

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Washington State University  
Docket No. 79-204  
Decision No. 145

DATE: January 29, 1981

DECISION

This case involves an appeal by Washington State University (WSU, Grantee) of an October 12, 1979 determination by the National Institutes of Health (NIH) Grant Appeals Board sustaining a disallowance made by the Chief of the Audit Resolution Section (ARS), NIH. The NIH/ARS disallowed \$218,764 (subsequently reduced by the NIH Grant Appeals Board to \$218,374) for the fiscal years 1975 and 1976, based on findings of alleged overcharges to projects for direct labor costs, fringe benefits, and indirect costs.

We find that the Grantee failed to properly account for its direct labor costs in accordance with a Federal regulation but that the Agency has not established the amount of overcharges for fiscal year 1975. Accordingly, we sustain the disallowance in part and overturn it in part as indicated below.

This decision is based on the Grantee's application for review, the parties' responses to an Order to Show Cause issued by the Board Chairman and a submission by the Grantee commenting on the Agency's response to the Order to Show Cause.

Statement of the Case

45 CFR Part 74, Appendix D, Section J.7.d. provides that direct labor costs charged for personal services must be based on an institutional payroll system and requires the following type of documentation as proof of actual direct labor costs:

Such institutional payroll systems must be supported by either:  
(1) an adequate appointment and workload distribution system accompanied by monthly reviews performed by responsible officials and a reporting of any significant changes in workload distribution of each professor or professional staff member, or (2) a monthly after-the-fact certification system which will require the individual investigators, deans, departmental chairmen or supervisors having first-hand knowledge of the services performed on each research agreement to report the distribution of effort. Reported changes will be incorporated during the accounting period into the payroll distribution system and into the accounting records. Direct charges for salaries and wages of non-professionals will be supported by time and attendance and payroll distribution records.

In 1974, WSU implemented a direct labor distribution "P - 1" system to comply with the requirements of Federal Management Circular (FMC) 73-8, Section J. 7.d. 1/ In 1976, the HEW Audit Agency, (HEWAA, now HHSAA) reviewed WSU's labor distribution system in order to determine if it supported the direct labor costs charged to Federal projects. The audit determined that overcharges to Federal projects for direct labor costs existed and could be extensive for fiscal years 1975 and 1976. As a result of this audit, the Agency requested WSU to make a review of fiscal year 1976 and identify overcharges by employee and by project. The WSU review found \$44,059 in labor overcharges. In 1978, HEWAA reviewed WSU's study of direct labor charges for fiscal year 1976. The HEWAA's 1978 audit concluded that overcharges for direct labor costs were actually greater than those found by WSU in its review and found labor overcharges of \$233,760. HEWAA stated that the reason it found more overcharges than WSU is because WSU made unsupportable adjustments for errors in its "P-1" system. In December 1978, NIH/ARS issued a final determination concerning direct labor overcharges for fiscal years 1975 and 1976 which accepted many of the overcharges identified by HEWAA in its 1978 audit. The disallowance letter also indicated that WSU had agreed with NIH/ARS that any results obtained from the fiscal year 1976 comparison would be extrapolated to fiscal year 1975. NIH/ARS determined overcharges of \$108,080 for fiscal year 1976 and applied this same figure to fiscal year 1975. It disallowed a total of \$218,764, determining that for fiscal years 1975 and 1976, WSU overcharged HEW (now HHS) projects for direct labor costs including fringe benefits and indirect costs in the amount of \$216,160 and finding that \$2,604 for costs transfers for fiscal year 1975 and 1976, were unallowable. (WSU does not dispute the \$2,604 disallowance for the cost transfers.)

Pursuant to the provisions of 42 C.F.R. Part 50, Subpart D and the regulations of this Board, WSU requested informal review from NIH. In October 1979, the NIH Grant Appeals Board issued its decision sustaining the determination of NIH/ARS. NIH, however, adjusted the original disallowance of \$218,764 to \$218,374 because of an addition error of \$390 found in the computation of the overcharges pertaining to fiscal year 1976. Because the NIH Grant Appeals Board failed to make this same adjustment when it extrapolated the overcharges to fiscal year 1975, we have deducted \$390 for fiscal year 1975. The disallowance should, therefore, be adjusted to \$217,982.

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1/ The provisions of FMC 73-8, Section J.7.d., are identical to those of 45 CFR Part 74, Appendix D, Section J.7.d., effective September 19, 1973 and made applicable to institutions of higher education by 45 CFR Part 74, Subpart Q.

