Glossary of Acronyms and Terms charged directly to grants, contracts, or to other programs against which cost are finally lodged. Direct costs may also be charged to cost objectives used for the accumulation of costs pending distribution in due course to grants and other ultimate cost objectives. (Note - consult OMB Circular A-87 for examples of direct costs.)

-EQUITY FUNDS: Special appropriations provided by Congress to the Indian Health Service to adjust recurring budget allocations to those regions which have major deficiencies after allocation of recurring base funding. Targeted to make services more equitable across the country.

-INDIAN PRIORITY SYSTEM: The budget planning system utilized by the Bureau of Indian Affairs to permit Tribes to prioritize funding for some of the programs operated by the BIA at their locations.

-INDIRECT COSTS: Generally those 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. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services and facilities to the grantee department. (OMB Circular A-87)

-MULTIPLE RATES: Indirect cost rate agreements having different indirect costs rates for different agencies, different operational units or for specific grant operations.

-NONRECOVERY: Means that amounts a grantee or contractor was entitled to on the basis of a negotiated indirect cost rate were not fully received. Result - the grantee does not recover all costs of operating the grant or contract program.

-OVERRECOVERY: Means recovery on the basis of negotiated indirect cost rate exceeds that which would have occurred on the basis of actual costs, which are not known until after the fact.

-PARITY: As used herein, means that a Tribe, when contracting a program under P.L. 93-638, is able to (is provided aufficient funds to) provide services equal to those provided, or that would have been provided by the government.

-PROGRAMS: As used in this publication, means programs operated by Indian Tribes for the benefit of their members, including Federal contract and grant programs, or programs operated by the Federal Government for the benefit of Indians.

-RECURRING BASE: Established budget bases used within the Indian Health Service to distribute part of available funds by geographic location (regions and service units) at a reasonably consistent level from year to year.

-SHORTFALLS: Means lack of available budgeted funds to pay legitimate indirect costs Tribes were entitled to based on negotiated indirect cost rates.

-UNDERRECOVERY: Means recovery on the basis of negotiated indirect cost rate is less than that which would have occurred on the basis of actual costs, which are not known until after the fact.

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United States General Accounting Office

GAO

Report to Congressional Committees

June 1999

INDIAN SELF-DETERMINATION ACT

Shortfalls in Indian Contract Support Costs Need to Be Addressed

GAO/RCED-99-150

GAO United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-282458

June 30, 1999

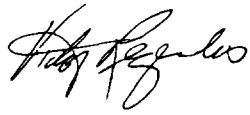
The Honorable Slade Gorton
Chairman
The Honorable Robert C. Byrd
Ranking Minority Member
Subcommittee on Interior and Related Agencies
Committee on Appropriations
United States Senate

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.

Chapter 1

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 though: 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 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.	Startup costs can include the costs of purchasing computer hardware and software, providing required training and staff development, establishing required administrative and management systems, and purchasing equipment and furniture to support an administrative unit.

[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

$$\text{Direct funding base for BIA's or IHS' programs} \times \frac{\text{Tribe's indirect cost pool}}{\text{Tribe's total direct cost base}} = \text{Indirect costs associated with BIA's or IHS' programs}$$

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.

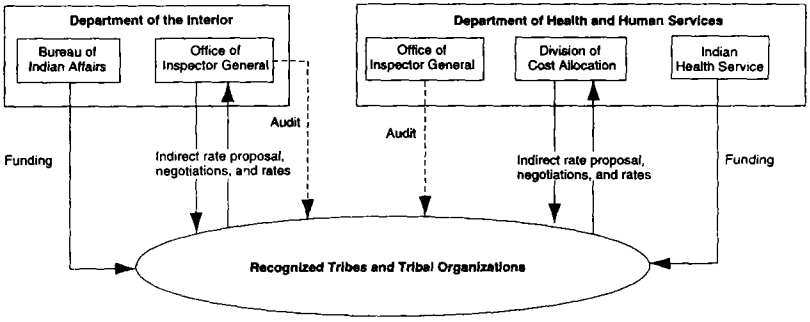
Tribes negotiate indirect cost rates annually in accordance with federal cost allocation principles and departmental guidance. In general, an indirect cost rate is determined by dividing a pool of indirect costs by a direct cost base. The direct base consists of program costs minus certain exclusions 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 s 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 o a tribal consortium. Tribes may administer multiple contracts from BIA an 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 int 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 contract 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 tc 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.

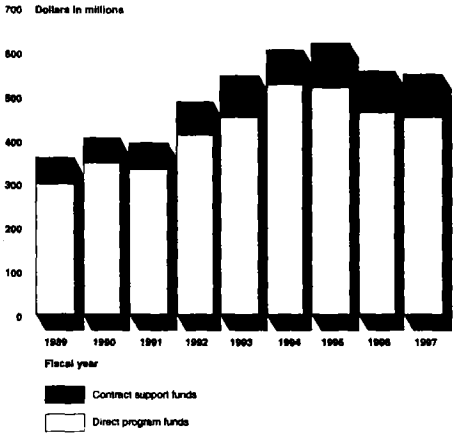
[1]The legislative history of the 1988 amendments to the Indian Self-Determination and Education Assistance Act discloses that the Congress substituted "contract support costs" for "contract costs" in the provision prescribing funding of reasonable costs to manage the contracts. It specifically chose 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



