

Lessons Learned from Federal Audits at Other Schools

OSP Brown Bag Lunch
September 22, 2006
Vicki Escalera, University Auditor

Overview

- Ancient audit history at Stanford University
 - Indirect costs
 - Allowable expenses
- Recent audit history at Yale, UPenn, & UChicago
 - Labor costs and effort reporting
 - Cost transfers
 - Direct (non-labor) costs
 - Sub-recipient monitoring
- Lessons for the future

Stanford University – circa 1990

- DCAA indirect cost audit & False Claims suit
- Unallowable costs, including yacht & antique commode on equipment inventory
- Related depreciation in the indirect cost rate
- Stanford's President questioned before Congress
- Federal and advisory audits continued for years
- Overhaul of administration and entire control system
- Impact at Brown – new subcodes and policies

Yale University

- HHS Office of Inspector General's review in 2005
- NIH grant of \$5.5 million to UMass Medical School
- UMass subaward of \$1.7 million to Yale
- \$508K in Yale's claimed costs, 2/1/01-8/31/02
- Result of review: \$193,779 (38%) disallowed
- PI's failure to provide proposed level of effort → "less than adequate assurance goals of project were met"
- Report posted Feb 2006 on <http://oig.hhs.gov>

OLG's review objectives & scope

- Determine if Yale claimed allowable costs under
 - Terms and conditions of the grant
 - Cost principles contained in OMB Circular A-21
- Reviewed payroll charges
- Reconciled to PAFs & semi-annual effort reports
- Reviewed purchasing & recharge center procedures
- Tested direct charges (materials, supplies, equipment, and travel) against source documents
- Referred to applicable Yale policies

Yale's Disallowances

- \$151,252 in unallowable cost transfers
 - labor costs
 - related fringe benefits
 - related indirect costs
- \$32,993 in non-labor costs
- \$9,534 for unconfirmed effort reports
- Non-compliance with OMB Circular A-21 and Code of Federal Regulations (CFR)
- UMass as prime awardee required to repay HHS

Comments by the OIG about Yale

Regarding cost transfers:

“Transfers were neither properly authorized nor adequately supported by a specific, clear and detailed explanation with related documentation as required.”

OIG comments about Yale (cont'd)

Regarding equipment maintenance costs:

“The University did not provide sufficient information to show that the charges to this subgrant were equitable.”

OIG comments about Yale (cont'd)

Regarding Yale's procedures:

“Although the University had established procedures for charging nonlabor goods and services and confirming effort reports, we found that these procedures were inadequate or were not always followed.”

Other findings at Yale

- Documentation to support the salary cost transfers for 2 researchers was altered
- Unaltered version stated transfers were needed to spend down the subgrant funds
- OIG comment: **“This alteration calls into question the accuracy of the information that the University supplied to us.”**

Fall-out at Yale

- Yale conducted its own investigation.
- HHS, DoD, and NSF subpoenaed documents on 47 of Yale's grants in June.
- FBI and DoJ are also involved.
- Yale President wrote on 6/30 to faculty and staff: "I urge everyone in the strongest possible terms to provide complete and truthful replies to questions about these matters."
- New senior research administrators recruited
- Adding 4-6 internal auditors (35-50% increase)

Regulations OIG cited in Yale report

NIH Grants Policy Statement (03/01), part H:

“The transfers must be supported by documentation that fully explains how the error occurred and a certification of the correctness of the new charge by a responsible organizational official of the grantee, consortium participant, or contractor. An explanation merely stating that the transfer was made ‘to correct error’ or ‘to transfer to correct project’ is not sufficient. **Transfers of costs from one budget period to the next solely to cover cost overruns are not allowable.**”

Cited regulations (continued)

OMB Circular A-21, section C.4.b:

“Any **costs** allocable to a particular sponsored agreement ... **may not be shifted to other sponsored agreements in order to meet deficiencies caused by overruns** or other fund considerations, to avoid restrictions imposed by law or by terms of the sponsored agreement, **or for other reasons of convenience.**”

OLG cited Yale's own policy & procedure ...

