

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF COSTS NORMALLY TREATED
AS ADMINISTRATIVE AND CLERICAL
COSTS BUT CHARGED DIRECTLY TO
HHS AWARDS AT THE UNIVERSITY OF
LOUISVILLE**

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Office of Inspector General

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The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

The University of Louisville did not always claim selected costs charged directly to HHS awards in accordance with Federal regulations and NIH guidelines. We estimated that the University claimed at least \$1.3 million in unallowable transactions charged directly to HHS awards.

WHY WE DID THIS REVIEW

The University of Louisville (the University) received \$114 million from the Department of Health and Human Services (HHS) over the 2-year period ended September 30, 2012. A previous audit (A-04-13-01528) that we conducted at the University (as the cognizant Federal agency) included significant findings. In that review of a \$7 million award that the University received from another Federal agency, we identified \$1.5 million in costs that was unallowable. Our audit of the \$7 million award covered costs the University claimed for the 66-month period ended June 2009. Therefore, we are concerned that the University's grant management is a high-risk area and performed an audit of subsequent costs charged to HHS awards.

Our objective was to determine whether the University claimed selected costs charged directly to HHS awards in accordance with Federal regulations and applicable guidelines.

BACKGROUND

University of Louisville

The University is a State institution located in Louisville, Kentucky. From October 1, 2010, through September 30, 2012 (audit period), the University claimed reimbursement for approximately \$114 million in costs incurred on grants, contracts, and other agreements (awards) from HHS.

By accepting HHS awards, the University agreed to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards were allowable under the cost principles established in 2 CFR part 220, Appendix A. These cost principles require that, to be allowable, costs must be reasonable, be allocable, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements. In addition, National Institutes of Health (NIH) awards are subject to NIH guidelines, which include limitations on salary costs.

Award Administration

The University's Sponsored Programs Administration accepts and administers awards on behalf of the University. It is responsible for reviewing transactions proposed by colleges, departments, and principal investigators to ensure that those transactions fully comply with Federal regulations.

Principal investigators are responsible for all programmatic and administrative aspects of an award, including the conduct of research or other activities described in a proposal for an award.

WHAT WE FOUND

The University did not always claim selected costs charged directly to HHS awards in accordance with Federal regulations and, where appropriate, NIH guidelines. In our sample of 120 salary transactions, 102 were allowable but 18 were not, for a total of \$85,065 in unallowable salary transactions. In addition, in our sample of 100 nonsalary transactions, 61 were allowable but 39 were not, for a total of \$104,302 in unallowable nonsalary transactions. These unallowable transactions occurred because the University did not provide adequate oversight to ensure consistent compliance with Federal regulations.

On the basis of our sample results, we estimated that the University charged at least \$1,311,067 in unallowable transactions and related facilities and administrative costs to HHS awards during our audit period.

WHAT WE RECOMMEND

We recommend that the University:

- refund \$1,311,067 to the Federal Government and
- enhance oversight of charges to Federal awards to ensure consistent compliance with Federal regulations.

UNIVERSITY OF LOUISVILLE COMMENTS AND OUR RESPONSE

In written comments on our draft report, the University said that the vast majority of the costs we questioned were reasonable, allowable and allocable. In addition to written comments, the University provided additional documentation that it believed would demonstrate the allowability of the 30 salary transactions and 47 nonsalary transactions that we classified as unallowable. On the basis of the additional documentation that the University provided, we revised the draft report to show that 12 of the 30 salary transactions and 8 of the 47 nonsalary transactions are now allowable. However, we maintain that 18 of the 30 salary transactions and 39 of the 47 nonsalary transactions are unallowable charges to the Federal awards.

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INTRODUCTION

WHY WE DID THIS REVIEW

The University of Louisville (the University) received \$114 million from the Department of Health and Human Services (HHS) over the 2-year period ended September 30, 2012. A previous audit¹ that we conducted at the University (as the cognizant Federal agency) included significant findings. In that review of a \$7 million award that the University received from another Federal agency, we identified \$1.5 million in costs that was unallowable. Our audit of the \$7 million award covered costs the University claimed for the 66-month period ended June 2009. Therefore, we are concerned that the University's grant management is a high-risk area and performed an audit of subsequent costs charged to HHS awards.

OBJECTIVE

Our objective was to determine whether the University claimed selected costs charged directly to HHS awards in accordance with Federal regulations and applicable guidelines.

BACKGROUND

University of Louisville

The University is a State institution located in Louisville, Kentucky. From October 1, 2010, through September 30, 2012 (fiscal years (FYs) 2011 and 2012)), the University claimed reimbursement for approximately \$114 million in costs incurred on grants, contracts, and other agreements (awards) from HHS.

Federal Requirements

By accepting HHS awards, the University agreed to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards were allowable under the cost principles established in 2 CFR part 220, Appendix A (the Circular).² The cost principles require that, to be allowable, costs must be reasonable, be allocable, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements. In addition, National Institutes of Health (NIH) awards are subject to NIH guidelines, which include limitations on graduate student salary costs supported by NIH research grants and cooperative agreements.

¹ University of Louisville Contract Closeout - Contract No. W9113M-04-C-0024 (A-04-13-01528).

² For Federal contracts awarded under the Federal Acquisition Regulation (FAR) to an educational institution, the OMB grant cost principles are applied to determine the allowability of costs (48 CFR § 31.303).

Award Administration

The University's Sponsored Programs Administration accepts and administers awards on behalf of the University. It is responsible for reviewing transactions proposed by colleges, departments, and principal investigators to ensure that those transactions fully comply with Federal regulations.

Principal investigators are responsible for all programmatic and administrative aspects of an award, including the conduct of research or other activities described in a proposal for an award.

HOW WE CONDUCTED THIS REVIEW

Of the \$114 million that the University claimed for reimbursement for FYs 2011 and 2012 (audit period), our audit covered approximately \$20 million in salary transactions and approximately \$5 million in nonsalary transactions.

We selected a stratified random sample of 120 salary transactions totaling \$728,524 and a stratified random sample of 100 nonsalary transactions totaling \$3,316,063 for review. We initially evaluated the sample transactions on the basis of documentation in the University's project files. For transactions not adequately supported by the project files, we asked the University's Department of Sponsored Programs Administration and the principal investigators on the related awards to submit additional information.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains the details of our audit scope and methodology, Appendix B lists the Federal requirements related to awards, Appendix C contains the sample design and methodology, Appendix D contains the sample results and estimates, and Appendix E contains a list of related OIG reports.

FINDINGS

The University did not always claim selected costs charged directly to HHS awards in accordance with Federal regulations and, where appropriate, NIH guidelines. In our sample of 120 salary transactions, 102 were allowable but 18 were not, for a total of \$85,065 in unallowable salary transactions. In addition, in our sample of 100 nonsalary transactions, 61 were allowable but 39³ were not, for a total of \$104,302 in unallowable nonsalary transactions.

³ For some of the transactions, we questioned only a portion of the transaction and the related facilities and administrative (F&A) costs.

These unallowable transactions occurred because the University did not provide adequate oversight to ensure consistent compliance with Federal regulations.

On the basis of our sample results, we estimated that the University charged at least \$1,311,067 in unallowable transactions and related F&A costs⁴ to HHS awards during our audit period. (See Table 1 below.)

Table 1: Estimated Unallowable Transactions Charged to HHS Awards During the Audit Period

	Amount Unallowable
Salary Transactions	\$585,659
Related F&A Costs	292,829
Subtotal Salary Costs	\$878,488
Nonsalary Transactions	348,379
Related F&A Costs	84,200
Subtotal Nonsalary Costs	\$432,579
Total	\$1,311,067

THE UNIVERSITY DID NOT ALWAYS CLAIM COSTS IN ACCORDANCE WITH FEDERAL REGULATIONS AND APPLICABLE GUIDELINES

Salary Costs

Of the 120 transactions totaling \$728,524 in our sample of salary costs, 18 transactions totaling \$85,065 were not allowable. Specifically:

- Fifteen transactions were for salary costs for administrative and clerical work such as ordering supplies, reconciling accounts, and caring for lab mice. These costs should not have been charged directly to the award because they involved salaries of administrative and clerical staff, and neither the nature of the work performed on the projects nor any other circumstances justified any unusual degree of administrative support or showed that the employees were necessary for the performance of the awards. Salaries of administrative and clerical staff should normally be treated as F&A costs unless an unusual degree of administrative support is justified as necessary to perform the award (the Circular § F.6.b.(2)).

