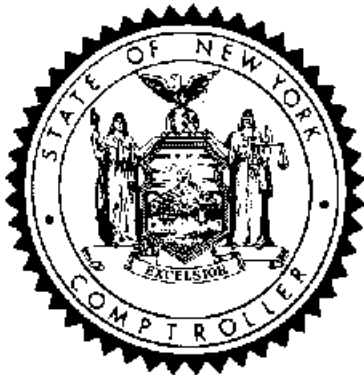


State of New York
Office of the State Comptroller
Division of Management Audit

DEPARTMENT OF HEALTH
HEALTH RESEARCH, INCORPORATED

REPORT 95-S-62



H. Carl McCall
Comptroller



State of New York Office of the State Comptroller

Division of Management Audit

Report 95-S-62

Barbara A. DeBuono, M.D., M.P.H.
Commissioner, Department of Health
President, Health Research, Inc.
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Empire State Plaza
Albany, New York 12237

Dear Dr. DeBuono:

The following is our audit report on certain financial activities related to the contract between Health Research, Incorporated and the Department of Health.

This audit was performed pursuant to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. Major contributors to this report are listed in Appendix A.

*Office of the State Comptroller
Division of Management Audit*

November 13, 1997

Executive Summary

Department Of Health Health Research, Incorporated

Scope of Audit

Health Research, Incorporated (HRI) was established in 1953 as a not-for-profit corporation, by administrative action of the Commissioner of the Department of Health (Commissioner), who is also President of HRI. Its primary purpose is to administer Federal, State and private financial funding to support, supplement and extend the research functions and programs of the Department of Health (Department). During the 1995-96 State fiscal year, HRI received about \$164.5 million from grants, contracts and donations, which are administered through the Externally Sponsored Program Fund. In addition, \$4.6 million was earned from technology transfer revenues, investment interest and contract fees, which are administered through the Internally Sponsored Program Fund. The Department, by contract, is responsible for the overall supervision and direction of HRI activities. The contract is generally renewed every two years. The most recently approved contract covers the period April 1, 1993 through March 31, 1995.

Our audit addressed the following question about State support for HRI for the period April 1, 1993 through March 31, 1996:

- Does the contract between HRI and the Department fairly represent and protect the State's interest?

Audit Observations and Conclusions

Our audit identified a number of provisions in the contract between HRI and the Department which we believe need to be addressed, before the contract is renewed. Some contract provisions do not benefit the State and permit the Department and HRI to engage in activities that are outside of standard governmental approval and oversight processes.

In administering research grants, HRI incurs direct and indirect costs. Direct costs include salaries for research scientists and technicians. Indirect costs include salaries for administrative and support personnel, as well as building and equipment costs. Indirect costs incurred by the Department and other State agencies that relate to providing services to HRI, such as building and overhead costs, are charged to HRI under a cost allocation plan.

The contract between the Department and HRI allows HRI initially to apply any indirect cost recoveries it receives through the Externally Sponsored Program Fund to satisfy its own overhead costs. Any remaining indirect cost recoveries are to be remitted to the State for reimbursement of the State's indirect costs. As a result of this contract provision, the State has not been fully reimbursed for its share of indirect costs. For the three State fiscal years ended March 31, 1996, this amounted to a \$9.06 million State subsidy of HRI. (See pp. 5-6)

For the most recently approved two-year contract period ended March 31, 1995, HRI's Internally Sponsored Program Fund had revenue of \$4.0 and \$4.1 million, respectively, and had a fund balance as of March 31, 1995 of \$4.2 million. HRI uses this Fund to sponsor Commissioner-approved projects without Legislative approval. Some of these monies could be used to repay the State its indirect costs. (See pp. 6-7)

We found that certain HRI employees perform primarily Department functions. The value of these services was estimated at \$24.68 million for the three State fiscal years ended March 31, 1996. Since the HRI employees who perform State functions are not on the State payroll, the control and oversight provisions provided in the State Constitution and statutes have effectively been avoided. (See p. 7)

