

**Memorandum**

Date AUG 24 1992

From Bryan B. Mitchell *Bryan Mitchell*  
Principal Deputy Inspector General

Subject Review of Medical Liability Insurance Costs Charged to Federal  
Research at Colleges and Universities with Medical Schools  
(A-04-91-04048)

To Arnold R. Tompkins  
Assistant Secretary for  
Management and Budget

The attached management advisory report is to provide you with the results of our review of medical liability insurance costs charged to Federal research at medical schools.

The objective of our review was to determine whether medical schools at colleges and universities (universities) were charging significant medical liability insurance costs, either directly or indirectly, to federally sponsored research grants not involving human test subjects. We also determined if there were significant differences in the way in which universities charged medical liability insurance costs to federally sponsored research.

Our review of \$81,110,069 of medical liability insurance costs at 28 universities showed that the universities were inconsistent in charging these costs to federally sponsored research. We found that: 2 universities charged medical liability insurance of \$51,840 as a direct cost to Federal awards that involved human test subjects; 13 universities charged no medical liability insurance costs to federally sponsored research, either as a direct cost or as an indirect cost; and 13 other universities included \$9,730,935 of medical liability insurance costs in their indirect cost proposals submitted for negotiation. Medical liability insurance costs charged as an indirect cost are normally allocated to all sponsored research projects, including those not involving human test subjects. We believe these costs have been handled in an inconsistent manner because universities have used varying interpretations of the Office of Management and Budget's (OMB) Circular A-21 concerning medical liability insurance costs.

To make the treatment of medical liability insurance costs more consistent and equitable we recommended that the Assistant Secretary for Management and Budget (ASMB) work with

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OMB to revise Circular A-21 to provide more specific guidance in this area. Such guidance would allow medical liability insurance to be allocated to research only to the extent that the research involved human test subjects.

The ASMB officials agreed with our conclusions that medical liability insurance costs are currently being handled inconsistently by the institutions. They also concurred with our recommendation that future changes to OMB Circular A-21 should include more specific guidance on how these costs should be treated. The ASMB comments to our recommendation are included as Appendix B and are incorporated in the body of this report.

We would appreciate your views, and the status of any further action taken or contemplated on our recommendations, within the next 60 days. If you have any questions, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301)443-3582.

Attachment

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICAL LIABILITY  
INSURANCE COSTS CHARGED TO  
FEDERAL RESEARCH AT COLLEGES  
AND UNIVERSITIES WITH MEDICAL  
SCHOOLS**



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The purpose of this management advisory report is to provide you with the results of our review of medical liability insurance costs charged to Federal research at medical schools.

The objective of our review was to determine whether medical schools at colleges and universities (universities) were charging significant medical liability insurance costs, either directly or indirectly, to federally sponsored research grants not involving human test subjects. We also determined if there were significant differences in the way in which universities charged medical liability insurance costs to federally sponsored research.

Our review of \$81,110,069 of medical liability insurance costs at 28 universities showed that the universities were inconsistent in charging these costs to federally sponsored research. We found that: 2 universities charged medical liability insurance of \$51,840 as a direct cost to Federal awards that involved human test subjects; 13 universities charged no medical liability insurance costs to federally sponsored research, either as a direct cost or as an indirect cost; and 13 other universities included \$9,730,935 of medical liability insurance costs in their indirect cost proposals submitted for negotiation. Medical liability insurance costs charged as an indirect cost are normally allocated to all sponsored research projects, including those not involving human test subjects. We believe these costs have been handled in an inconsistent manner because universities have used varying interpretations of the Office of Management and Budget's (OMB) Circular A-21 concerning medical liability insurance costs.

To make the treatment of medical liability insurance costs more consistent and equitable we recommended that the

Assistant Secretary for Management and Budget (ASMB) work with OMB to revise Circular A-21 to provide more specific guidance in this area. Such guidance would allow medical liability insurance to be allocated to research only to the extent that the research involves human test subjects. The ASMB concurred with our recommendation and stated they would work for their inclusion in future revisions of Circular A-21. The ASMB comments are included as Appendix B and are incorporated in the body of this report.