⁴ The Circular § E.1 defines F&A costs as “those that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity.”

- Three transactions were for salary costs for which the University did not have a properly signed effort report. Effort reports that supported one transactions had no signature. Effort reports supporting two other transactions were signed by administrative staff rather than the Principal Investigator responsible for the award. However, the Principal Investigator subsequently signed effort reports for the two transactions over a year later. Salary costs should be claimed on the basis of an effort report signed by a responsible person with suitable means of verifying that the work was performed (2 CFR part 220, App. A § J.10b(2)(b)).

On the basis of our sample results, we estimate that these unallowable salary transactions resulted in overcharges of at least \$878,488 to HHS awards during our audit period (\$585,659 in salary costs plus \$292,829 in related F&A costs).

Nonsalary Costs

Of the 100 transactions totaling \$3,316,063 in our sample of nonsalary costs, 39 transactions totaling \$104,302 were not allowable. Specifically:

- Seven transactions were not supported with sufficient documentation. These transactions were costs for which the University could not provide original invoices or any means to tie the cost to the award. Recipient financial management systems must provide for accounting records, including cost accounting records, that are supported by source documentation (45 CFR § 74.21(b)(7)).
- Eighteen transactions related to specialized service centers were not charged in accordance with Federal regulations.
 - The University did not provide a schedule of rates that supported charges for its physical plant center.
 - Some invoices had additional fees for hardware and administrative costs even though these costs duplicated costs that were already included in the specialized service centers' schedule of rates.
 - A specialized service center did not provide an invoice to support a transaction.

The costs of services provided by specialized facilities must be charged on the basis of actual usage of the services and on the basis of a schedule of rates or established methodology (the Circular § J.47.b.).

- Four transactions were for general-purpose equipment and office supplies that should have been treated as F&A costs and not charged as direct costs to the award. "Items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs" (the Circular § F.6.b.(3)). Furthermore, beginning in October 2010, the Grants Policy Statement (GPS), section 7.9.1, specifically stated: "Office equipment (copiers, laptops, desktop computers, personal handheld computers, fax machines,

scanners, etc.) that is used for general office purposes (rather than justified as a specific research purpose) are not allowable as direct costs; they are allowable as an F&A cost.”⁵

- Ten transactions did not meet the Circular’s criteria for allocable costs. For example, the University charged multiple cell phones, which were rarely used, against a single award. The University also charged an award for a subscription to an online meeting service and the postage cost of a visa to enter Japan. The University did not provide documentation that showed these costs benefitted the award. A cost is allocable to a sponsored agreement if it benefits both the sponsored agreement and other work of the institution in proportions that can be approximated through use of reasonable methods (the Circular § C.4.(a)).

On the basis of our sample results, we estimated that these unallowable nonsalary transactions resulted in overcharges of at least \$432,579 to HHS awards during our audit period (\$348,379 in nonsalary costs plus \$84,200 in F&A costs).

THE UNIVERSITY DID NOT ALWAYS PROVIDE ADEQUATE OVERSIGHT

These unallowable transactions occurred because the University did not always provide adequate oversight to ensure consistent compliance with Federal regulations. Although its procedures often incorporated text from the applicable cost principles, the University’s Sponsored Programs Administration did not review transactions to ensure that the principal investigator’s proposed transactions fully complied with Federal regulations. Without adequate oversight, the University could not ensure that administrative expenses charged as direct costs to HHS awards complied with applicable Federal regulations.

ESTIMATE OF UNALLOWABLE COSTS

On the basis of our sample results, we estimated that the University’s unallowable transactions resulted in total overcharges of at least \$1,311,067 to HHS awards during our audit period.

RECOMMENDATIONS

We recommend that the University:

- refund \$1,311,067 to the Federal Government and
- enhance oversight of charges to Federal awards to ensure consistent compliance with Federal regulations.

UNIVERSITY OF LOUISVILLE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, the University said that the vast majority of the costs we questioned were reasonable, allowable, and allocable. In addition to written comments, the

⁵ These transactions were claimed on NIH grant awards; therefore, NIH grant criteria apply.

University provided additional documentation that it believed would demonstrate the allowability of the 30 salary transactions and 47 nonsalary transactions that we classified in the draft report as unallowable. On the basis of the additional documentation that the University provided, we revised the draft report to show that 12 of the 30 salary transactions and 8 of the 47 nonsalary transactions are now allowable. However, we maintain that 18 of the 30 salary transactions and 39 of the 47 nonsalary transactions are unallowable charges to the Federal awards for the reasons discussed below.

Salary Costs

Of the 18 salary transactions that we questioned, the University argued that 15⁶ transactions related to individuals that worked on a major project, or held positions that were approved by the awarding agency or prime grantee, or performed technical and programmatic work. The remaining three salary transactions related to individuals that did not have properly signed effort reports.

University Comments - Administrative and Clerical Salaries – Individuals Worked on Major Projects

The University argued that many employees whose salary we questioned worked on major projects. The University said that it may charge administrative or clerical costs directly to HHS awards when a “major project” explicitly budgets for such costs. The University cited six examples of major projects that are referenced in the Circular (Exhibit C) and said that many of the transactions we questioned pertained to major projects that were similar to the projects referenced in the Circular examples.

OIG Response – Administrative and Clerical Salaries - Individuals Worked on Major Projects

The Circular (F.6.b(2)) defines a major project as a project that requires an extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments. For a transaction applicable to one award, the University provided evidence that the award was a large complex program that involved managing teams of investigators from multiple institutions. We did not question this transaction. However, we did question transactions, where the University did not provide evidence that the award required an extensive amount of administrative or clerical support, as defined in the Circular. For example, the University claimed as a major project, an award that it received from another institution as a subrecipient. The University argued that the award was a major project because it was large, but did not provide documentation that the award required administrative or clerical support which was significantly greater than the routine level of such services it would have provided.

⁶ The University said that six transactions related to individuals that worked on major projects or had positions that were in the approved award budget, five transactions related to individuals who performed technical and programmatic duties and four transactions related to individuals who performed technical and programmatic duties, worked on major projects or had positions that were in the approved award budget.

University Comments – Administrative and Clerical Salaries - Individuals Were Named in the Approved Award Budget

The University said that many of the salary transactions that we questioned related to individuals who were named in the approved award budget. The University was of the opinion that the inclusion of these individuals' names and positions in the sponsor or prime grantee-accepted budget was persuasive evidence that the sponsor or the prime grantee agreed to the charge.

University officials also said that the auditors took the extreme view that any indication of any administrative or clerical activity warranted questioning an entire salary charge. The University said that the auditors' standard for questioning administrative and clerical costs was inconsistent with the Circular's effort-reporting requirements, which were explicit in terms of recognizing that responsibilities at a university are inextricably intermingled and that mathematically precise time-keeping was not required.

OIG Response - Administrative and Clerical Salaries – Individuals Were Named in the Approved Award Budget

We do not agree with the University's contention that listing individuals' names and positions in the approved budget is persuasive evidence that the individuals' salary costs are allowable charges to an award. To be allowable as a direct charge to an award, the administrative activities that an individual performed must be solely related to the project to which their salary was charged. The employees' administrative duties benefited multiple activities and could not always be tied to an individual project. Because the administrative activities did not solely benefit the project to which the University charged the salary costs, we applied cost principles that state: "The apportionment of employees' salaries and wages which are chargeable to more than one sponsored agreement or other cost objective will be accomplished by methods which will ... (iii) distinguish the employees' direct activities from their F&A activities" (J.10.b (1)(b) of the Circular). In addition, we could not determine the percentage of effort these employees spent on administrative activities because the University's effort reports did not reflect time spent on administrative tasks. Therefore, we continue to question costs related to these transactions.

We also do not agree with the University's comments that we questioned salary charges solely on the basis of one limited element of an employee's duties. We questioned the administrative and salary costs on the basis of our analysis of the documentation that the University provided to support the costs.

