

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**THE UNIVERSITY OF ALABAMA AT  
BIRMINGHAM OVERSTATED CHILLED  
WATER COSTS IN ITS FACILITIES AND  
ADMINISTRATIVE COST PROPOSAL**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
[Public.Affairs@oig.hhs.gov](mailto:Public.Affairs@oig.hhs.gov).*



Gloria L. Jarmon  
Deputy Inspector General  
for Audit Services

May 2018  
A-04-14-00095

# *Office of Inspector General*

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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.

## Report in Brief

Date: May 2018

Report No. A-04-14-00095

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES  
**OFFICE OF INSPECTOR GENERAL**



### Why OIG Did This Review

Our prior survey work at the University of Alabama at Birmingham (UAB) indicated that UAB may have overstated chilled water costs in its fiscal year (FY) 2010 Facilities and Administrative (F&A) cost proposal and, therefore, overstated its negotiated F&A rates for FYs 2012 through 2015. UAB also ranked within the top 10 percent in Federal research funding for the same 4-year period and used service centers to allocate costs.

Our objective was to determine whether UAB included chilled water costs in its FY 2010 F&A cost proposal in accordance with Federal requirements.

### How OIG Did This Review

We reviewed \$16.5 million in chilled water costs included in \$103.7 million of Operations and Maintenance costs reported in the FY 2010 cost proposal. We identified unallowable chilled water costs and determined their effect on UAB's negotiated F&A rates for FYs 2012 through 2015. We calculated potential overpayments by multiplying modified total direct costs on Federal awards by the 1-percent overstatement we identified. We did not review UAB's negotiated F&A rates, based on its 2006 cost proposal, for FYs 2010 and 2011.

## The University of Alabama at Birmingham Overstated Chilled Water Costs in Its Facilities and Administrative Cost Proposal

### What OIG Found

In its FY 2010 F&A cost proposal, UAB included \$8.6 million in chilled water costs that were not in accordance with Federal requirements that costs must be reduced by applicable credits. Specifically, UAB officials did not reduce chilled water costs included in the cost proposal by \$8.6 million in chilled water revenues that it received from various users.

Separate from its comments on our draft report, UAB officials provided us with information acknowledging that UAB did not net \$8.6 million in chilled water revenues that it received from various users against costs included in its FY 2010 F&A cost proposal. As a result, UAB's negotiated F&A rate was inflated by 1 percent per year for FYs 2012 through 2015, and it potentially received as much as \$5.9 million in overpayments from the Federal Government.

### What OIG Recommends and University of Alabama at Birmingham Comments

We recommend that UAB work with the Department of Health and Human Services' Cost Allocation Services to determine the portion of the \$5.9 million that was unallowable under Federal requirements, refund the unallowable portion (including any interest) to the Federal Government, and ensure that appropriate officials review future proposals for compliance with Federal requirements prior to submission.

UAB acknowledged that it overstated chilled water costs in its proposal and commented that it had taken steps to ensure that appropriate officials review future proposals for compliance prior to submission. However, UAB contended that it included \$16.5 million in chilled water costs in the proposal, that it overstated chilled water costs by \$3.6 million, and that its costing model identified overcharges made to Federal awards of \$1 million.

After reviewing UAB's comments and additional information, we agreed that UAB included \$16.5 million in chilled water costs, composed of \$7.9 million incurred costs to produce chilled water and \$8.6 million in chilled water costs billed to user accounts, in its proposal. After analysis of the additional information, we maintain that UAB overstated chilled water costs by \$8.6 million in costs not reduced by revenues (applicable credits) and that it received as much as \$5.9 million in overpayments.