We recommend that the contract between HRI and the Department be amended to provide that the State's indirect costs are fully reimbursed, and that projects funded by the Internally Sponsored Program Fund and State functions performed by HRI funded employees are subject to the standard budgetary approval and Legislative appropriation process. (See p. 9)

This contract is generally renewed every two years and is submitted for the Attorney General's and State Comptroller's approval. The most recently approved contract covers the period April 1, 1993 through March 31, 1995. When the contract for the period April 1, 1995 through March 31 1997 was submitted by the Department for approval, the State Comptroller's Bureau of Contracts identified several issues in the contract that needed to be addressed, and brought these issues to the Department's attention. Some of the issues are similar to those identified in this report. As of October 1997, the Department had not responded. (See pp. 1-2)

Comments of Department Officials

Department officials disagree with the recommendations in this report, indicating that a change in the relationship would inhibit HRI and the Department from aggressively seeking external funding, thereby reducing the amount of funding obtained.

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Introduction

Background

Health Research, Incorporated (HRI) was established in 1953 as a not-for-profit corporation, by administrative action of the Commissioner of the Department of Health (Commissioner), who is also President of HRI. Its primary purpose is to administer Federal, State and private financial funding to support, supplement and extend the research functions and programs of the Department of Health (Department). Gifts and donations made to HRI are tax-exempt. During the 1995-96 State fiscal year, HRI received about \$164.5 million from grants, contracts and donations, which are administered through the Externally Sponsored Program Fund. In addition, \$4.6 million was earned from technology transfer revenues, investment interest income and contract fees, which are administered through the Internally Sponsored Program Fund. HRI employs over 1,400 administrative and technical support staff.

Most of HRI's major research projects are carried out in State facilities, using State scientists and available administrative and laboratory resources. HRI employees often work side-by-side with Department employees and generally share similar job responsibilities. HRI maintains its executive office in Rensselaer and operates two divisions in Albany and Buffalo. The Albany Division includes work done in cooperation with the Wadsworth Center for Laboratories and Research, which is the Department's public health laboratory. The Buffalo Division includes work done in cooperation with Roswell Park Memorial Institute, primarily a cancer research hospital directly operated by the Department.

The Department biennially contracts with HRI. The major provisions of the contract are:

- the Department is responsible for the overall supervision and direction of HRI activities;
- HRI pays the State monthly for a portion of the State's indirect costs (personal service, facilities and support services); and
- the State authorizes HRI to serve as the technology transfer and copyright administrator for the Department.

This contract is generally renewed every two years and is submitted for the Attorney General's and State Comptroller's approval. The most recently approved contract covers the period April 1, 1993 through March 31, 1995. When the contract for the period April 1, 1995 through March 31 1997 was submitted by the Department for approval, the State Comptroller's Bureau of Contracts identified several issues in the contract that needed to be addressed, and brought these issues to the Department's attention. Some of the issues are

similar to those identified in this report. As of October 1997, the Department had not responded.

Audit Scope, Objective and Methodology

We audited certain HRI financial activities for the period April 1, 1993 through March 31, 1996. The primary objective of our audit was to determine whether the contract between HRI and the Department fairly represented and protected the State's interests. To accomplish our objective we surveyed current operations, reviewed State laws, rules and regulations, examined HRI policies and procedures, reviewed Department and HRI cost allocation plans, as well as State and other HRI financial and management related records, and interviewed HRI officials.

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 operations of HRI which are included within the 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 which are 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 that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach to select activities for audit. We therefore focus 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 finite audit resources to identify where and how improvements can be made. We devote little audit effort 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.

**Response of
Department
Officials to Audit**

A draft copy of this report was provided to Department and HRI officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the 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.

