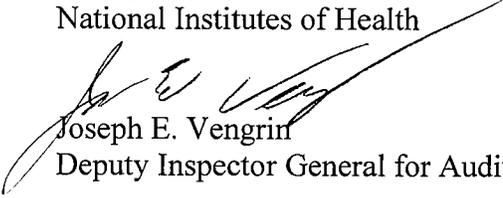




JAN 16 2009

TO: Raynard S. Kington, M.D., Ph.D.
Acting Director
National Institutes of Health

FROM: 
Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, Through September 30, 2004 (A-04-05-01014)

Attached is an advance copy of our final report on administrative and clerical costs at Duke University (the University). We will issue this report to the University within 5 business days.

The University is a private institution located in Durham, North Carolina. During the period October 1, 2002, through September 30, 2004, the University claimed reimbursement for \$594,104,781 of costs incurred on 2,566 grants, contracts, and other agreements with components of the Department of Health and Human Services (HHS).

Office of Management and Budget (OMB) Circular A-21 contains specific guidance regarding the treatment of charges for administrative and clerical expenses, the subject of this audit. The Circular states that the salaries of administrative and clerical staff and items such as office supplies, postage, local telephone costs, and memberships should normally be treated as Facilities and Administrative costs.

The only specific exception to this guidance is provided for "major projects," where direct charging of administrative and clerical expenses may be appropriate. "Major projects" are defined in 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."

Our objective was to determine whether the University had claimed reimbursement for administrative and clerical expenses as direct costs to grants, contracts, and other agreements with HHS components in accordance with applicable Federal regulations.

Based on our two samples, consisting of 114 charges for administrative and clerical salaries and 120 charges for other administrative costs, we estimate that the University claimed approximately \$1.7 million in unallowable charges as direct costs to grants, contracts, and other agreements with HHS components during fiscal years 2003 and 2004.

These unallowable claims occurred because the University had not established adequate controls to ensure consistent compliance with the Federal requirements applicable to charges for administrative and clerical costs. Although its “General Accounting Procedures” (GAP) often incorporates text from the Circular, the University had largely left it to the discretion of its individual colleges, departments, and principal investigators to interpret the GAP correctly and to comply with the Federal requirements.

The Office of Sponsored Research did not provide adequate scrutiny for charges proposed by colleges, departments, and principal investigators to ensure that those charges fully complied with Federal regulations. The University’s policies essentially allowed direct charges to any project needing any administrative or clerical support.

We are recommending that the University:

- refund \$1,661,011 to the Federal Government and
- revise its policies as needed to comply with the requirements of OMB Circular A-21 and ensure consistent treatment of administrative and clerical costs.

The University partially agreed with our first recommendation and disagreed with our second recommendation. While the University agreed that some of the questioned costs were not supported with documentation, it stated that most of the questioned costs were allowable and that we had not appropriately applied the allowability standards. Further, the University did not believe that it was appropriate to estimate unallowable costs using a statistical sample. The University stated that its policies complied with Federal requirements.

Under separate cover from its response, the University provided additional documentation for 55 unallowable items. Based on a review of this documentation, we concluded that the University had adequately supported 24 of the 55 items, and, accordingly, we revised the total amount recommended for recovery from \$2.4 million to \$1.7 million. The University’s assertions that we had misinterpreted applicable criteria and should not have extrapolated our findings based on statistical sampling techniques, however, did not support the University’s assertion that any further charges were allowable. While the University had formal policies and procedures, the results of our audit showed that those policies were not always effective.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact Lori S. Pilcher, Assistant Inspector General for Grants, Internal Activities, and Information Technology Audits, at (202) 619-1175 or through e-mail at Lori.Pilcher@oig.hhs.gov or Peter J. Barbera, Regional Inspector General for Audit Services, Region IV, at (404) 562-7750 or through e-mail at Peter.Barbera@oig.hhs.gov. Please refer to report number A-04-05-01014.

Attachment

cc: Julie L Gerberding, M.D., M.P.H.
Director
Centers for Disease Control and Prevention
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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

REGION IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

JAN 21 2009

Report Number: A-04-05-01014

Richard H. Brodhead, President
Duke University
207 Allen Building
Box 90001
Durham, North Carolina 27708-0001

Dear President Brodhead:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, through September 30, 2004." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by P.L. No. 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Mary Ann Moreno, Audit Manager, at (404) 562-7770 or through e-mail at MaryMoreno@oig.hhs.gov. Please refer to report number A-04-05-01014 in all correspondence.

Sincerely,

Peter J. Barbera
Regional Inspector General for
Audit Services, Region IV

Enclosure

Direct Reply to HHS Action Official:

Director, Division of Audit Resolution
Office of Grant and Acquisition Management
Assistant Secretary of Management and Budget
U. S. Department of Health and Human Services
Wilbur J. Cohen Building, Room 1067
330 Independence Avenue, S.W.
Washington, D.C. 20201

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF ADMINISTRATIVE
AND CLERICAL COSTS AT DUKE
UNIVERSITY FOR THE PERIOD
OCTOBER 1, 2002, THROUGH
SEPTEMBER 30, 2004**



Daniel R. Levinson
Inspector General

January 2009
A-04-05-01014

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5).

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

BACKGROUND

Duke University (the University) is a private institution located in Durham, North Carolina. During the period October 1, 2002, through September 30, 2004, the University claimed reimbursement for \$594,104,781 of costs incurred on 2,566 grants, contracts, and other agreements with components of the Department of Health and Human Services (HHS).

In accepting grants, contracts, and other agreements awarded by HHS and other Federal agencies, the University agreed to comply with regulations governing the use of Federal funds and ensure that costs charged to those grants, contracts, and other agreements were allowable under the cost principles established in Office of Management and Budget (OMB) Circular A-21 (the Circular). These cost principles require that, to be allowable, costs must be reasonable, be allocable, conform to any exclusions or limitations set forth in the cost principles or sponsored agreements, and be given consistent treatment through the application of generally accepted accounting principles.

One limitation is set forth in section F.6.b of the Circular. This section adds specific guidance regarding the treatment of charges for administrative and clerical expenses, the subject of this audit, 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 [Facilities and Administrative] costs” (section F.6.b.2) and “Items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs” (section F.6.b.3).

The only specific exception to this guidance is provided for “major projects,” where direct charging of administrative and clerical expenses 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.”

OBJECTIVE

Our objective was to determine whether the University had claimed reimbursement for administrative and clerical expenses as direct costs to grants, contracts, and other agreements with HHS components in accordance with applicable Federal regulations.

SUMMARY OF FINDINGS

Based on our two samples, consisting of 114 charges for administrative and clerical salaries and 120 charges for other administrative costs, we estimate that the University claimed approximately \$1.7 million in unallowable charges as direct costs to grants, contracts, and other agreements with HHS components during fiscal years 2003 and 2004.

These unallowable claims occurred because the University had not established adequate controls to ensure consistent compliance with the Federal requirements applicable to charges for

administrative and clerical costs. Although its “General Accounting Procedures” (GAP) often incorporates text from the Circular, the University had largely left it to the discretion of its individual colleges, departments, and principal investigators to interpret the GAP correctly and to comply with the Federal requirements.

The Office of Sponsored Research did not provide adequate scrutiny for charges proposed by colleges, departments, and principal investigators to ensure that those charges fully complied with Federal regulations. The University’s policies essentially allowed direct charges to any project needing any administrative or clerical support.

RECOMMENDATIONS

We recommend that the University:

- refund \$1,661,011 to the Federal Government and
- revise its policies as needed to comply with the requirements of OMB Circular A-21 and ensure consistent treatment of administrative and clerical costs.

UNIVERSITY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

The University partially agreed with our first recommendation and disagreed with our second recommendation. Although the University agreed that some of the questioned costs were not supported with documentation, it stated that most of the questioned costs were allowable and that we had not appropriately applied the allowability standards. Further, the University did not believe that it was appropriate to estimate unallowable costs using a statistical sample. The University stated that its policies complied with Federal requirements.

Under separate cover from its response, the University provided additional documentation for 55 unallowable items. Based on a review of this documentation, we concluded that the University had adequately supported 24 of the 55 items, and, accordingly, we revised the total amount recommended for recovery from \$2.4 million to \$1.7 million. The University’s assertions that we had misinterpreted applicable criteria and should not have extrapolated our findings based on statistical sampling techniques, however, did not support the University’s assertion that any further charges were allowable.

While the University’s policies and procedures were generally effective, some University employees did not always comply with them. Accordingly, the University agreed to continue the process of revising its policies, procedures, training, monitoring, and other internal controls as needed to ensure that the University remains fully compliant with applicable Federal criteria.

The full text of the University’s comments is included as Appendix F of this report.

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INTRODUCTION

BACKGROUND

Duke University

Duke University (the University) is a private institution located in Durham, North Carolina. During the period October 1, 2002, through September 30, 2004 (fiscal years (FY) 2003 and 2004), the University claimed reimbursement for \$594,104,781 of costs incurred on 2,566 grants, contracts, and other agreements with organizational components of the Department of Health and Human Services (HHS).

Cost Principles

Principles for determining the allowability of costs charged to Federal grants, contracts, and other agreements with the University and other educational institutions are set forth in Office of Management and Budget (OMB) Circular A-21 (the Circular). These cost principles apply both to direct costs, the expenses which are incurred solely for the performance of a particular project or projects, and to Facilities and Administrative (F&A) costs, the indirect expenses that are incurred for common or joint objectives of the institution and which, therefore, cannot be readily and specifically identified with a particular project or projects.¹

In accordance with section C.4.d.1 of the Circular, each college or university is responsible for ensuring that costs charged to Federal grants, contracts, and other agreements, both direct costs and F&A costs, are allowable under those cost principles.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the University had claimed reimbursement for administrative and clerical expenses as direct costs to grants, contracts, and other agreements with HHS components in accordance with applicable Federal regulations.