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## INTRODUCTION

### WHY WE DID THIS REVIEW

Our prior survey work at the University of Alabama at Birmingham (UAB) indicated that UAB may have overstated chilled water costs in its fiscal year (FY) 2010 Facilities and Administrative (F&A) cost proposal and, therefore, overstated its negotiated F&A rates for FYs 2012 through 2015. UAB also ranked within the top 10 percent in the amount of Federal research funding received for the same period and used service centers to allocate costs. (See “Service Centers” below.) During FYs 2010 through 2015 (October 1, 2009, through September 30, 2015), UAB received approximately \$1.8 billion related to grant awards, contracts, and other agreements with components of the Department of Health and Human Services (HHS).

### OBJECTIVE

The objective of our audit was to determine whether UAB included chilled water costs in its FY 2010 F&A cost proposal in accordance with Federal requirements.

### BACKGROUND

#### Service Centers

UAB defines a service center as “an operating unit providing services or products to users for a fee.” UAB used service centers to accumulate and allocate the costs of certain goods or services, such as chilled water, to users<sup>1</sup> based on usage rates or some other allocation method (such as square footage). The operating costs of the service centers were ultimately allocated to users that benefited from the goods or services. Such costs are allowable provided that they meet certain conditions (2 CFR part 220), including, among other things, being reduced by applicable credits (2 CFR part 220, App. A, §§ C.2. and C.5.a).

#### University of Alabama at Birmingham’s Chilled Water Service Center

UAB operates a centralized cooling distribution system that produces chilled water used to cool 52 buildings, totaling approximately 8 million square feet, on UAB’s main campus. UAB measures chilled water flow to each building and bills users monthly based on the building’s usage. In FY 2010, UAB used a service center to account for the costs of producing chilled water and the revenues received from chilled water billed to users.

Consistent with Federal requirements, UAB’s accounting policy, entitled *Service Center Procedures*, incorporated two explicit requirements: recipients of Federal funds are not to

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<sup>1</sup> Chilled water users included UAB Hospital and academic, administrative, and auxiliary areas within UAB such as the School of Medicine, the School of Public Health, etc.

recover more than cost, and they are not to discriminate between Federal internal users and other non-Federal internal users in prices charged for the services.

### **Facilities and Administrative Rate**

The F&A rate (also known as the indirect cost rate) is the mechanism universities use to obtain reimbursement for costs that they incur for common or joint objectives and, therefore, cannot identify readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity (2 CFR 220, App. A, § E.1). Generally, the F&A rate is a percentage calculated by dividing overhead by the direct costs. Universities obtain F&A reimbursement by applying the negotiated rate to direct costs on Federal awards.

### **University of Alabama at Birmingham's Cost Proposal and Base Year**

UAB negotiates F&A rates with HHS's Cost Allocation Services (CAS). These negotiated rates are effective until renegotiated or changed. In August 2011, UAB submitted its FY 2010 F&A cost proposal to CAS. CAS used this cost proposal as the base year for determining the negotiated F&A rates that UAB used to obtain reimbursement for costs incurred for common or joint objectives for FYs 2012 through 2015. Based on the costs UAB reported for FY 2010, CAS approved a 46.5-percent F&A rate for FYs 2012 and 2013 and a 47-percent F&A rate for FYs 2014 and 2015.

### **HOW WE CONDUCTED THIS REVIEW**

We reviewed \$16,450,754 in chilled water costs that UAB included in \$103,691,719 of Operations and Maintenance (O&M) costs reported in its FY 2010 F&A cost proposal.<sup>2</sup> We identified unallowable chilled water costs included in the F&A cost proposal and determined their effect on UAB's negotiated F&A rates for FYs 2012 through 2015.

We calculated potential overpayments by multiplying modified total direct costs on Federal awards by the 1-percent overstatement we identified. See Appendix A for our audit scope and methodology and Appendix B for Federal requirements.

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.

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<sup>2</sup> The \$16,450,754 in chilled water costs was composed of \$7,857,571 in incurred costs to produce chilled water and \$8,593,183 in chilled water costs billed to user accounts.

