



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

AUG 3 2004

Report Number: A-04-04-01001

Dr. Steve Ballard, Chancellor
East Carolina University
105 Spilman Building
Greenville, North Carolina 27858-4353

Dear Dr. Ballard:

Enclosed are two copies of the Office of Inspector General report entitled *Audit of Costs Claimed for Reimbursement by East Carolina University Under National Library of Medicine Contract No. N01-LM-9-3541 – September 30, 1999 Through September 30, 2003*. A copy of this report is also being forwarded to the departmental action official named below for her review and a final determination on all matters reported.

We request that you respond to the action 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.

In accordance with 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 issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 CFR Part 5).

To facilitate identification, please refer to report number A-04-04-01001 in all correspondence related to this report.

Sincerely,

Charles J. Curtis
Regional Inspector General
for Audit Services, Region IV

Enclosures – As stated

Direct Reply to Departmental Action Official

Ms. Lynn M. Furtaw, Contracting Officer
Office of Acquisition Management
National Library of Medicine
Building 38A, Room B1N17
8600 Rockville Pike
Bethesda, Maryland 20894

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF COSTS CLAIMED FOR
REIMBURSEMENT BY EAST
CAROLINA UNIVERSITY UNDER
NATIONAL LIBRARY OF MEDICINE
CONTRACT No. N01-LM-9-3541 –
SEPTEMBER 30, 1999 THROUGH
SEPTEMBER 30, 2003**



Inspector General

**AUGUST 2004
A-04-04-01001**

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:

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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

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





August 3, 2004

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

Report No: A-04-04-01001

Dr. Steve Ballard, Chancellor
East Carolina University
105 Spilman Building
Greenville, North Carolina 27858-4353

Dear Dr. Ballard:

This report discusses our interim audit of costs claimed for reimbursement by East Carolina University under contract NO1-LM-9-3541 from the National Library of Medicine (NLM).

BACKGROUND

Effective September 30, 1999, the NLM awarded contract number NO1-LM-9-3541, entitled *Biomedical Applications of the Next Generation Internet*. The NLM funded the contract in the amount of \$4,539,441 with a period of performance, as amended, from September 30, 1999 through September 30, 2004. As of September 30, 2003, the University had claimed reimbursement for \$4,070,528 under the contract.

In response to assertions by an employee working on the contract, the University's Office of the Internal Auditor performed an operational and compliance audit of contract activities from September 30, 1999 through November 30, 2002. This audit identified a number of deficiencies in the University's internal and management controls related to the performance of contract activities and the use of contract funds.

Objective

The objective of our audit was to determine if costs claimed for reimbursement by the University were allowable in accordance with terms of the contract and applicable Federal regulations.

Scope

Our audit covered the period September 30, 1999 through September 30, 2003.

We used Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions*, in determining the allowability of costs claimed under the contract.

Audit fieldwork was performed from October 14, 2003 through February 9, 2004 at the University's offices in Greenville, North Carolina.

Methodology

To accomplish our audit objective, we reviewed the NLM contract and modifications, examined financial records, reports and other documents, identified costs charged to the contract and tested the allowability of selected charges. The audit did not include an assessment of the University's overall internal control environment, which was not required to fulfill the limited objectives of our audit.

We provided a draft of this report to University officials on April 20, 2004. The University's response to our draft findings and recommendations, dated July 19, 2004, are summarized following our recommendations and are incorporated in their entirety as Appendix B.

Our audit was performed in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

Of the \$4,070,528 claimed for reimbursement by the University, we believe \$1,718,140 was allowable in accordance with the contract and with applicable regulations. Of the remaining \$2,352,388:

- We are recommending \$565,820 for financial adjustment because these charges did not comply with requirements that allowable costs must be reasonable, allocable and in conformance with any applicable limitations and exclusions.
- We are setting aside \$1,786,568 for adjudication by NLM officials because the University's documentation was not adequate to allow a determination as to whether the costs were allowable.