University Comments - Administrative and Clerical Salaries - Individuals Performed Technical Work

The University said that many of the salary transactions that we questioned related to individuals who performed technical and programmatic work. As such, the Circular section F.6.b.(2) is not applicable to individuals performing technical and programmatic duties, according to the University.

OIG Response - Administrative and Clerical Salaries - Individuals Performed Technical Work

On the basis of our review of the additional documentation that the University provided with its comments on our draft report, we agree that some transactions or portions of some transactions that we had previously determined involved employees whose duties were administrative or clerical were, in fact, related to technical employees assigned to a specific project. In instances in which the additional documentation showed that the nature of the work performed on the projects or other circumstances justified an unusual degree of administrative support or showed that the employees were necessary for the performance of the awards, we did not question the salary cost.

In instances in which the additional documentation showed that an employee's duties were technical in nature, we revised the draft report to allow these employees' salary costs. In instances in which the documentation showed that employees had administrative duties that benefited multiple activities and could not be tied to an individual award, we continue to question the transactions' allowability.

University Comments - Improperly Signed Effort Reports

The University did not agree that we should question transactions because the associated effort reports were not properly signed. The University cited two examples as support for its contention that the effort reports should be accepted. In the first example, the University said that the effort report was not signed in the signature block, but it was signed elsewhere. The University said that it obtained a letter from the PI who confirmed that a "not particularly legible" signature on the form was his and therefore, should be accepted.

In the second example, the University disagreed that we should question an effort report because an administrator, who lacked a suitable means of verification, signed it. The University argued that the Circular did not define "suitable means of verification," and the Circular did not place any limits on who might have the requisite level of knowledge. The University further said that the employee was not an administrator, as it originally stated, but was actually the study coordinator for the award and, as such, had reasonable means of verifying the effort of other employees.

OIG Response - Improperly Signed Effort Reports

In our draft report, we questioned five transactions that were for salary costs for which the University did not have a properly signed effort report. The University provided with its written comments properly signed effort reports for two transactions. We continue to question the remaining three transactions for reasons discussed below.

For one of the three improperly signed effort reports, we agree that there was what appeared to be a signature on the effort report; however, there was no signature in the certification section of the effort report certifying that the effort report reasonably reflected the distribution of time and effort expended by the individual within the time period covered by the report.

For the two remaining improperly signed effort reports, the University stated that the study coordinator's duties involved screening and enrolling patients, collecting specimens, compiling and entering data, and activities related to regulatory compliance such as informed consent and HIPAA training for all personnel. Listing the various duties that the study coordinator performed was not sufficient evidence that the study coordinator had a requisite level of knowledge of other employees' actual efforts or a reasonable means of verifying the other employees' efforts. However, the Principal Investigator subsequently signed effort reports over a year later for these two transactions. The University did not provide an explanation for why it took the PI over a year to sign the effort reports.

Nonsalary Costs

University Comments - Costs Inadequately Documented

Of the 11 questioned transactions the University agreed that 2 transactions were not adequately documented and were, therefore, unallowable. The University did not agree, however, that the other nine transactions were unallowable.

To demonstrate that the nine transactions were allowable, the University provided an example that was associated with the allocation methodology that it used to charge an award for the use of scientific equipment. The University said that the PI allocated \$5,013 in equipment-usage cost on the basis of historical use and usage estimates aided by the electronic equipment's usage logs. The University said that historical usage plus a reasonable estimate of anticipated use complied with the Circular's guidance (§ C.4.a) that costs can be allocated using any reasonable method.

OIG Response - Costs Inadequately Documented

We revised the draft report to show that 4 of the 11 transactions were allowable on the basis of the additional documentation that the University provided with its written comments. However, the additional documentation that the University provided did not support that the remaining five transactions were allowable. For these five transactions, the University used allocation methods that were not supported with documentation which would allow us to determine the reasonableness of the methodology.

In regard to the University's example of the \$5,013 equipment usage charge, the documentation the University provided showed that the charge was for an equipment service contract. According to the University's documentation, a portion of the service contract was allocated to the award on the basis of estimated use. The University did not provide any documentation that showed the extent of the equipment's actual use for the award. Charging equipment service contract costs to an award on the basis of estimated equipment use does not meet the Circular's reasonable allocation method requirement at C.4.a. Therefore, the \$5,013 equipment-usage charge was not allowable.

University Comments - Specialized Service Center Costs (Physical Plant)

The University said that its specialized service center costs were generally allowable, but it said that it had discovered that it inadvertently over-allocated back office support to its craft labor rates. However, it corrected for this over-allocation, which made only a minor adjustment to the rates. The University further thought that the mean hourly wage paid to certain University Physical Plant employees in FYs 2011 and 2012 was, in all but a few cases, not more than the mean hourly wage paid for each similar occupation in the local area, at the National level, and at colleges, universities, and professional schools.

OIG Response - Specialized Service Center Costs (Physical Plant)

The University acknowledged that it made errors in its rate calculation for physical plant labor costs. The University acknowledged errors in its rate calculation as low as a few dollars to over \$500. We also have other concerns with the University's rate calculations that the University did not address in its written comments. For example, the University included payroll costs for unfilled positions in its rate calculation when rates should be calculated on the basis of actual costs. Using payroll costs for unfilled positions to calculate rates causes rates to be inflated. The documentation that the University provided did not allow us to determine the impact that excluding over 20 unfilled positions in its physical plant had on its rate calculations. Also, the University did not provide any evidence to show that it had calculated its physical plant rates using actual costs.

Therefore, we continue to question these nine transactions.

University Comments - Specialized Service Center Costs (IT Design and Printing Services)

The University said that it had provided an invoice supporting a charge for \$5,603 associated with the cost of printing questionnaires and forms for a large population of high school teenagers. The University further stated that the rate structure associated with the charge included overhead and procurement costs that it should not have included. The University said that it recalculated the rates excluding the overhead and procurement costs and believe the costs are reasonable. The University stated that it had identified similar issues with some of its other rate schedule calculations and it had made financial adjustments to account for those situations.

OIG Response - Specialized Service Center Costs (IT Design and Printing Services)

The University acknowledged that there were costs included in its rate calculations that should not have been included. The University's additional documentation included a new calculation of IT design and printing services costs using a new rate. According to the University, there was a possible overcharge of \$886. However, the University's additional documentation did not contain enough information for us to validate its revised rate calculation. Therefore, we continue to question the allowability of all the University's IT design and printing services charges.

University Comments - General Purpose Equipment and Office Supplies

The University agreed that two of six transactions associated with general purpose equipment should have been treated as F&A costs and not charged directly to HHS awards. The University also provided documentation to demonstrate that one other transaction, a computer software purchase, was scientific in nature and therefore allowable.

In regard to one of the three remaining transaction in question, the University said that it had made a specific request to the cognizant contracting officer seeking permission to purchase two computers. The University said that it was searching for the contracting officer's response. The University also said that, in lieu of the contracting officer's response, a University employee would provide testimonial evidence that the request was approved. The University further said that the computers were specifically referenced in a security plan that the sponsor approved and that the award's budget justifications specifically identified the computers.

The University offered a similar justification for purchasing two other computers in question. The University added that the costs of these two computers should have been prorated by five percent.

OIG Response – General Purpose Equipment and Office Supplies

The University did not provide evidence that showed the contracting officer approved the purchase of the computer. Also, according to evidence provided by the University, using laptop computers on the National Children's Study (NCS) award, which was the award in question, was prohibited. Furthermore, the University's interim NCS award proposal to NIH specifically stated that the University's proposed budget did not include line items for computer, office furniture, or equipment purchases. The University provided NIH with assurance of these exclusions after NIH told the University that the NCS Coordinating Center would provide computers and software that were compatible with the NCS Information Management System.

In regard to the purchase of two other computers, the University acknowledged that charging the entire cost of the computers was incorrect. According to the University, the award should have been charged for 95 percent of the costs. However, the University did not provide any evidence to support its contention that 95 percent of the computers' costs was the correct charge.