Contract Changes

Our audit identified a number of provisions in the contract between HRI and the Department which we believe should be changed, before the contract is renewed. Some contract provisions do not benefit the State and permit the Department and HRI to engage in activities that are outside of standard governmental approval and oversight processes. The need for such changes is further indicated because of the relationship between HRI and the Department, which may not be “arms-length.” The Commissioner of the Department of Health is also the President of HRI. While this has been the situation for many years, beginning in 1995, the Commissioner began receiving an annual salary directly from HRI. Previously, the position of President of HRI was unsalaried.

State Operating Subsidy to HRI

In administering research grants, HRI incurs direct and indirect costs. Direct costs include salaries for research scientists and technicians. Indirect costs include salaries for administrative and support personnel, as well as building and equipment costs. Indirect costs incurred by the Department and other State agencies that relate to providing services to HRI, such as building and overhead costs, are charged to HRI under a cost allocation plan. HRI uses this cost allocation information and its own indirect cost charges to develop an indirect cost rate which can be charged to the grants it receives. For grants received from the Federal government, HRI negotiates an indirect cost recovery rate with the United States Department of Health and Human Services. For the 1995-96 State fiscal year, Federal grants represented approximately 84.5 percent of HRI's externally funded program revenues. Some other funding sources, however, do not reimburse fully for indirect costs.

The contract between the Department and HRI allows HRI initially to apply any indirect cost recoveries to recover its own overhead costs. Any remaining indirect cost recoveries are to be remitted to the State for reimbursement of its indirect costs. As a result of this process, and the fact that not all indirect costs are recovered, the State is not fully reimbursed for its share of indirect costs. For the three State fiscal years ended March 31, 1996, this amounted to a State subsidy of HRI of about \$9.06 million. HRI, however, does have sources of revenue, such as interest income earned on the grant funds awarded to HRI on behalf of the State, which could be used to repay the State its indirect costs. However, HRI uses these monies as only HRI and the Department determine. HRI does deploy and assign its staff to State functions and considers the value of these services as a means of repaying the State for some of the State's overhead expenses. These practices, however, are done without Legislative oversight or approval. In our judgment, the contract between HRI and the Department should be amended to require HRI to use all

sources of revenue, including Internally Sponsored Program Fund revenues, to reimburse the State for its indirect costs.

Use of HRI Earnings on the Internally Sponsored Program Fund

For the two-year contract period ended March 31, 1995, HRI's Internally Sponsored Program Fund (Fund) had revenue of \$4.0 and \$4.1 million, respectively, and a fund balance as of March 31, 1995 of \$4.2 million. Fund revenues result from contract fees, technology transfers and investment income. As discussed above, HRI does not utilize these revenues to repay the State for the value of unreimbursed State provided services.

This Fund is used to sponsor Commissioner-approved projects without Legislative approval. It has been a long-standing practice for HRI to separately account for these funds and for HRI and the Department to determine how these funds are expended. Our prior audit report (89-S-34, issued November 15, 1989) stated that HRI had no formal system to: solicit project proposals; review project proposals for need and potential effectiveness; determine necessary funding levels; and, ensure such projects were research related. In addition, we found and reported that some projects' needs were not fully documented, and the projects appeared to have been beyond HRI's stated purpose. In our follow-up review (93-F-4, issued September 2, 1992), HRI officials continued to disagree with our prior audit conclusion that some Fund projects were outside the scope of HRI's purpose. We also noted that HRI continued to fund some of the previously cited projects.

The contract between the Department and HRI states that its purposes are essentially to support, supplement or extend the research functions of the Department. During this audit, we reviewed 5 of the 12 Fund projects for HRI's Albany Division for the State fiscal year ended March 31, 1995. These projects represented 63 percent (\$536,000 of \$845,000) of the Fund's Albany Division expenditures. For example, the Task Force on Life and Law, with a budget of \$155,621, provides legal, medical and ethical guidance in the development of policies and regulations addressing moral issues confronting medical practice. HRI has been supporting this project since 1986. Because of State cutbacks in 1995-96, HRI was asked to support three laid off State employees through this project. We question whether the use of the Internally Sponsored Program Fund for these projects is consistent with the stated purpose of HRI; i.e., the research functions of the Department. In addition, we found HRI continues to lack formal procedures for evaluating and approving Fund projects. HRI officials stated that Fund revenues are used to support the Department's mission of promoting public health issues.