## FINDINGS

### UNIVERSITY OF ALABAMA AT BIRMINGHAM OVERSTATED CHILLED WATER COSTS IN ITS FACILITIES AND ADMINISTRATIVE COST PROPOSAL

In its FY 2010 F&A cost proposal, UAB included \$8,593,183 in chilled water costs that were not in accordance with Federal requirements that costs must be reduced by applicable credits (2 CFR part 220, App. A, § C.5.a). Specifically, UAB officials did not reduce chilled water costs included in the F&A cost proposal by \$8,593,183 in chilled water revenues that UAB received from various users. As a result, UAB's negotiated F&A rate was inflated by 1 percent per year for FYs 2012 through 2015,<sup>3</sup> and it received as much as \$5,901,378 in overpayments from the Federal Government for FYs 2012 through 2015. (See Appendix C.)

In FY 2010, the base year for calculating the proposed F&A rate, UAB used the central utilities chilled water account, a service center, to record \$7,857,571 for incurred costs of electricity, water and sewer, gas, and utility taxes used to produce chilled water. UAB also used the central utilities chilled water account to record \$8,593,183 in chilled water costs that it billed to user accounts and to record \$8,593,183 in user revenues.

UAB's FY 2010 F&A cost proposal, which CAS used as the base year in negotiating the F&A rate for FYs 2012 through 2015, included \$16,450,754 in chilled water costs composed of \$7,857,571 in incurred costs to produce chilled water and \$8,593,183 in chilled water costs billed to user accounts. Because it did not report these costs net of \$8,593,183 in user revenues (applicable credits) in its FY 2010 F&A cost proposal, UAB overstated chilled water costs (and O&M costs) by \$8,593,183. As a result, UAB's negotiated F&A rate was inflated by 1 percent per year for FYs 2012 through 2015, and it received as much as \$5,901,378 in overpayments from the Federal Government. (See Appendix C.)

UAB officials did not adequately review the F&A cost proposal prior to submitting it to CAS. Separate from its comments on our draft report, UAB officials provided us with information acknowledging that UAB did not net \$8,593,183 in chilled water revenues that it received from various users against costs included in its FY 2010 F&A cost proposal.

## RECOMMENDATIONS

We recommend that UAB work with HHS's CAS to:

- determine the portion of the \$5,901,378 that was unallowable under Federal requirements,
- refund the unallowable portion (including any interest) to the Federal Government, and
- ensure that appropriate officials review future F&A cost proposals for compliance with Federal requirements prior to submitting the proposals to CAS.

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<sup>3</sup> CAS used UAB's FY 2006 F&A cost proposal to negotiate the F&A rates for FYs 2010 and 2011.

## **UNIVERSITY OF ALABAMA AT BIRMINGHAM COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

### **UNIVERSITY OF ALABAMA AT BIRMINGHAM COMMENTS**

In written comments on our draft report, UAB acknowledged that it overstated chilled water costs in its FY 2010 F&A cost proposal and commented that it had taken steps to ensure that the appropriate officials review future proposals for compliance prior to submitting them to CAS. However, UAB contended that it included \$16,450,754 in chilled water costs in the proposal, that it overstated chilled water costs by \$3,634,268,<sup>4</sup> and that its costing model identified overcharges made to Federal awards of \$1,014,477. Separate from its comments, UAB submitted additional information supporting its contentions. UAB's comments are included in their entirety as Appendix D.

### **OFFICE OF INSPECTOR GENERAL RESPONSE**

After reviewing the comments and additional information submitted by UAB, we agreed with UAB's contention that it included \$16,450,754 in its FY 2010 F&A cost proposal, and we revised our report accordingly. After analysis of the additional information, we maintain that UAB overstated chilled water costs by \$8,593,183 in costs not reduced by applicable credits and that it received as much as \$5,901,378<sup>5</sup> in overpayments from the Federal Government.

