



THE SECRETARY OF VETERANS AFFAIRS  
WASHINGTON

January 11, 2018

The Honorable David P. Roe, M.D.  
Chairman  
Committee on Veterans' Affairs  
U.S. House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

In accordance with the requirements of title 38, United States Code, section 7366(d), enclosed is the Department of Veterans Affairs' (VA) report on Nonprofit Research and Education Corporations, as well as the required statement of cost for preparing the report.

This report has also been sent to other leaders of the House and Senate Committees on Veterans' Affairs.

Sincerely,

A handwritten signature in blue ink that reads "David J. Shulkin, M.D." with a stylized flourish at the end.

David J. Shulkin, M.D.

Enclosures



THE SECRETARY OF VETERANS AFFAIRS  
WASHINGTON

January 11, 2018

The Honorable Johnny Isakson  
Chairman  
Committee on Veterans' Affairs  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman:

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David J. Shulkin, M.D.

Enclosures



THE SECRETARY OF VETERANS AFFAIRS  
WASHINGTON

January 11, 2018

The Honorable Tim Walz  
Ranking Member  
Committee on Veterans' Affairs  
U.S. House of Representatives  
Washington, DC 20515

Dear Congressman Walz:

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Enclosures



THE SECRETARY OF VETERANS AFFAIRS  
WASHINGTON

January 11, 2018

The Honorable Jon Tester  
Ranking Member  
Committee on Veterans' Affairs  
United States Senate  
Washington, DC 20510

Dear Senator Tester:

In accordance with the requirements of title 38, United States Code, section 7366(d), enclosed is the Department of Veterans Affairs' (VA) report on Nonprofit Research and Education Corporations, as well as the required statement of cost for preparing the report.

This report has also been sent to other leaders of the House and Senate Committees on Veterans' Affairs.

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David J. Shulkin, M.D.

Enclosures

# **DEPARTMENT OF VETERANS AFFAIRS (VA)**

## **Nonprofit Research and Education Corporations (NPC)**



### **2016 Annual Report**

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## I. BACKGROUND

In 1988, Congress passed Public Law (P.L.) 100-322, now codified at sections 7361-66 of title 38, United States Code (U.S.C.), which permitted the Secretary of the Department of Veterans Affairs (VA) to authorize the establishment of Nonprofit Research and Education Corporations (NPCs) at VA medical centers (VAMCs). This laid the foundation for creation of unique partnerships to conduct VA-approved research. P.L. 100-322 allowed the establishment of private, state-chartered, nonprofit entities to provide flexible funding mechanisms for the administration of funds, other than those appropriated to VA, for the conduct of VA-approved research.

## II. NPCs' ROLE IN SUPPORT OF VA RESEARCH AND EDUCATION

In 1999, Congress expanded the NPCs' authority to include support for VA's education and training missions. The fundamental purpose of NPCs is to serve Veterans by supporting VA research and education in order to improve the quality of care that Veterans receive.

Beyond administering research projects and education activities, NPCs support a variety of VA research infrastructure and administrative expenses. They have provided seed and bridge funding for investigators, staffed animal care facilities, funded recruitment of clinician researchers, paid for research administrative and compliance personnel, supported staff and training for institutional review boards, and much more.

In the past 10 years, 2007 through 2016, the NPCs contributed \$2.2 billion to VA research and education.

## III. NPC LOCATIONS

VAMCs throughout the country have long recognized the benefit of establishing NPCs to help support the conduct of VA-approved research and education activities. During 2016, there were 83 NPCs located in 44 states, Puerto Rico, and the District of Columbia. All of the NPCs filed annual reports. During 2016, there were 76 research and education NPCs and 7 research-only NPCs. As shown in the table below, the NPCs vary greatly in size:

Revenues Range	# of NPCs (2016)	# of NPCs (2015)	# of NPCs (2014)	# of NPCs (2013)	# of NPCs (2012)	# of NPCs (2011)
Below \$500K	22 (27%)	23 (28%)	29 (36%)	27 (33%)	33 (41%)	25 (32%)
\$500K- \$1M	19 (23%)	14 (17%)	12 (14%)	15 (18%)	9 (11%)	13 (16%)
\$1M- \$ 10M	36 (43%)	39 (47%)	35 (42%)	34 (41%)	33 (41%)	34 (43%)
\$10M & above	6 (7%)	7 (8%)	7 (8%)	7 (8%)	6 (7%)	7 (9%)
Total NPCs	83	83	83	83	81	79

**NOTE: Inactive NPCs not included in 2011 through 2013**

#### IV. ANNUAL REPORTING

Under title 38, U.S.C., section 7366(b), NPCs must submit to the Secretary of VA a detailed statement of their operations, activities and accomplishments during the previous year.