Department and HRI officials stated that Section 2 (13a) of the State Finance Law allows for projects that are not research related. We note that this section of the law does not provide HRI with the Legislative authority to fund such projects.

HRI Employees Performing State Services

Certain HRI employees perform primarily Department functions. For example, HRI employees work as supervisors and staff at the Department's Wadsworth Laboratories. In addition, HRI funds certain building and maintenance functions for the Department. The value of these services was estimated at \$24.68 million for the three State fiscal years ended March 31, 1996. This long-standing practice has allowed the Department to engage in activities without Legislative approval and oversight. Since the HRI employees who perform State functions are not on the State payroll, the controls and oversight provisions provided in the State Constitution and statutes have effectively been avoided.

We believe these payroll costs and all other facility and support services provided by HRI should be subject to the standard budgetary approval and Legislative appropriation processes. The funds currently used by HRI to pay these employees and services could be remitted to the State and used to reimburse these employees' salaries and the cost of other services, assuming the Executive and Legislative branches agree that these functions need to be continued. Under this scenario, there would be no increase in costs to the State.

Annual Summary Financial Plan

The HRI contract states, "Pursuant to the State Finance Law, HRI shall submit to the State... an annual summary financial plan which shall set forth estimates of all revenues and all expenses for the current and succeeding fiscal year, along with actual results from the prior fiscal year." The contract does not require nor does HRI consider or report the State's actual indirect costs. We believe these costs, which represented about 10 percent of HRI's total expenditures for the 1995-96 State fiscal year, are material and a fundamental part of HRI's operations. They should be reported in the annual summary financial plan and the financial statements. At present, the value and costs of State provided services are not disclosed in HRI's financial statements. The cost and revenue estimates for the annual summary financial plan should also provide for an allowance of sufficient Fund revenues to repay the State's indirect costs which are incurred on behalf of HRI.

In its response, the Department asserts that our recommended changes to the contract will fundamentally change the relationship between the Department and HRI, putting at risk millions of dollars of funds flowing into the State. According to the Department the changes proposed by this audit would inhibit the Department and HRI from aggressively seeking external funding and would lead directly to a reduction in the amount of funding obtained. Specifically, the Department believes our recommendations, if implemented, would force HRI to reject any funding that does not fully reimburse for indirect costs, would not allow HRI to retain its discretionary funds, and would preclude HRI from providing support services to Department programs.

The Department's response does not provide specific facts to support its statements as to how the State would be unable to obtain grants or how our recommendations would inhibit the Department and HRI from aggressively pursuing grant dollars. Our report makes recommendations regarding controls and oversight over monies received and administered by HRI on behalf of the State. Our report does not suggest that HRI reject any funding that does not reimburse fully for indirect costs nor give up its discretionary funds.

The Department's response also indicates that HRI would not be able to provide support services to Department programs because all HRI indirect cost recoveries, not utilized directly for HRI administrative activities, would need to be cycled through the long lead times inherent in the State budget and appropriation process. We cannot accept the Department's argument that it cannot obtain needed support services because the budgetary approval process and Legislative appropriation process are too lengthy. We believe the Department and HRI could effectively plan a process that would address the State's annual budget process.

The Department's response further indicates that this audit did not include the other State-affiliated corporations in the recommendations. This report reflects our audit of HRI. It would not be appropriate to make recommendations in this report regarding other affiliated corporations.