University Comments - Costs Were Not Allocable to Federal Awards

Of the 13 transactions we questioned in the draft report, the University agreed that 3 transactions were unallowable. The University did not agree that the remaining 10 transactions were unallowable. The University, for example, did not agree with our conclusion that the costs for three cell phones (one transaction) and six microscope lamps (one transaction) were not allocable to the Federal award. In regard to the cell phones, the University said that it was a security requirement of the relevant project that all electronic devices be Federal Information Security Management Act (FISMA) compliant and that the cell phones were not used for any purposes other than the award. The University also said the awarding agency required the University to

submit a security plan, and the security plan listed three cell phones for exclusive use on the award.

In regard to one transaction where the University purchased six microscope lamps for \$1,040, the University said that the PI performed a rigorous analysis in which it estimated the number of hours per week that the microscope would be used, the number of weeks the microscope would be used, and the useful life of the lamps. On the basis of this analysis, the PI purchased the six lamps. The University also said the PI purchased the lamps in bulk so that it could obtain a quantity discount and it could reduce shipping charges.

OIG Response – Costs Were Not Allocable to Federal Awards

We still maintain that the remaining 10 transactions are unallowable. The University did not provide evidence to show that the cell phones were dedicated solely to the project and necessary to comply with award security restrictions.

The University stated that the microscope lamps would be used from October 25, 2010, to November 30, 2012, which is two budget periods. A cost paid in advance of a budget period is a prepaid expense. Prepaid expenses are unallowable.⁷ We allowed \$173 for the cost of one lamp. However, we maintain that the remaining \$867 that the University charged to the award for five lamps was unallowable.

The University did not provide evidence to show that the remaining five unallowable transactions, which included the cost for three computers, one postage charge, and one annual computer maintenance fee, were allocable to the Federal awards.

The University said that it constantly looked for ways to improve its administration of HHS and other federally sponsored awards. To that end, the University highlighted several enhancements that it said that it had made since the audit period.

The University's comments, excluding the additional documentation that contained confidential information and information that the University considered proprietary, are included as Appendix F.

⁷ HHS Departmental Appeals Board Decision No. 2481, October 3, 2012.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered approximately \$20 million in salary transactions and approximately \$5 million in nonsalary transactions claimed for reimbursement from October 1, 2010, through September 30, 2012 (audit period). We limited the audit to grants, contracts, and other agreements between the University and organizational components of HHS, including NIH, the Administration for Children and Families, and the Health Resources and Services Administration. We did not evaluate transactions charged to the University's agreements with other Federal departments and agencies.

We limited our assessment of internal controls to the University's policies and procedures for charging costs to Federal awards. We conducted our fieldwork at the University's offices in Louisville, Kentucky.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal regulations and NIH guidelines;
- reviewed the University's policies and procedures for charging costs to Federal awards;
- reviewed the University's Cost Accounting Standards Board Disclosure Statement (DS-2);
- obtained from the University a list of transactions charged to HHS awards, including approximately \$114 million in salary and nonsalary transactions charged directly to HHS awards;
- obtained a statement from the University attesting to the completeness and accuracy of the list of transactions it provided;
- selected and reviewed a stratified random sample of 120 salary transactions and a stratified random sample of 100 nonsalary transactions (Appendix C);
- computed the F&A costs related to the transactions determined to be unallowable by our review; and
- estimated the unallowable amounts that the University charged to HHS awards (Appendix D).

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions

based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REQUIREMENTS

FEDERAL REGULATIONS AND HHS GUIDANCE

The HHS grant-administration rules require recipients of grant awards to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards were allowable under the applicable cost principles (45 CFR § 74.27(a)). The cost principles for educational institutions are established in the Circular. These cost principles require that, to be allowable, costs must be reasonable, be allocable, be treated consistently, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements (the Circular § C.2). Additionally, OMB Circular A-133 sets forth standards for obtaining consistency and uniformity in auditing.

We applied a number of provisions in these rules and policies in the body of our report:

Pursuant to the Circular § C.4.a.:

A cost is allocable to a particular cost objective (i.e., a specific function, project, sponsored agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a sponsored agreement if it is incurred solely to advance the work under the sponsored agreement; it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods, or it is necessary to the overall operation of the institution and, in light of the principles provided in this Appendix, is deemed to be assignable in part to sponsored projects.

Included in the Circular § F.6.b are specific guidelines regarding the treatment of charges for administrative and clerical expenses incurred within various departments of a college or university, including the following: “The salaries of administrative and clerical staff should normally be treated as F&A costs” (§ F.6.b.2). In addition, “Items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs” (§ F.6.b.3). The Circular’s F&A guidelines provide an exception for “major projects” in instances where direct charging of the salaries of administrative and clerical staff may be appropriate. “Major projects” are defined in section F.6.b.2 of the Circular as projects that require an “extensive amount of administrative or clerical support which is significantly greater than the routine level of such services provided by academic departments.”

If the costs of services provided by specialized service facilities are material, they must be charged directly to applicable awards on the basis of actual usage of the services and on the basis of a schedule of rates or established methodology (§ J.47.b).

Furthermore, Federal regulations require recipients’ financial management systems to provide for accounting records, including cost accounting records, that are supported by source documentation (45 CFR § 74.21(b)(7)).

NIH GUIDELINES

NIH awards are also subject to NIH guidelines. Beginning in October 2010, the NIH GPS, section 7.9.1 specifically states: “Office equipment (copiers, laptops, desktop computers, personal handheld computers, fax machines, scanners, etc.) that is used for general office purposes (rather than justified as a specific research purpose) are not allowable as direct costs; they are allowable as an F&A cost.”

COST ALLOCATION SERVICES BEST PRACTICES

The HHS Division of Cost Allocation’s⁸ *Best Practices Manual for Reviewing College and University Long-Form Facilities & Administrative Cost Rate Proposals*, dated December 2006, defines a specialized service facility as:

a service center that provides highly complex or specialized services that include, but are not limited to telecommunication centers, super computers, animal care facilities (vivariums), wind tunnels and reactors. The costs for these services should be charged directly to the users through a billing rate mechanism. Billing rates should be calculated for each SSF [(specialized service facility)] that do not discriminate between Federal and non-Federal users including internal university activities. The billing rates should be designed to recover the aggregate costs of providing the service and shall include both direct and an allocable portion of F&A costs. Billing rates must be adjusted biennially to adjust for under or over recoveries ... (p. 112).

⁸ Cost Allocation Services (formerly the Division of Cost Allocation) provides negotiation services for indirect cost rate proposals and cost allocation plans and reviews of cost allocation methods and practices of entities that receive Federal funds.

APPENDIX C: SAMPLE DESIGN AND METHODOLOGY

SALARY SAMPLE

Target Population

The population consisted of salary transactions that the University charged directly to HHS awards for FYs 2011 and 2012.

Sampling Frame

We received an Excel file from the University's Director of Sponsored Programs Financial Administration containing transactions charged directly to HHS awards for FYs 2011 and 2012. The file contained 98,078 transactions totaling \$114,183,963. We selected only salary transactions with account codes for costs normally treated as administrative costs. In addition, we removed all transactions less than \$100. The resulting sampling frame contained 6,607 transactions totaling \$20,184,853.

Sample Unit

The sample unit was a transaction.

Sample Design

We used a stratified sample containing four strata and divided the sampling frame on the basis of transaction amounts as follows in Table 2:

Table 2: Sampling Frame by Stratum

Stratum	Range	Number of Transactions	Total Dollars
1	\$100.01 through \$999.99	2,157	\$1,209,436
2	\$1,000 through \$4,999.99	3,213	8,129,009
3	\$5,000 through \$9,999.99	910	6,094,057
4	\$10,000 and above	327	4,752,351
	Total	6,607	\$20,184,853

Sample Size

We selected a sample size of 120 transactions as follows in Table 3:

Table 3: Sample Size by Stratum

Stratum	Number of Sample Items
1	30
2	30
3	30
4	30
	120

Source of Random Numbers

We used the Office of Inspector General, Office of Audit Services (OIG/OAS), statistical software to generate the random numbers.

Method of Selecting Sample Items:

We consecutively numbered each stratum. The Region IV Statistical Specialist generated random numbers for each stratum, and we selected the corresponding frame items.

