

ALAN G. HEVESI  
COMPTROLLER



110 STATE STREET  
ALBANY, NEW YORK 12236

STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

August 21, 2003

Antonia C. Novello, M.D., M.P.H., Dr. P.H.  
Commissioner  
Department of Health  
Corning Tower  
Empire State Plaza  
Albany, NY 12237

Re: Health Research, Incorporated  
Disbursement of Grant Funds  
Report 2002-S-39

Dear Dr. Novello:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have audited selected aspects of the disbursement of grant funds by Health Research, Incorporated (HRI). Our audit covered the period April 1, 2000 through September 30, 2002.

**A. Background**

HRI is a not-for-profit corporation established by administrative action of the Commissioner of the Department of Health (Department) to administer federal, State, and private funding in order to support, supplement, and extend the research functions and programs of the Department. HRI is organized into three divisions, headed by one executive director. The Corporate Division and one operating division (Albany Division) are located together in the Capital District, while the second operating division (Buffalo Division) is located in Buffalo. The Albany Division serves major Department programs, including those at the Wadsworth Center and the AIDS Institute. The Buffalo Division serves the research programs of the Roswell Park Cancer Research Center (Roswell Park). The Corporate Division is responsible for the overall administration of the Albany and Buffalo Divisions.

Each operating Division has its own purchasing, payroll, and accounting staff to administer and authorize disbursements of grant funds. In general, HRI assists the Department and Roswell Park in obtaining and administering grants that enable Department and Roswell Park lead scientists, referred to as principal investigators, program managers and employees, to conduct scientific investigations into health research and to deliver public health programs. When a grant opportunity

is identified, the principal investigator or program manager works with HRI's grant managers to help prepare and submit a grant application.

HRI establishes a separate account for each grant awarded to it when the funds are received. Grants are typically for a three- to five-year period, with funding renewed on an annual basis. The grants are funded on a cost reimbursable basis. A cost reimbursable grant or contract is an agreement whereby a budget is established along with a scope of work. The grantee or contractor is then reimbursed for expenses incurred in performing the scope of work.

The majority of HRI funds are provided by federal grants with the National Institutes of Health (NIH) and its parent agency, the Department of Health and Human Services. According to the audited financial statements provided by HRI officials, during the fiscal year ended March 31, 2001, the Albany Division expended \$191 million for direct research, prevention, and treatment costs. Direct cost disbursements included \$38 million for personal services and \$153 million for other direct cost categories including subcontractor awards, travel, equipment, supplies, and miscellaneous expenses. During the fiscal year ended March 31, 2002, the Albany Division expended \$205 million for direct costs: \$40 million for personal services and \$165 million for other direct costs. During the fiscal year ended March 31, 2001, the Buffalo Division expended \$29 million for direct costs: \$16 million for personal services and \$13 million for other direct costs. During the fiscal year ended March 31, 2002, the Buffalo Division expended \$34 million for direct costs: \$20 million for personal services and \$14 million for other direct costs.

HRI may also enter into agreements with subcontractors in order to carry out grant requirements. While HRI may contract with the same subcontractor over the term of the grant, subcontracts are typically renewed on an annual basis. As of March 31, 2003, the Albany Division maintained 752 subcontracts valued at \$81 million with 479 subcontractors. The number of subcontracts increased from about 400 in early 2000 and HRI expects new grants, awarded to enable bio-terrorism research, to continue to increase the total number of subcontracts throughout 2003. As of March 31, 2003, the Buffalo Division maintained 18 subcontracts valued at \$1.5 million with 16 subcontractors. Like grants, the majority of subcontracts are funded on a cost reimbursable basis.

## **B. Audit Scope, Objectives and Methodology**

We audited HRI's administration of grant fund disbursements from the Albany and Buffalo Divisions for the period April 1, 2000 through September 30, 2002. The objectives of this financial related audit were to determine whether HRI has adequate controls over the disbursement of grant funds, whether those funds were disbursed consistently with the terms of the grant agreements, and whether HRI has accounted for those disbursements correctly.

