

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**THE UNIVERSITY OF NORTH CAROLINA
AT CHAPEL HILL DID NOT ALWAYS
CLAIM SELECTED COSTS CHARGED
DIRECTLY TO DEPARTMENT OF
HEALTH AND HUMAN SERVICES
AWARDS IN ACCORDANCE WITH
FEDERAL REQUIREMENTS**

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Lori S. Pilcher
Regional Inspector General
for Audit Services

June 2014
A-04-13-01024

Office of Inspector General

<https://oig.hhs.gov>

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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

The University of North Carolina at Chapel Hill did not always claim selected costs charged directly to HHS awards in accordance with Federal requirements. The University claimed \$352,843 in unallowable transactions charged directly to HHS awards.

WHY WE DID THIS REVIEW

The U.S. Department of Health and Human Services (HHS) is the largest grant-making organization and the third largest contracting agency in the Federal Government. The HHS Office of Inspector General has identified grants management and administration of contract funds as a top management and performance challenge and, in recent years, has identified significant findings related to the management of HHS awards at colleges and universities.

The University of North Carolina at Chapel Hill (the University) is a recipient of a relatively large amount of HHS funding. For Federal fiscal years 2010 and 2011, the University ranked ninth in HHS award dollars received among U.S. institutes of higher education.

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

BACKGROUND

University of North Carolina at Chapel Hill

The University is a public institution located in Chapel Hill, North Carolina. From July 1, 2009, through June 30, 2011 (audit period), the University claimed reimbursement for approximately \$956.3 million in costs incurred on 1,447 grants, contracts, and other agreements (awards) from HHS.

Federal Requirements

By accepting HHS awards, the University agreed to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards are allowable under the cost principles established in 2 CFR part 220 (Office of Management and Budget (OMB) Circular A-21). These cost principles require that, to be allowable, costs must be reasonable, be allocable, be adequately documented, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements.

Award Administration

The University's Office of Sponsored Research (OSR) negotiates and administers awards on behalf of the University. Some of OSR's responsibilities include monitoring institutional compliance with terms and conditions of Federal awards, pre-auditing expenditures for sponsored programs, and other billing and financial reporting activities.

Principal Investigators (PIs) are responsible for administrative, technical, and fiscal management of sponsored projects. The PI's administrative responsibilities include authorizing that all expenses charged to projects are allowable, allocable, and reasonable in accordance with OMB Circular A-21 and other applicable guidelines.

WHAT WE FOUND

The University did not always claim selected costs charged directly to HHS awards in accordance with Federal requirements. Of the 163 transactions totaling \$8,496,835 that we reviewed, 155 transactions totaling \$8,160,961 were allowable, but 8 transactions totaling \$335,874 were either not allowable or partially allowable. In addition, the University claimed unallowable facilities and administrative costs totaling \$16,969 that were related to the unallowable transactions.

The University claimed unallowable costs under HHS awards because PIs and OSR staff did not comply with University policies and procedures for adequately documenting cost transfers, adequately reviewing costs charged to awards, and assuring that costs are treated consistently.

As a result, the University did not always administer its HHS awards cost effectively or in compliance with Federal requirements.

RECOMMENDATIONS

We recommend that the University:

- refund to the Federal Government the \$352,843 in unallowable costs and
- enhance oversight of charges to Federal awards to ensure consistent compliance with Federal requirements.

UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL COMMENTS

In written comments on our draft report, University officials concurred with our recommendations and described the corrective actions that they were taking.

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INTRODUCTION

WHY WE DID THIS REVIEW

The U.S. Department of Health and Human Services (HHS) is the largest grant-making organization and the third largest contracting agency in the Federal Government. The HHS Office of Inspector General (OIG) has identified grants management and administration of contract funds as a top management and performance challenge and, in recent years, has identified significant findings related to the management of HHS awards at colleges and universities.

The University of North Carolina at Chapel Hill (the University) is a recipient of a relatively large amount of HHS funding. For Federal fiscal years 2010 and 2011, the University ranked ninth in HHS award dollars received among U.S. institutes of higher education.

OBJECTIVE

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

BACKGROUND

University of North Carolina at Chapel Hill

The University is a public institution located in Chapel Hill, North Carolina. From July 1, 2009, through June 30, 2011, the University claimed reimbursement for approximately \$956.3 million in costs incurred on 1,447 grants, contracts, and other agreements (awards) from HHS.