Universities Must Ensure That Costs Charged to Federally Funded Projects Are Allowable

OMB Circular A-21 requires universities to commit themselves to follow "sound management practices" in managing their institutions. Further, universities are also responsible for ensuring that all costs charged to a federally funded agreement, such as the NLM contract, are allowable.

Section C of the OMB Circular A-21 establishes basic standards governing the allowability of costs claimed for reimbursement under Federal grants, contracts and other agreements with colleges and universities, and requires that costs must be allocable and reasonable, as follows.

“A cost is allocable to a particular cost objective (i.e., A specific project, sponsored agreement, department or the like) if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received or other equitable relationship.” (§C.4)

“A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefore, reflect the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made.” (§C.3)

Section C of the Circular also requires that costs claimed for reimbursement must conform to any of the limitations and exclusions established in the Circular. These conditions range from, for example, an outright prohibition of such charges as alcoholic beverages to requirements for specific types of control systems and documentation intended to ensure that certain other costs are allocable and reasonable.

With respect to personal services costs, including salaries, wages and fringe benefits, Section J.8 of the Circular requires that colleges and universities maintain effort reporting systems that, in brief: encompass all employee activities on an integrated basis; confirm effort expended on an after-the-fact basis; require certification by an individual with knowledge of all an employee’s actual efforts or provide some other adequate means of verification; and require certifications to be performed on a regular periodic basis.

The Circular also limits charges for costs associated with certain categories of employees. In addressing charges for the salaries, wages and fringe benefit costs of an institution’s clerical and administrative personnel, the Circular states that:

“The salaries of administrative and clerical staff should normally be treated as F&A costs. (§F.5.b.2)

The Circular does recognize that, in certain unusual instances, direct charges for personal services costs for clerical and administrative staff may be appropriate. However, the University must show that it has accounted for these costs on a consistent basis and the: *“...individuals involved can be clearly identified with the project or activity...” (§ F.5.b.2)*

The NLM Contract Was Regularly Charged for Unallowable Costs

Contrary to the guidance provided through OMB Circular A-21, University employees charged the contract for unallowable costs on a routine basis. For example:

- The contract was charged for the salaries, wages and fringe benefits of employees who had been instructed to falsely certify that they were devoting effort to the NLM contract even though they were not actually working on the project.

- The contract was charged for equipment even though it was not and would not ever be used for project operations; and payments to firms with business relationships with the former Co-Principal Investigator, even though the services were either not rendered or were not related to contract operations.
- The contract was charged for the salaries, wages and fringe benefits of clerical and administrative personnel whose duties did not apply directly to the project.

As discussed in greater detail in Appendix A, we concluded that the University had charged the NLM contract for \$565,820 of costs that did not meet the standards of allowability established in OMB Circular A-21. These costs were not reasonable, allocable and in conformance with applicable limitations and exclusions.

In addition, we concluded that another \$1,786,568 of charges to the contract had not been documented sufficiently to allow a determination as to whether the costs were allowable.

The University Did Not Maintain Adequate Internal and Management Controls

As discussed above, more than 57 percent of the costs claimed for reimbursement by the University are recommended for financial adjustment or set aside for NLM adjudication. These conditions demonstrate that the University's internal and management controls during the period of our audit were seriously deficient, at least with respect to the NLM contract.

The University, for example, had not implemented an effort reporting system adequate to comply with the requirements of OMB Circular A-21 and document the actual efforts of covered employees. Instead, the University relied upon an incomplete, inconsistent system that was subject to frequent errors and could be easily manipulated.

- Time and effort reports prepared by University employees were based on inconsistent methods. Some employees reported based on a percentage of time and effort while other employees reported the numbers of hours supposedly worked while other employees didn't report at all.
- Neither the University's Grants Administration Office nor their Manager of Effort Reporting fully understood the procedures required to correctly report and compute the costs of employees' paid leave.
- There were no procedures in place to compare the time and effort reported for each employee to the approved funding levels for the contract.
- There was no requirement for the timely submission of employee effort reports to the contract administrator.

- There was no procedure to reconcile the reported time and effort to the University's actual payroll distribution.

Similarly, the University's control environment was not adequate to prevent charges for equipment and other costs that provided no documented benefit to the NLM contract.