Estimation Methodology

We used the OIG/OAS statistical software to estimate the amount of unallowable administrative and clerical salary costs claimed as direct costs and to estimate the unallowable F&A costs associated with these unallowable items.

NONSALARY SAMPLE

Target Population

The population consisted of nonsalary transactions that the University charged directly to HHS awards for FYs 2011 and 2012.

Sampling Frame

We received an Excel file from the University's Director of Sponsored Programs Financial Administration containing transactions charged directly to HHS awards for FYs 2011 and 2012. The file contained 98,078 transactions totaling \$114,183,963. We selected only nonsalary transactions with account codes for costs normally treated as administrative costs. We removed all transactions less than \$10. The resulting sampling frame contained 2,741 transactions totaling \$5,216,935.

Sample Unit

The sample unit was a transaction.

Sample Design

We used a stratified sample containing four strata. We divided the sampling frame on the basis of transaction amounts as follows in Table 4:

Table 4: Sampling Frame by Stratum

Stratum	Range	Number of Transactions	Value of Transactions
1	\$10 through \$999.99	2,320	\$349,521
2	\$1,000 through \$4,999.99	317	675,805
3	\$5,000 through \$64,999.99	98	1,407,964
4	\$65,000 and above	6	2,783,645
	Total	2,741	\$5,216,935

Sample Size:

We selected a sample size of 100 transactions as follows in Table 5:

Table 5: Sampling Size by Stratum

Stratum	Number of Sample Items
1	30
2	30
3	34
4	6
Total	100

Source of Random Numbers

We used the OIG/OAS statistical software to generate the random numbers.

Method of Selecting Sample Items

We consecutively numbered each stratum. After generating the random numbers for strata 1, 2, and 3, we selected the corresponding frame items. For stratum 4, we selected all 6 transactions.

Estimation Methodology

We used the OIG/OAS statistical software to estimate the amount of unallowable administrative and clerical nonsalary costs claimed as direct costs, as well as the unallowable F&A costs associated with these unallowable items.

APPENDIX D: SAMPLE RESULTS AND ESTIMATES

Table 6: Sample Results for Salary Transactions

Stratum	Frame Size	Value of Frame	Sample Size	Value of Sample	Number of Unallowable Transactions	Value of Unallowable Transactions	Value of F&A Associated With Unallowable Transactions
1	2,157	\$1,209,436	30	\$17,831	2	\$1,312	\$656
2	3,213	8,129,009	30	73,024	1	1,065	532
3	910	6,094,057	30	194,337	7	7,537	3,769
4	327	4,752,351	30	443,332	8	75,151	37,575
Total	6,607	\$20,184,853	120	\$728,524	18	\$85,065	\$42,532

Table 7: Estimated Value of Unallowable Salary Transactions
(Limits Calculated for a 90-Percent Confidence Interval)

	<u>Unallowable Transactions</u>	<u>Unallowable F&A</u>
Point estimate	\$1,256,191	\$628,095
Lower limit	585,659	292,829
Upper limit	1,926,723	963,361

Table 8: Sample Results for Nonsalary Transactions

Stratum	Frame Size	Value of Frame	Sample Size	Value of Sample	Number of Unallowable Transactions	Value of Unallowable Transactions	Value of F&A Associated With Unallowable Transactions
1	2,320	\$349,521	30	\$4,960	13	\$1,428	\$351
2	317	675,805	30	70,066	10	19,464	7,944
3	98	1,407,964	34	457,392	12	67,524	9,527
4	6	2,783,645	6	2,783,645	4	15,886	0
Total	2,741	\$5,216,935	100	\$3,316,063	39	\$104,302	\$17,822

Table 9: Estimated Value of Unallowable Nonsalary Transactions
(Limits Calculated for a 90-Percent Confidence Interval)

	<u>Unallowable Transactions</u>	<u>Unallowable F&A</u>
Point estimate	\$526,625	\$138,585
Lower limit	348,379	84,200
Upper limit	704,872	192,970

APPENDIX E: RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Report Title	Report Number	Date Issued
University of California, San Diego, Did Not Always Claim Nonpayroll Administrative and Clerical Costs Charged Directly to HHS Awards in Accordance with Federal Regulations	A-09-13-01003	04/30/15
The University of North Carolina at Chapel Hill Did Not Always Claim Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance with Federal Requirements	A-04-13-01024	06/27/14
University of California, San Diego, Generally Claimed Administrative and Clerical Payroll Costs Charged Directly to HHS Awards in Accordance with Federal Regulations	A-09-12-01001	6/26/14
The University of South Florida Did Not Always Claim Costs in Accordance With Federal Regulations	A-04-12-01016	4/25/14
Review of Select Expenditures Claimed by The Research Foundation of the State University of New York, State University of New York at Stony Brook	A-02-11-02008	8/28/12
Florida State University Did Not Always Claim Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance With Federal Regulations and National Institutes of Health Guidelines	A-04-11-01095	7/19/12
Review of Administrative and Clerical Costs at The Ohio State University for the Period July 1, 2008, Through June 30, 2010.	A-05-11-00030	12/13/11
Review of Select Expenditures Claimed by The Research Foundation of the State University of New York, State University of New York at Albany	A-02-11-02000	10/13/11
Review of Administrative and Clerical Costs at Dartmouth College for Fiscal Years 2009 Through 2010	A-01-11-01500	8/05/11
Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, Through September 30, 2004	A-04-05-01014	1/21/09

APPENDIX F: UNIVERSITY OF LOUISVILLE COMMENTS



William M. Pierce, Jr., Ph.D.
Executive Vice President for Research and Innovation
Professor of Pharmacology and Toxicology
Professor of Chemistry

May 27, 2016

Lori S. Pilcher
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Office of Audit Services, Region IV
61 Forsyth Street, SW, Suite 3T41
Atlanta, GA 30303

Re: Audit Report Number: A-04-13-01022

Dear Ms. Pilcher:

The University of Louisville (UofL) appreciates the opportunity to respond to the April 15, 2016 U.S. Department of Health and Human Services (DHHS), Office of Inspector General (OIG), draft report entitled *Audit of Costs Normally Treated as Administrative and Clerical Costs but Charged Directly to HHS Awards at the University of Louisville*.

UofL's response consists of the enclosed comments, as well as a detailed transaction by transaction discussion, including additional supporting documentation for each expenditure questioned by the OIG Office of Audit Services. We respectfully request that the DHHS and OIG maintain the confidentiality of the transaction by transaction discussion and the related supporting documentation as these materials contain confidential and proprietary information exempt from disclosure under the Freedom of Information Act (FOIA).

As you and your team review the information submitted herein, UofL will be happy to meet with you to answer any questions that you may have. We look forward to receiving the final findings and opinions of the OIG Office of Audit Services and to working with the authorized officials of the DHHS in resolving this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "W. M. Pierce, Jr." with a stylized flourish at the end.

William M. Pierce, Jr., Ph.D.
Executive Vice President for Research and Innovation
University of Louisville

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University of Louisville – Response to Draft Audit Report

The University of Louisville (“Louisville” or “the University”) is pleased to submit this response to the Department of Health and Human Services, Office Inspector General’s April 15, 2016 draft audit report “Audit of Costs Normally Treated as Administrative and Clerical Costs but Charged Directly to HHS Awards at the University of Louisville” (the “Draft Audit Report”).

For the reasons set forth below, the University submits that the vast majority of costs preliminarily questioned in the Draft Audit Report are reasonable, allowable, and allocable and should therefore be accepted. Because the vast majority of the preliminarily questioned costs are appropriate charges to HHS awards, we also take issue with the Draft Audit Report’s recommendation that the University should enhance its oversight of charges to Federal awards. The University’s response to the audit, which covers federal fiscal years 2011 and 2012, addresses in detail the costs the auditors have preliminarily questioned.¹ In addition, although we respectfully largely disagree with the Draft Audit Report’s tentative conclusions and recommendations, the University is always striving to improve its grants management infrastructure and compliance program. We, therefore, include at the end of these comments a discussion of some of the enhancements the University has made since the audit period in that regard.²

1. *The University’s response to the tentatively questioned salary charges.*

The Draft Audit Report reviewed 120 salary transactions with a total value of \$728,524, incurred during the audit period of October 1, 2010 through September 30, 2012. Of those 120 transactions, the Draft Audit Report questioned 30 that had a collective value of \$126,705. The Draft Audit Report explains that 25 of the 30 questioned transactions reflect “work such as ordering supplies, performing general information technology work, and caring for lab mice” that should not be charged directly to HHS awards. Additionally, the Draft Audit Report preliminarily questions an additional 5 transactions on the basis of alleged effort reporting deficiencies. We have included at Exhibit 2 a detailed discussion of each of the 30 preliminarily questioned transactions. Here, we provide a more general response to the auditors’ tentative findings.