Federal Requirements

By accepting HHS awards, the University agreed to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards are allowable under the cost principles established in 2 CFR part 220 (Office of Management and Budget (OMB) Circular A-21). These cost principles require that, to be allowable, costs must be reasonable, be allocable, be adequately documented, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements.

Award Administration

The University's Office of Sponsored Research (OSR) negotiates and administers awards on behalf of the University. Some of OSR's responsibilities include monitoring institutional compliance with terms and conditions of Federal awards, pre-auditing expenditures for sponsored programs, and other billing and financial reporting activities.

The University assigns other responsibilities to its Principal Investigators (PIs) including administrative, technical, and fiscal management of awards. As part of these responsibilities, PIs

authorize that all expenses charged to awards are allowable, allocable, and reasonable in accordance with OMB Circular A-21 and other applicable guidelines.

HOW WE CONDUCTED THIS REVIEW

Our audit covered approximately \$112.2 million in transactions claimed for reimbursement for the period July 1, 2009, through June 30, 2011 (audit period). We limited the audit to grants, contracts, and other agreements between the University and HHS. We did not evaluate transactions charged to the University's agreements with other Federal departments and agencies.

We selected a random sample¹ of 163 transactions totaling \$8,496,835 for review. We evaluated the allowability of the selected transactions by reviewing documentation including contract proposals and grant application packages, notices of award and contracts, invoices, payment vouchers, purchase orders, and other documentation the University provided in support of the transactions. We also conducted interviews with University employees from OSR and selected PIs.

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

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

FINDINGS

The University did not always claim selected costs charged directly to HHS awards in accordance with Federal requirements. Of the 163 transactions totaling \$8,496,835 that we reviewed, 155 transactions totaling \$8,160,961 were allowable, but 8 transactions² totaling \$335,874 were either not allowable or partially allowable. In addition, the University claimed unallowable facilities and administrative (F&A) costs totaling \$16,969 that were related to the unallowable transactions.

The University claimed unallowable costs under HHS awards because PIs and OSR staff did not comply with University policies and procedures for adequately documenting cost transfers, adequately reviewing costs charged to awards, and assuring that costs are treated consistently.

¹ Per OIG policy, we did not use the results of the random sample to create an estimate. Instead, we only discuss the specific items in error in this report.

² For two transactions, only a portion of the transaction was unallowable.

As a result, the University did not always administer its HHS awards cost effectively or in compliance with Federal requirements.

THE UNIVERSITY DID NOT ALWAYS CLAIM COSTS IN ACCORDANCE WITH FEDERAL REQUIREMENTS

Of the \$335,874 in costs we identified as unallowable, the University claimed:

- \$298,275 in costs that were not adequately documented,
- \$34,557 in costs that were not reasonable, and
- \$3,042 in costs that were not treated consistently.

In addition, the University claimed unallowable F&A costs totaling \$16,969 that were associated with the unallowable costs.

Costs Were Not Adequately Documented

Federal regulations require that university accounting practices provide for adequate documentation to support costs charged to awards (2 CFR part 220, Appendix A, § A.2.e).

Scientific Equipment, Supplies, and Services

The University claimed the costs of research-related equipment, supplies, and services totaling \$284,865 that it had transferred from University fund accounts (or other accounts) to HHS award accounts without documenting the basis for the amounts transferred, the reason the transfers were necessary, or why transfers occurred several months after the University initially recorded the charges.

For example, the University claimed \$265,000 for scientific equipment that it initially charged to a University trust fund account³ but transferred the amount to an HHS grant 10 months later. The documentation supporting the transfer was limited to a note that stated that, after review, the University determined that a portion of the equipment should be charged to the grant. The University did not document the allocation basis for the amount transferred and did not document why it took so long to transfer the costs.

The University also claimed \$10,301 for other scientific equipment, \$7,694 for research animal care, and \$1,870 for lab supplies transferred from University fund accounts (or other accounts) to HHS award accounts without adequately documenting the nature or justification of the transfers.

³ The total cost of the equipment was \$778,075; however, the University only charged \$265,000 of this amount to the HHS award.