The University Has Taken Steps to Improve Its Control Environment

At the time our fieldwork began, the University had neither disclosed to the NLM that they had improperly claimed significant amounts of Federal funds nor made appropriate financial adjustments for the unallowable costs. However, as observed during our audit work at the University and reflected in the University's comments to our report, they have initiated a number of significant actions to enhance their controls over federally funded projects.

Recommendations

We recommend that the University:

- continue its efforts to strengthen its internal and management control environment and more effectively oversee federally funded projects
- complete implementation of a new effort reporting system in full compliance with the requirements of OMB Circular A-21
- reimburse the NLM for the \$565,820 of unallowable costs charged to the contract from September 30, 1999 through September 30, 2003 in accordance with terms of the contract and applicable Federal regulations
- provide appropriate evidence that the additional \$1,786,568 of salaries, wages and fringe benefit costs charged to the contract were allowable in accordance with OMB Circular A-21 or reimburse the NLM for these costs

University Response

In their response to our draft report, the University stated that it was continuing to take significant actions to strengthen the internal and management control environment over federally funded projects, and that additional actions were underway. For example, the University has named a new Chancellor and Acting Vice-Chancellor for the Research and Graduate Studies Division. In addition, the University asserts that it has:

- reorganized the Research and Graduate Studies Division, and begun the process of developing strengthened policies and procedures related to financial management and administration of sponsored programs

Page 6 - Dr. Steve Ballard

- revamped its budgetary oversight of federally funded projects and identified additional support positions to strengthen the control environment
- increased staffing and established a position of Research Compliance Officer within the Office of Risk and Compliance
- initiated development of new policies and procedures to complement the new effort reporting system implemented since our audit was performed

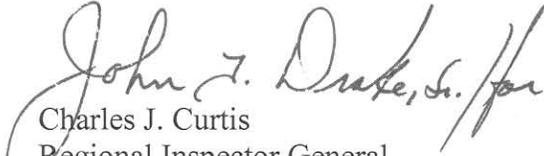
The University also stated that they would negotiate directly with the NLM regarding the allowability of specific costs discussed in our report.

OIG Comments

The actions described by the University will significantly improve internal and management controls over federally funded projects. We appreciate the University's efforts as well as the cooperation and assistance provided to our staff during the audit.

If we can provide any additional information or assistance, contact Jeff Bullock at (404) 562-7761. Please refer to report number A-04-04-01001 in any correspondence related to the report.

Sincerely,


Charles J. Curtis
Regional Inspector General
for Audit Services, Region IV

Enclosures

APPENDICES

**East Carolina University
Greenville, North Carolina
Statement of Results of Audit
For the Period September 30, 1999 through September 30, 2003
Contract Number NO1-LM-9-3541
Report Number A-04-04-01001**

	Costs Claimed	Costs Recommended For Adjustment	Costs Set Aside	Costs Accepted	Notes
Direct Labor	\$1,347,459				
Fringe Benefits	226,612				
	<u>\$1,574,071</u>	<u>\$293,377</u>	<u>\$1,280,694</u>	<u>\$0</u>	1
Accountable Personal Property					
General Purpose < \$5,000	\$224,931	\$13,804	0	\$211,127	
Maintenance Contracts	33,701	0	0	33,701	
General Purpose > \$5,000	408,557	108,706	0	299,851	
	<u>\$667,189</u>	<u>\$122,510</u>	<u>0</u>	<u>\$544,679</u>	2
Materials & Supplies	\$67,992	\$0	\$0	\$67,992	
Contracted Services	183,311	20,500	0	162,811	3
Travel	31,466	0	0	31,466	
Subcontract Costs	561,509	0	0	561,509	
Other	100,003	0	0	100,003	
Total Direct Costs	<u>\$3,185,541</u>	<u>\$436,387</u>	<u>\$1,280,694</u>	<u>\$1,468,460</u>	
Indirect	884,987	129,433	505,874	249,680	4
Total Costs	<u><u>\$4,070,528</u></u>	<u><u>\$565,820</u></u>	<u><u>\$1,786,568</u></u>	<u><u>\$1,718,140</u></u>	

**East Carolina University
Greenville, North Carolina
Statement of Audit Results
For the Period September 30, 1999 through September 30, 2003
Contract Number NO1-LM-9-3541
Report Number A-04-04-01001**

Notes:

1. Of the \$1,574,071 of salaries, wages and fringe benefits claimed for reimbursement by the University, we are recommending \$293,377 for financial adjustment. In addition, we are setting aside the remaining \$1,280,694 for NLM adjudication.