#### BACKGROUND

The OMB Circular A-21, Principles for Determining Costs Applicable to Grants, Contracts, and other Agreements with Educational Institutions, states that the cost of insurance maintained by the university in connection with the general conduct of its business is allowable. However, OMB Circular A-21, section C.4, in defining allocable cost states, in part:

"A cost is allocable to a particular cost objective ...if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received or other equitable relationship."

Under this criteria, we do not believe medical liability insurance costs would be allocable to organized research which does not involve human test subjects. This type of research does not involve a risk of malpractice claims and, thus, would receive no relative benefit from the medical liability insurance coverage.

#### SCOPE

The objective of our review was to determine whether a change to OMB Circular A-21 relating to medical liability insurance is warranted. To accomplish this objective, we determined for a number of universities whether they were charging significant medical liability insurance costs, either directly or indirectly, to federally sponsored research not involving human test subjects. We also determined if there were significant differences in the way in which universities charged medical liability insurance costs to federally sponsored research.

Our review combines the results obtained from reviews of universities completed during Fiscal Years (FY) 1989 and 1990 with work performed during our latest reviews during FY 1991. We identified 126 medical schools in the United States that could perform research on human test subjects that are subject to the provisions of OMB Circular A-21. Our reviews were conducted at 19 of the 126 medical schools during FYs 1989 and

1990. Internal reports were issued on these universities. We conducted reviews at nine additional universities with medical schools during FY 1991. Audit reports were issued to the universities on these reviews.

By combining the results of the 2 reviews, we have data on medical liability insurance costs at 28 of the 126 medical schools. A listing of the universities at which reviews were performed on medical liability insurance costs during FY 1988 through 1991 is found in Appendix A.

In FY 1987, during a survey of the medical liability insurance issue, we contacted the underwriting department of St. Paul Fire and Marine Insurance Company to determine if research effort was a risk factor in determining medical liability insurance rates. This company was selected because it is reported to be the largest underwriter of medical liability insurance in the country.

#### RESULTS OF REVIEW

Our review of \$81,110,069 of medical liability insurance costs at 28 universities showed that the universities were inconsistent in charging these costs to federally sponsored research. We found that medical liability insurance costs were not charged, either directly or indirectly, to federally sponsored research by 13 of the 28 universities with medical schools. Two of the universities charged medical liability insurance as a direct cost to awards that involved human test subjects. The remaining 13 universities used a variety of methods to include medical liability insurance costs in their indirect cost proposals. Four schools appear to be handling these costs in an acceptable manner, four allocated only an insignificant amount to research and in five cases the Division of Cost Allocation (DCA) either removed all medical liability insurance costs or made adjustments to limit charges.

Our review showed that there were inconsistencies in the way these costs were handled. Some universities charged a significant portion of their medical liability insurance costs to sponsored research while others charged only a small amount. As noted in the examples, in a number of cases, DCA had made adjustments to remove medical liability insurance costs or to limit the amount that could be allocated to that attributable to research projects involving human test subjects. The following examples are presented to show the variety of methods used to charge medical liability insurance costs to research.

- At Johns Hopkins University, about \$900,000 of medical liability insurance costs was charged as indirect costs to

sponsored research during FY 1988. This method of charging medical liability insurance costs did not restrict the charges to only those Federal awards which involved human test subjects. The inclusion of medical liability insurance costs in the cost pool resulted in an increase in the FY 1988 indirect cost rate of .84 percent.

According to the Health and Human Services Departmental Appeals Board (formerly Grant Appeals Board), such costs are allowable if properly allocated. The DCA accepted the university's allocation methods as reasonable, primarily because the majority of the costs were allocated to clinical services before the remainder was allocated to other university activities, including Federal research.