To accomplish our objectives, we interviewed Corporate, Albany and Buffalo Division officials about controls over grant funds, and examined HRI's policies and procedures pertaining to grant fund disbursements. We judgmentally selected nine Albany Division grants from those that had expenditures over \$200,000 in other direct cost categories during our scope period. In addition, we judgmentally selected three Buffalo Division grants from those that had expenditures over \$25,000 in other direct cost categories during our scope period. We also analyzed a sample of 173 grant fund disbursements totaling \$764,107 that the Albany Division made directly to vendors and

159 disbursements totaling \$667,063 that the Buffalo Division made directly to vendors during our audit period. Our sample was judgmentally selected from those cost categories with the highest disbursement totals and the individual disbursements within those categories with the highest dollar value. In addition, we judgmentally selected and analyzed transactions from nine Albany Division subcontracts worth \$519,045 during site visits to six subcontractors. We selected these subcontractors because they had the highest expenditures in other direct costs. We did not select any of the Buffalo Division subcontracts for review because the subcontractors were located outside of New York State.

For each of the sampled grants and subcontracts, we reviewed the grant award notice to identify any limitations or restrictions on grant disbursements. We reviewed grant disbursements to verify they were adequately justified with supporting documentation and had sufficient authorizations. We also analyzed the supporting documentation for the selected transactions to determine whether the expense was in conformance with the terms of the grant agreement. NIH can recover funds from HRI, including those disbursed to subcontractors, that are determined to be misspent or unallowable.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those HRI operations that are within our audit scope. Further, these standards require that we understand HRI's internal control structure and compliance with those laws, rules, and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records, and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those activities we have identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use our finite audit resources to identify where and how improvements can be made. Thus, we devote little effort to reviewing operations that may be relatively efficient or effective. As a result, we prepare our audit reports on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

### **C. Internal Control and Compliance Summary**

Our evaluation of the internal control structure at HRI identified internal control weaknesses over grant fund disbursements. As a result of these deficiencies, there is increased risk for overpayments and disallowances, and an increased potential for fraud and abuse. These matters are presented throughout this report.

### **D. Results of Audit**

We found that the Albany and Buffalo Divisions disbursed the sampled grant funds for direct payment to vendors according to the terms of the grant agreements and have generally accounted for

those disbursements correctly. However, we found the Albany Division can improve controls and monitoring practices over the disbursements made to subcontractors. We tested \$519,045 in disbursements that the Albany Division made to six subcontractors. We found that \$64,496 (or 12.4 percent) of the payments tested, involving five subcontractors, could not be supported by adequate documentation or were not allowable under the terms of the grant agreements. We noted that the Albany Division has a review process in place, including desk audits, to control and monitor disbursements to subcontractors. Our findings indicate the need for HRI to strengthen its controls and monitoring over disbursements to subcontractors to help ensure HRI spends grant funds as efficiently and effectively as possible.

## **1. Disbursement of Grant Funds**

HRI, the Department, Roswell Park, and subcontractors can all incur grant expenses. For expenses incurred by HRI, the Department, and Roswell Park, HRI disburses funds directly to the vendor that provided the goods or services. However, when subcontractors incur grant expenses, they are responsible for paying the vendor invoices directly and then submitting a voucher to HRI to receive reimbursement. The subcontractor submits a voucher to the principal investigator or program manager that shows the total expenses incurred by budgetary line item for the invoice period. This is usually done on a monthly or quarterly basis. HRI requires subcontractors to retain all supporting documentation (vendor invoices, sales receipts, time cards) for claimed expenses for a minimum of three years.

The principal investigators or program managers are responsible for making sure that the subcontractor is performing the required work and that the expenses are appropriate. After the principal investigators or program managers approve the vouchers, they forward them to the Albany or Buffalo Division for payment. The Albany or Buffalo Division's grant managers review the expenses to make sure they are within the contract budget, they are allowable based on the terms of the grant agreement, and that funds are available.

We found the Albany Division can improve controls and monitoring practices relating to reimbursement vouchers submitted by subcontractors. The vouchers submitted by subcontractors are a summary of expenses and do not detail costs by transaction. HRI officials informed us that under federal guidelines, HRI does not have to require subcontractors to submit detailed supporting documentation (such as purchase requisitions, vendor invoices or receipts) along with the reimbursement voucher. As a result, there is an increased the risk of overpayments and disallowances, and an increased potential for fraud and abuse. These matters are explained below.