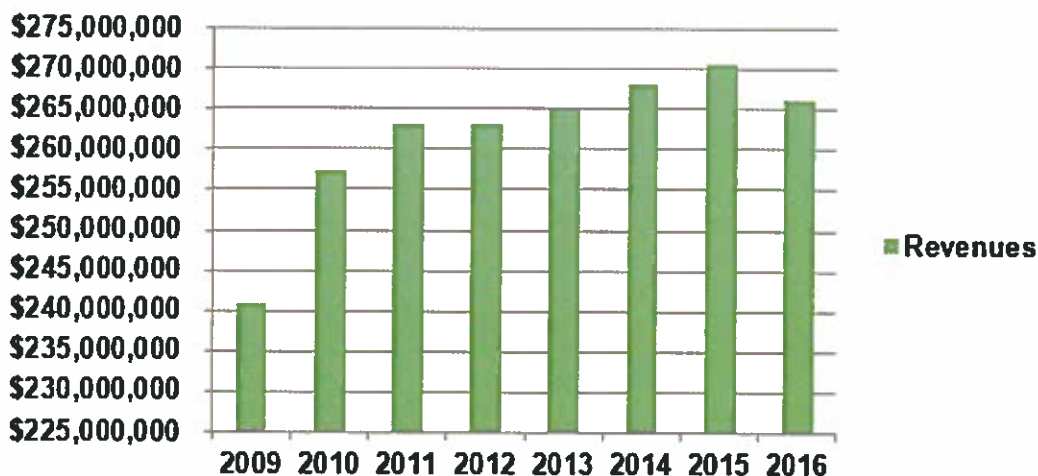
Veterans Health Administration (VHA) *Handbook 1200.17, VA Nonprofit Research and Education Corporations Authorized by Title 38 U.S.C., Sections 7361 through 7366*, dated April 27, 2016, requires each NPC to submit an Annual Report to VA's Chief Research and Development Officer on or before June 1 of each year. VA's Nonprofit Program Office (NPPO), located in VHA Office of Research and Development (ORD), reviews the NPC Annual Reports and is responsible for summarizing the information for NPC Annual Report to Congress. The information submitted by NPCs consists of, but is not limited to, IRS Form 990 – *Return of Organizations Exempt from Income Tax*, audited financial statements, auditor's management letter (if applicable), and related revenue and expense information.

#### V. FINANCIAL REPORTING

##### Revenues

In June 2017, NPCs reported \$266,154,701 total revenues during the 2016 reporting period, including interest income and other miscellaneous receipts. This represents an approximately 2 percent decrease in NPC revenues over the previous year. From 2000 through 2007, total NPC revenue trended up. In 2008 and 2009, revenues decreased. Revenues increased substantially in 2010 and 2011, were flat for 2012, but increased again in 2013, 2014, and 2015. Revenues for 2016 decreased by 2 percent. Thirty-five NPCs reported an increase in overall revenues in 2016 compared to 52 in 2015. For 2016, 48 NPCs experienced declines in revenues.

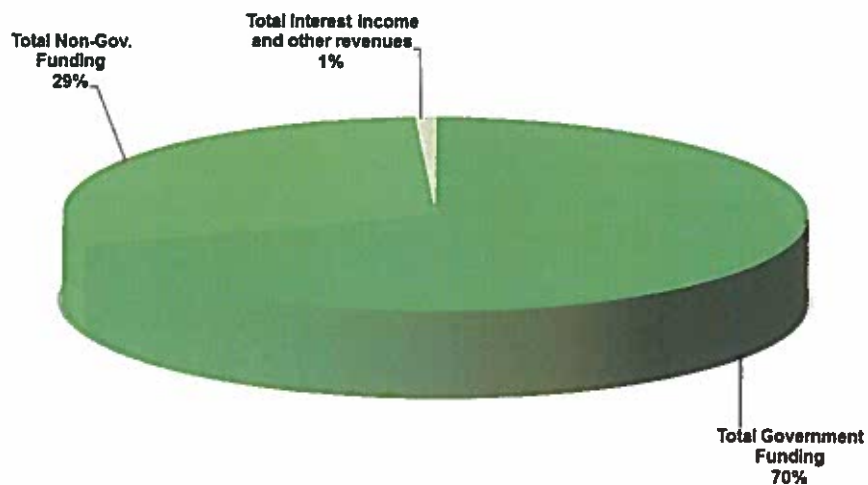
**NPC Annual Revenues – 2009 to 2016**





Under the title 38 statutory reporting requirements, NPCs are required to report research and education revenues and expenditures separately. In addition, they must report revenues based on governmental or non-governmental (private) funding sources. Ninety-eight percent of total revenue was received in support of research, while 1 percent was received in support of education. The remaining 1 percent was received from other sources such as interest income.

### 2016 NPC Revenues by Funding Source



As in the previous year, revenue from governmental research and education sources comprised the largest component of funding received by NPCs (approximately 69 percent). In 2016, governmental funding decreased to \$185 million, from the previous \$186 million in 2015.