Scope

Our audit covered costs claimed for reimbursement from October 1, 2002, through September 30, 2004. The audit was limited to grants, contracts, and other agreements between the University and organizational components of HHS, including the National Institutes of Health (NIH), the Centers for Disease Control and Prevention (CDC), the Food and Drug Administration, and the Health Resources and Services Administration. We did not evaluate

¹Educational institutions are reimbursed for F&A costs through a rate or rates negotiated with the Federal Government. Institutions with significant numbers of federally funded agreements frequently have multiple F&A rates applicable to different functions, such as research, training, or other institutional activities. The F&A rates are made up of two components: a facilities component and an administrative component. For FYs that begin on or after October 1, 1991, the administrative component is limited to 26 percent of modified total direct costs.

charges to the University's agreements with other Federal departments and agencies during this audit.

Our assessment of internal controls was limited to policies and procedures related to the University's identification of and accounting for administrative and clerical expenses.

We conducted our audit field work intermittently between April 2005 and March 2007 at the University's offices in Durham, North Carolina.

Methodology

To accomplish our audit objective, we:

- held discussions with University officials in the Office of Sponsored Research and the Office of Internal Audits;
- reviewed the University's policies and procedures related to the identification of and accounting for administrative and clerical expenses;
- reviewed the University's Cost Accounting Standards Board Disclosure Statement (DS-2);²
- identified codes assigned to administrative and clerical expenses in the University's chart of accounts;
- extracted transactions from the accounting records involving administrative and clerical expenses charged to HHS-funded grants, contracts, and other agreements;
- selected and tested statistical samples of 114 administrative and clerical salary expenditures and 120 other administrative and clerical expenditures charged directly to HHS-funded grants, contracts, and other agreements (Appendixes A and B of this report) to determine whether the charges were allowable in accordance with cost principles;
- projected the results of the statistical samples to the universes (Appendix C of this report); and
- computed the F&A related to unallowable direct costs and projected the results to the universes.

We initially evaluated the sample expenditures based on documentation in the University's project files. Following our initial evaluation, we then asked the University's Office of Sponsored Research and the involved principal investigators to submit additional information

²Educational institutions that receive aggregate sponsored agreements totaling \$25 million or more are required to disclose their cost accounting practices by filing a disclosure statement (the DS-2). The University has submitted a DS-2 to the HHS Division of Cost Allocation.

that might support that direct charges to the grants, contracts, or other agreements were appropriate.

We met with NIH representatives in Bethesda, Maryland, during our audit to ensure a complete understanding of applicable criteria and to discuss our tentative findings and conclusions. We provided NIH with copies of documentation gathered during our audit so NIH officials could independently evaluate our statistical sample of administrative and clerical expenses charged to NIH-funded projects. NIH provided us with additional information regarding the nature of the projects to which the sampled salary expenses were charged, and we considered that information in reaching our conclusions on the allowability of the charges.³

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 objective.

FINDINGS AND RECOMMENDATIONS

Based on our two samples, consisting of 114 charges for administrative and clerical salaries and 120 charges for other administrative costs, we estimate that the University claimed \$1.7 million⁴ in unallowable charges as direct costs to grants, contracts, and other agreements with HHS components during FYs 2003 and 2004. Of the 114 charges in our sample of administrative and clerical salaries, we accepted 79 charges with a total value of \$332,267 and determined that 35 charges with a total value of \$17,829 were unallowable. Of the 120 charges in our sample of other administrative and clerical costs, we accepted 74 charges with a total value of \$97,740 and determined that 46 charges with a total value of \$10,657 were unallowable.

Unallowable claims, such as those described in our report, occurred because the University had not established adequate controls to ensure consistent compliance with the Federal requirements applicable to charges for administrative and clerical costs. Although its “General Accounting Procedures” (GAP) often incorporates text from the Circular, the University had largely left it to the discretion of its individual colleges, departments, and principal investigators to interpret the GAP correctly and to comply with the Federal requirements. The University’s policies essentially allowed direct charges to any project needing any administrative or clerical support.

DETERMINING ALLOWABILITY

Section C.2 of the Circular establishes four criteria governing the allowability of costs charged to Federal grants, contracts, and other agreements. To be allowable, costs must be reasonable, be

³We dealt primarily with NIH during the audit because the majority of our sample charges were made to NIH awards.

⁴This amount consists of \$577,554 of salaries and fringe benefits and \$175,687 of the related F&A plus \$619,121 of other administrative costs and \$288,649 of the related F&A. These amounts are the lower limits of the 90-percent confidence interval.

allocable, conform to any exclusions or limitations set forth in the cost principles or sponsored agreements, and be given consistent treatment through the application of generally accepted accounting principles.

One limitation is set forth in section F.6.b of the Circular. This section adds specific guidance regarding the treatment of charges for administrative and clerical expenses (the subject of this audit), 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” (section F.6.b.2) and “Items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs” (section F.6.b.3).

The only specific exception to this guidance is provided for “major projects,” where direct charging of administrative and clerical expenses 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.”

Exhibit C to the Circular provides examples of projects for which direct charges for administrative and clerical expenses may be appropriate, as quoted here:

- 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 the 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.

As stated in the Exhibit, “[t]hese examples are not exhaustive nor are they intended to imply that direct charging of administrative or clerical salaries would always be appropriate for the situations illustrated in the examples.”

SALARY COSTS

Of the 114 charges in our sample of administrative and clerical salaries, we accepted 79 charges with a total value of \$332,267. In these instances, the University provided sufficient documentation to show that the involved grants, contracts, or cooperative agreements qualified as major projects and that the administrative and clerical support being charged directly was beyond the level of support normally required. For example, we concluded that an NIH project entailing extensive data collection at multiple sites in the United States and other countries qualified as a “major project” and, due to the nature of the funded work and the wide geographical distribution of research sites, required administrative or clerical support above the routine level of such services provided by academic departments.

However, we concluded that the University had not adequately documented that the other 35 charges in our sample, with a total value of \$17,829, were allowable in accordance with the requirements of the Circular. The University’s project files contained no documentation that the involved grants, contracts, or other agreements met the definition of “major projects.” Further, the University provided no persuasive evidence that the nature of the work performed on the projects, or any other circumstances, justified any unusual degree of administrative and clerical support to accomplish project objectives.

For example, in our sample, the University charged salary and fringe benefit costs for:

- an administrative assistant for the NIH research project “Targeting BETAARK 1 in Heart Failure,”
- two clerical employees for the NIH-funded grant “Molecular Biophysics Training Program,” and
- a staff assistant for the NIH-funded grant “Genetic Epidemiology of Alzheimer’s Disease in Twins.”

The cost proposals, technical proposals, award documents, and other materials contained in the University’s project files contained no evidence that any of these grants should have been charged for administrative and clerical support. Further, for these 35 charges, our requests for additional information from the University’s Office of Sponsored Research and the involved principal investigators produced no persuasive evidence that direct charges for administrative and clerical salaries were justified.

The principal investigator for the “Targeting BETAARK 1 in Heart Failure” project, for example, stated that he considered clerical salaries “. . . specific to creating, copying, and assembling the annual progress report . . .” to be allowable. However, he provided no explanation why the production of an annual report, which is required of almost every sponsored project awarded to the University, might be interpreted as requiring an “extensive amount of administrative or clerical support” as required for reimbursement under section F.6.b.2 of the Circular.

The principal investigator for “Genetic Epidemiology of Alzheimer’s Disease in Twins” also cited “. . . administrative support to assist in report preparation . . .” and added that support was justified by the need to “. . . arrange travel and process paperwork for travel expenses for the study assessment teams who traveled biweekly . . .” However, the detailed project budget included only \$10,811 of total staff travel costs over the year, or less than \$416 per biweekly period, and neither the University nor the principal investigator provided any evidence that the effort involved in arranging that \$416 of travel was significantly greater than the routine level of such services provided by academic departments.

Repeatedly, principal investigators asserted that the administrative and clerical personnel whose salaries had been charged directly to their projects were performing essential tasks specific to the project goals. However, many of the projects had little in common with the programs and activities listed in Exhibit C to the Circular as examples of what might actually be considered major projects. Further, neither the University nor the principal investigators provided any evidence that their projects required significant administrative and clerical support over and above the level normally provided.

OTHER ADMINISTRATIVE COSTS

Of the 120 charges in our sample of other administrative and clerical costs, we accepted 74 charges with a total value of \$97,740. In these instances, the University provided sufficient documentation to show that direct charging of the involved costs was justified by the nature and extent of the involved work or other circumstances.

For example, we concluded that direct charging for the costs of copying services was justified on an NIH project entailing the production of spiral bound reference books for 300 teachers. Similarly, we concluded that postage and express delivery charges were warranted on a number of projects that required mass mailings to program participants or shipments of biological samples.

However, the University had not adequately documented that the other 46 charges in our sample, with a total value of \$10,657, were allowable pursuant to the Circular. Neither the University nor the principal investigators provided any persuasive evidence that the nature of the work performed on the projects, or any other circumstances, justified charging of the involved costs directly.

Some examples of items from our sample that we consider unallowable are:

- The University charged an NIH-funded project \$3,364 for a laptop computer and asserted that the computer was used solely for project data and allowed the employee “the opportunity to work from home or wherever she may be located at anytime of the day.” We noted, however, that the involved employee was budgeted to devote only 5 percent of her University time to the project charged for her computer.

- The University charged an NIH project \$193 for a swivel chair. In response to our request for justification, the University did not address the chair itself but pointed out that they had requested grant funding for miscellaneous office supplies.
- The University charged an NIH grant \$47 for two letter trays. When asked to explain circumstances related to the expense, the University asserted this was a major project that required “separate files for patient and site information in accordance with the scope of work.”

The other administrative expenses charged directly to HHS-funded grants, contracts, and other agreements ranged from monthly local telephone line charges, pager services, and copier paper to general office supplies such as a pair of scissors, postage, paper, pens, markers, file folders, and envelopes. However, the project proposals, award documents, and other materials in the University’s project files contained no evidence indicating that the nature or extent of work carried out on the projects, or any other circumstances, required any unusual degree of administrative and clerical support to accomplish project objectives.