During our six site visits, we found that five subcontractors could not provide us with adequate documentation to support expenses claimed on vouchers submitted to and approved by HRI for reimbursement. In addition, we determined some expenses were not allowable based on the terms of the grant agreement. In total, \$64,496 of claimed expenses were questionable, as follows:

- One subcontractor could not provide us with adequate documentation for claimed expenses totaling \$40,000. The subcontractor claimed a total of \$37,561 in grant expenses for such items as refreshments, training space, and training manuals based on the amount budgeted in the subcontractor's agreement with HRI instead of actual

expenses incurred. For example, subcontractor officials explained they purchased refreshment items in bulk because it was cost effective. They then allocated the expense based on an estimated cost per person attending training. They used a similar approach for claiming costs related to training manuals. However, the subcontractor officials could not provide us with adequate documentation, including vendor invoices or lease agreements, to support the \$37,561 of costs claimed. HRI should work with the subcontractor to resolve this issue and request a refund for any portion of the claimed expenses that cannot be supported by adequate documentation.

The subcontractor also submitted claimed expenses to HRI that included \$2,439 for vendor purchases that could be supported only by check stubs or credit card statements. Albany Division officials stated they do not accept check stubs and credit card statements as adequate documentation. HRI officials should request a full refund of \$2,439 from the subcontractor.

- A second subcontractor could not provide us with documentation for claimed expenses totaling \$15,988. Subcontractor officials explained that the former staff members responsible for submitting the vouchers to HRI and the program manager did not clearly document the methodology used in preparing the vouchers. As a result, the current subcontractor officials were unable to match documentation to the vouchers. We encourage Albany Division officials to continue to assist the subcontractor in reconciling the vouchers submitted for reimbursement to the available documentation. HRI should request a refund for any unsupported expenses.
- We reviewed three subcontracts HRI maintains with a third subcontractor. The subcontractor could not provide supporting documentation for claimed expenses totaling \$2,764, including \$1,572 for vendor purchases and a \$1,192 journal entry for a computer link-up. HRI should request a full refund of the \$2,764. We also noted the subcontractor claimed reimbursement of \$625 for supplies that included a \$207 microwave oven. During our interview with subcontractor officials, we learned the microwave was purchased for staff use, not program use. We question the appropriateness of this expense.
- At a fourth subcontractor, officials could not provide adequate documentation for claimed expenses totaling \$1,888, including a claim of \$1,350 for conference fees even though staff members did not attend the conference and the subcontractor received a full refund. As a result of our review, Albany Divisions officials requested the subcontractor refund the full \$1,888.
- A fifth subcontractor could not provide documentation for a \$163 journal entry for supplies nor a \$50 conference fee. We also noted four occasions when the subcontractor reimbursed a consultant for duplicate expenses for a total of \$32. HRI officials should request the subcontractor reimburse the \$245.

In addition, this subcontractor may not have complied with terms of the contract on one occasion when purchasing a \$2,510 laptop computer. According to the contract budget, "For any item whose unit costs exceeds \$2,000; or for a group of like items whose total costs exceeds \$2,000, the contractor MUST obtain three bids and submit documentation proposed vendor selection with Justification to (your) AIDS Institute Contract Manager to obtain written approval PRIOR to Purchase." We requested such documentation, but subcontractor officials have not provided it.

According to the standard agreement that HRI uses for subcontracts, "HRI reserves the right to request additional back up documentation on any voucher submitted." Given our findings with respect to the adequacy of documentation maintained by subcontractors to support claimed expenses, we believe that HRI officials should evaluate their current practices relating to the submission of supporting documentation by subcontractors. For example, it may be appropriate to define circumstances when additional documentation should be required from subcontractors before HRI reimburses claimed expenses. In addition, Albany Division officials should clearly communicate and reinforce HRI's policy requiring subcontractors to retain all supporting documentation for claimed expenses for a minimum of three years.