- The University of Minnesota included an insignificant portion of medical liability insurance costs in its indirect cost proposal.
- At the University of California - Los Angeles, sponsored research was allocated approximately \$2 million of medical liability insurance costs. The medical liability insurance was considered unallowable by DCA and the university's indirect cost rate was adjusted accordingly.
- Medical liability insurance costs were included in the general liability policy for Boston University, and premium charges applicable to the medical liability endorsement were not separately identified. Amounts for insurance were included in the general and administrative costs pool and the indirect costs were spread to all research, whether or not the research involved human test subjects.
- At the University of Wisconsin - Madison, we determined that a small amount for medical liability insurance costs was included in the determination of the indirect cost rate for Federal research. The application of this rate indirectly charged medical liability insurance costs to Federal research awards.
- The University of Arizona proposed charging medical liability insurance to federally sponsored research through its indirect cost rate. The negotiated indirect cost rate was 3 points less than proposed; and the certified public accountant (CPA) was unable to determine if any of the proposed medical liability insurance costs were removed in arriving at the final approved indirect cost rate. The proposal showed approximately \$500,000 of medical liability insurance costs were allocated to the sponsored research costs pool during FY 1988. Had these costs remained in the cost pool, they would have accounted for .81 percent of the FY 1988 indirect cost rate.

- The University of California - San Francisco proposed charging \$2,093,935 of medical liability insurance costs to Federal projects through its indirect cost rate. The negotiated rate was 8.41 percent less than the proposed amount; however, the costs which made up this difference were not separately identified. Therefore, the CPA could not determine if medical liability insurance costs were charged indirectly to federally sponsored research. During negotiations, however, the DCA made downward adjustments to the rate to reflect the improper inclusion of such costs.
- The University of California - San Diego included medical liability insurance costs in its FY 1988 indirect cost proposal; however, the costs were removed by DCA. Therefore, the university did not charge any amount either directly or indirectly to federally sponsored research projects. For FY 1989 and 1990, it segregated medical liability insurance costs as a separate component of an indirect cost pool and proposed no rate for this component in its sponsored research indirect cost rate.
- At Washington University, medical liability insurance costs reported by the School of Medicine and charged to departmental administration were \$3,682,993. These costs were comprised of medical liability insurance totaling \$3,374,154 and administrative support totaling \$308,839. The DCA and the school agreed that these costs would be allocated on the basis of instruction and organized research salaries to the total of these two salary groups. Salaries for instruction totaled \$101,075,272 and salaries for organized research totaled \$45,234,568 for a total of \$146,309,840 in salaries. Salaries for instruction represent approximately 69 percent of total salaries and salaries for organized research represent approximately 31 percent of total salaries.

To determine the amount allocated to organized research, the university applied the organized research salary percent (30.917 determined above) to the \$3,682,993 reported by the School of Medicine which resulted in \$1,138,671 of the costs being allocated to the organized research costs pool. The university then applied the percent for research on human subjects (37.35) to the amount allocated to the organized research costs pool ( $\$1,138,671 \times 37.35$ ), and determined that organized research should be charged \$425,348. The remaining \$713,323 was charged to instruction within the departmental administration costs pool.

- The University of Pittsburgh charged approximately \$57,000 of medical liability insurance costs to sponsored research through the general and administrative costs pool.



- At the University of Chicago, \$1.9 million of medical liability insurance costs was allocated to organized research through the departmental administration costs pool. We determined that approximately 33 percent of the university's awards involved the use of human test subjects. The remaining 67 percent of the awards did not involve human test subjects and; therefore, should not bear any medical liability insurance costs. The DCA made adjustments to remove the costs that did not involve human test subjects.
- At the University of Texas Southwestern Medical Center, \$406,792 of medical liability insurance costs was allocated to sponsored research through the departmental administration costs pool.
- At the University of Miami, \$494,110 of medical liability insurance costs was allocated to sponsored research through the departmental administration costs pool. As a result of negotiations with DCA, only \$158,000 was actually included in the negotiated rate agreement.