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<sup>4</sup> UAB's overstatement was \$4,958,915 (\$8,593,183 minus \$3,634,268) less than our overstatement because UAB added \$4,958,915 in other costs to allowable chilled water costs when calculating its overstatement. However, UAB did not submit sufficient documentation for us to evaluate the nature and propriety of these other costs. Accordingly, we did not add them to allowable chilled water costs when calculating our overstatement.

<sup>5</sup> UAB calculated overpayments of \$1,014,477 using its costing model and allowable cost of \$12,816,486. We calculated potential overpayments of \$5,901,378 as described in our methodology and using allowable cost of \$7,857,571.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

Our audit covered \$16,450,754 in chilled water costs that UAB included in \$103,691,719 of O&M costs reported to CAS in its FY 2010 F&A cost proposal and UAB's negotiated F&A rates for FYs 2012 through 2015.

Our review of internal controls was limited to gaining an understanding of UAB's account structure and methods for accounting for chilled water costs.

We performed our fieldwork at UAB in Birmingham, Alabama.

### METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal laws and regulations;
- reviewed UAB's account structure and codes;
- downloaded from UAB's accounting system all utility transactions, including payment and billing data, for FY 2010;
- downloaded from UAB's website a list of all utility payments made for FY 2010;
- reconciled recorded utility costs to vendor payment information;
- obtained from UAB's accounting system the account titles and cost pool identification (e.g., General Administration, O&M, Service Center, Departmental Administration, etc.) for each account;
- traced utility and labor costs associated with energy management and central utilities to the FY 2010 F&A cost proposal;
- calculated potential overpayments for FYs 2012 through 2015 by:
  - reducing base-year F&A costs by \$8,593,183 in overstated chilled water costs and recalculating the F&A rate, which resulted in a 1-percent rate adjustment;
  - obtaining from UAB's accounting system the indirect costs associated with Federal awards for FYs 2012 through 2015;

- determining UAB's modified total direct costs (MTDC) for Federal awards for each year by dividing the indirect costs applied to Federal awards for the year by the negotiated F&A rate for the year; and
- calculating the overpayment for each year by applying the 1-percent F&A rate adjustment to UAB's MTDC for each year; and
- discussed the results of our audit with UAB officials.

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 B: FEDERAL REQUIREMENTS

### COST PRINCIPLES FOR EDUCATIONAL INSTITUTIONS: 2 CFR PART 220 (OMB CIRCULAR A-21)

These cost principles require that, to be allowable:

- Costs must be allocable and reasonable under A-21's cost principles. Section C.1 states, "The cost of a sponsored agreement is comprised of the allowable direct costs incident to its performance, plus the allocable portion of the allowable F&A costs of the institution, less applicable credits . . ." (App. A, § C.1).
- Costs must be reasonable and necessary. "Major considerations involved in the determination of the reasonableness of a cost are: whether or not the cost is of a type generally recognized as necessary for the operation of the institution or the performance of the sponsored agreement; the restraints or requirements imposed by such factors as arm's length bargaining . . ." (App. A, § C.3).
- Costs must be allocable to a particular cost objective (App. A, § C.4).
- Costs must be reduced by applicable credits. "[A]pplicable credits' refers to those receipts or negative expenditures that operate to offset or reduce direct or F&A cost items. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; and adjustments of overpayments or erroneous charges" (App. A, § C.5.a).
- Costs must be estimated, accumulated, and reported consistently (App. A, § C.10).

Additionally, 2 CFR part 220 states:

- "F&A costs are those that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project, an instructional activity, or any other institutional activity" (App. A, § E.1).
- O&M costs are those that are "normally incurred for such items as janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; care of grounds; maintenance and operation of buildings and other plant facilities . . ." (App. A, § F.4.a).
- Previously negotiated F&A cost rates containing unallowable costs may be adjusted (App. A, § C.9).
- "Negotiated F&A cost rates based on a proposal later found to have included costs that are unallowable . . . shall be adjusted, or a refund shall be made, in accordance with the

requirements of this section . . . . The adjustments or refunds will be made regardless of the type of rate negotiated (predetermined, final, fixed, or provisional)” (App. A, § C.9).