We also found the Albany Division reimbursed four subcontractors for items such as sales tax and late fees that are not allowable under the terms of the grant agreements. As not-for-profit organizations, none of the subcontractors is required to pay local and New York State sales tax. However, we noted 69 vendor receipts that included \$853 in sales tax paid. In most cases, subcontractors incurred the sales tax expense when employees made purchases with personal credit cards or petty cash disbursements. Officials from all four subcontractors stated they have policies regarding the payment of sales tax, but subcontractors' staff members reviewing the invoices or reimbursement requests for payment failed to note the sales tax. In addition, we noted one subcontractor incurred late fees totaling \$41 on seven occasions when their hospital division failed to pay vendor invoices in a timely manner, even though the subcontractor received a grant advance.

HRI officials agreed sales tax and late fees are not allowable, and stated they would request refunds from the subcontractors. As HRI cannot directly control subcontractor payments to vendors and subcontractor employees, it is important that HRI officials clearly communicate allowable and unallowable costs to subcontractors to ensure grant funds are spent efficiently and effectively.

## **2. Desk Audits**

The Albany Division's controls over disbursements to subcontractors include the performance of desk audits. Albany Division Finance Office staff members determine the subcontracts to audit based on a risk assessment completed for each subcontract, taking into account the contract value, time since HRI's last audit of the subcontractor, prior HRI audit findings, contractor experience, type of organization, and independent audit opinion. The subcontracts considered to have the highest risk are judgmentally selected for audit, while the remaining contracts are randomly selected.

According to HRI's Controller, the Albany Division's Finance Office schedules approximately 20 desk audits to be performed each year. However, we found that the Albany Division completed only 20 desk audits during the two and one-half year period April 1, 2000 through September 30, 2002. Finance Office staff members disallowed \$5,784 of the \$1,041,734 of direct costs (other than personal services) claimed by subcontractors on the vouchers reviewed during the desk audits. Finance Office staff perform their voucher review based on photocopies of documentation submitted by subcontractors, and do not include site visits as part of their review process. Albany Division officials cited staffing issues as the reason why they completed fewer desk audits than planned. They stated they plan to hire an additional staff member sometime during 2003 to assist in performing desk audits. Given the results of our site visits and the increasing number and monetary value of subcontracts, Albany Division officials should increase the number of desk audits planned and performed on an annual basis. In addition, we encourage the HRI Finance Office staff members to incorporate site visits as part of their audit process.

### **Recommendations**

1. *Recover from subcontractors all claimed expenses that cannot be supported by adequate documentation or that are unallowable under the terms of the grant agreements.*
2. *Evaluate current practices relating to the submission of supporting documentation by subcontractors. For example, it may be appropriate to define circumstances when additional documentation should be required from subcontractors before HRI reimburses claimed expenses.*
3. *Clarify and better communicate current policies and procedures with regard to sales tax, late fees, refunds and retention of supporting documentation.*
4. *Increase the number of desk audits performed. Consider incorporating site visits as part of the audit review process.*

We provided draft copies of this report to Department officials for their review and comment. We considered their comments in preparing this report. Department officials agreed with the report's recommendations and indicated actions planned or taken to implement them. A complete copy of the Department's response is included as Appendix A.

In addition to the matters discussed in this report, we have also reported separately to Department officials about other audit issues. While these are matters of lesser significance, officials should implement our recommendations related to these issues to improve HRI's controls over disbursements of grant funds.

Within 90 days after the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the New York State Department of Health shall report to the Governor, the State Comptroller and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this report were Stuart Dolgon, Kristee Iacobucci, Mary Roylance, Shawn Smith, David Bell and Paul Bachman.

We wish to thank the management and staff of Health Research, Incorporated for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Kevin M. McClune  
Audit Director

cc: Deirdre A. Taylor



STATE OF NEW YORK  
DEPARTMENT OF HEALTH

Corning Tower The Governor Nelson A. Rockefeller Empire State Plaza Albany, New York 12237

Antonia C. Novello, M.D., M.P.H., Dr.P.H.  
*Commissioner*

Dennis P. Whalen  
*Executive Deputy Commissioner*

July 31, 2003

Kevin M. McClune  
Audit Director  
Office of the State Comptroller  
110 State Street  
Albany, New York 12236

Dear Mr. McClune:

Enclosed are the Department of Health's comments on the Office of the State Comptroller's draft audit report (2002-S-39) entitled "Health Research Inc.'s Disbursement of Grant Funds."