Revenues from non-governmental sources decreased 5 percent, from \$83 million in 2015 to \$79 million in 2016. Other revenue sources (e.g., interest income) remained approximately the same as in 2015, at \$2 million.

In 2016, the number of NPCs reporting revenue from governmental sources (including VA) was 66, the same as in 2015.

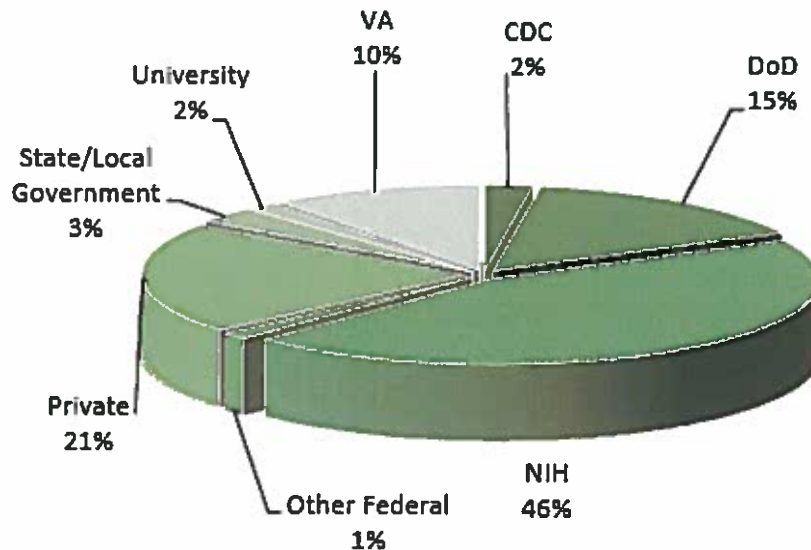
### Funding Sources

NPCs continue to obtain funding from diverse sources, including private-sector companies, charitable foundations, private individuals, state and local governments, universities, and Federal entities such as the National Institutes of Health (NIH), Department of Defense (DoD), and Centers for Disease Control and Prevention.

Funds coming to NPCs from VA are for Intergovernmental Personnel Act (IPA) assignment agreement reimbursements, or are funds from another agency or private entity that have been passed through VA to NPCs.

NPCs are required to identify the funding sources for both governmental and non-governmental amounts greater than \$25,000 (see chart below for the breakdown). For 2016, the total revenue received from these sources was \$228 million.

### 2016 Revenues >\$25,000 by Funding Source



### Expenses

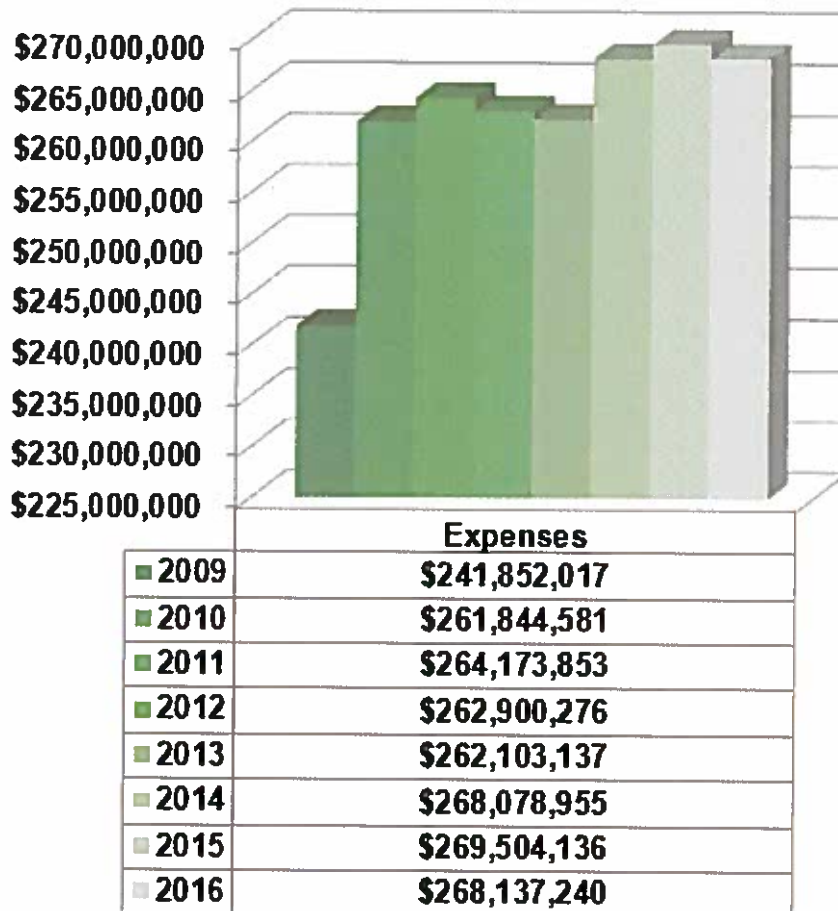
In June 2017, NPCs reported expenses totaling \$268,137,240 during 2016, a decrease from 2015 expenses which were \$270 million. These expenses financed research projects and their supporting infrastructure as well as salaries, equipment, and other research and education-related costs. NPCs employed approximately 2,600 people, supported more than 2,100 principal investigators, and administered approximately 3,300 research projects.