Conceivably, medical liability insurance costs could be an allowable charge to those federally sponsored awards which benefit from the insurance. Generally, the sponsored awards that benefit from medical liability insurance are those which involve human test subjects (patient care). We confirmed this by contacting one of the Nation's leading underwriters of medical liability insurance, St. Paul Fire and Marine Insurance Company. We were told that premium rates are based on each individual being insured and that individual's exposure to patient contact. Research not involving patient care is not a risk factor when establishing the premium.

#### CONCLUSIONS AND RECOMMENDATIONS

Of the 28 medical schools reviewed, 13 included medical liability insurance in their indirect cost computations, 2 claimed medical liability insurance costs as a direct cost to awards involving human test subjects, and 13 did not claim the cost either directly or indirectly.

As noted above, the allowability of medical liability insurance costs has been subject to varying interpretations by different universities. Some universities have charged this cost directly to research projects, some as an indirect cost, and others not at all. We believe this inconsistency results from the absence of specific guidance in Circular A-21. In order to provide for consistent and equitable treatment of medical liability insurance costs, we believe they should be allowed only when the Federal research project involves human test subjects (patient care) because that is the risk factor considered when establishing the premiums. Whenever feasible,

such costs should be charged as a direct cost to the research project involved.

To make the treatment of medical liability insurance costs more consistent and equitable we are recommending that ASMB work with OMB to revise Circular A-21 to provide more specific guidance in this area. Such guidance should allow medical liability insurance to be allocated to research only to the extent that the research involves human test subjects.

ASMB COMMENTS

The ASMB agreed with our conclusion that medical liability insurance costs are currently being handled inconsistently by the institutions. Also, they concurred with the recommendation that OMB Circular A-21 should provide more specific guidance on how these costs should be treated. They have advised us that they will forward the final report to OMB with their suggestions that this subject be addressed in a future revision of the Circular.

We would appreciate your views, and the status of any further action taken or contemplated on our recommendations, within the next 60 days. If you have any questions, please call me or have your staff contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301)443-3582.

bcc:

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PHSAD/RCWainscott/RCW-JLJ - 08/12/92

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APPENDICES

**LISTING OF 28 UNIVERSITIES WHERE  
MEDICAL LIABILITY INSURANCE COSTS WERE REVIEWED**

Johns Hopkins University  
Medical University of South Carolina  
University of Minnesota  
Baylor College of Medicine  
University of California - Los Angeles  
Boston University  
Tufts University  
New York University  
University of Pennsylvania  
Wake Forest University  
University of South Florida  
University of Florida  
University of Michigan  
University of Wisconsin - Madison  
University of Kansas  
University of Arizona  
Charles Drew University  
University of California - San Francisco  
University of California - San Diego  
Yale University  
Washington University  
Duke University  
University of Pittsburgh  
University of Chicago  
University of Southern California  
Emory University  
University of Texas - Southwest Medical Center  
University of Miami



JUL 30 1992

Washington, D.C. 20201

IG	_____
PDIG	_____
DIG-AS	_____ ✓
DIG-EI	_____
DIG-OI	_____
AIG-MP	_____ ✓
OGC/IG	_____
EX SEC	_____
DATE SENT	8/3

TO: Bryan B. Mitchell  
Acting Inspector General

FROM: *AR* Arnold R. Tompkins  
Assistant Secretary for  
Management and Budget

*Elysheth M. James*

SUBJECT: Draft OIG Report -- Review of Medical Liability  
Insurance Costs Charged to Federal Research at Colleges  
and Universities with Medical Schools (A-04-91-04048)

We've reviewed the draft OIG report on medical liability insurance costs charged to Federal research programs by universities. We agree with your conclusion that these costs are currently being handled inconsistently by the institutions.

We concur with the recommendation in the report that OMB Circular A-21 should provide more specific guidance on how these costs should be treated. When the final report is issued, we will forward it to OMB with the suggestions that this subject be addressed in a future revision of the Circular.