A. *Many of the questioned salary costs relate to individuals performing technical work.*

OMB Circular A-21, sec. F.6.b(2) explains that

[t]he salaries of administrative and clerical staff should normally be treated as F&A costs. Direct charging of these costs may be appropriate where a major project or activity explicitly budgets for administrative or clerical services and individuals involved can be specifically identified with the project or activity.

¹ Exhibit 1 to this response provides, in a table format, a brief synopsis of the University’s views on each of the questioned charges. Exhibit 2 addresses the salary costs in detail and Exhibit 3 covers non-salary transactions. As noted in the letter transmitting this response, we request that Exhibits 1-3 be treated as confidential.

² The University also takes issue with the statement in the Draft Audit Report that an earlier review of a \$7 million award received from another agency caused DHHS to view the University as high-risk. As DHHS knows, the University challenged that disallowance and amicably resolved it for less than a quarter of what DHHS claimed was improperly charged. We respectfully suggest that the reference to the prior audit should be removed from the final report.

That language does not, however, apply to personnel performing technical and programmatic duties, which are plainly designated as direct costs and addressed by OMB Circular Section F.6.b(1) ("salaries of technical staff . . . shall be treated as direct cost"). Here, of the 25 transactions that the Draft Audit Report designates as administrative or clerical, 17 are associated with personnel who perform duties that are technical and/or programmatic. Notably, for almost all of the charges at issue, even if we were to assume that the personnel were performing administrative or clerical duties, which they were not, their positions (and in many cases their names) were specifically included in the budget submitted to and accepted by the sponsor. Although there is no specific prior approval requirement for these charges – indeed NIH, through guidance issued in 1994, NIH Guide, *Treatment of Administrative and Clerical Salaries under NIH Grants and Cooperative Agreements Awarded to Educational Institutions* (1994), has expressly stated that it has waived any such prior approval requirement – their specific and detailed inclusion in the accepted budget is persuasive evidence that the sponsor agreed to the charge. See NIH Grants Policy Statement, Section 7.9, *Allowability of Costs/Activities* (October 1, 2011) (noting that acceptance of a detailed budget meets any prior approval requirements). To tentatively disallow these costs when they meet an even higher standard of allowability than that actually applicable is unreasonable and we consequently respectfully request that, at a minimum, in those cases where employees are identified by name in approved budgets the auditors should reverse their preliminary decision.

OIG Note: University of Louisville comments have been deleted here because the comments pertain to matters that are no longer discussed in this report.

- Another individual deemed in the Draft Audit Report to be performing administrative or clerical duties was in actuality overseeing regulatory compliance aspects of a large, complex clinical trial. Because that trial involved human study subjects, this employee's duties involved managing all interactions with the University's Institutional Review Board and study sponsor, including project specific regulatory submissions and protocol renewals. In addition, the budget submitted and approved by the HHS sponsor explicitly requested 1.2 calendar months of support to draft, revise, and submit IRB applications. Even if this individual's duties were administrative, which they were not, this clear request for, and granting of, support makes this charge allowable.
- Three transactions were tentatively questioned on the basis that the employee supported what the Draft Audit Report characterized as a core facility. This is not a core facility as that term is used in research compliance. Rather, the individual supported an imaging facility used only by three lab groups and that was not organized under the then current A-21 rules regarding recharge centers. The individual who performed the analyses, in this instance, flow cytometry, is allocated to sponsored projects based on effort. If he had been performing through a recharge center, the "facility" would have charged based on rates developed for specific services and not based on employee effort. In sum, this technician was an expert in flow cytometry who assisted with experimental design and data analysis and his work was allocated to the HHS award based on the effort contributed to the project. This charge should be accepted.

OIG Note: University of Louisville comments have been deleted here because the comments pertain to matters that are no longer discussed in this report.

- B. *To the extent the University did charge administrative and clerical personnel directly to HHS awards, it did so appropriately.*

Of the 25 charges the Draft Audit Report tentatively questioned on the basis that administrative or clerical personnel were charged directly to an HHS award, only eight involved personnel performing administrative work. The University may charge administrative or clerical costs directly to HHS

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awards when a "major project" explicitly budgets for such costs. OMB Circular A-21 provides that a "major project" is one that "requires an extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments." OMB Circular A-21 at sec. F.6.b(2). The Circular also provides six major project examples:

Large, complex programs such as General Clinical Research Centers, Primate Centers, Program Projects, environmental research centers, engineering research centers, and other grants and contracts that entail assembling and managing teams of investigators from a number of institutions.

Projects which involve extensive data accumulation, analysis and entry, surveying, tabulation, cataloging, searching literature, and reporting (such as epidemiological studies, clinical trials, and retrospective clinical records studies).

Projects that require making travel and meeting arrangements for large numbers of participants, such as conferences and seminars.

Projects whose principal focus is the preparation and production of manuals and large reports, books and monographs (excluding routine progress and technical reports).

Projects that are geographically inaccessible to normal departmental administrative services, such as research vessels, radio astronomy projects, and other research fields sites that are remote from campus.

Individual projects requiring project-specific database management; individualized graphics or manuscript preparation; human or animal protocols; and multiple project-related investigator coordination and communications.

Each of the seven transactions preliminarily questioned in the Draft Audit Report pertains to a project that is on all fours with one or more of the foregoing examples. We set forth some examples below and address all of these charges in Exhibit 2.

- Two transactions involved an administrator who was charged directly to two large NIH Program Project grants. These grants are a large, complex multi-project awards with a dedicated Administrative Core. For the first grant, the Business Manager supported the Administrative Core and his position was specifically included in the approved budget of a program that notably was explicitly presented to the HHS sponsor as a major project:

TBN (Unit Business Manager) Funds are budgeted for 20% (2.4 calendar months) of the Business Manager's salary. He/ She will be responsible for all financial accounts and personnel activity with the Division, and is the liaison between the Division and University administrative offices. The Business Manager will supervise all financial and compliance issues related to the management of the Program, including all purchasing, regular institutional and governmental financial reporting. The Business Manager will also oversee the subcontractual agreement with OSU, communicating on a regular basis with Research Administration officials and reviewing related expenditures.

Shortly after submission of this application, the individual was named to the Business Manager position. For the second grant, the Business Manager was also identified by name in the budget submitted to and approved by the HHS sponsor. We respectfully submit that a

Program Project grant with a dedicated Administrative Core is a quintessential "major project" and that these charges should therefore be accepted.

- A similar issue arose with respect to an individual charged directly to a NIH Program Project grant that supports infrastructure and capacity building for biomedical and health-related research and training and bioinformatics through a collaborative network composed of numerous universities in Kentucky. The approved budget for this major project specifically requested support for two full-time administrative office assistants:

Office Staff: The administrative office is requesting funds for 2 full-time staff members and a part-time clerk. The administrative office assists with the preparation of the subcontract documents, reviews and tracks subcontract invoices for payment, provides logistical support for our INBRE researchers, workshops and the programs committees including the Steering Committee, External Advisory Committee, the Summer Undergraduate Research Sub-Committee, and the Faculty Fellowship Sub-Committee. In addition the administrative office assists with the annual report and university reporting and compliance and acts as a liaison with our regional universities.

The individual at issue was also specifically identified by name in the budget request. Given that the grant directly charged was a Program Project grant with an administrative core/office, that the position was specifically requested, and the individual charged was identified by name, there is no principled basis on which to conclude this cost is unallowable.

- The final example focuses on a program coordinator charged directly to a multi-site pilot study focused on assessing the acceptability, feasibility, and cost of a Provider-Based Sampling Strategy. Her role as Program Coordinator was specifically listed and approved in the budget under the title "Study Coordinator/Operational Manager."