The \$293,377 recommended for recovery includes 4 components, as described below.

- A. \$147,335 of salaries, wages and fringe benefits for six individuals was charged to the contract based on effort reports that had been falsely certified to reflect time and effort that had not actually been expended on the contract. Four of the six individuals involved confirmed that they had been instructed to falsely certify that their effort had been devoted to the NLM contract even though they had actually worked on other University activities.
- B. \$118,315 of salaries, wages and fringe benefits for 11 individuals was charged to the contract based on errors resulting from the University's inadequate and inconsistent effort reporting procedures in place during much of the audit period.
- C. \$10,237 of salaries, wages and fringe benefits for two temporary employees was charged to the contract even though the individuals were not working on the NLM project and, in one instance, was not even at the University for much of the time he was paid.
- D. \$17,490 of salaries, wages and fringe benefits for an employee who was performing routine clerical duties for the University's Center for Health Sciences Communication and had no direct relationship to the NLM contract.

In addition, we are setting aside the remaining \$1,280,694 of salaries, wages and fringe benefits for NLM adjudication. During our audit period, the University's effort reporting system could not be relied upon to ensure that salaries, wages and fringe benefits charged to federally funded grants and contracts were based on effort actually devoted to those projects, or that the charges reflected expenses actually incurred by the University as required by OMB Circular A-21.

2. Of the \$667,189 of equipment costs claimed for reimbursement by the University, we are recommending \$122,510 for financial adjustment.

East Carolina University
Greenville, North Carolina
Statement of Audit Results
For the Period September 30, 1999 through September 30, 2003
Contract Number NO1-LM-9-3541
Report Number A-04-04-01001

During the contract period of performance, the University used \$122,510 of NLM funds to purchase 12 items of equipment that were not necessary for performance of contract operations. After purchase, the equipment was diverted for use on other University activities or was simply stored for possible use at some future date.

The \$122,510 includes \$24,692 expended in September 2003, the last month of the contract's performance period prior to the latest extension. The current Principal Investigator was unable to justify why his predecessor had purchased \$24,692 of new equipment so near the end of the contract period. The equipment was not being used at the time of our audit and the current Principal Investigator had no plans for its future use.

3. Of the \$183,311 of contracted services costs claimed, we are recommending \$20,500 for financial adjustment.

The \$20,500 represents six payments to business associates of the University's former Co-Principal Investigator for services that were either not related to the NLM contract or were not rendered. In at least one instance, it appears that an individual was paid for work that was actually performed by a University employee whose salaries, wages and fringe benefits had already been charged to the NLM contract.

4. Of the \$884,987 of indirect costs claimed for reimbursement by the University, we are recommending \$129,433 for financial adjustment and setting aside \$505,874 for NLM adjudication.

In accordance with its negotiated agreement, the University claimed indirect costs of 39.5 percent of eligible direct costs, including salaries, wages, fringe benefits, materials, supplies, services, travel and the first \$25,000 of each subaward. The indirect costs recommended for financial adjustment and set aside for NLM adjudication above were computed by applying the negotiated rate to the eligible direct costs recommended for adjustment or set aside above.



Office of the Chancellor
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JUL 22 2004

Office of Audit Svcs.

July 19, 2004

Mr. Charles J. Curtis
Regional Inspector General
for Audit Services, Region IV
Department of Health and Human Services
Office of Inspector General, Audit Services
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

Re: Report Number A-04-04-01001

Dear Mr. Curtis:

Thank you for the opportunity to review and comment on the draft report dated April 20, 2004, entitled *Audit of Cost Claimed by East Carolina University under National Library of Medicine Contract No. N01-LM-9-354, September 30, 1999 through September 30, 2003*. Below you will find our formal responses to the four recommendations as listed in the draft report.