Foreign Housing and Subsistence

The University claimed \$13,410 under a foreign award for the costs of a housing rental and an expatriate allowance with documentation that did not support that costs were incurred. The University's documentation of the housing rental was limited to a letter requesting rent payment for a 6-month period and a memo approving payment for an expatriate allowance.

The University told us the letter reflected a housing valuation used to determine a reimbursement rate for renting the property. However, the University also stated that the University employee requesting reimbursement for the rental owned the property. Thus, the documentation of the housing rental did not reflect costs incurred.

In addition, the University stated that the expatriate allowance was to cover the employee's utilities and incidentals; however, the documentation did not support the year in which the allowance applied (the approval shown was for a prior year).

Costs Were Not Reasonable

Federal regulations state that, for costs to be allowable, they must be reasonable. In determining reasonableness, major factors include whether or not the cost is necessary for the operation of the institution or the performance of the sponsored agreement and whether or not the individuals concerned acted with due prudence (2 CFR part 220, Appendix A § C.2 - 3).

The University claimed \$34,557 in various costs charged to a foreign award that were duplicate costs and were therefore not reasonable and allowable.

For example, the University claimed \$19,667 for audit fees to meet accountability status requirements with foreign regulatory bodies; however, the University claimed two charges for the fees: one for \$19,667 and another for \$6,667 (reflecting an allocated portion of the total fees). The University agreed that it should have only claimed the \$6,667 and told us it would credit the award for the \$19,667.

Similarly, the University claimed \$5,429 for foreign housing, \$5,303 for equipment insurance, and \$4,158 for scientific equipment that was unallowable because the University had already claimed these costs under other transactions. The University agreed that the amounts were duplicate charges that should not have been claimed.

Costs Were Not Treated Consistently

Federal regulations require that costs be treated consistently as either direct or F&A to be allowable under Federal awards. If a university treats a particular type of cost as a direct cost of awards, all costs incurred for the same purpose in like circumstances must be treated as direct costs of all activities of the university (2 CFR part 220, Appendix A § D.1).

The University claimed \$3,042 for the costs of a laptop computer and printer cartridges that had not been treated consistently as F&A costs; thus, the costs were unallowable. According to

University policies and procedures, the University generally treated computer hardware as an F&A cost unless an awarding agency approved in advance the direct charging of the cost. Likewise, the University classified general administrative supplies, such as printer cartridges, as F&A costs. The University had not obtained prior approval for charging these costs as direct costs and had not otherwise justified this inconsistent treatment.

THE UNIVERSITY DID NOT FOLLOW POLICIES AND PROCEDURES

The University claimed unallowable costs because PIs and OSR staff did not comply with University policies and procedures for adequately documenting cost transfers, adequately reviewing costs charged to awards, and assuring that costs are treated consistently.

According to University policies and procedures, cost transfers are only allowed when initiated in a timely fashion, fully justified, and documented. Cost transfers that are not completed within 90 days require additional documentation and an explanation why errors were not corrected sooner. For the unallowable transactions we identified, the University had not provided the type of justifications described in its policies and procedures.

The University's policies and procedures also state that PIs and OSR are responsible for the administration and financial management of awards. As part of these responsibilities, PIs must review award expenditures monthly and authorize that direct charges to awards are in accordance with OMB Circular A-21. OSR confirms the accuracy and appropriateness of award transactions and oversees financial compliance related to award terms and conditions. For the unallowable transactions we identified, PIs and OSR had not sufficiently reviewed the transactions to ensure claimed costs were adequately documented, were treated consistently, and had not been previously claimed.

AWARD ADMINISTRATION NOT ALWAYS COST EFFECTIVE

By claiming unallowable costs to HHS awards, the University did not always administer its HHS awards cost effectively or in compliance with Federal requirements. Federal grantor agencies expect grantees to ensure accountability in award administration. With respect to the awards charged with unallowable costs, the University did not meet this expectation.

RECOMMENDATIONS

We recommend that the University:

- refund to the Federal Government the \$352,843 in unallowable costs and
- enhance oversight of charges to Federal awards to ensure consistent compliance with Federal requirements.

UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL COMMENTS

In written comments on our draft report, University officials concurred with our recommendations and described the corrective actions that they were taking.