Because the statutory purpose of NPCs is to facilitate VA research and education, all funds spent must support those activities with the exception of amounts that cover NPC administration.

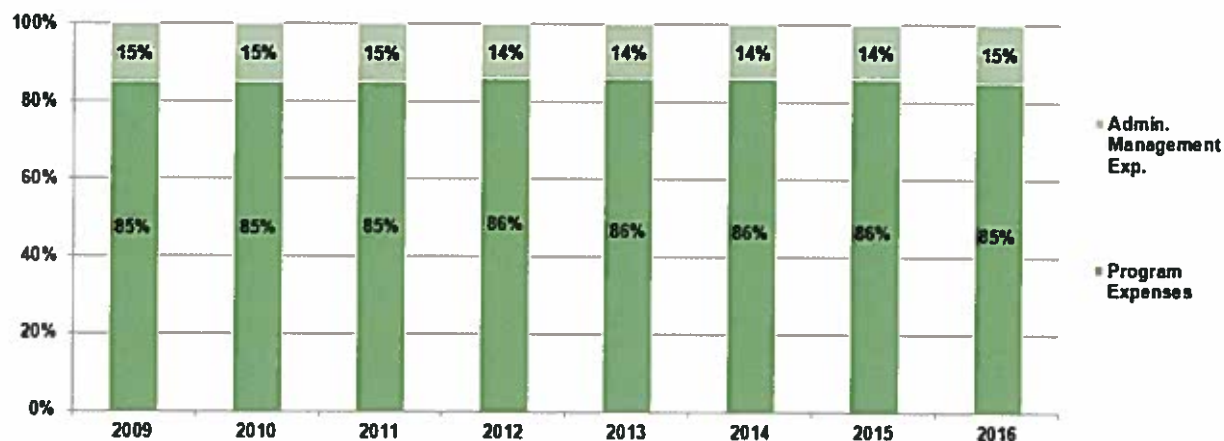
## NPC Annual Expense 2009-2016

During 2016, approximately 55 percent of total expenses covered salaries and benefits; approximately 1 percent of total expenses covered travel, and the remaining 44 percent represented other expenses in direct support of VA research and education activities or NPC business operations.

NPCs continue to spend a relatively small amount on administrative expenses, averaging 15 percent (\$39 million) of total expenditures for 2016.



### NPC Total Combined Administrative Management Expenses vs. Direct Program Expenses 2009-2016

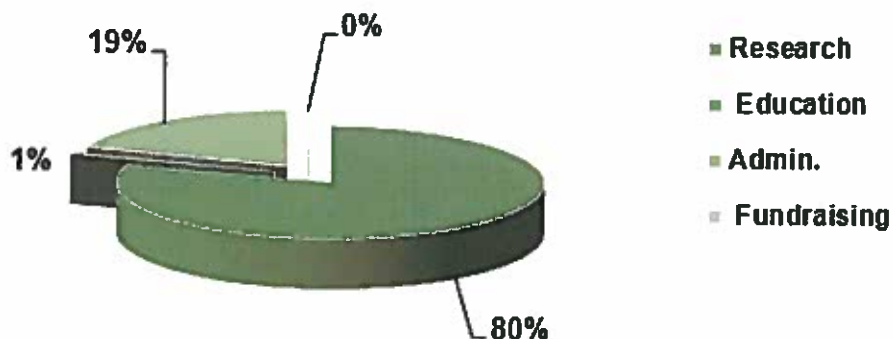


### Compensation Expense

During 2016, 80 NPCs reported compensation expenses including benefits totaling \$146 million, approximately a half percent increase from 2015. The NPC salary expenditures supported a variety of personnel (including research technicians, pharmacists, scientists, nurses, physicians, and administrative staff).

Of the \$146 million spent for compensation, 80 percent (\$117 million) was used to support personnel directly engaged in VA research. Approximately 19 percent (\$28 million) was expended for NPC administrative salaries. Less than \$1 million or 1 percent was expended in support of staff involved in educational activities.