In addition to the foregoing examples, there were certain other instances when the auditors questioned the entirety of a salary charge because one limited element of an employee's duties involved performing what they characterized as administrative or clerical duties. For example, the job descriptions of a limited number of laboratory technicians, who are performing technical and programmatic work, include the phrase "ordering supplies." In effect, the auditors have taken the extreme view that any indication of any administrative or clerical activity warrants questioning an entire salary charge. As a practical matter, that standard is unworkable and inconsistent with the effort reporting requirements in effect under now superseded Circular A-21, which were explicit in terms of recognizing that responsibilities at a university are "inextricably intermingled" and that mathematically precise time-keeping was not required. Someone who might occasionally take 15 minutes to place an on-line supply order or walk to the stockroom to collect supplies should not have to account separately for that time.

- C. *The transactions questioned on the basis of alleged effort reporting issues should be accepted.*

The Draft Audit Report has questioned five transactions on the basis that the associated effort reports were not properly signed. The University does not agree that these transactions should be questioned, although we recognize that in certain instances the documentation was perhaps not as clear as it could have been. In other cases we have been able to locate additional supporting documentation subsequent to the auditors' fieldwork.

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For example, in one case, the effort report was not signed in the signature block but was signed elsewhere. The University has now obtained a letter from the Principal Investigator who signed this effort report confirming that the admittedly not particularly legible signature is his. That transaction should therefore be accepted. Another transaction was questioned on the basis that it was signed by an administrator who lacked a suitable means of verification. OMB Circular A-21 did not define the phrase "suitable means of verification," nor did it place any limits on who might possess the requisite level of knowledge. In this instance, the signer was a Study Coordinator who was responsible for overseeing the operational aspects of a large, complicated clinical trial. As the person who managed the study's operational aspects and who was working side-by-side with the researchers she possessed sufficient knowledge to complete effort reports. Indeed, her situation is materially different from a situation where an investigator's assistant who sits back in his or her departmental office completes effort reports for personnel working in a lab. Here, the signer was – as noted – working side-by-side with the researchers, was herself working on the project, and therefore was in a position to complete effort reports for certain of her colleagues.

The final series of effort reporting-related transactions at issue were those where the Draft Audit Report tentatively concludes that the reports were signed too late. Again, Circular A-21 provided no rule addressing the timeliness in which an effort report must be completed and, in some circumstances expressly contemplates that researchers will be certifying salary charges related to time periods over a year earlier. Each of the transactions questioned on the basis of timeliness were based on critiques of a Twelve Month effort report.

OIG Note: University of Louisville comments have been deleted here because the comments pertain to matters that are no longer discussed in this report.

2. *The University's response to the tentatively questioned non-salary charges.*

The Draft Audit Report reviewed 100 non-salary transactions with a total value of \$3,316,063. Of those 100 transactions, the Draft Audit Report questioned 47 that had a collective value of \$153,889. The Draft Audit Report explains that 11 of the 47 questioned transactions lacked sufficient documentation, generally an original invoice. An additional 17 transactions associated with specialized service centers were also questioned. The stated basis for questioning these costs was that rate schedules were not provided, aspects of invoices were deemed problematic, and one invoice could not be located. The Draft Audit Report preliminarily found that 6 transactions reflected costs that should not have been charged directly to HHS awards. And, there were 13 transactions allegedly not allocable to the award to which they were charged. We have included at Exhibit 3 a detailed discussion of each of the 47 preliminarily questioned transactions. Here, we provide a more general response to the auditors' tentative findings.

- A. *The vast majority of the costs questioned on the basis of inadequate documentation should be accepted.*

The Draft Audit Report tentatively questioned 11 transactions on the basis that they were inadequately documented. We agree with the auditors that two of the questioned costs were not adequately documented but disagree with the remaining questioned transactions. The following examples put forward explanations of why we believe the transactions should be accepted.

OIG Note: University of Louisville comments have been deleted here because the comments pertain to matters that are no longer discussed in this report.

- The Draft Audit Report questions a \$121.57 charge associated with United Parcel Service ("UPS") shipping costs. The auditors' tentatively questioned this charge because they concluded there was no evidence showing that the University had just passed through the actual UPS rates. Accompanying this submission is a detailed invoice showing that the price for shipping two packages containing cryopreserved samples consisted of the CampusShip charge of \$82.90, plus \$6.51 for package pickup, plus \$32.16 for a next-day air adjustment that was due to a weight correction ($\$82.90 + \$6.51 + \$32.16 = \121.57). Because no costs other than those charged by UPS were posted to the HHS award, this charge should be accepted.

OIG Note: University of Louisville comments have been deleted here because the comments pertain to matters that are no longer discussed in this report.

- The Draft Audit Report questioned a \$5,013.19 charge associated with the usage of a Flow Core LSR II machine. The auditors took the view that the University had not adequately documented the allocation methodology. Accompanying this submission is a detailed explanation showing that the Principal Investigator allocated costs based on historical use and usage estimates aided by the fact that the equipment keeps an electronic log of all use. The University submits that historical usage plus a reasonable estimate of anticipated use fully comports with Circular A-21's guidance that costs can be allocated based on any reasonable method. OMB Circular A-21, sec. C.4.a.

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B. *The questioned special service center costs are generally allowable.*

The Draft Audit Report questioned 17 charges associated with specialized service centers. Although we have identified some minor anomalies in the rate structures of certain recharge centers, those issues do not have a material impact on the University's cost recovery and are discussed in detail in Exhibit 3. The vast majority of these costs should be acceptable.

1. *The physical plant costs are largely allowable.*

The Draft Audit Report has questioned nine transactions associated with the University's Physical Plant Department labor charges. The University allocates these charges to HHS awards through a recharge center that is established in accordance with Circular A-21. Specifically at issue are labor costs associated with the "craft" labor classification. Rates for craft personnel are determined primarily through an analysis of salary and fringe benefit costs plus an equitable share of the expenses associated with operating the entire Physical Plant Department. In the course of preparing its response to the Draft Audit Report, the University learned that it had inadvertently over-allocated back office support to the craft labor rates. As explained in detail in Exhibit 3, we have corrected for this over-allocation, which in any case makes only a minor adjustment to the rates, and agree that the amount of the over-allocation should be returned to the government. The remainder of the rates, however, are appropriately calculated and reasonable.

With respect to their reasonableness, the Draft Audit Report asserted – without providing any supporting analysis of which we are aware – that the rates were unreasonable. To address that concern, we have compared our craft rates to comparable U.S. Department of Labor rates and have determined that the mean hourly wage paid by the University to Physical Plant employees in FY2011 and FY2012 was, in all but a few cases, not more than the mean hourly wage paid for each respective occupation 1) in the Louisville, KY area, 2) at the National level, and 3) by Colleges, Universities, and Professional Schools. As mentioned previously, in calculating the Physical Plant craft rates, the University not only included wages but also fringe benefits and a share of the office support staff costs. If one were to add fringe benefits and overhead costs to the U.S. Department of Labor rates, the resulting rates would be higher than the rates charged by the University's Physical Plant. Thus, the University contends that its rates are reasonable.

The same holds true when analyzing data published by the Kentucky Labor Cabinet. We compared our craft rates to those published by the Kentucky Labor Cabinet. The hourly wage paid by the University to Physical Plant employees in FY2011 and FY2012 was, in all cases in which data were available, not more than the base hourly rate included in the Kentucky Labor Cabinet Prevailing Wage Determination. In addition, when charging federal grants for these services, the standard hourly rates charged by the University Physical Plant (which include fringe benefits and a share of

the office support staff costs) were, in all cases in which data was available but one, lower than the total wage (base plus fringe) included in the Kentucky Labor Cabinet Prevailing Wage Determination. As an example, the 2011 Kentucky Labor Cabinet Prevailing Wage Determination documents a total wage (base plus fringe) of \$33.09 for a Carpenter, whereas the University Physical Plant charged a rate of \$27.33 for this craft in FY2011. As a result, the University submits that its rates are reasonable.