The University's comments are included in Appendix D.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered approximately \$112.2 million in transactions claimed for reimbursement for the period July 1, 2009, through June 30, 2011 (audit period). We limited the audit to grants, contracts, and other agreements between the University and HHS. We did not evaluate transactions charged to the University's agreements with other Federal departments and agencies.

We limited our assessment of internal controls to the University's policies and procedures for charging costs to Federal awards. We conducted our fieldwork at the University's offices in Chapel Hill, North Carolina, from April through August 2013.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal requirements;
- reviewed the University's policies and procedures for charging costs to Federal awards;
- reviewed the University's Cost Accounting Standards Board Disclosure Statement (DS-2);⁴
- reviewed the University's HHS-approved rate agreement for the F&A cost rates applicable to the audit period;
- reviewed a schedule of transactions provided by the University showing all costs it charged directly to HHS awards during the audit period;
- reconciled the schedule of transactions provided by the University to audited expenditure data provided by the North Carolina State Auditor's Office to assess the reliability of the data;
- obtained an attestation from the University stating that the schedule of transactions was current and complete;

⁴ Educational institutions that receive aggregate sponsored agreements totaling \$25 million or more are required to disclose their cost accounting practices by filing a DS-2. The University has submitted a DS-2 to HHS, Division of Cost Allocation.

- reviewed the University’s account codes and identified accounts that we considered to be at high risk of noncompliance;⁵
- removed from the approximately \$109.2 million in transactions claimed for reimbursement during the audit period offsetting transactions,⁶ low-dollar transactions (less than \$10), and negative transactions that did not have a corresponding positive transaction;
- selected a random sample⁷ of 163 transactions from the remaining \$112,239,649 in transactions;⁸
- determined the allowability of the selected transactions by reviewing:
 - contract proposals and grant applications⁹ under which the transactions occurred;
 - the terms and conditions of the awards related to the transactions; and
 - documentation such as invoices, vouchers, purchase orders, and other documentation supporting the transactions;
- interviewed University and HHS awarding agency officials responsible for the awards related to the selected transactions;
- computed the F&A costs related to the unallowable transactions; and
- discussed our findings with University officials on February 20, 2014.

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

⁵ We considered accounts with costs that Federal requirements and the University normally treat as indirect costs to be at greater risk of being improperly charged directly to awards.

⁶ Offsetting transactions are expenditures charged to an award that were subsequently adjusted by transferring the costs to another funding source(s) or otherwise zeroed out.

⁷ Per OIG policy, we did not use the results of the random sample to create an estimate. Instead, we only discuss the specific items in error in this report.

⁸ The dollar value of the remaining transactions is greater than the dollar value of the transactions claimed during the audit period because many of the transactions that we removed from the original list were negative.

⁹ The University submitted proposals for Federal contracts and applications for grants and cooperative agreements.

APPENDIX B: FEDERAL REQUIREMENTS

FEDERAL REGULATIONS

The HHS grant administration rules require recipients of grant awards to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards were allowable under the applicable cost principles (45 CFR § 74.27(a)).

The cost principles for educational institutions are established in 2 CFR part 220, Appendix A (the Circular). These cost principles require that the accounting practices of universities provide for adequate documentation to support costs charged to sponsored agreements (the Circular § A.2.e.).

The cost principles also require that, to be allowable, costs must be reasonable, be allocable, be treated consistently, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements (the Circular § C.2). Whether or not a cost is necessary for the operation of the institution or the performance of a sponsored agreement and whether or not individuals concerned acted with due prudence are major considerations in determining cost reasonableness. (the Circular § C.3).

In addition, the cost principles state that costs incurred for the same purpose in like circumstances must be treated consistently as either direct or F&A costs (the Circular § D.1).