Recommendations

1. Amend the Department and HRI contract to provide that:
 - before funding any Internally Sponsored Program Fund projects and using all revenue sources, all State and HRI indirect costs are fully reimbursed;
 - projects funded by Internally Sponsored Program Fund revenues be subject to standard budgetary approval and Legislative appropriation processes; and
 - State functions performed by HRI funded employees, as well as all other support services paid and provided by HRI, be subject to standard budgetary approval and Legislative appropriation processes.

(The Department disagrees with the first part of this recommendation claiming that its implementation would require HRI to reject funding from sources that do not provide for full reimbursement of indirect costs. This is not the case. HRI has a large pool of discretionary funds which could reimburse the State its costs and not impact the ability of HRI to seek grants.

Department officials indicate that all of HRI's discretionary income would need to be used to pay the State its unrecovered indirect costs. Since HRI uses its discretionary income primarily as seed money to attract additional grant funds, this would then result in a reduction in grant funding. They indicate that earnings in the 1996 fiscal year, exclusive of technology transfer, totaled \$2 million. However, HRI's financial statements for the 1996 fiscal year show total revenue for contract fees, technology transfers and investment income of over \$4.6 million. The State is entitled to be fully reimbursed for its indirect costs.

Recommendations (continued)

The Department disagrees with the second part of this recommendation, stating HRI is not a State agency and that applying the State appropriation process and executive budget process to a non-state corporation is not consistent with the law.

We recognize that HRI is not a State agency; however, it administers State funds. The controls and procedures that we are recommending are those which are typically used to provide oversight and controls over State funds. Only the State Legislature has the constitutional authority to determine how the State's taxpayers money will be spent.

The Department also disagrees with the third part of this recommendation regarding use of the budgetary and legislative process. Department officials indicate that implementation of this oversight would inhibit the Department from aggressively seeking new grant funds because budgetary reductions in State funding would not permit the Department to hire additional support staff and that the budget cycle is too slow to adequately react to new funding opportunities.

We cannot accept the Department's argument that the budget cycle is too slow and that they should continue to be exempt from this oversight. We believe the Department and HRI could effectively plan a process that would address the State's annual budget process.

The Department has also indicated that we have inaccurately characterized support services funded by HRI as purely "State" services. The Department's statement is incorrect. Our report states that certain HRI employees perform primarily Department functions and we have included some examples in the text of our report.)

Recommendations (continued)

2. To provide for full disclosure and as part of HRI's annual summary financial plan, report the current costs of State provided services and estimated revenue reserves needed to reimburse the State's costs incurred on behalf of HRI for each succeeding fiscal year. Current costs should also be disclosed in HRI's financial statements.

(The Department disagrees with our recommendation to disclose the current costs of State provided services and estimated revenue reserves needed to reimburse the State's costs. This recommendation relates simply to disclosing information. We do not understand the reluctance of the Department to do this.)

Major Contributors to This Report

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September 10, 1997

Kevin McClune
Audit Director
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Division of Management Audit and
Financial Reporting
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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 95-S-62 entitled, "Health Research, Incorporated".

Thank you for the opportunity to comment.

Very truly yours,

A handwritten signature in cursive script that reads "Barbara DeBuono".

Barbara A. DeBuono, M.D., M.P.H.
Commissioner of Health



100% RECYCLED PAPER, 50% POST CONSUMER WASTE

Department of Health
Comments on the
Office of the State Comptroller's
Draft Audit Report 95-S-62 Entitled
"Health Research, Incorporated"

For 44 years the New York State Department of Health (DOH) has successfully worked with Health Research, Inc. (HRI) in attracting external funding from grants and contracts. It has long been recognized that cumbersome state processes inhibit the ability of State agencies to compete for such funding. For that reason, those State agencies that attract major amounts of competitive grant funding (the State University, Office of Mental Health, Office of Mental Retardation, Department of Health) all utilize the services of affiliated, nonprofit corporations. These corporations offer the flexibility required to obtain and administer grants and contracts.

In achieving its stated purpose of attracting outside funding, the DOH-HRI affiliation has been remarkably successful. Through the fiscal year ended March 31, 1997, HRI had administered almost **\$1.5 billion** in external funding, with \$690 million of the total obtained in the last 5 years.