UNIVERSITY HAD NOT ESTABLISHED ADEQUATE CONTROLS

Unallowable claims, such as those described above, occurred because the University had not established adequate controls to ensure consistent compliance with the Federal requirements applicable to charges for administrative and clerical costs. Although its GAP often incorporates text from the Circular, the University had largely left it to the discretion of its individual colleges, departments, and principal investigators to interpret the GAP correctly and to comply with the Federal requirements. The University’s policies essentially allowed direct charges to any project needing any administrative or clerical support.

As discussed earlier, Federal regulations specify that administrative and clerical costs will generally be treated as F&A, with the only specific exception provided for “major projects” defined in section F.6.b.2 of the Circular as projects requiring an “extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments.”

University policies (GAP 200.320 “Direct Costing on Sponsored Projects” and GAP 200.360 “Administrative and Technical Expenses for Federally Funded Project”) acknowledge “major project” requirements and incorporate relevant wording from the regulations. However, the policies provide no further guidance to help colleges, departments, and principal investigators determine whether a particular project falls within the definition of a major project to which administrative and clerical costs can appropriately be charged.

The Office of Sponsored Research did not provide adequate scrutiny for charges proposed by colleges, departments, and principal investigators to ensure that those charges fully complied with Federal regulations. The Office of Sponsored Research regularly allowed direct charges for administrative and clerical costs even though the involved departments and principal investigators could provide no evidence that their grants, contracts, and cooperative agreements

were major projects or that the project required any unusual degree of administrative and clerical support to accomplish project objectives.

Correctly defining a major project is not the only area in which the University's policies provided limited benefit to involved departments and principal investigators in trying to determine whether a particular charge was appropriate. For example, GAP 200.360 requires that any administrative expenses must be "explicitly listed" in an approved budget, and a budget must include "explicit justifications" as to why those charges are appropriate. However, the University's Office of Sponsored Research accepted and approved descriptions such as "office supplies" to justify the swivel chair charged to an NIH project and required no justifications to support charges for administrative and clerical expenses. The lack of adequate justification is further demonstrated by the University's immediate reversal of charges for 8 of the 120 sample items for other administrative costs when we requested the supporting documentation.

In accordance with University policy (GAP 200.320), principal investigators were able to budget and charge directly almost any type of administrative and clerical costs to a sponsored project. In fact, the policy specifically listed as potentially allowable these cost items quoted below:

- clerical and administrative salaries;
- office supplies;
- postage;
- local telephone charges, modem lines, fax lines, internet access fees;
- memberships;
- subscriptions;
- answering machine, pager, cell phones; and
- items generally thought of as having multifunctional use (e.g., staplers, hole punches, filing cabinets, chairs, desks, computers, printers, fax machines, calculators, waste baskets, etc.).

Without adequate controls or a policy requiring compliance with the Circular to ensure consistent compliance with Federal requirements, the University could not ensure that administrative and clerical expenses charged as direct costs to grants, contracts, and other agreements with HHS components complied with the applicable Federal regulations.

UNALLOWABLE COSTS

During the period October 1, 2002, through September 30, 2004, we estimate that the University's unallowable claims for administrative and clerical costs resulted in overcharges to HHS-funded grants, contracts, and other agreements. The overcharges included salary and fringe benefit expenses for administrative and clerical personnel and other administrative and clerical costs that should not have been charged directly to the projects, as well as the additional F&A allocated to the projects based on those unallowable direct costs.

RECOMMENDATIONS

We recommend that the University:

- refund \$1,661,011 to the Federal Government and
- revise its policies as needed to comply with the requirements of OMB Circular A-21 and ensure consistent treatment of administrative and clerical costs.

UNIVERSITY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

The University partially agreed with our first recommendation. Although the University agreed that some of the questioned costs were not supported with documentation, it stated that most of the questioned costs were allowable and that the Office of Inspector General (OIG) had not appropriately applied the allowability standards. Further, the University did not believe that it was appropriate to estimate unallowable costs using a statistical sample.

The University disagreed with our second recommendation. It stated that its policies complied with Federal requirements.

First Recommendation

University Comments – Standards Applied

The University asserted that, in some cases, “. . . the findings of the draft audit report resulted from the auditors’ incomplete or inaccurate understanding of the nature of the questioned costs” while, in other cases, “. . . it appears that there is a difference of view between the University and the auditors as to the standards applicable to the allowability of administrative costs”

The University identified a number of specific items recommended for disallowance in our draft report and maintained that these costs had been incurred for “major projects,” had been incurred in “unlike circumstances,” or were incurred for other allowable purposes in accordance with the Circular. In addition, according to the University, many of the salary-related costs we recommended for disallowance were for personnel who performed technical, rather than administrative or clerical, functions.

The University excerpted statements from such sources as the NIH “Grants Policy Statement” and the NIH “Guide for Grants and Contracts” to support its position that direct charges for administrative and clerical costs were allowable.

Office of Inspector General Response – Standards Applied

Based on our analysis of the University’s comments and the additional documentation,⁵ we concluded that the University had adequately supported 24 of the 55 items, and, accordingly, we revised the total amount recommended for recovery from \$2.4 million to \$1.7 million.

The University’s assertions and citations from the NIH “Grants Policy Statement,” the NIH “Guide for Grants and Contracts,” and other documents, however, did not support the University’s assertion that any further charges were allowable. While the University cited excerpts from these NIH documents to justify its position that administrative and clerical costs are explicitly allowable on many training grants, we maintain that the NIH documents were intended to implement the overarching principles established in the Circular, not to supersede them.

For example, the University cites volume 23, number 34 of the NIH “Guide for Grants and Contracts” (September 23, 1994), to address the issue of consistency and to support their claiming of administrative costs. However, the NIH “Guide for Grants and Contracts” simply restates the basic principles from the Circular that we applied throughout our audit when assessing the allowability of the University’s charges.

The University did not provide us with adequate evidence that the involved charges met these basic requirements. Further, the University’s comments did not address additional guidance presented in the NIH “Guide for Grants and Contracts,” such as the statement that “. . . grantee institutions that have negotiated indirect cost rates based on the revised principles contained in Section F.6.b may not directly charge administrative or clerical salaries when inconsistent with the Circular, even though these costs may not have been deleted from the noncompeting award.” Similarly, the University did not address the statement that “[t]he awarding unit staff will determine, in accordance with A-21, whether or not the costs are allocable as a direct cost under the particular project.”

The University’s references to a Direct Charge Equivalent computation also fail to persuade us that any other direct charges for administrative and clerical costs should be considered allowable. The Direct Charge Equivalent is used to compute bases for the allocation of indirect costs on a University-wide basis and does not specifically relate to the University’s direct charges to particular projects.

University Comments – Use of Extrapolation

The University contended that we should limit any liability for repayment of disallowed charges to the actual costs related to the specific charges reviewed during our audit, rather than basing liability upon an extrapolation of the results from our two statistical samples. The University also asserted that we should not have projected our findings across the entire University because

⁵Under separate cover, the University provided additional documentation, including grant applications and award documents, budget and accounting data, and other records that it had not provided during our audit fieldwork, to support its claims for 55 of the 105 items that we identified as unallowable. In addition, the University reserved the right to provide additional supporting documentation during the audit resolution process if required.

more than 70 percent of the costs recommended for disallowance related to only 4 of the 23 divisions represented in our statistical samples, and it added that many OIG audits at other universities did not involve the use of extrapolation.

Office of Inspector General Response – Use of Extrapolation

We disagree with both the University's positions. It is longstanding OIG policy to use statistical sampling techniques and recommend recoveries based on estimates of our sample results when it is conducive to our audit objectives. Because the University had charged HHS-funded projects for more than 55,000 separate items of administrative or clerical costs during our audit period, use of statistical sampling techniques was the only practical methodology for accomplishing our audit objectives.

While the University is correct in stating that many previous OIG audits at Duke University, as well as at other institutions around the country, did not involve statistical sampling, the objectives of those particular audits did not justify statistical sampling. In many cases, we used judgmental sampling to evaluate the reasonableness of proposed and claimed costs, or, in other cases, we examined 100 percent of the involved costs. Extrapolations to our audit universe in these cases were neither statistically appropriate nor required to meet our objectives.

Second Recommendation

University Comments

The University stated that its policies were not fairly represented in our draft report and that they complied with Federal requirements.

Office of Inspector General Response

We acknowledged in our draft report that the University had formal policies and procedures in place regarding direct charges of administrative and clerical costs to Federal grants and contracts throughout the audit period. Those policies and procedures provided detailed guidance related to Federal criteria applicable to charges for administrative and clerical costs.

While the University's policies and procedures were generally effective, some University employees did not always comply with them. Accordingly, we believe the additional enhancements implemented by the University since completion of our audit fieldwork and explained by the University in its comments represent a positive step toward ensuring even greater compliance. The University agreed to continue the process of revising its policies, procedures, training, monitoring, and other internal controls as needed to ensure that the University remains fully compliant with applicable Federal criteria.

APPENDIXES

**SAMPLING METHODOLOGY:
SALARY COSTS**

OBJECTIVE

Our objective was to determine whether Duke University (the University) had claimed reimbursement for administrative and clerical expenses as direct costs to grants, contracts, and other agreements with the Department of Health and Human Services (HHS) components in accordance with applicable Federal regulations.

POPULATION

The population consisted of all clerical and administrative salaries for fiscal years 2003 and 2004 charged to HHS that were greater than \$5. There were 4,641 transactions greater than \$5, totaling \$5,494,657.17. The 4,641 transactions contained:

- 4,627 transactions greater than \$5 and less than or equal to \$15,000 and
- 14 transactions greater than \$15,000.

SAMPLING UNIT

The sampling unit was a transaction.

SAMPLE DESIGN

The sample was a stratified sample. Stratum 1 consisted of all transactions greater than \$5 and less than or equal to \$15,000. Stratum 2 was a certainty stratum of all transactions greater than \$15,000.

SAMPLE SIZE

We randomly selected 100 transactions that were greater than \$5 and less than or equal to \$15,000. We reviewed all 14 transactions that were greater than \$15,000. The total sample size was 114.