### 2016 Compensation Expense by Category

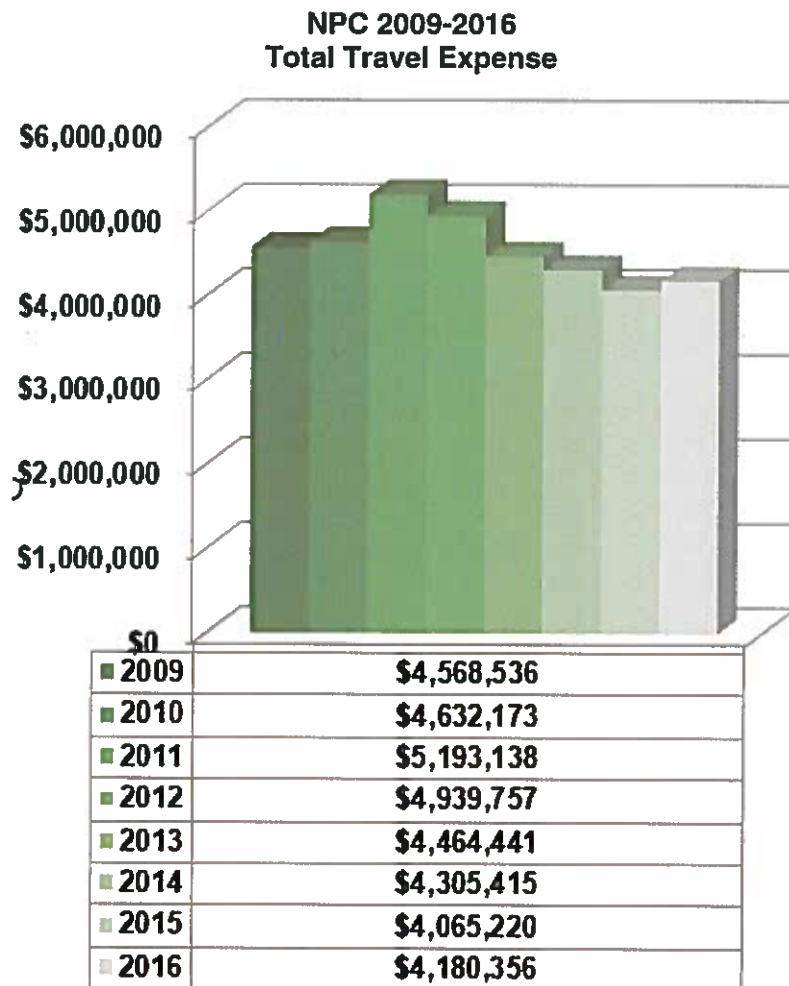


### Travel Expense

NPCs support travel for VA and NPC personnel to attend scientific and educational meetings, seminars, and conferences. VA benefits from such travel because it

enhances the ability of VA staff to pursue research and education endeavors important to VA's health care, training, and research missions. Seventy-two NPCs reported travel expenditures totaling \$4 million for 2016, approximately the same as for 2015.

Of the \$4 million in travel expenditures, approximately 90 percent supported travel for personnel directly engaged in research or education activities.



### Other Expenditures

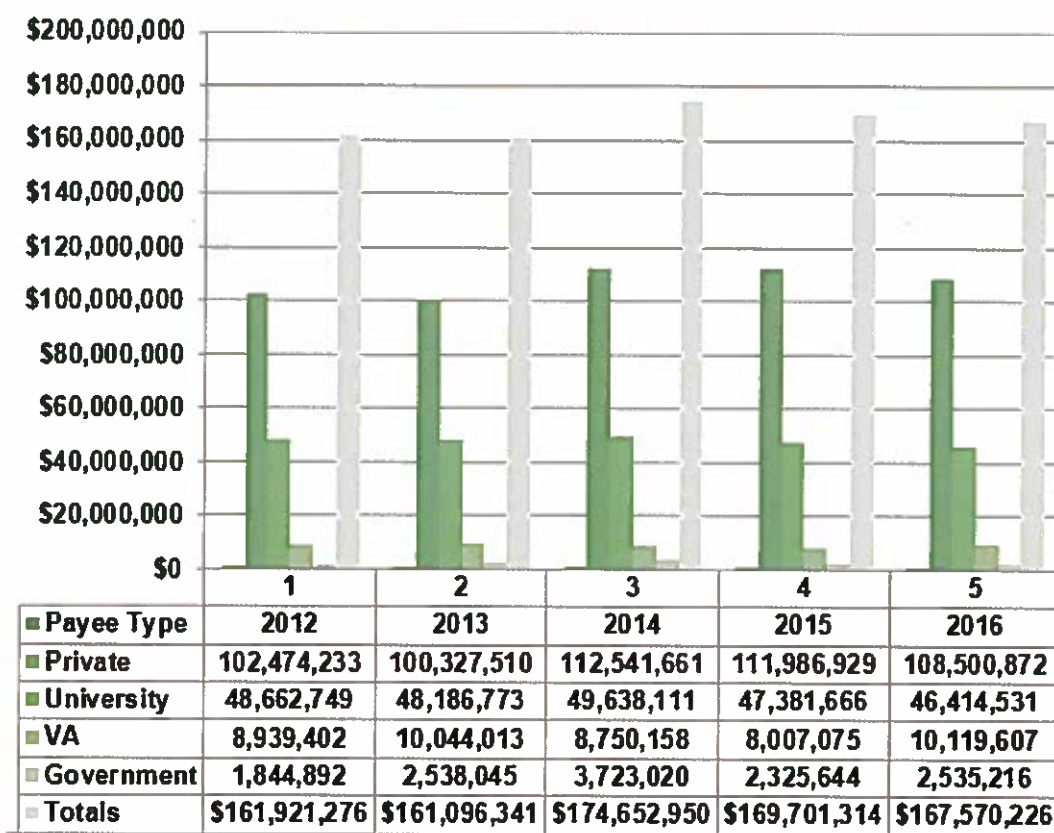
While furthering VA's research and education missions, NPCs incur a number of costs in addition to payroll, benefits, and travel. During the 2016 reporting period, other expenses totaled \$118 million, down by two percent from \$121 million in 2015. They included, but were not limited to, legal fees, insurance, accounting, auditing, consulting services (statisticians, information technology experts, etc.), supplies, postage, shipping, equipment purchases, rentals and maintenance, printing, publications, utilities, and conference registrations.