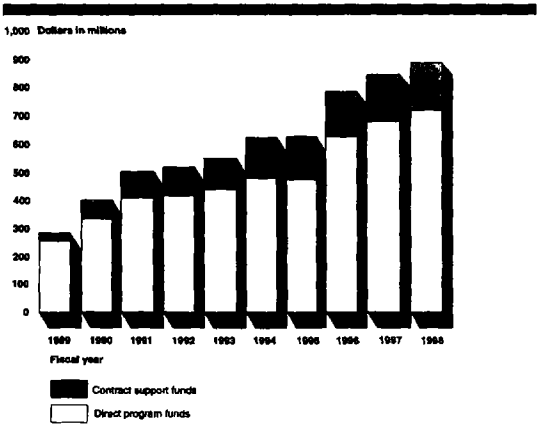
Note 1: Funds are in constant 1998 dollars.

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.

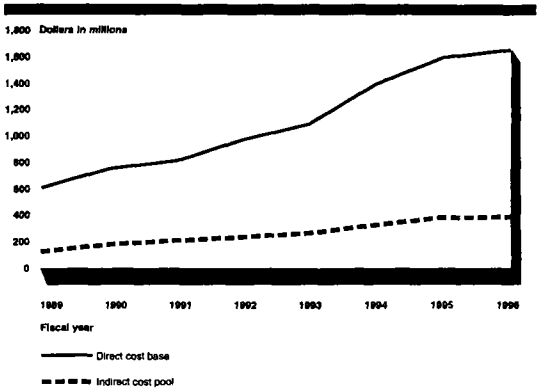
Source: GAO's analysis of IHS data.

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.

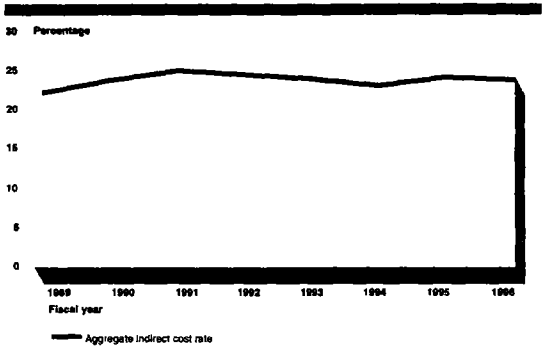
Note 2: Data on the indirect cost pool represents tribes' total indirect costs for all rates negotiated by Interior's Office of Inspector General. Only a portion of these costs would be allocated to BIA's and IHS' programs. The direct cost base also represents the total direct cost base for all tribes' 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.

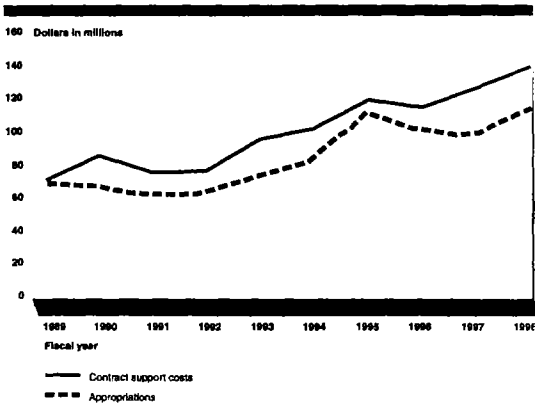
[3]This ratio reflects only the indirect cost component of contract support costs. According to IHS officials, the ratio would be closer to 3 to 1 when direct contract support costs and startup costs are included.

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.

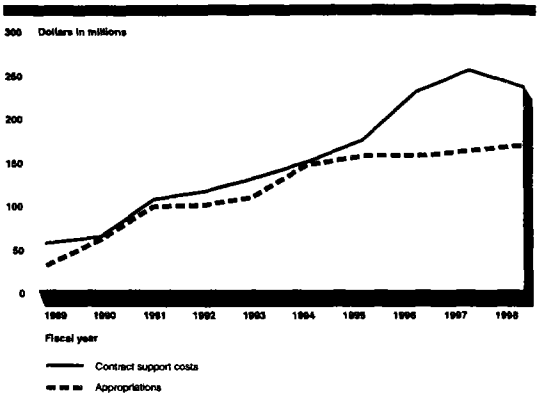
Source: GAO's analysis of BIA's data.

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 1996 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. Babbitz, 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 indicate 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.

Chapter 4

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

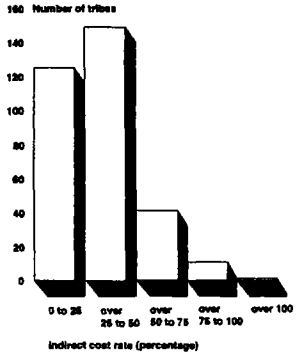
As with the second alternative, this one has the advantage of imposing limitations on the growth of contract support funding and of eliminating the expectation created by the law's current language that full contract

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.[5] 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

[5]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.

Appendix I

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)

Appendix II

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	$7,466,000	$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	**$7,466,000**	**$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

Appendix V

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.*

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.

See comment 2.

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.

Appendix VI

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 1992

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 these 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

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.

Appendix VIII

GAO Contacts and Staff Acknowledgments

GAO Contacts

Chet Janik, (202) 512-6508
Jeff Malcolm, (303) 572-7374
Susan Iott, (202) 512-8767

Acknowledgments

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