**SAMPLING METHODOLOGY:
ADMINISTRATIVE COSTS OTHER THAN SALARIES**

OBJECTIVE

Our objective was to determine whether the University had claimed reimbursement for administrative and clerical expenses as direct costs to grants, contracts, and other agreements with HHS components in accordance with applicable Federal regulations.

POPULATION

The population consisted of all administrative costs, other than salaries, for fiscal years 2003 and 2004 charged to HHS that were greater than \$5. There were 50,478 transactions greater than \$5, totaling \$2,417,002.15. The 50,478 transactions contained:

- 50,458 transactions greater than \$5 and less than or equal to \$3,000 and
- 20 transactions greater than \$3,000.

SAMPLING UNIT

The sampling unit was a transaction.

SAMPLE DESIGN

The sample was a stratified sample. Stratum 1 consisted of transactions greater than \$5 and less than or equal to \$3,000. Stratum 2 was a certainty stratum of all transactions greater than \$3,000.

SAMPLE SIZE

We randomly selected 100 transactions that were greater than \$5 and less than or equal to \$3,000. We reviewed all 20 transactions that were greater than \$3,000. The total sample size was 120.

SAMPLE RESULTS AND ESTIMATES

SAMPLE RESULTS

Salaries and Facilities and Administrative Costs (F&A) Related to Salaries

Stratum	Sample Size	Amount of Sample Transactions	Number of Unallowable Transactions	Amount of Unallowable Transactions - Salaries	Amount of Unallowable Transactions – F&A Related to Salaries ¹
> \$5 - \$15,000	100	\$101,855	35	\$17,829	\$6,166
> \$15,000	14	248,241	0	0	0
Total	114	\$350,096	35	\$17,829	\$6,166

Other Administrative Costs and F&A Related to Other Administrative Costs

Stratum	Sample Size	Amount of Sample Transactions	Number of Unallowable Transactions	Amount of Unallowable Transactions – Other Administrative Costs	Amount of Unallowable Transactions – F&A Related to Other Administrative Costs
> \$5 - \$3,000	100	\$3,880	44	\$2,076	\$ 964
> \$3,000	20	104,517	2	8,581	3,277
Total	120	\$108,397	46	\$10,657	\$4,241

PROJECTION RESULTS: ESTIMATES OF UNALLOWABLE CHARGES

90-Percent Confidence Interval

	Point Estimate	Lower Limit	Upper Limit
Salaries	\$824,950	\$577,554	\$1,072,345
F&A Related to Salaries	285,318	175,687	394,949
Other Administrative Costs	1,055,882	619,121	1,492,643
F&A Related to Other Administrative Costs	489,849	288,649	691,049

¹F&A is computed based on a percentage of direct cost. For each unallowable direct cost transaction identified, we computed the unallowable F&A related to that item based on the F&A rate as stated in the award document.

UNALLOWABLE SAMPLE ITEMS: SALARIES

Sample Selection Order	University's Project Code	Grant Number	Position	Amount Recommended for Adjustment	Direct Costs Awarded	Indirect Cost Rate	Indirect Costs Related to Unallowable Costs	Total Direct + Indirect Costs	OPDIV
4	3039597	5 R01 AG08549-11	Research Secretary	\$150.92	\$708,424	54%	\$81.50	\$232.42	NIH
7	3032118	5 R01 CA089053-02	Staff Assistant	29.14	507,589	54%	15.74	44.88	NIH
9	3039419	5 R01 0H03979-02	Staff Assistant	687.45	175,000	54%	371.22	1,058.67	CDC
11	3032689	5 R01 CA81191-02	Staff Assistant	75.76	297,683	54%	40.91	116.67	NIH
13	3037307	5 R01 MH057448-04	Project Assistant	609.70	418,901	54%	329.24	938.94	NIH
14	3039424	FD-R-002154-02	Administrator	333.41	299,941	54%	180.04	513.45	FDA
16	3039424	FD-R-002154-03	Administrator	319.61	299,826	54%	172.59	492.20	FDA
17	3025003	5 T32 HD40372-02	Trainee-related expenses	484.83	288,114	8%	38.79	523.62	NIH
19	3036344	5 R01HL0690-05	Administrative Assistant	842.04	186,959	54%	454.70	1,296.74	NIH
21	3034862	5 R01 GM000091-58	Staff Assistant	337.78	336,913	54%	182.40	520.18	NIH
22	3024380	5 T32 GM007754-23	Trainee-related expenses	526.92	286,208	8%	42.15	569.07	NIH
25	3029871	5 T15 HG00026-10	Staff Assistant	773.36	106,798	8%	61.87	835.23	NIH
29	3099001	5 H70 MC 00002-02	Administrative Assistant	884.07	230,606	10%	88.41	972.48	HRSA
30	3029813	5 D09 HP 00392-02	Administrative Support	837.82	193,911	8%	67.03	904.85	HRSA
33	3032689	5R01 CA081191-04	Staff Assistant	72.89	282,973	54%	39.36	112.25	NIH
34	3034862	5R01 GM000091-58	Staff Assistant	320.46	336,913	54%	173.05	493.51	NIH
35	3029813	5 D09 HP00392-02	Administrative Support	837.81	209,424	8%	67.02	904.83	HRSA
41	3032907	5 R01 CA76016-05	Research Assistant	290.88	289,431	54%	157.08	447.96	NIH
49	3039141	5 P60 AG011268-09	Research Secretary	152.33	1,233,085	54%	82.26	234.59	NIH
50	3029809	5d01 HP00006-02	Project Assistant	982.51	406,448	8%	78.60	1,061.11	HRSA
53	3025003	5T32 HD40372-02	Trainee-related expenses	116.98	288,114	8%	9.36	126.34	NIH
54	3039597	5 R01 AG008549-12	Staff Specialist	151.86	480,282	54%	82.00	233.86	NIH
55	3039424	FD-R-002154-01	Administrator	1,564.16	298,517	54%	844.65	2,408.81	NIH
58	3029802	5D22-HP00081-03	Position not identified	858.31	108,000	8%	68.66	926.97	HRSA
66	3036077	5 U01 HL072289-02	Staff Assistant	424.16	247,402	54%	229.05	653.21	NIH

UNALLOWABLE SAMPLE ITEMS: SALARIES

Sample Selection Order	University's Project Code	Grant Number	Position	Amount Recommended for Adjustment	Direct Costs Awarded	Indirect Cost Rate	Indirect Costs Related to Unallowable Costs	Total Direct + Indirect Costs	OPDIV
68	3029804	1D21-HP19168-01	Position not identified	\$75.73	\$154,877	8%	\$6.06	\$81.79	HRSA
69	3036580	5 R01 HL57354-05	Financial Analyst	216.99	557,867	54%	117.17	334.16	NIH
71	3029814	7 U78 HP 00023-02	Administrative Assistant	311.16	499,987	8%	24.89	336.05	HRSA
75	3037231	5 R01 MH061744-05	Staff Specialist	1,296.19	280,074	54%	699.94	1,996.13	NIH
76	3036580	5 R01 HL57354-05	Financial Analyst	231.77	557,867	54%	125.16	356.93	NIH
85	3034862	5 R01 GM00091-57	Staff Assistant	320.46	327,159	54%	173.05	493.51	NIH
86	3037498	5 R01 MH49679-08	Administrative Secretary	1,032.30	365,410	54%	557.44	1,589.74	NIH
92	3024379	5 T32 GM07184-28	Trainee-related expenses	\$419.07	1,073,280	8%	\$33.53	452.60	NIH
94	3024376	5 T32 GM08487-09	Trainee-related expenses	454.48	207,516	8%	36.36	490.84	NIH
98	3039436	UR6 CCU 420565-01	Data Technician	805.73	96,726	54%	435.09	1,240.82	CDC
Total Stratum 1				\$17,829.04			\$6,166.37	\$23,995.41	
Total Stratum 2				\$0.00			\$0.00	\$0.00	
Total				\$17,829.04			\$6,166.37	\$23,995.41	

OPDIV = Operating Division

CDC = Centers for Disease Control and Prevention

FDA = Food and Drug Administration

HRSA = Health Resources and Services Administration

NIH = National Institutes of Health

UNALLOWABLE SAMPLE ITEMS: OTHER ADMINISTRATIVE COSTS

Sample Selection Order	University's Project Code	Grant/Contract Number	Item Purchased	Amount Recommended for Adjustment	Transferred Due to Audit	Indirect Cost Rate	Indirect Costs Related to Unallowable Costs	Total Direct + Indirect Costs	OPDIV
1	3039399	2 R37 AG00443-28A1	Scissors and desk organizer	\$6.67	N	54%	\$3.60	\$10.27	NIH
3	3039900	NO1MH12012	Postage	57.96	N	54%	31.30	89.26	NIH
8	3027424	5 T32 MH065742-02	Envelopes	16.54	N	8%	1.32	17.86	NIH
9	3036520	5 U01 HL069015-03	Tray letter	46.96	N	54%	25.36	72.32	NIH
11	3036092	1 R01 HL074103-01	25 report covers	16.65	N	54%	8.99	25.64	NIH
12	3031614	5 R01 DK055808-06	Printer cartridge	49.99	N	28%	14.00	63.99	NIH
13	3032119	3 R01 CA091947-03S1	Paper and hole punch	4.08	N	54%	2.20	6.28	NIH
17	3032951	5 R37 CA011898-34	Antibiotic ointment	6.38	N	54%	3.45	9.83	NIH
19	3037581	5 R01 MH054846-07	Unknown	35.92	35.92	54%	19.40	55.32	NIH
20	3039597	5 R01 AG08549-11	Stamps	22.20	N	54%	11.99	34.19	NIH
21	3037240	1 R01 MH063949-01A2	Shredder	201.13	N	54%	108.61	309.74	NIH
23	3037220	5 R01 MH063970-02	Local phone	39.20	N	54%	21.17	60.37	NIH
24	3037498	5 R01 MH49679-08	Ivory paper	6.34	N	54%	3.42	9.76	NIH
27	3039235	5 P422 EES010356-04	Unknown	30.31	30.31	54%	16.37	46.68	NIH
28	3037246	5 P50 MH060451-03	Ball point pens	15.12	N	54%	8.16	23.28	NIH
35	3037204	1 P50 MH60451-01A2	Local phone	30.60	N	54%	16.52	47.12	NIH
36	3038297	Information not provided because item was transferred	Courier service	14.02	14.02	54%	7.57	21.59	NIH
37	3037222	5 P50 MH60451-02	Local service	30.60	N	54%	16.52	47.12	NIH
38	3039433	U81 CCU417759-04	6 sorters	31.68	N	54%	17.11	48.79	CDC
39	3036380	5 R01 HL063346-04	Postage	16.89	16.89	54%	9.12	26.01	NIH
40	3035006	5 P01 HD039948-03	Office supplies	6.96	6.96	54%	3.76	10.72	NIH
41	3032460	5 U10 CA086004-05	FedEx	13.98	N	54%	7.55	21.53	NIH
42	3036434	5 P01 HL042444-13	Copy paper	40.80	N	54%	22.03	62.83	NIH
46	3036161	5 R01 HL067145-02	Appointment book	19.75	N	54%	10.67	30.42	NIH
47	3033415	5 M01 RR000030-42	FedEx	13.84	N	8%	1.11	14.95	NIH
48	3039173	5 U01 AG022132-02	FedEx	7.54	N	54%	4.07	11.61	NIH
54	3099001	I H70 MC 00002-01	10 Inkjet cartridges	294.40	N	10%	29.44	323.84	HRSA
57	3036977	5 R01 HL65222-03	FedEx	7.84	N	54%	4.23	12.07	NIH
61	3036429		Association dues	324.00	324.00	54%	174.96	498.96	NIH
64	3039173	5 U01 AG022132-02	FedEx	8.18	N	54%	4.42	12.60	NIH