After 44 years of successful operation, the auditors are proposing to fundamentally change the relationship between DOH and HRI, in effect putting at risk millions of dollars flowing into the state and the valuable projects funded by those dollars. The changes proposed by the auditors, if implemented, would inhibit DOH and HRI from aggressively seeking external funding, and would lead directly to a reduction in the amount of funding obtained. Specifically:

- ✓ HRI would be forced to reject any funding that does not reimburse fully for indirect costs. In FY96, HRI administered \$26 million in such funding from organizations such as the American Cancer Society, and the Robert Wood Johnson Foundation. The benefits of these dollars, both programmatic and economic, would be lost because these highly reputed sponsors do not, by policy, provide full reimbursement for some indirect costs allocated by the State to these grants. The State's indirect costs are largely fixed in nature, (i.e. buildings, administration, etc.) and will be incurred regardless of whether grants are accepted or not. While HRI could eliminate all unreimbursed State indirect costs by refusing to accept such grant funding, the State would gain nothing, and the only winners would be competitor states that would obtain the funding.
- ✓ HRI would not be allowed to retain its discretionary funds (from interest earnings and technology transfer) to provide seed money for projects that attract additional grant funding. For example, in the past 3 years, HRI's Albany Division has provided \$240,000 in support to new investigators. *Recipients of that support now hold over \$4 million in grant awards,*

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and have filed another \$17.5 million in grant applications. In the past 5 years, HRI's Roswell Park Division has provided \$2.5 million in support for new investigators. *Recipients of that support hold over \$10 million in grant awards and have filed another \$3 million in grant applications.* These are just 2 examples of the ways in which HRI utilizes its discretionary funding to generate additional grant funding flowing into the state.

- ✓ HRI would not be able to provide support services to department programs with a high volume of HRI grants. Under the auditors' proposal, all HRI indirect cost recoveries not utilized directly for HRI administrative activities would be cycled through the state budget and appropriation process. The long lead times built into this process would not allow DOH to obtain needed support services in a timely manner, thus building in a disincentive for DOH to seek additional grant funding.

The DOH disagrees with all of the recommendations contained in this audit report. The department's existing relationship with HRI has proven to be of great benefit to the State. The auditors fail to provide a compelling reason to change this relationship, nor do they assure that such change will not result in less grant funding flowing into New York State.

Further, the auditors are proposing that these changes apply only to HRI, and not to the other State affiliated corporations. The failure of the auditors to include the other affiliated corporations in their recommendations is particularly noteworthy since, in audit report 93-D-4, the State Comptroller's Office found that:

- ✓ HRI returned more in indirect cost recoveries to the State than the other corporations;
- ✓ HRI's administrative costs were the lowest of all the corporations;
- ✓ HRI had no questionable expenses.

RECOMMENDATIONS AND RESPONSES:

1. **Amend the department and HRI contract to provide that:**

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"Health Research, Incorporated"

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- ✓ before funding any Internally Sponsored Program Fund projects and using all revenue sources, all State and HRI indirect costs are fully reimbursed.

RESPONSE: We disagree. Projects in which HRI is involved are joint projects with the DOH. When the department asks HRI to seek funding for a specific project, and the sponsor that HRI identifies will not reimburse for full indirect costs, the department must decide whether or not to continue to seek the grant. It is well within the authority of the department to determine whether or not the programmatic benefits of obtaining the grant outweigh the fact that all indirect costs will not be reimbursed.

HRI judiciously uses its discretionary funding (generated from interest earnings on funds that HRI administers) to provide seed grants so that additional outside grant funds can be generated, support promising new scientists until they can obtain grant funding, fund the program that transfers DOH generated technology, and provide for a Corporate reserve to meet unforeseen needs, among other things.