- “For rates covering a past period, the Federal share of the unallowable costs will be computed for each year involved and a cash refund (including interest chargeable in accordance with applicable regulations) will be made to the Federal Government” (App. A, § C.9(b)).
- “The amount or proportion of unallowable costs included in each year’s rate will be assumed to be the same as the amount or proportion of unallowable costs included in the base year proposal used to establish the rate” (App. A, § C.9(d)).

**APPENDIX C: CALCULATION OF POTENTIAL OVERPAYMENTS**

<b>FY</b>	<b>Indirect Costs Claimed on Federal Awards</b>	<b>UAB's Negotiated Rate</b>	<b>UAB's MTDC on Federal Awards</b>	<b>OIG-Calculated Rate Adjustment</b>	<b>OIG-Calculated Potential Overpayment<sup>6</sup></b>
2012	\$73,294,672	46.5%	\$157,622,951	1%	\$1,576,230
2013	69,115,743	46.5%	148,636,006	1%	1,486,360
2014	66,872,944	47.0%	142,282,861	1%	1,422,829
2015	66,550,090	47.0%	141,595,936	1%	1,415,959
<b>Total</b>					<b>\$5,901,378</b>

OIG: Office of Inspector General.

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<sup>6</sup> Potential overpayment equals UAB's MDTC multiplied by the rate adjustment.



Knowledge that will change your world

**Ray L. Watts, MD**  
President

February 7, 2018.

Report Number: A-04-14-00095

Lori S. Pilcher  
Regional Inspector General for Audit Services  
Office of Audit Services, Region IV  
61 Forsyth Street, SW, Suite 3T41  
Atlanta, GA 30303

Dear Ms. Pilcher:

Enclosed is the University of Alabama at Birmingham response to the draft report entitled *The University of Alabama at Birmingham Overstated Chilled Water Costs in Its Facilities and Administrative Cost Proposal*.

If you have any questions or comments about this response, please do not hesitate to call or email Mr. Clay Hester, Director of Cost Analysis and Asset Accounting at (205) 934-7650 or [clayh@uab.edu](mailto:clayh@uab.edu).

Sincerely,

A handwritten signature in blue ink that reads 'Ray L. Watts'. The signature is written in a cursive, flowing style.

Ray L. Watts, MD

1070 Administration Building  
701 20th Street South  
205.934.4636  
Fax 205.975.8505  
[www.uab.edu](http://www.uab.edu)

Mailing Address:  
AB 1070  
1720 2ND AVE S  
BIRMINGHAM AL 35294-0110

## **UAB RESPONSE TO HHS OIG REPORT NO. A-04-14-00095**

The University of Alabama at Birmingham has reviewed the Draft HHS OIG Audit Report Number A-04-14-00095, dated January 11, 2018, titled "The University of Alabama at Birmingham Overstated Chilled Water Costs in its Facilities and Administrative Cost Proposal". Per your request, these are our comments on the Draft Report findings and recommendations. UAB understands our comments will be incorporated in the Final OIG Report on this matter.

### **Draft OIG Findings and Recommendations**

The Draft OIG Findings and Recommendations, as stated in the Report Brief, stated:

" In its 2010 F&A cost proposal, UAB included \$19.1 million in chilled water costs that were not in accordance with Federal requirements that costs must be reduced by applicable credits. Specifically, UAB did not reduce chilled water costs included in the cost proposal by \$19.1 million in chilled water revenues that it received from various users.

UAB officials acknowledged that they did not reduce chilled water costs included in the cost proposal by the \$19.1 million in chilled water revenues. As a result, UABs F&A rate was inflated by 21Percent per year for FYs 2012 through 2015, and it potentially received \$12.4 million in overpayments from the Federal Government."