UNALLOWABLE SAMPLE ITEMS: OTHER ADMINISTRATIVE COSTS

Sample Selection Order	University's Project Code	Grant/Contract Number	Item Purchased	Amount Recommended for Adjustment	Transferred Due to Audit	Indirect Cost Rate	Indirect Costs Related to Unallowable Costs	Total Direct + Indirect Costs	OPDIV
65	3037202	1 P50 MH60451-01A2	FedEx	\$8.84	N	54%	\$4.77	\$13.61	NIH
70	3037249	5 P50 MH060451-03	Printer cartridge	71.39	N	54%	38.55	109.94	NIH
73	3032074	1 R01 CA100734-01A1	Shredder, pens, mouse pad, etc.	119.52	N	54%	64.54	184.06	NIH
75	3036380	5 R01 HL63346-04	Information not provided because item was transferred	49.13	49.13	54%	26.53	75.66	NIH
76	3039453	5 R18 HS09706-03	Unknown	57.53	N	54%	31.07	88.60	AHRQ
78	3034682	5 P01 AI044975-05	Phone charges	30.60	N	54%	16.52	47.12	NIH
79	3030788	5 P01 A1044975-05	Pens and markers	8.87	N	54%	4.79	13.66	NIH
80	3032178	5 R01 CA085740-02	Envelopes	26.43	N	54%	14.27	40.70	NIH
84	3036069	9 R01 HL71536-06	50 compact disks	31.66	N	54%	17.10	48.76	NIH
87	3036418	5 R01 HL064894-04	Hanging folders	8.33	8.33	54%	4.50	12.83	NIH
89	3030240	5 U01 AI046725-04	Swivel chair	193.43	N	54%	104.45	297.88	NIH
90	3037557	5 R01 MH57027-05	Inkjet cartridge	25.59	N	54%	13.82	39.41	NIH
93	3030789	5 P01 AI044975-04	Unknown	15.75	N	54%	8.51	24.26	NIH
96	3039507	5 U18 HS010548-05	FedEx	11.99	N	54%	6.47	18.46	AHRQ
Total Stratum 1				\$2,075.59			\$964.31	\$3,039.90	
109	3032004	5 R01 CA90548-02	Computer and supplies	5,216.95	N	28%	1,460.75	6,677.70	NIH
113	3036306	7 P01 HL36059-15	IBM laptop	3,364.24	N	54%	1,816.69	5,180.93	NIH
Total Stratum 2				\$8,581.19			\$3,277.44	\$11,858.63	
Total				\$10,656.78	\$485.56		\$4,241.75	\$14,898.53	

Duke University

DURHAM
NORTH CAROLINA
27708

FINANCIAL SERVICES
Research Costing Compliance

TELEPHONE (919) 684-5723
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April 3, 2008

Peter J. Barbera
Regional Inspector General for Audit Services
HHS OIG Office of Audit Services
61 Forsyth St., SW, Suite 3T41
Atlanta, GA 30303-8909

Re: Report Number A-04-05-01014

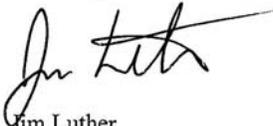
Dear Mr. Barbera:

Thank you for providing an opportunity for us to review and comment on the draft report entitled "Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, Through September 30, 2004". Attached is Duke University's response to your report.

On behalf of Duke University, I want to express my appreciation for the cooperation and attention that we have received from your staff, particularly Jeff Bullock and Fran Cowper, as we communicated with them regarding our response to the draft audit. As the attached written response indicates, we are not in agreement with all of the findings of the draft report. Nonetheless, the audit process has given us an opportunity to review and refine further the processes and procedures around this area of compliance, and in that respect the process has been positive.

If you have any questions, please don't hesitate to contact me. Thank you.

Sincerely,



Jim Luther
Assistant VP, Research Costing Compliance & Federal Reimbursement
Duke University
James.Luther@Duke.Edu
Phone: 919.684-5723

April 4, 2008
Duke University Response

Duke University Response to Draft Audit Report

Introduction and Summary

Duke University submits these comments in response to the HHS OIG draft audit report entitled "Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, Through September 30, 2004" (the "draft audit report"), which was transmitted to the University by a letter dated January 31, 2008. We understand that this audit was a "pilot" audit, undertaken for the purpose of determining how to conduct audits of administrative and clerical costs, and whether such audits should be conducted at other universities.

Our comments on the draft audit report address three subjects: (1) the allowability standards applied by the auditors, and use of extrapolation to determine the recommended refund amount; (2) the draft audit report's characterization of the University's internal controls during the audit period; and (3) the steps taken by the University since the audit period to reduce further the incidence of unallowable direct charges of administrative costs to HHS awards.

As these comments will indicate, the University does not agree in all respects with the findings of the draft audit report, either as to individual charges and the recommended refund amount, or as to the adequacy of the University's internal controls over the direct charging of administrative costs. The experience of this audit, however, has caused the University to increase its attention to this aspect of cost reimbursement under federal awards, and has led to improvements in the University's policies and procedures in this area. In this respect the pilot audit's focus on administrative costs has been productive and positive. Nonetheless, we strongly believe that there are aspects of the draft audit report that are erroneous and should be revised prior to finalization of the report.

The University has carefully studied the direct charge transactions that the draft audit report proposes to disallow. In some cases, the University agrees that the documentation associated with the costs questioned in the draft audit report does not support the allowability of the costs as direct charges to HHS awards. These transactions were inconsistent with federal cost reimbursement policy as well as with University policy at the time.

The University believes, however, that at least 55 of the 107 charges questioned by the draft audit report, representing approximately 61% of the total dollar amount of the questioned costs, are allowable as direct charges. These 55 charges represent the administrative charges that the University believes are most clearly allowable as direct charges to HHS awards under OMB Circular A-21 and other applicable authorities. The table at Attachment A summarizes the

April 4, 2008
Duke University Response

University's position on each of these 55 defended charges.¹ Under separate cover, the University has provided detailed documentation of its position with respect to each of these charges.

In addition to the 55 charges in Attachment A, the University believes that a number of other charges questioned in the draft audit report are also defensible. The University reserves the right to defend such additional charges during the audit resolution process, if required.

In some cases the University believes that the findings of the draft audit report resulted from the auditors' incomplete or inaccurate understanding of the nature of the questioned costs. In other cases it appears that there is a difference of view between the University and the auditors as to the standards applicable to the allowability of administrative costs as we believe in a number of cases that there is specific NIH guidance that applies and supports the allowability of the expense. In its separate submission the University has provided a complete description of each charge defended by the University, and the circumstances in which it was incurred, including a reference to the sponsoring agency's approval of the cost. It is important to note that in all instances the sponsoring agency approved the administrative costs included in the budget. The University has also provided copies of documentation of key facts relating to the allowability of each defended charge. In each case, the University believes that the circumstances fully justify the allowability of the defended charge. Section A of these comments sets forth the University's interpretation of the applicable standards governing direct charges of administrative and clerical costs.

Section A also sets forth the University's position regarding the draft audit report's extrapolation from the 107 questioned costs. The questioned costs occurred for the most part in a relatively small number of divisions within the School of Medicine, and were not the result of systematic deficiencies in the University's internal controls. In these circumstances, and given the fact that the HHS OIG has not used extrapolation in other recent audits involving university research, the University submits that extrapolation is neither appropriate nor equitable in this case.

Section B of these comments addresses the draft audit report's characterization of the University's internal controls with respect to charging of administrative costs during the audit period. Although the University's policies, procedures and controls in this area have become stricter over time, and are stricter today than they were during the audit period, the University strongly believes that its internal controls during the audit period were compliant with applicable standards and reasonable in the circumstances. During the audit period the

¹ We have attached a redacted version of the table with the expectation that it will be made publicly available, but we have separately provided to you an unredacted version.