Discussion

Jurisdiction of Departmental Grant Appeals Board

The materials submitted by WSU in support of the Board's jurisdiction consisted of the notice of grant award for 25 different grants as well as three negotiated contracts. The grants which are direct, discretionary project grants, are within the jurisdiction of the Board. For the reasons discussed in the Order to Show Cause, the amount of the disallowance attributable to the three negotiated contracts is not subject to the Board's jurisdiction. The amount attributable to the contracts for overcharges for direct labor costs, fringe benefits, and indirect costs for fiscal years 1975 and 1976 is \$28,788. 2/ The actual amount of the disallowance subject to the Board's jurisdiction in this appeal, therefore, is \$189,204 (\$217,982 - 28,778). The Board's calculations of the amount of the disallowance appears on the following chart:

COMPUTATION OF DISALLOWANCE

Total of direct labor overcharges plus benefits and indirect costs for fiscal year 1976	<u>Disallowed</u> \$107,689
Less direct labor overcharges and fringe benefits and indirect cost under contracts not subject to this Board's review	-14,389
Total for 1976	<u>\$ 93,300</u>
Equal amount for fiscal year 1975	\$93,300
Cost Transfer disallowed for fiscal years 1975 and 1976 which are not disputed by the parties	2,604
TOTAL	<u>\$189,204</u>

2/ Board Computation of Amount of Overcharges under Contracts.  
(The Board's Computation is based on the Agency's response to the Order to Show Cause and has not been reviewed or agreed to by the parties.)

Fiscal Year 1976

Contracts Identified and Reviewed by HEWAA	<u>Disallowed</u> \$ 6,781
Contracts Identified but not Reviewed by HEWAA	2,502
Subtotal	<u>\$ 9,283</u>
Plus Applicable Fringe Benefits and Indirect Cost at 55%	5,106
Total for 1976	<u>\$14,389</u>
Equal Amount for Fiscal Year 1975	14,389
TOTAL ATTRIBUTABLE TO CONTRACTS FOR FISCAL YEARS 1975-1976	<u>\$28,778</u>

Compliance with Section J.7.d. and Documentation of Costs.

NIH/ARS determined that WSU was not complying with Section J.7.d. It determined that WSU was not incorporating into its accounting records the changes in distribution of effort from the "P-1" system effort reports. As a consequence, the accounting records, which served as the basis for WSU's direct labor charges, reflected an amount budgeted for labor costs rather than an amount derived from documented distribution of effort. The budgeted amount for labor costs in WSU's accounting records was higher than its documented labor costs, and NIH/ARS concluded that WSU had overcharged the Agency for the period in question.

In response to NIH/ARS's determination, WSU contends that the amounts originally billed for direct labor costs derived from its accounting records reflect the actual effort on the projects but that there may appear to be overcharges because of errors in the "P-1" effort reports. As support for its contention, WSU relies on certifications made by the principal investigators or other parties from one to three years after the initial "P-1" effort reports were made.

Section J.7.d. of 45 CFR Part 74, Appendix D requires a direct labor distribution system which during the accounting period incorporates into the payroll distribution system and into the accounting records any changes reported. Under the provisions of Section J.7.d., a monthly after-the-fact certification system by the principal investigator would have been sufficient. That requirement, however, is not satisfied by certifications made from one to three years after the effort was expended. As was stated in the Board's decisions in University of Pacific, Decision No. 15, April 21, 1976, and Head Start of New Hanover County, Inc., Decision No. 65, September 26, 1979, there is a question as to the credibility, reliability, and persuasiveness of this kind of evidence, inasmuch as such documentation has been found to be less acceptable than records made contemporaneously with the performance of the services claimed or shortly thereafter. Therefore, we find that Grantee did not comply with Section J.7.d. since its accounting records were not adjusted to reflect the "P-1" system effort reports and that evidence submitted was inadequate to prove that direct labor costs charged under WSU's institutional payroll system in fact reflected actual effort.

Use of Extrapolation from Fiscal Year 1976 to Fiscal Year 1975

WSU contends that the Agency's use of extrapolation from fiscal year 1976 to fiscal year 1975 is not proper for the following reasons: (1) there is no statistical support for the extrapolation, in that conditions in fiscal year 1975 were materially different than conditions in fiscal year 1976; and (2) proper auditing techniques would require at least the making of a statistical sample of fiscal year 1975. WSU contends that although WSU administrators initially agreed to extrapolation during a negotiating session with HEW, WSU subsequently learned that conditions were different in fiscal year 1975 than in fiscal year 1976. The Board Chair directed the Agency to show cause, with respect to the use of extrapolation to fiscal year 1975, why the disallowance should not be reversed.