- 1. Continue its efforts to strengthen its internal and management control environment and more effectively oversee Federally funded projects.**

University Response: East Carolina University continues its efforts to strengthen its internal and management control environment and more effectively oversee Federally-funded projects.

Personnel responsible for administration and oversight of the National Library of Medicine project are no longer associated with Federally-funded projects at the University. East Carolina University no longer employs the Principal Investigator, the Co-Investigator, two technicians, and one administrative assistant. Further, as stated in the audit draft, the Chancellor is no longer employed by institution.

The University has reorganized the Research and Graduate Studies Division and appointed a new Acting Vice Chancellor since the audit period, who brings over twenty years of experience working with Federally-funded projects on a variety of administrative levels. The Acting Vice Chancellor for Research and Graduate Studies has formally directed that the Policy and Guidelines for External Funding (ECU Faculty Manual Part VII, Section I) and Grants and Contracts Administration (Financial) be reviewed by senior administrators within the Division, with comments and proposed revisions submitted to him no later than August 13, 2004. Those revised policies will be reviewed by the Academic Council at the start of the 2004 academic year and presented for approval to the Chancellor. Following the approval process, ongoing training will be provided to Deans, Directors, faculty and staff.

In addition to policy review, the Acting Vice Chancellor has mandated a draft of Standard Operating Procedures for Sponsored Programs. The former Director of the Office of Sponsored Programs retired in May, 2004. The Interim Director has been tasked to complete a comprehensive baseline review of operations by mid-August 2004, with process improvements identified and in place to support faculty at the start of the academic calendar.

East Carolina University has reorganized budgetary oversight of Federally-funded grants and contracts, and identified additional support positions to strengthen the control environment and provide front-line oversight of project budget development and implementation as functions of both Pre- and Post-Award Management.

The position of Research Compliance Officer was established as a function of the Office of Risk and Compliance. Staffing levels were increased to provide for, among other functions, auditing expertise to be available to systematically review research efforts.

2. Complete implementation of a new effort reporting system in full compliance with the requirements of OMB Circular A-21.

University Response: Under the direction of the Senior Associate Vice Chancellor for Finance and Administration, the Director of Grants and Contracts is preparing an Effort Reporting Policy for East Carolina University, to complement the effort reporting system implemented in October of 2003. This system (Maximus) is nationally-recognized as one of the best software management tools commercially available to ensure full compliance with the requirements of OMB Circular A-21.

Extensive training of personnel has been completed and we continue to offer broad assistance and ongoing training to all users. Two full-time personnel are employed to manage the system and assist users.

3. Reimburse the NLM for the \$565,820 of unallowable costs charged to the contract from September 30, 1999 through September 30, 2003.

University Response: East Carolina University will negotiate directly with the National Library of Medicine concerning costs charged to the contract from September 30, 1999 through September 30, 2003.

4. Provide appropriate evidence that the additional \$1,786,568 of salaries, wages and fringe benefits and related indirect costs charged to the contract were allowable in accordance with OMB Circular A-21 or reimburse the NLM for these costs.

University Response: East Carolina University will negotiate directly with the National Library of Medicine concerning costs charged to the contract from September 30, 1999 through September 30, 2003.

If you should have any questions regarding our responses, please contact Stacie Tronto, Director of Internal Audit at (252) 328-6044.

Sincerely,

A handwritten signature in cursive script that reads "Steve Ballard/st".

Steve Ballard
Chancellor, East Carolina University

cc: President Molly Corbett Broad
Mr. Jeffrey R. Davies
Dr. Russ Lea
Mr. George Burnette
Mr. James R. Talton, Jr.
Dr. Michael Lewis
Dr. John Lehman
Mr. Ben Irons
Dr. Gregory Hassler
Mr. Chuck Hawkins
Ms. Stacie Tronto