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University held HHS awards involving approximately 2500 fund codes. Only about 12% of those fund codes involved any direct charging of administrative and clerical salaries and approximately 10% of HHS awards had non-salary administrative charges >\$1,000 over the two years included in the audit. Moreover, of the approximately \$458,000 in administrative costs examined by the auditors, more than 90% in dollar terms were accepted by the auditors as allowable. In short, even if the draft audit report's findings of unallowability are accepted in full, they demonstrate that the University's internal controls during the audit period (a) prevented any material direct charging of administrative costs at all to the vast majority of HHS awards, and (b) were more than 90% effective in ensuring that administrative and clerical costs that were charged to HHS awards were allowable. As indicated above, moreover, the University believes that many of the costs questioned by the draft audit report are in fact allowable. Based on the University's analysis of the charges reviewed by the auditors, over 95% of the administrative costs charged directly to HHS awards during the audit period were allowable. This data refutes the draft audit report's finding that the University lacked adequate internal controls with respect to direct charging of administrative costs during the audit period.

Section C responds to the recommendation of the draft audit report that the University "revise its policies as needed to comply with the requirements of OMB Circular A-21 and ensure consistent treatment of administrative and clerical costs." As indicated above, the University believes that its internal controls during the audit period were generally compliant with applicable standards, and were effective in minimizing the unallowable direct charging of administrative and clerical costs. Nevertheless, since the audit period – and in fact since the HHS OIG audit began – the University has tightened its standards and controls over direct charging of such costs.

Overall data on the University's charging of administrative costs to federal awards reveals that the University's internal controls improvements have been effective. The draft audit report finds, in effect, that the dollar amount of direct charges of administrative and clerical costs should have been approximately 9% less than they were during the audit period. (That is, only 9% of the dollars in the auditors' two samples were questioned by the auditors.) Since the audit period, the University has instituted policies, procedures and additional controls that have further tightened the approval and monitoring of such direct charges to federal awards. The details concerning these recently instituted policies, procedures, and controls are provided in Section C.

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A. Standards Applicable to the Direct Charging of Administrative and Clerical Costs

The University agrees for the most part with the draft audit report's description of the applicable standards of OMB Circular A-21 for the direct charging of administrative and clerical costs. In some important respects, however, the University's interpretation of the applicable standards differs from that stated in the draft audit report.

1. Direct charging of "administrative and clerical" salary charges

a. Personnel performing technical functions

The draft audit report correctly cites OMB Circular A-21 F.6.b(2) as the principal section governing the direct charging of administrative and clerical staff salaries. Before addressing that section, however, it is important to recognize that by its terms this section does not apply to staff who are performing a technical function (even if they may have a clerical personnel code in the university's payroll distribution system). Section F.6.b(2) applies only to those personnel who are providing "administrative or clerical services". Many of the salary costs questioned in the draft audit report are salaries of personnel who performed technical functions – not administrative or clerical functions. Neither the "major project" condition nor the budgeting provision of section F.6.b(2) applies to personnel performing technical functions.

b. Personnel providing administrative or clerical services

As the draft audit report states, section F.6.b(2) of OMB Circular A-21 provides that "[t]he salaries of administrative and clerical staff should normally be treated as F&A costs." The section goes on to say, however, that direct charging of such costs is permissible "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."

Exhibit C to OMB Circular A-21 provides six "examples" of major projects. These examples fall into three categories, as follows:

- The first category, represented by example #1 in Exhibit C, relates to programs that are inherently large and complex, because of their very nature – such as General Clinical Research Centers, Primate Centers, Program Project grants, environmental research and engineering research centers, and the like.

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- The second category, represented by examples #2, #3, #4 and #6 in Exhibit C, relates to projects that may not involve inherently large or complex programs, but that nevertheless have specific requirements that make it necessary to use unusual amounts or types of administrative or clerical services. Examples are projects that involve extensive data accumulation, analysis and entry, projects that involve extensive travel and meeting arrangements for large numbers of conference participants, projects involving production of manuals, large reports, books and monographs, projects involving human or animal protocols, and the like.
- The third category, represented by example #5 in Exhibit C, relates to projects that are inaccessible to normal departmental administrative services, including research sites that are remote from campus. It should be noted that this category does not require a showing that the project requires an unusually high degree of administrative support. It is sufficient that the project not be supported by “normal departmental administrative services”.

The common theme of these three categories is that the nature, location, or extent of the administrative or clerical services used by the projects in each category is such that the services would not be available through “normal departmental administrative services”. A Program Project grant typically has an administrative core that is too extensive and specialized to be supported by normal departmental resources. An R01 involving production of a large manuscript, or a need for special graphics skills, or a complex human subjects protocol, ordinarily would not be able to obtain the necessary support from regular departmental administrative staff. A free-standing center or remote site might need its own secretarial assistant to perform routine administrative tasks, because normal departmental administrative support is unavailable. In each case, the “unlike circumstance” is that the administrative need cannot be served by normal departmental staff support.

The fact that a particular administrative salary charge may relate to an employee who is also performing normal departmental administrative services does not necessarily mean that the salary charge to the grant is not incurred in unlike circumstances. The test in each case is not the job title of the employee or what the employee does during his or her other time, but whether the duties performed by the employee with respect to the federal grant are, by their nature or extent, over and above what the user of the services could reasonably expect from normal departmental resources. This test is not always easy to apply, but it is required by the “unlike circumstances” condition of OMB Circular A-21.

It should be noted that, with the exception of example #1, none of the examples in Exhibit C requires that the projects in question be particularly large or complex. Apart from the inherently large and complex programs in example #1, it is not the size or complexity of a project that matters; the only issue is whether the

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project requires administrative or clerical support beyond that offered by “normal departmental administrative services”. For example, if an R01 grant involving a human or animal protocol (example #6) requires administrative support not available from normal departmental resources, the grant would clearly qualify for direct charging of such administrative support under Exhibit C.

It should also be noted that the examples in Exhibit C are just that – examples. Exhibit C makes it clear that the examples are not exhaustive. There can be other circumstances in which the “major project” designation would be appropriate.

Although there is no express standard as to what percentage of an institution’s federal grants might be expected to fall within the special circumstances of Exhibit C, in the University’s case that percentage is very low. For example, during the audit period only about 12% of all University HHS awards had any administrative or clerical salary charges assigned to them at all. This low percentage suggests that the University applied the “major project” condition with appropriate restraint and recognition of its exceptional character.

Attachment A to these comments summarizes the administrative and clerical salary charges that the University believes are most clearly defensible as direct charges to HHS awards. With respect to the three salary charges given as examples on page 5 of the draft audit report, the University agrees with the auditors’ position on the first and third examples, but not the second. The questioned salary charges in the second example (S-94) relate to two staff specialists, who served as administrators for a number of NIH training programs in the biomedical sciences at the University. Their effort was specifically identifiable with these training programs and their salaries are properly considered direct charges under the guidance issued by NIH concerning training grants. See Section A.3 below.

While the University agrees with some of the auditors’ findings with respect to the direct charging of administrative salaries, in most such cases the University believes the salary charges are allowable. For example, the auditors questioned two salary charges totaling \$1,430.97 associated with an administrative assistant in the information technology department within the Duke Comprehensive Cancer Center (see S-56, S-81). The salary costs were charged directly to the Cancer Center’s core support P30 grant from NIH, which explicitly funds the administrative infrastructure needed for the operation of this stand-alone research center, including the information technology operation. The administrative assistant in question was identified in the budget approved by NIH and the Cancer Center clearly qualifies as a “major project”.

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In another case (S-9), the auditors questioned the salary cost of \$687.45 for a staff assistant that was direct charged to a Centers for Disease Control (“CDC”) modular grant. The assistant in question entered data from over 4,000 four-page questionnaires associated with this occupational health study, and she performed data quality control and made follow-up phone calls to respondents to clarify vague answers. The work she performed was technical in nature, and differed in nature and extent from the routine administrative support that would typically be provided by departmental clerical staff. Her effort is specifically identifiable with this study, and she was explicitly identified in the budget approved by the CDC. This study qualifies as a “major project”, given its unique need for substantial technical support not routinely provided by a department.

2. Direct charging of non-salary “administrative” costs

The draft audit report is premised on the belief that non-salary administrative expenses may be charged directly to federal sponsored projects only if the “major project” exception applies and the project in question requires more than the routine amount of administrative support typically provided by departments. See Draft Audit Report at 4-5 and 6-7. OMB Circular A-21, however, does not apply the “major project” condition to non-salary administrative costs, and does not require a showing that the project charged with non-salary administrative costs required an unusual degree of administrative and clerical support. The Circular states only that “[i]tems such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs.” OMB Circular A-21 at F.6.b.3 (emphasis added). Moreover, whereas administrative and clerical salary costs may ordinarily be charged directly to a federal project only if budgeted, there is no budgeting requirement with respect to non-salary administrative costs.

Under OMB Circular A-21, administrative costs such as office supplies are “normally” treated as F&A costs because they typically represent the kinds of costs “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.” OMB Circular A-21 at E.1. There are some cases, however, where a non-salary administrative cost can be “identified readily and specifically with a particular sponsored project”, and in such cases the cost can and should be charged directly. OMB Circular A-21 makes it clear that whether a particular cost can be “identified” with a particular sponsored project does not depend on the nature of the charge (e.g., administrative vs. technical): “identification with the sponsored work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from F&A costs of sponsored agreements.” OMB Circular A-21 at D.2.

For example, it is clear that a long-distance telephone charge is an administrative cost by its nature, but because long-distance charges can be

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specifically identified with a particular project, they may be charged directly to the project. Again, there is no requirement in OMB Circular A-21 that the project be a "major project", or that the grantee include the charge in its grant budget. The University's review of the non-salary charges questioned by the draft audit report indicated numerous instances in which the costs could be specifically identified with the project to which they were charged. The University respectfully submits that all of these charges are allowable.

OMB Circular A-21 also states that universities must be consistent in their direct charging practices. OMB Circular A-21 at D.2. What this means is that to the extent that administrative costs that are specifically identifiable with research are charged to sponsored research projects, administrative costs specifically identifiable with other functions (such as instruction) must in like circumstances be directly charged to those functions. NIH has expressed the consistency requirement as follows:

[C]are must be exercised to assure that costs incurred for the same purpose in like circumstances are consistently treated as direct costs for all activities. This should be accomplished through a "Direct Charge Equivalent" or other mechanism that assigns the costs directly to the appropriate activities.

NIH GUIDE, Volume 23, Number 34, September 23, 1994.