## Payees

Each NPC hires employees and contracts with various vendors (“payees”) to support the conduct of VA-approved research and education activities.

The vendors provide products and services that sustain research, education, and business operations. Any payee receiving more than \$50,000 per year is identified in the NPC report and is presented in chart below:

**Chart of NPC Payees Greater than \$50K  
By Type 2012-2016**



The table above lists the four major types of payees and provides the total amount paid to each type. Private payees include employees, consultants, etc. State and private university payees may include reimbursements from grants or sub-awards. VA reimbursements are costs reimbursed in support of VA research and education activities. Other governmental payees include sub-awards or pass-through funds to non-VA government entities.

## Financial Position

NPCs reported net worth totaling \$201,707,234 at the end of 2016, approximately a 1 percent decrease from 2015 net worth, which was \$203 million. Gross assets under management were \$278 million and liabilities were \$77 million. It should be

noted that in many cases the NPC's include funds that are obligated for the future performance of research projects in net worth. Although this is acceptable under U.S. generally accepted accounting principles, there is nonetheless an obligation to expend project funds counted as equity in order to accomplish research and education projects. Unencumbered net worth for all the NPCs combined is estimated at \$58 million.

The ratio of net worth to revenues was 76 percent for all the NPCs. For the top 20 NPCs that comprised 77 percent of total revenues, the net worth ratio was 57 percent. Some individual large NPCs that rely heavily upon awards from National Institute of Health, Department of Defense, and other Federal agencies, had substantially lower net worth ratios than the average and have been advised to conserve their net worth as best they can and to augment it when possible.

## **VI. PROJECTS, ACTIVITIES AND ACCOMPLISHMENTS**

NPCs facilitated a variety of projects during the 2016 reporting period. Many of these research projects were clinical studies that focused on the treatment of medical conditions prevalent in the Veteran population. Veterans benefit from getting access to innovative cutting-edge pharmaceuticals and medical care devices. Many Veterans who participate in VA studies benefit from the actual "hands on" care provided, but also directly from the interaction between NPC staff and patients.

The quality of care given to Veterans enrolled in clinical studies is exceptional and is a direct result of the close one-on-one relationships between the caregivers conducting research and the Veterans. VAMCs may potentially benefit from drugs and devices donated by sponsoring institutions and pharmaceutical companies as well as from NPC salary support for nurses and physicians caring for Veteran patients enrolled in clinical studies.

NPCs also support VA in many ways beyond administering funds. Several examples are listed below:

- Renovate and upgrade VA research infrastructure;
- Provide funds, staffing, and training support to VA and affiliate universities to help cover Institutional Review Board requirements;
- Pay for expenses related to recruitment of research investigators to the VA system;
- Fund seed grants to new investigators to aid them in establishing their VA research careers;
- Employ support staff for VA research projects;
- Cover the cost of training VA research personnel in topics such as research compliance, good clinical practice, and board governance;
- Underwrite bridge funding for VA investigators who are between research grant awards;
- Support travel and registration fees for VA investigators to attend scientific conferences;

- Procure personnel, equipment, and supplies for VA animal research facilities;
- Provide funds for research pharmacy staff and equipment; and
- Host national educational conferences for VA personnel with incidental attendance by health professionals from surrounding communities.

## **VII. CONFLICTS OF INTEREST**

NPC directors, officers, and employees are subject to the conflict of interest policy adopted by that NPC. VA employees who serve as NPC directors as part of their official VA duty are also subject to the Federal conflict of interest laws and regulations. At any time there is a conflict with the NPC policy, the Federal conflict of interest laws and regulations take precedence.