Consequently, implementation of this proposal would require HRI to eliminate all unreimbursed indirect costs by refusing to seek funding from sources that do not provide for such full reimbursement. In the year ended March 31, 1996, that would have meant foregoing \$26 million in outside funding, primarily from private foundations (total funding received by HRI for the year was \$167.4 million).

Would the State's interests be best served by not accepting \$26 million in outside funding? This is funding that would most probably be diverted away from New York and toward other states if not attracted by HRI. Moreover, this \$26 million includes \$3.4 million in indirect cost recoveries, while the fully allocated indirect costs total \$6.2 million. Would the state's expenditures actually be \$6.2 million (or even \$3.4 million) less if HRI did not accept these grants? Since the State's indirect costs are largely fixed costs, it is unlikely that state expenditures would decrease at all. Consequently, by failing to accept these grants, indirect revenues of \$3.4 million would be lost. More importantly, the state would lose the economic and program benefits of \$26 million in outside funding.

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"Health Research, Incorporated"

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If the auditors' proposal were implemented, all of HRI's discretionary income would be used to pay the state for unrecovered indirect costs (earnings in FY96, exclusive of technology transfer, totaled \$2 million). Since HRI uses its discretionary funding primarily to promote the attraction of additional external funding (i.e. seed funding, bridge funding), the loss of HRI's modest amount of discretionary funds would most likely also result in a reduction in grant funding that does reimburse for full indirect costs.

- ✓ **projects funded by Internally Sponsored Program Fund revenues be subject to standard budgetary approval and Legislative appropriation processes.**

RESPONSE: We disagree. HRI is not a state agency. The auditors are recommending that the state appropriations and executive budget process be applied to a non-state corporation. This recommendation is not consistent with state law.

- ✓ **State functions performed by HRI funded employees, as well as all other support services paid and provided by HRI, be subject to the standard budgetary approval and Legislative appropriation processes.**

RESPONSE: We disagree. In the fiscal year ended March 31, 1997, HRI administered \$165.2 million in grants and contracts, and ended the year with 1,300 full-time equivalent (FTE) staff. The DOH could not possibly absorb funding of this magnitude without additional support services. Implementation of the auditors' recommendation would inhibit the department from aggressively seeking new grant funds because budgetary reductions in State funding would not permit the department to hire additional support staff.

Under the current arrangement, the department is free to pursue additional funding, because HRI can utilize the indirect cost revenue from the grant to provide any support services (such as central services, laboratory renovations, etc.) that may be required. The state budget cycle is simply too slow to react adequately to new funding opportunities. HRI, additionally, has the flexibility to reduce, or redirect, support services immediately in response to reduced needs.

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"Health Research, Incorporated"

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The auditors have characterized support services funded by HRI as purely "State" services. This is inaccurate. All positions and other expenses funded by HRI are related to HRI grant activities. HRI provides support services to those areas of the department where HRI grant activity is the greatest. When HRI assists in supporting the Department Library, for example, that resource serves both DOH and HRI interests. At Roswell Park Cancer Institute, since HRI activities constitute almost 20% of the total Institute, HRI utilizes indirect cost recoveries to provide services in almost every support area.

- 2. To provide for full disclosure and as part of HRI's annual summary and financial plan, report the current costs of State provided services and estimated revenue reserves needed to reimburse the State's costs incurred on behalf of HRI for each succeeding fiscal year. Current costs should also be disclosed in HRI's financial statements.**

RESPONSE: We disagree. As noted previously, if HRI were required to reimburse the State for costs not reimbursed by grant sponsors, HRI would be forced to refuse to accept grants that do not provide full reimbursement.

Further, the State does not incur costs on behalf of HRI. HRI serves DOH, DOH does not serve HRI. HRI seeks only grants which DOH is interested in obtaining. When DOH determines that a specific project is worth devoting resources to, it acts to provide those State resources. Similarly, if DOH determines that HRI should seek a grant, HRI does so; if DOH determines otherwise, HRI does not seek the grant.