The University meets this "consistency" requirement. In the calculation of its F&A rate, the University takes two steps to ensure that the instruction activity receives an appropriate allocation of direct charges of administrative and clerical costs. First, as in the case of research, the University assigns directly to the instruction function the salaries of personnel who perform administrative and clerical services in connection with instruction. Second, the University assigns non-salary administrative costs to the instruction function by means of a "Direct Charge Equivalent" (DCE), based on the percentage of administrative and clerical salary charges in each department. In the last F&A rate calculation the salary and non-salary administrative costs directly charged to the research function and the instruction function as a percentage of total direct charges in each function were as follows:

	Direct Charges to Research as % of Total Direct Charges	Direct Charges to Instruction as a % of Total Direct Charges
Administrative and clerical salaries	1.9%	3.2%
Non-salary administrative costs	0.8%	1.4%

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As this table demonstrates, the University directly assigns an even higher percentage of salary and non-salary administrative charges to instruction than it does to research.

Although the University does not agree with the standards stated in the draft audit report with respect to non-salary administrative costs, the University accepts some of the findings made with respect to specific cost items. For example, the University agrees that the three non-salary administrative charges cited at page 7 of the draft audit report should not have been charged directly to federal awards. These items are multi-purpose in nature, and there is not enough evidence to indicate that they were used specifically on the grants to which they were charged. In these instances, it is not possible to allocate these charges "relatively easily with a high degree of accuracy," as OMB Circular A-21 requires. OMB Circular A-21 at D.1.

In other cases, however, the University believes that the non-salary costs questioned by the auditors are in fact specifically identifiable with the HHS award to which they were charged. The non-salary costs that the University is defending, and a summary of the University's position on each cost, appears in Attachment A to these comments. For example, the auditors questioned a \$8.18 cost for a Federal Express shipment that was direct charged to an NIH grant (O-64). The package was a shipment of confidential patient sample data from the core laboratory performing analysis of patient tests to one of the clinical trial sites in the study. The Federal Express airbill specifically identifies the shipper, the core laboratory, and the recipient, a research coordinator for one of the study's clinical trials. Thus, this charge is specifically identifiable with the grant in question. It is indistinguishable from a long distance telephone charge in this respect.

Similarly, the auditors questioned the direct charge of \$210.13 for a paper shredder which was used to destroy confidential psychiatric advance directives and other sensitive patient records in a study funded by the National Institute of Mental Health (see O-21). The shredder was purchased specifically for this study because of the large volume of sensitive records that could not easily be transported to another location to be shredded. The shredder was located in the suite where the study research was being conducted and was used only on that project. Here too it is possible to directly allocate this charge to the grant "with a high degree of accuracy."

3. Direct Charging Administrative Costs to Training Grants

A number of the costs questioned in the draft audit report (e.g., S-17, S-22, S-25, S-53, S-92, S-94, S-30, S-35, S-50, S-58, S-68) were direct charges of

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administrative costs to training grants. NIH and HHS have expressly recognized that institutions may directly charge administrative costs to training grants.² This is accomplished through a mechanism known as the “institutional allowance” (for fellowship awards), or the “training related expenses” allowance (for institutional research training awards) which provides funding to grantees to use at their discretion to defray some of the expenses associated with the training programs.

The NIH Grants Policy Statement (2003) provides that “NIH awards an institutional allowance to help support the costs of training” associated with the fellowship programs. See NIHGPS at p. 175. NIH explains that “[t]he institutional allowance is a fixed amount. Expenditures under institutional allowances are not subject to NIH prior-approval requirements, and the institution is not required to account for these expenditures on an actual cost basis.” Id. According to the NIHGPS, the universities may use the institutional allowance to “defray expenses for the individual fellow such as research supplies, equipment, travel to scientific meetings, and health insurance and to otherwise offset, insofar as possible, appropriate administrative costs of training. Funds are paid directly to and administered by the sponsoring institution.” Id.

NIH also provides an allowance to offset “training related expenses” associated with the institutional research training awards.

Funds are provided to defray costs such as staff salaries, consultant costs, equipment, research supplies, staff travel, and other expenses directly related to the training program. Funds are requested and awarded as a lump sum on the basis of the predetermined amount per predoctoral and postdoctoral trainee approved for support.

NIH Grants Policy Statement (2003) at 197.

The HHS Grants Policy Statement provides a similar institutional allowance for training grants, though the exact terms may vary by operating division. HHS Grants Policy Statement (Jan. 2007) at II-111. HRSA routinely approves administrative costs, including administrative salaries, as direct costs to HRSA training grants under its program guidance. For example, the 2007 program guidance for the geriatric training program directs applicants to include in their budget justification the names, positions, and proposed effort for each “professional” (i.e., faculty and technical staff) and “nonprofessional” (i.e., administrative and

² NIH training grants include fellowship awards F30, F31, F32, and F33 and institutional research training awards T32, T34, and T35. Collectively, such awards are known as the Ruth L. Kirschstein National Research Service Awards (“Kirschstein-NRSA” or “NRSA”). The HHS training grants include Health Resources and Services Administration/Bureau of Health Professions (“HRSA” or “BHP”) grants to train health care professionals.

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clerical) person "for whom salary is requested." 2007 HRSA Program Guidance "Geriatric Training for Physicians, Dentists, and Behavioral and Mental Health Professionals Grant Program" at 15.

NIH has expressly stated that such administrative costs, including administrative salaries, can be directly charged to a training grant even if they were not included in the approved grant application:

For example, administrative or clerical salaries not identified in the application could be charged to the Training Related Expenses associated with Institutional National Research Service Awards (T32) when the activity involves a large amount of tracking and completion of forms directly related to the purpose of the grant.

NIH GUIDE, Volume 23, Number 34, September 23, 1994.

4. Direct charging administrative costs to modular grants

The auditors appear to have taken the position that direct charges of administrative and clerical costs to modular NIH grants are impermissible, either because of the nature of the grants or because the charges are not contained in the budget submission, or both (e.g., S-9). If this is the auditors' position, it is directly contradicted by policy guidance on modular grants that was issued by NIH on August 23, 2006. That policy guidance contained a number of FAQs on submission of modular grant applications, including the following:

13. *How do we request funds for general administrative and clerical support?*

The NIH GUIDE, Volume 23, Number 34, September 23, 1994, <http://grants.nih.gov/grants/guide/notice-files/not94-276.html>, discussed the treatment of administrative and clerical salaries. If you plan to use grant funds to pay for clerical salaries and/or other administrative costs that are covered in the examples provided, you will not need NIH approval to charge those costs to the project. NIH has already determined these are acceptable direct costs charges. If you wish to charge those costs to an NIH supported project and they are not one of the examples provided in the NIH GUIDE, you will need to contact NIH prior to obligating grant funds to ensure the costs are allocable as a direct cost to the project.

See http://grants.nih.gov/grants/funding/modular/modular_faq_pub.htm#q13c

This guidance makes it clear (a) that in appropriate circumstances administrative costs may be charged to modular grants; (b) that NIH has pre-

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approved the direct charging of certain administrative costs in its 1994 guide on the subject, and (c) that there is no requirement for a separate NIH approval of such costs, through the grant budget or otherwise.

5. Rebudgeting of grant funds to support administrative and clerical costs

The auditors appear to have taken the position that an institution may not rebudget award funds to cover administrative and clerical costs not anticipated at the time of the initial budget submission. This position is contradicted by the NIH's 1994 guidance on the subject of administrative and clerical costs, which provides as follows:

This revision also affects any postaward rebudgeting of funds for the purpose of charging administrative or clerical salaries. Where grant or cooperative agreement applications do not anticipate the need to directly charge administrative and clerical salaries, institutions may rebudget funds, without awarding office prior approval, to cover these costs when consistent with the criteria and examples described above.

NIH GUIDE, Volume 23, Number 34, September 23, 1994.

6. Summary

As noted in the introduction to these comments, the University has provided the auditors with extensive documentation and justification of the questioned costs that the University believes are most clearly allowable as direct charges to HHS awards. Attached to these comments as Attachment A is a table summarizing these defended charges, with a brief explanation of the basis for the University's position on each charge. Attachment A covers 55 of the 107 questioned costs. The dollar value of these 55 defended charges is \$35,698, which represents 61% of the total dollar value of the questioned charges.³ The University respectfully submits that the draft audit findings should be revised to allow the charges contained in Attachment A.

³ In addition to the 55 charges that the University is defending as allowable direct administrative charges, the University has identified two charges (O-39 and O-75) that the University concedes are unallowable, but not because they were administrative costs. Both involved clerical errors. They related to Federal Express shipments incorrectly charged to the grant in question because a staff member inadvertently used the wrong pre-printed Federal Express airbill. In each case the department removed the charge once the error was discovered. Because these unallowable charges occurred as a result of a clerical error, rather than the incorrect application of OMB Circular A-21's cost principles regarding administrative costs, we believe that these charges should not be included among the charges from which the auditors extrapolated to arrive at a recommended refund amount.

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The University also believes that the liability of the University for repayment of disallowed charges should be limited to the costs relating to the charges themselves, including, where applicable, fringe benefits and F&A. The draft audit report recommends that the University provide a refund to HHS that is over 40 times the aggregate amount of the disallowed charges. This refund recommendation is based on an extrapolation of the results of the auditors' two samples, using a statistical methodology that the draft audit report explains only in broad terms. A review of over twenty HHS OIG audits of sponsored research issues at other universities since 2001 reveals that none of these audits involved sampling for the purpose of statistical extrapolation of the auditors' findings. Nothing in the draft audit report indicates why extrapolation was used in this audit, when it has not been used in any other recent research audits conducted by the HHS OIG.

We would also note in this regard that analysis of the charges disallowed by the auditors reveals that 70% of the charges related to only four divisions within the University's School of Medicine, out of a total of 23 divisions represented in the audit samples. These four divisions represent an even smaller portion of the total number of divisions in the University that are involved in HHS research. Given this circumstance, and the fact that there were no systemic deficiencies in the University's internal controls (see Section B below), the University believes it is inappropriate and inequitable to extrapolate the sample results across the entire University. It seems particularly inappropriate to extrapolate in this case, where the audit was a "pilot" audit designed to help the HHS OIG determine whether and how to audit direct charging of administrative costs at other grantee institutions.