The Agency in its response did not identify why it would be reasonable to assume that overcharges in labor costs identified for fiscal year 1976 would be identical to those for fiscal year 1975. Nor did the Agency cite Department guidelines or accounting principles which would justify this type of extrapolation or which could make it unnecessary to perform a statistical sample for fiscal year 1975. Given Grantee's assertion that conditions had changed, we believe that the mere allegation of an agreement between the parties is inadequate to support the Agency's extrapolation without some independent basis to support the reasonableness of its application in this instance. There is no indication from the audit reports or the NIH/ARS disallowance letter that can justify finding overcharges or that demonstrates that the amount disallowed for fiscal year 1975 is correct. The only indication from the record that overcharges exist for fiscal year 1975 is an assumption that the same overcharges must exist for fiscal year 1975 as for fiscal year 1976 because the same direct labor distribution system was in effect for both years. Accordingly, we are unable to sustain the disallowance relating to fiscal year 1975. If the Agency subsequently performs a statistical sample for fiscal year 1975 or finds some other basis for sustaining a disallowance for that year, our present action would not preclude it from taking a later disallowance.

Additional Contentions

Grantee was directed by the Board Chair to show cause why the disallowance should not be upheld based on its failure to comply with Section J.7.d. The Grantee's submission was not responsive to the Order and did not cite any basis in law or fact which would convince this Board to overturn the disallowance for 1976 in light of prior Board decisions and the Grantee's

non-compliance with Federal regulations. Instead, WSU raises two new issues in its response to the Order. First, WSU contends that HEWAA in its audit adjusted the amount of overcharges for errors in the "P-1" effort reports (such as paperwork and clerical errors) but did not make equal adjustments in all similar situations in which these types of errors occurred. Grantee does not demonstrate how this relates to the amount in dispute here since the total overcharges found by the Audit Agency in its 1978 audit were not sustained by NIH/ARS in its later disallowance letter, NIH/ARS having disallowed a much lower amount than recommended by HEWAA. Although WSU contends that proper auditing procedures would require such equal adjustments, we find WSU's citation of United States General Accounting Office publication, "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," Part IV, as support for this argument, unpersuasive. That publication explains general auditing standards but does not directly refer to or deal with WSU's contention. Furthermore, the record indicates that the Agency adjusted for errors only where it had sufficient documentation of actual effort. It is the Grantee's obligation to accurately and correctly document its costs. Accordingly, the Agency is under no obligation to look behind each piece of original documentation for errors and to adjust for them. Such time consuming verification of original documentation is not required. Therefore, one cannot conclude that because the Agency made adjustments for some errors in the "P-1" effort reports that it is under an obligation to find and make adjustments for all errors.

Secondly, in its response to the Order to Show Cause, WSU argues that the Audit Agency, in determining the total amount of overcharges for fiscal year 1976, incorrectly extrapolated the amount of actual overcharges where potential overcharges were identified by the Audit Agency but not reviewed by it. Using WSU's cost sharing reports, HEWAA identified the potential direct labor overcharges for all WSU projects. HEWAA reviewed a portion of the potential overcharges for those projects included in the WSU review and determined the amount actually overcharged. These actual overcharges were then reflected as a percentage rate ( $\text{Actual Overcharges} \div \text{Reviewed Potential Overcharges} = \text{Percentage Rate}$ ) which was applied in order to project the actual overcharges for the potential overcharges which had been identified but not reviewed. NIH/ARS used this same formula to determine its later disallowance, making adjustment for the fact that it subsequently disallowed less (Actual Overcharges) than initially questioned by the Audit Agency and revising its percentage rate accordingly. We find WSU's general objection to this projection unpersuasive since WSU failed to institute an appropriate direct labor distribution system and in the Board's view the Agency acted reasonably in an effort to compute the resulting overcharges.

Conclusion

The Board finds that the Grantee has violated the provisions of 45 CFR Part 74, Appendix D, Section J.7.d. and has failed to provide credible, convincing evidence to refute the findings of NIH/ARS as supported by HEWAA audits. The Board, therefore, upholds the disallowance of \$95,904 -- that portion of the disallowance which relates to fiscal year 1976 -- plus unallowable cost transfers for fiscal years 1975 and 1976 in the amount of \$2,604 as agreed to by the parties.

The Board finds that the Agency has not adequately explained why extrapolation of the fiscal year 1976 overcharges to fiscal year 1975 is proper; therefore, the Board overturns the disallowance as it relates to fiscal year 1975 inasmuch as the record indicates that there is no independent basis for that year to justify the disallowance. The Agency, however, is not precluded from taking a later disallowance for fiscal year 1975 on other grounds.

/s/ Cecilia Sparks Ford

/s/ Donald F. Garrett

/s/ Norval D. (John) Settle, Panel Chair