## **VIII. VA NONPROFIT PROGRAM OVERSIGHT BOARD**

In 2004, VA senior leadership created the VA Nonprofit Program Oversight Board to serve as VA's senior management oversight body over NPC activities and programs. The Board meets on a quarterly basis to review the activities of the NPCs for consistency with VA policy and interests. The Board may also make recommendations to the Secretary and Deputy Secretary concerning changes to, and implementation of, VA policy regarding NPCs. Board membership is limited to VA employees and includes:

- Under Secretary for Health;
- General Counsel;
- Assistant Deputy Under Secretary for Health for Operations and management;
- Chief Research and Development Officer;
- VA Nonprofit Program Officer;
- Chief Academic Affiliations Officer;
- Chief Financial Officer for VHA, or a designee.
- Member, Office of Research and Development Field Research Advisory Committee; and
- Chief Officer, VA Office of Research Oversight.

## **IX. INDEPENDENT AUDIT REPORTS**

The VA Nonprofit Program Office (NPPO) reviews the independent audit reports and the related NPC audited financial statements for the NPCs. The NPPO also reviews other documents such as the independent audit management letters, lists of program activities and accomplishments, and supplemental revenue and expenditure information. This oversight is performed in order to obtain substantive evidence of accountability and to have a balanced picture of NPC program activity.

Any material weaknesses or significant deficiencies in internal controls and related recommendations made by the NPCs' independent auditors are noted. NPPO tracks these from year to year to determine whether the NPCs have taken the appropriate corrective actions as recommended by their independent audits.



Under title 38 U.S.C. section 7366(b) each NPC with annual revenues in excess of \$500,000 for the year is required to obtain an independent audit of its financial statements for the year. NPCs with annual revenues between \$100,000 and \$500,000 must obtain an independent audit every 3 years. For those NPCs with \$100,000 or less in annual revenues, an independent audit is not required. For fiscal year (FY) 2016, 17 NPCs were not required to obtain an independent audit. Of the 83 NPCs, 66 (or 80 percent) submitted audited financial statements. For 2016, 99 percent of total NPC revenues and 99 percent of total expenses were subject to independent audits.

There are three ascending levels of independent audits:

- (1) Generally Accepted Auditing Standards (GAAS) in the United States of America Audit: This audit requires the auditor to plan and perform the audit in order to obtain reasonable assurance that the financial statements are free of material misstatements. The auditor assesses internal controls, management, and governance. An NPC receiving more than \$100,000 but less than \$500,000 in funding is required to obtain, at a minimum, an audit in accordance with GAAS once every 3 years.
- (2) Generally Accepted Government Accounting Standards (GAGAS) Audit: This audit also obtains reasonable assurance that the financial statements are free of material misstatements. The GAGAS audit is used when required by provisions of laws, regulations, contracts, and grants.
- (3) Uniform Guidance Audit: This audit is performed in accordance with Office of Management and Budget published Rules and Regulations, when annual expenditures are from Federal funds exceeding \$750,000. The uniform guidance audit is designed to provide assurance that the financial statements are reasonable and there is compliance with the legal and regulatory requirements of the Federal contract(s) and grant(s), and with sound internal controls.

Six NPCs were cited by their auditors for material weaknesses. These material weaknesses are different than those reported in 2015. NPCs with material weaknesses are working closely with NPPO and their external auditors to ensure correction of the weaknesses prior to the next audit.

The NPPO requires an in-depth action plan from each NPC with material weaknesses and significant deficiencies and follows-up on these during periodic on-site reviews.

Two of the NPCs reporting material weaknesses were audited under GAAS and four were audited under a uniform guidance audit. The NPPO will follow-up to ensure these material weaknesses and other deficiencies are corrected.

The Executive Director of each NPC is responsible for providing a copy of the auditor's report to the NPC's Board of Directors and involving the Board directly in

the resolution of any deficiencies. NPPO has requested a remediation action plan from these NPCs.

## **X. NPPO OVERSIGHT PLAN AND RESULTS**

NPPO is charged with conducting oversight for the 83 VA affiliated nonprofit research and education corporations nationwide. NPPO reviews the Operations Oversight Questionnaire with the Executive Director and the Internal Control Questionnaire that is provided in advance of the on-site visit. NPPO routinely tests samples of various transactions and accounting records, such as policies and procedures, cash disbursements, credit card purchases, bank statements and reconciliations, payrolls, and IPA assignment agreements.

The limited on-site reviews by NPPO are for the purpose of providing audit, investigative, and oversight-related services that do not involve a GAGAS full financial, attestation, or performance audit examination. NPPO's limited reviews are not designed to detect fraud, waste, abuse, or other irregularities. NPPO's reviews are substantially narrower in scope than an audit examination. The objective of an audit examination is the expression of an opinion on the subject matter, and accordingly, no such opinions are expressed. *Ref. Government Auditing Standards 2011 Revision, Chapters 2.12 and 5.56, Pages 19 and 116.* Nonetheless, NPPO reserves the rights to extend its limited reviews; initiate other reviews or investigations; and arrange for the conduct of complete GAGAS financial, attestation, or performance audits if needed for effective VHA oversight. NPPO observes auditing standards set by the Comptroller General of the United States.