2. *The additional questioned specialized service center costs are also largely allowable.*

The Draft Audit Report questioned one transaction for \$5,602.80 on the basis that the University's IT Design and Printing Services center had not produced an invoice. The charge at issue relates to the printing of questionnaires, consent forms, and assent forms for a survey of a large population of high school teenagers. The invoice supporting this charge was produced previously and also accompanies this submission. The University notes, however, that the rate structure associated with this charge includes components associated with overhead cost recovery and e-procurement costs that upon reflection should not have been included. We have recalculated the rates without those costs and submit that the recalculated amount is reasonable and should be accepted.

In certain other instances, the University has identified similar issues with some of the other rate schedule calculations. The discussion of these transactions in Exhibit 3 addresses in detail where we have made financial adjustments to account for those situations.

- C. *The questioned general purpose equipment and office supplies should be accepted.*

The Draft Audit Report preliminarily found that six transactions reflected costs that should have been treated as F&A costs and therefore not charged directly to HHS awards. The University agrees with two of those preliminary findings but disagrees with the other four.

The Draft Audit Report questioned a \$3,455.40 charge associated with two computers on the basis that the University had not adequately established that it was required by the terms of the award to purchase computers dedicated to this project. As an initial matter, accompanying this submission is a specific request from the University to the cognizant contracting officer seeking permission to acquire these laptops. Although the University is continuing to search for the response, if this charge is not accepted the business manager who asked permission will be able to offer testimonial evidence that the request was approved. Moreover, this was a project that focused on collecting highly confidential data from children. It therefore required development and submission of a detailed security plan, a copy of which accompanies this submission. Notably, the computers at issue are specifically referenced in this plan, which the sponsor approved. Likewise, budget justifications also specifically identify the computers. For all of these reasons, this charge should be accepted. Exhibit 3 also contains a similar justification for another charge in the amount of \$4,416.54 for two computers, although in this instance the University acknowledges that its cost should have been prorated by 5%.

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The final cost questioned on the basis of alleged general use related to a data acquisition system upgrade that was necessary due to the large amount of data collected under this project. Specifically, the purchased materials prevented the acquisition system from "freezing," which often occurs when the amount of data being collected exceeds the temporary storage ability of the system. The upgrade helped the research team to complete critically important experiments as proposed in the grant. Because this data acquisition system upgrade is not a general use supply item, but rather is project-specific material. Thus, this charge is acceptable.

D. *Most of the transactions questioned on the basis of allocability should be accepted.*

The Draft Audit Report has preliminarily questioned 13 transactions on the basis of allocability. The University agrees with three of those transactions and disagrees with the remainder.

For example, the Draft Audit Report questioned \$194.88 of costs associated with cell phones. These were appropriate because three members of the project's research staff had to be able to communicate with their colleagues while collecting data in the field and schedule and coordinate participant appointments. As noted in a prior submission, it was a security requirement of the relevant project that all electronic devices be FISMA (Federal Information Security Management Act) compliant; therefore, the cell phones used for this award were kept completely separate from any other devices and not used for any purposes other than this award. Likewise, due to the confidential nature of the study, the agency required the University to complete and submit a security plan. In this security plan the University listed three cell phones for exclusive use on the award.

Similarly, the Draft Audit Report questioned \$845 for the purchase of six lamps used in a microscope. The Principal Investigator undertook a rigorous analysis based on the anticipated number of hours the microscope would be in use, estimated useful lifespan of the lamps, and the number of weeks he would be using the microscope to determine that it was reasonable to purchase six lamps. He also purchased the lamps in bulk so as to obtain a quantity discount and reduce shipping charges. All in all, this was a reasonable way to minimize the costs associated with essential supplies all of which were used specifically for the project to which they were charged.

3. *The University continually strives to achieve best in class internal controls and administration of HHS awards*

Although the University disagrees with many of the tentatively questioned charges in the Draft Audit Report, and the recommendation that it should enhance oversight of charges to Federal awards, we take the strong view that we have an ongoing obligation to constantly look for ways to improve our

administration of HHS and other federally sponsored awards. To that end, we thought it worthwhile to highlight certain enhancements we have made since the 2010-2012 audit period.

- Reorganization of the Grants and Contracts Accounting Office – Effective April 1, 2013, the Grants and Contracts Accounting Office was merged with the Office of Grants Management to create the Office of Sponsored Programs Administration (SPA). SPA is a combined pre-award/post-award office that was created in order to enhance the oversight and management of sponsored programs, primarily federally sponsored grants and contracts. SPA is managed by a single director as opposed to the previous structure wherein there were two directors (one for pre-award grants management and one for post-award accounting).
- Strengthening of Effort Reporting Controls – Effective with the creation of the Office of Sponsored Programs Administration, the controls and procedures around the effort reporting process at the University have been strengthened. As part of the strengthened procedures, a post collection monitoring has been implemented in order to provide reasonable assurance that the institutional process is complete.
- Federal Grant and Contract Spot Check Program – Beginning in the fall of 2013, the University developed and implemented a program to conduct periodic spot checks on federal grants and contracts throughout the University. These reviews are completed in order to assess the health of fiscal management of federal programs and when required, to recommend corrective measures. Since inception, the spot check program has reviewed federal awards totaling over \$39 million.
- Implementation of 2 CFR 200, Uniform Guidance – In 2014, the University developed and charged the Uniform Guidance Implementation Workgroup with the review of internal controls, policies, procedures, etc. governing federally sponsored research. The workgroup worked throughout 2014 and 2015 to ensure that the management of federally sponsored research at the University aligns with the regulations contained in 2 CFR 200. Numerous presentations on 2 CFR 200 were delivered to the University research community by this workgroup.
- Gap Analysis of Internal Controls for Compliance in Research – In 2015, the University's internal Audit Services performed an analysis of the system of internal controls over research activities to determine whether the system included the components and fundamental concepts of internal control required to maintain effective internal control for compliance in research. The scope of the analysis included reviewing the policies and identifying key controls that help ensure compliance using the COSO (Committee of Sponsoring Organizations of the Treadway Commission) model. The final report, issued March 18, 2016, reported "no significant gaps or internal control deficiencies were identified."
- Revision of the University's Research Handbook to ensure alignment with 2 CFR 200 – The Research Handbook (<https://louisville.edu/research/support/research-handbook/toc>) provides assistance and guidance to faculty and staff who are involved in the preparation of proposals to and in the administration of awards received from external sponsors, including the federal government. The Research Handbook was rewritten in 2015 to ensure alignment with 2 CFR 200.

- Implementation of a revised Service Center Policy, effective February 1, 2014.

We also have several ongoing research administration and internal control initiatives underway at this time. A few of the primary initiatives are described below.

- Education - Reconciliation of Sponsored Research Accounts – The University's Account Reconciliation policy (updated in 2014 and available at <https://sharepoint.louisville.edu/sites/policies/library/SitePages/Finance/Account%20Reconciliations.aspx>) requires all programs and projects to be reconciled on a monthly basis and serves as a key element of the University's system of internal controls. An educational session will provide a best practices summary with particular attention to the unique aspects of sponsored programs that should be addressed during the monthly reconciliation process. Targeting all business managers who administer sponsored research awards/accounts, this session will outline an optimal approach to reconciliation and provide information on the resources available to support the process. The training will incorporate "lessons learned" from internal reviews and external audits to educate participants on the regulations, policies, and documentation requirements for sponsored awards with special attention to Federal awards.
- The "Amid" Award Management Program – The "Amid" award management program is a sponsored programs financial compliance program designed to decrease risk of fiscal noncompliance on sponsored awards (with particular attention to federal awards).
- Implementation of Shared Services Model at the University of Louisville – The University is quickly moving toward the implementation of a shared services model, which will allow for common services across multiple academic and business units. Business operations that are utilized to support federally sponsored research (i.e., finance, purchasing, HR, etc.) will be included in shared services. The University will explore opportunities to leverage the newly implemented model to enhance the management of federal awards.

4. *Conclusion*

The University appreciates the opportunity to work with the auditors as they completed their fieldwork and to respond to this Draft Audit Report. While we disagree with many of the findings, we understand and take very seriously our obligation to serve as an effective steward of HHS funds. We look forward to working with the audit team to resolve this matter as expeditiously as possible.