B. The University's Internal Controls During the Audit Period

At page 7 of the draft audit report is a section headed "University Had Not Established Adequate Controls". The first paragraph of that section concludes that "The University's policies essentially allowed direct charges to any project needing any administrative or clerical support." With all due respect, the University submits that the draft audit report has not fairly represented the University's policies and internal controls during the audit period. Moreover, the fact that the draft audit report accepted over 90% of the administrative and clerical dollars charged directly to the University's HHS awards during the audit period is a persuasive indication that the University's internal controls were working. As discussed in Section C below, these controls have been tightened even further since then.

The University policy that most directly governs the direct charging of administrative and clerical costs to federal awards is General Accounting Procedure (GAP) 200.320 – "Direct Costing on Sponsored Projects". GAP 200.320 has been in

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effect since April, 2002, and was revised on October 7, 2002. GAP 200.320 was in effect, therefore, for the entire audit period. It is an extensive document, with 19 pages of discussion of the various principles governing the direct charging of costs to research projects. Pages 8-12 of GAP 200.320 contain detailed discussion of the principles applicable to direct charging of administrative and clerical costs, with numerous examples. The subject of direct charging of administrative costs is also addressed specifically in GAP 200.360 – “Administrative and Technical Expenses for Federally Funded Project” (issued June 2003).

The University’s internal controls with respect to direct charging of administrative costs were not limited to published policies. In November 2002 the University issued an extensive Roles and Responsibilities (R&R) document relating to sponsored research. The R&R document specifically assigned responsibilities with respect to direct charging of administrative costs. For example, the Financial Administrators in the departments were assigned responsibility for ensuring that: “The transaction is treated consistently with regard to direct/indirect cost purposes if the transaction occurs on a federal project (refer to GAPs 200.320 and GAP 200.330). Examines and confirms costs normally charged as indirect when proposed as direct charges such as office supplies, administrative and clerical salaries, or local telephone service charges.” The University also delivered mandatory training programs and presentations to research faculty and staff that provided detailed instruction on all aspects of proper charging of costs to federal grants, including administrative costs.

During the audit period the University also had in place several other internal controls with respect to direct charging of administrative costs. On a monthly basis, the Office of Sponsored Programs reviewed direct charges of administrative and clerical salaries to federal awards, and flagged any charges that had not been approved in a grant budget. Departments were informed that “Failure to respond to this memorandum by deadline date ... will cause a Journal Voucher to be processed by this Office writing off the unallowable expenses.” A similar review was conducted by the Office of Sponsored Programs at the time of grant close-out. In addition, the University’s Office of Information Technology required that all requests for local telecommunication service charged to federal sponsored projects be justified to and approved by three offices: Grants & Contracts, Research Support, and Sponsored Programs.

In short, throughout the entire audit period the University had in place detailed policies governing the direct charging of administrative costs, and those policies complied with federal requirements. The University also had in place several other internal controls designed to promote compliance with the published policies. Review, reconciliation and removal of unallowable charges to federal grants was a multi-layered process involving departmental/PI monthly review of all charges, removal of unallowable charges, review of all charges at close-out,

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certification of these charges as allowable, and/or removal of unallowable charges. Further review by the Office of Sponsored Programs of the final project charges prior to final reporting added a further verification step in the process.

The data on the University's direct charging of administrative and clerical costs during the audit period and the auditors' own findings make it clear (a) that direct charging of such costs to HHS awards was relatively infrequent during the period, and (b) that most of the administrative and clerical salaries that were charged to HHS awards were valid and supportable. As noted previously, only about 12% of the HHS fund codes active during the audit period involved any direct charging of administrative and clerical salaries, and only 4% involved charging of such salaries in excess of \$1,000. And only 10% of HHS awards had non-salary administrative charges >\$1,000 over the two years included in the audit. This data refutes the draft audit report's finding that the University allowed direct administrative charges to any project that needed administrative and clerical support. Virtually all HHS awards during the audit period needed such support to some extent, but only a small portion of them received any material direct charges for such support. Clearly, the University's internal controls during the audit period substantially limited the number of instances in which direct charges of administrative and clerical costs were made.

Moreover, the great majority of the dollars charged to HHS awards for administrative and clerical costs during the audit period were fully justifiable and allowable. Based on the University's analysis of the charges reviewed by the auditors, in dollar terms over 95% of the administrative costs charged directly to HHS awards during the audit period were allowable. Even the draft audit report accepted more than 90% of the dollars charged. The University respectfully submits that this data also contradicts the draft audit report's finding that the University lacked adequate internal controls during the audit period.

C. The University's Improvements in Internal Controls

Subsequent to the audit period, the University instituted four additional enhancements to its controls over direct charging of administrative costs. They are as follows:

1. A training tool-kit was created, to identify best-practice recommendations for the monthly reconciliation process that is conducted by departmental business managers. One of the key elements of this monthly reconciliation process is the identification and review of direct charges of administrative costs to sponsored projects.

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2. As part of the grant closeout process, a "Post-award Close-out Checklist" was created that requires that both a departmental representative and the principal investigator attest to the allowability and compliance with federal regulations of the charges on the grant.
(http://www.finsvc.duke.edu/Resources/forms_secured/PostAwardChecklist.pdf).
The mandatory close-out checklist identifies directly charged administrative costs at time of close-out if they have not been previously identified during the monthly reconciliation process performed by department grant managers. The monthly reconciliation process, combined with the close-out checklist and certification of charges by department grant managers, serves as a dual mechanism for identifying, reconciling, and certifying federal charges. These processes also provide an opportunity to remove charges not appropriate as direct charges to federal awards. The follow-up review provided through the Office of Sponsored Programs as a part of final close-out review and reporting adds another layer of internal control. It should be noted that these required controls were substantially enhanced by the rigor and thoroughness of the mandatory training and tools provided to department grant managers and researchers.
3. In support of the Institutional Ethics and Compliance Program, a risk assessment process was developed that requires the Research Costing Compliance (RCC) Office to develop monitoring plans for specific areas of potential risk. In support of this program, an SOP was developed to document the monitoring and reporting for risks related to this topic. RCC, in cooperation with other University compliance units, has developed a comprehensive list of administrative charges that may pose questions regarding their allowability under 2 CFR Part 220. RCC uses this list to monitor direct charges to federally sponsored projects in two ways:

Global/Overview. RCC prepares and reviews a 100% sample of all direct charged accounts for three purposes:

- a) Determine the relationship of the total direct charges to the overall federal expenditure for the monitoring time period (monthly). The purpose of this review is to develop an overview of the approximate level of direct charging expense and to evaluate the % of these charges to all federal expense (relative level of risk).
- b) Determine whether account codes have been established for these charges, indicating formal approval by pre-award.
- c) Identify for further review charges appearing in GL accounts that have not been pre-established by the Office of Sponsored Programs.

Sampling. RCC utilizes the global monthly report to conduct a representative sample for the following purposes:

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- a) Verify that an Exception Form has been completed for fund codes containing cost categories identified on the administrative charges list.
 - b) Verify that the charges applied to sampled fund codes are the charges approved during the Exception review process.
4. The University has established a formal process for reviewing and approving directly charged administrative costs to federally funded awards. The internal review, assessment and approval process is managed by the two pre-award offices (Office of Research Support and Office of Research Administration), and coordinated with post-award management (Office of Sponsored Programs). Compliance oversight to the process is provided through the Research Costing Compliance monitoring program.

Pre-award review. The proposal and proposal budget is reviewed by the appropriate pre-award office at the time of proposal submission. Pre-award staff notify the submitting department that certain administrative costs are included in the budget. A preliminary assessment of allowability is completed. If there is consensus that these costs may be allowable, the department is permitted to make the decision as to whether or not the current budget should be revised before being submitted for sponsor review. If the budget is submitted with these costs included, the department is informed that an Exception Form must be completed if the project is funded.

Review at time of award. The respective pre-award office reviews the awarded proposal documentation and notifies the submitting department that an Exception Form is required to justify administrative costs included in the awarded budget. The department completes either or both Exception Forms (Administrative Salary and/or Non-Salary Costs) and submits the form(s) for review and approval. The form is attached to these comments as Attachment B.

If administrative costs are not approved by the respective pre-award office, the PI/department is required to remove these costs from the sponsor-approved budget prior to account set-up by the post-award office. If these costs are approved according to federal and university standards, the project package transferred by pre-award to the post-award area must contain the approved Exception Form(s) as verification that the review and approval procedure has been followed.

Some of the improvements that the University has made in this area have been in response to the auditors' findings in this audit. Although the University did not receive a working draft of the audit report until quite recently, the University was aware during the course of the audit that the auditors were finding some direct charges of administrative costs that were not allowable. The University responded

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to that information by tightening its procedures further with respect to approval and monitoring of such charges. As recommended by the draft audit report, moreover, the University will continue to revise its policies, procedures, training, monitoring and other internal controls as necessary in order to ensure that the University remains fully compliant with the requirements of OMB Circular A-21.

D. Conclusion

The University believes that at least 55 of the 107 transactions questioned in the draft audit report are clearly allowable. The University has assembled documentation relating to these transactions, which has been provided to the auditors under separate cover. A summary of the University's positions with respect to these 55 defended charges appears at Attachment A. The University is prepared to make a refund to HHS with respect to any charges that the University does not defend, together with applicable fringe benefits and F&A costs. For the reasons stated in Section A, however, the University does not believe that extrapolation from these charges is appropriate or equitable.

In Sections B and C of these comments, the University has presented summaries of its internal controls over direct charging of administrative costs, both during the audit period and currently. The University respectfully submits that the draft audit report does not accurately characterize the internal controls in place during the audit period, and we request that the draft audit report be revised to reflect the information provided in Section B. The University also requests that the draft audit report be revised to reflect the improvements that the University has made in its internal controls in this area since the period covered by the audit.