1. All NPCs will be reviewed triennially regardless of financial condition. To accomplish this, one-third of the NPCs are audited each year.
2. NPCs with identified operating problems or serious internal control weaknesses will be reviewed on-site annually and monitored. Once the issues are resolved and the NPC receives a satisfactory review, its review schedule will be moved to the triennial schedule.
3. New Executive Directors (ED's) are welcomed and notified of the next ED workshop and the availability of the NPPO website. They are also given NPPO staff contact information within the first 45 days of employment.
4. NPCs that are starting-up, reactivating, merging, or deactivating will be visited as needed.
5. NPCs with reported irregularities (e.g., by whistleblowers) will be reviewed on-site immediately and have appropriate follow-up action taken.
6. NPCs requesting on-site visits to resolve internal control, financial systems, or financial management problems will be visited as soon as possible.

All 83 NPCs were reviewed by NPPO in FY 2011 through 2013. The second triennial reviews began in FY 2014 and were completed in FY 2016. For the second reviews, all prior required actions were followed-up along with the normal review. Results for the first and second triennial review periods were:

First triennial period, FY 2011 – 2013:

- 585 required actions
- 219 consultative suggestions

Second triennial period, FY 2014 – 2016:

- 577 required actions
- 153 consultative suggestions
- 92 percent success rate for implementing prior required actions

During the second triennial period, the NPPO developed and implemented Executive Director and Financial Manager training classes held in Kansas City, MO. We anticipate this will result in fewer required actions for the third triennial period, FY 2017-2019. Formal review reports are prepared for each NPPO review and discussed with the NPC Executive Directors and the Medical Center Directors and their key staff while on site. Additionally, the written responses from the NPCs to the review reports are incorporated into the reports before they are forwarded to the VHA Chief Financial Officer's office.

In addition to the routine triennial reviews, NPPO has performed non-routine whistleblower complaint, timekeeping, and fraud investigations.

Other routine oversight conducted at NPPO offices include reviews of:

1. Annual reports due June 1 on forms prescribed by NPPO.
2. Annual audited financial statements due to NPPO by June 1.
3. Annual Form 990 income tax returns due to NPPO by June 1.
4. Remediation plans for all NPCs with material weaknesses reported by their independent auditors.
5. Remediation plans for all NPCs with significant deficiencies and auditor recommendations.
6. Monthly financial statements compared to budget and last year for NPCs with identified operating problems and/or inadequate reserves.
7. Immediate attention to all NPC requests for assistance or advice.

## **XI. NPPO TRAINING**

Over the past 4 years, NPPO has been engaged in training the NPCs' boards of directors and other personnel by:

1. Providing a half-hour presentation on board governance during each on-site review.
2. Developing and facilitating a two-day workshop for Executive Directors that is held twice a year.
3. Developing and initiating a two-day workshop for NPC top level financial managers.
4. Developing training courses designed for VA's Talent Management System for mandatory courses:
  - a. Internal Controls;
  - b. Conflict of Interest.
5. Providing training sessions for the boards of directors as part of the on-site oversight reviews.
6. Maintaining an easy-to-navigate, user friendly and informative website.
7. Developing PowerPoint trainings for the proper completion of Intergovernmental Personnel Act assignment agreements and for preparing for NPPO on-site reviews.

## **XII. CONCLUSION**

VA-affiliated NPCs continue to make a substantial contribution to VA research and education missions. The 2016 NPC Annual Report to Congress demonstrates that NPCs are fulfilling their Congressional mandate in a responsible and conscientious manner.

Expertise in NPC governance and management is improving as evidenced in the on-site reviews and the NPCs' annual reporting to VA. VA-affiliated NPCs contribute significantly to the success of VA's research and education programs.

This report and NPPO's on-site reviews illustrate that NPCs are a highly efficient means to maximize the benefits to VA of externally funded research conducted in VA facilities. NPCs greatly facilitate research and education that benefit Veterans. Additionally, NPCs foster vibrant research environments at VAMCs, enhancing VA's ability to recruit and retain clinician-investigators and other talented personnel who apply their knowledge to state-of-the-art care for Veterans.

**Estimate of Cost to Prepare  
Congressionally-Mandated Report**

ATTACHMENT

**Short Title of Report:** 2016 VA Nonprofit Corporations Annual Report to Congress  
**Report Required By:** December 30, 2017

In accordance with Title 38, Chapter 1, Section 116, the statement of cost for preparing this report and a brief explanation of the methodology used in preparing the cost statement are shown below.

<b>Manpower Cost:</b>	<u>\$35,335</u>
<b>Contract(s) Cost:</b>	<u>\$0</u>
<b>Other Cost:</b>	<u>\$0</u>
<b><u>Total Estimated Cost to Prepare Report:</u></b>	<b><u><u>\$35,335</u></u></b>

**Brief Explanation of the methodology used in preparing this cost statement:**  
Hours worked directly on the Report were accumulated by preparer and then multiplied by the employees' actual hourly pay rates including an estimated amount for payroll fringes.