APPENDIX C: RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Report Title	Report Number	Date Issued
<i>The University of Colorado Denver Did Not Always Claim Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance With Federal Regulations</i>	<u>A-07-11-06013</u>	6/2013
<i>Thomas Jefferson University Generally Claimed Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance With Federal Regulations</i>	<u>A-03-11-03300</u>	6/2013
<i>Review of Select Expenditures Claimed by The Research Foundation of the State University of New York, State University of New York at Stony Brook</i>	<u>A-02-11-02008</u>	8/2012
<i>Florida State University Did Not Always Claim Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance With Federal Regulations and National Institutes of Health Guidelines</i>	<u>A-04-11-01095</u>	7/2012
<i>Review of Administrative and Clerical Costs at The Ohio State University for the Period July 1, 2008, Through June 30, 2010</i>	<u>A-05-11-00030</u>	12/2011
<i>Review of Select Expenditures Claimed by The Research Foundation of the State University of New York, State University of New York at Albany</i>	<u>A-02-11-02000</u>	10/2011
<i>Review of Administrative and Clerical Costs at Dartmouth College for Fiscal Years 2009 Through 2010</i>	<u>A-01-11-01500</u>	8/2011
<i>Review of Administrative and Clerical Costs at Duke University for the Period October 1, 2002, Through September 30, 2004</i>	<u>A-04-05-01014</u>	1/2009

APPENDIX D: UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
COMMENTS



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

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May 5, 2014

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

Re: Report Number: A-04-13-01024

Dear Ms. Pilcher:

This letter provides the University of North Carolina at Chapel Hill's ("University") response to Report Number: A-04-13-01024 titled *"The University of North Carolina at Chapel Hill Did Not Always Claim Selected Costs Charged Directly to Department of Health and Human Services Awards in Accordance with Federal Requirements."* The University takes seriously its obligations to be an effective steward of federal funds and the opportunity to enhance its policies and procedures related to sponsored research compliance.

Recommendation #1

HHS recommends that the University refund \$352,843 of unallowable costs to the Federal Government.

University Response: The University concurs with this recommendation and will refund the costs identified in the audit as unallowable. In those instances where the costs are associated with an active award, the University will reverse the costs off of the award. In those instances where the award is closed, the University will follow the sponsors' processes for returning such funds.

Recommendation #2

HHS recommends that the University enhance oversight of charges to Federal Awards to ensure consistent compliance with Federal requirements.

University Response: The University concurs with this finding and is undertaking the following corrective actions:

1. The University will communicate with each of the Principal Investigators and Departmental Administrators connected to transactions questioned in the report regarding the responsibility of the Principal Investigator and Departmental Administrator to monitor transactions to ensure costs are appropriately incurred on sponsored projects.

2. The Office of Sponsored Research (OSR) will provide additional training sessions for its staff to reiterate the importance of ensuring the proper documentation and justification is provided prior to approving costs and document the types of supporting documentation that are appropriate. In addition, in instances where non-compliance is identified, OSR will remind departments of applicable policy requirements.
3. The University is revising its Cost Transfer policy to more clearly specify the timeline for initiating cost transfers, acceptable criteria for making a cost transfer and guidelines on suitable explanations in support of a cost transfer. Once complete, this policy will be widely disseminated to campus and an informational session will be offered by the Office of Sponsored Research to respond to any questions.
4. The University is developing additional guidance on the criteria for determining the treatment of computers and hand-held devices as direct versus indirect costs to sponsored projects. Once complete, the guidance will be widely disseminated to campus and additional training will be offered by the Office of Sponsored Research.
5. The University will update its Cost Accounting Standards Exemption procedure to provide additional clarification on when prior approval is required. Once complete, this procedure will be communicated to campus and an informational session will be offered by the Office of Sponsored Research to respond to any questions.
6. The University will provide additional guidance to campus regarding the appropriate methodologies that should be used for allocating costs to sponsored research awards.
7. The University will be holding a full day symposium in July 2014 that will be offered to Research Administrators and will cover a wide range of compliance topics such as cost transfers, cost accounting standards and roles and responsibilities. An emphasis will be placed on reviewing federal compliance requirements and university policies and procedures.
8. The University has purchased an audit software package to assist with monitoring certain categories of expenses.

On behalf of the University, I would like to thank Mr. Ben Johnson and Ms. Stacy Mullins for their professionalism and cooperation during the audit process.

Please do not hesitate to contact me if you have any questions regarding the University's' response.

Sincerely,

Barbara Entwisle, PhD
Vice Chancellor for Research

cc: Carol Folt, Chancellor, University of North Carolina at Chapel Hill
Robin Cyr, Director, Office of Sponsored Research
Phyllis Petree, Director of Internal Audit