"We recommend that UAB work with the Department of Health and Human Services' Cost Allocation Services to determine the portion of the \$12.4 million that was unallowable under Federal requirements, refund the unallowable portion (including interest) to the Federal Government, and ensure that appropriate officials review future F&A cost proposals for compliance with Federal requirements prior to submitting the proposals to Cost Allocation Services."

### **UAB Comments on the OIG Findings and Recommendations**

UAB disagrees that \$19.1 million in chilled water revenues was included in the chilled water costs in the FY 2010 F&A proposal. UAB included a total of \$16,450,754 in chilled water costs in the O&M pool in the FY 2010 F&A proposal. UAB agrees that this amount is higher than the allowable cost of chilled water of \$12,816,486, which was computed by

reducing the total expenses for chilled water of \$16,902,840 per the FY 2010 expense reports by unallowable expenses of \$4,086,354. The allowable expenses include internal expenses for salaries and wages, etc. and external payments made to utility companies for utilities and related taxes that were consumed in producing the chilled water. Hence, the total amount of the overcharge for chilled water in the FY 2010 F&A proposal is the difference between the charged amount of \$16,450,754 and the allowable amount of \$12,816,486, which is \$3,634,268.

UAB ran the correct figure for allowable chilled water costs of \$12,816,486 through the FY 2010 F&A costing model to determine the impact of the change to the F&A rates for Organized Research, Instruction, and Other Sponsored Activities. The calculation determined that the F&A rates were overstated by the following percentages:

Organized Research – 0.4 percent

Instruction - 0.3 percent

Other Sponsored Activities – 0.2 percent

UAB applied these percentage factors to all Federal new awards and competing renewals, which received the full F&A rates (excluding off-campus awards, instructional awards limited to 8.0 percent, etc.) to arrive at the amount that was overcharged for each different rate for FYs 2012 through 2015. The attached Attachment A shows the amount of overcharges made to Federal awards by type of award and year. The total amount of overcharges is \$1,014,477. We have not computed any interest on this amount, as we are not aware of how this should be computed, if at all. Please cite the relevant Federal regulations that require that interest be applied to any refund regarding an OIG finding on over claimed F&A costs.

The University has taken steps to ensure that appropriate officials review future F&A cost proposals for compliance with Federal requirements prior to submitting the proposals to Cost Allocation Services.

**University of Alabama at Birmingham  
Computation of Overcharges for Chilled Water  
in the FY 2010 F&A Proposal**

**Attachment A**

Sponsored Research	FY 2012	FY 2013	FY 2014	FY 2015	Total
Negotiated Rate	46.5%	46.5%	47.0%	47.0%	
Base	10,786,988.41	54,932,918.34	79,920,130.19	103,331,284.75	248,971,321.69
Rate Impact %	0.4%	0.4%	0.4%	0.4%	0.4%
Rate Impact	43,147.95	219,731.67	319,680.52	413,325.14	995,885.29

Sponsored Instruction	FY 2012	FY 2013	FY 2014	FY 2015	Total
Negotiated Rate	43.5%	45.0%	45.0%	45.0%	
Base	30,139.69	64,499.16	63,448.35	68,063.41	226,150.61
Rate Impact %	0.3%	0.3%	0.3%	0.3%	0.3%
Rate Impact	90.42	193.50	190.35	204.19	678.45

Other Sponsored Activities	FY 2012	FY 2013	FY 2014	FY 2015	Total
Negotiated Rate	31.0%	36.0%	36.0%	36.0%	
Base	134,087.24	2,973,465.85	3,885,797.47	1,963,117.41	8,956,467.97
Rate Impact %	0.2%	0.2%	0.2%	0.2%	0.2%
Rate Impact	268.17	5,946.93	7,771.59	3,926.23	17,912.94

<b>Total Impact</b>	<b>43,506.55</b>	<b>225,872.10</b>	<b>327,642.46</b>	<b>417,455.56</b>	<b>1,014,476.67</b>
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