Thank you for the opportunity to comment.

Sincerely,

Dennis P. Whalen  
Executive Deputy Commissioner

Enclosure

**Department of Health's  
Comments on the  
Office of the State Comptroller's  
Draft Audit Report  
2002-S-39 Entitled  
Health Research, Inc.  
Disbursement of Grant Funds**

---

---

The following are the Department of Health's comments on the Office of the State Comptroller's (OSC) Draft Audit Report (2002-S-39) entitled "Health Research Inc.'s (HRI) Disbursement of Grant Funds."

**Recommendation #1:**

Recover from subcontractors all claimed expenses that cannot be supported by adequate documentation or that are unallowable under the terms of the grant agreements.

**Response #1:**

HRI audit staff reviewed documentation provided by OSC auditors and have issued draft and final reports to the subcontractors requesting reimbursement of costs determined to be unallowable. HRI has already received payment from one subcontractor and continues to pursue the remaining outstanding recoveries.

**Recommendation #2:**

Evaluate current practices relating to the submission of supporting documentation by subcontractors. For example, it may be appropriate to define circumstances when additional documentation should be required from subcontractors before HRI reimburses claimed expenses.

**Response #2:**

HRI is evaluating current practices related to subcontractor monitoring. The Corporation currently follows standards from the Federal Office of Management and Budget Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations." Under these standards HRI established and maintains policies and procedures which provide a sufficient level of assurance that grant funds are being used for allowable activities, are reasonable and that transactions and expenditure records are maintained properly. Adherence to this requirement is also made part of HRI's contracts. Federal Notice of

**Response #2 (continued):**

Grant Awards detail the level of documentation HRI is required to submit to obtain reimbursement from its sponsors and by virtue of flow down clauses determines the subcontractor requirements. It is currently HRI's practice to request additional supporting documentation from subcontractors in situations where there are identified conditions that warrant an additional level of detail.

HRI has surveyed several State agencies and affiliated not for profit agencies to ascertain the level of supporting documentation they require as back up to contractor reimbursement vouchers. HRI's required level of documentation is consistent with their requirements. HRI will review supporting documentation policies and consider increasing the levels required if certain categories of expense are determined to be more vulnerable.

**Recommendation #3:**

Clarify and better communicate current policies and procedures with regard to sales tax, late fees, refunds and retention of supporting documentation.

**Response #3:**

As an ongoing process, new subcontractors are provided with documentation on how to process their vouchers and instructions on the documentation that must be maintained and provided. In addition to this practice, a technical assistance notice will be sent to all HRI subcontractors and relevant Department of Health (DOH) program areas to communicate and address the issues reflected in this recommendation, as well as, any other areas we may identify.

**Recommendation #4:**

Increase the number of desk audits performed. Consider incorporating site visits as part of the audit review process.

**Response #4:**

HRI is currently in the process of reviewing its monitoring practices and identified the need to supplement staffing to increase the number of audit reviews conducted. As a result, a new auditor has been hired to bolster the Corporation's monitoring activity. The auditor will conduct several site visits each year in addition to increasing the number of desk audits conducted annually. Subcontractors will be identified for site review based on a risk assessment model.

In addition to increasing Corporate resources dedicated to subcontractor monitoring and review, HRI is participating in a DOH workgroup to develop, standardize, and promulgate fiscal monitoring review standards to be applied to subcontractors during the course of

**Response #4 (continued):**

regular ongoing programmatic site monitoring. Fiscal monitoring of funded subcontractors by HRI and DOH staff currently occurs in many program areas; however, it is anticipated that the activity of this workgroup will provide all program areas which administer contracts with the knowledge to complement program reviews with a fiscal component. This will significantly augment current HRI and DOH fiscal monitoring resources and audit review activities and will serve to further strengthen stewardship of public funds.