- Prohibiting use of a sponsored project as a holding account
- Requiring cost transfers to be approved in the system before they can be posted
- Requiring approvers to authorize a cost transfer only when satisfied it's proper and its explanation is "specific, clear, and detailed"
- Requiring similar approval procedures for non-labor journal entries as for cost transfers

Other cited regulations

OMB Circular A-21, section D.1 and D.2:

“Direct costs are those costs that can be identified specifically with a particular sponsored project ... or that can be directly assigned to such activities relatively easily with a high degree of accuracy.... The **cost of materials** supplied from stock or services rendered by specialized facilities or other institutional service operations **may be included as direct costs** of sponsored agreements, **provided such items are charged under a recognized method of computing actual costs and conform to generally accepted cost accounting practices consistently followed by the institution.**”

Other cited regulations

OMB Circular A-21, section C.4.a:

“A cost is allocable to a particular cost objective (i.e., a specific **sponsored agreement**) if the goods or services involved are chargeable or assignable to such cost objective **in accordance with relative benefits received or other equitable relationship.”**

Other cited regulations

Title 43 CFR, part 74, subpart C, section 74.25(b) & (c):

“**Recipients are required to** report deviations from budgets and program plans and request prior approvals for budget and program plan revisions ... (and) ... for nonconstruction awards, recipients shall **obtain prior approval from the HHS** awarding agency ... **for a 25 percent reduction in time devoted to the project by the** approved project director or **principal investigator.**”

Other cited regulations

OMB Circular A-21, section J.10.c(2):

“Under this system the distribution of **salaries and wages** by the institution **will be supported by** activity reports.... These reports will reflect an **after the fact reporting of the percentage distribution of activity of employees.**”

University of Pennsylvania

- NSF Office of Inspector General's audit in 2005
- Audit of Penn's effort reporting system
- Report dated June 8, 2006 says audit is "first in the series of our planned audits regarding labor costs"
- Audit objectives
 - Evaluate adequacy of Penn's internal controls for ensuring salary and wages are allowable
 - Determine the amount of unallowable salary and wages charged to NSF awards in FY 2002 - 2004

Findings of NSF audit at Penn

- Business managers approved 23 effort reports w/o after-the-fact confirmation (48% of costs sampled)
- 24 effort reports weren't approved timely, within 45 days per Penn policy (29% of costs sampled)
- “Systematic control weakness”
- \$27,121 overcharged (6.7% of \$404,781 in sample)

Findings at Penn (continued)

- Business managers had insufficient suitable means of verification:
 - Improper reliance on monthly financial reports
 - Incomplete information on projects hourly employees worked on
 - Lack of any documentation to support labor effort allocations

OIG's comments on Penn

“We are 95% confident UPENN could not demonstrate that at least \$9.2 million, or 37 percent of the \$24.9 million of labor costs charged to NSF in fiscal years 2002 through 2004, actually benefited NSF awards as opposed to other Federal or university activities. Further, the systematic nature of this control weakness raises concerns about the reasonableness and allowability of the labor effort charges on UPENN's other \$525 million of Federal awards.”

Other findings at Penn

- Lack of procedures to help business managers understand types of documents necessary to support effort reports
- Dept Chairs weren't held accountable for ensuring effort reports completed in 45 days
- Penn didn't conduct independent evaluation of its payroll distribution system as required by OMB Circular A-21

OLG's recommendations to 2 NSF divisions' directors

- Work with UPenn to ensure that effective review & approval process for charging labor costs to NSF awards is established; requiring:
 - Internal evaluation of payroll distribution system
 - Written after-the-fact verification of work from PIs
 - Policy statement that business managers must require this before approving effort reports
 - Hourly employees' timesheets to itemize projects worked on
 - Electronic effort certification system's implementation asap
 - Dept Chair accountability for 45-day report completion
- Recover questioned costs totaling \$27,121

Response from Penn

- “Didn’t disagree” with findings of errors
- Asserted new procedures and corrective actions already taken met intent of OIG recommendations on the 3 major control issues of report:
 - Timeliness and reliability of effort reports
 - Suitable means of verification
 - Independent evaluation of payroll distribution system
- OIG reaffirmed each of its recommendations. “NSF should work with the cognizant audit agency and/or UPENN to ensure UPENN develops an acceptable action plan to resolve each audit recommendation.”

University of Chicago

- HHS (Region V) OIG's audit of FY2005 cost transfers to NIH grants
- Report dated June 16, 2006, available at <http://oig.hhs.gov>
- “Probe”-sampled 30 of 8,661 transfers >\$100
- One transfer lacked documentation to explain how error occurred
- 4 late transfers without required University approval form

OLG's Recommendation to Chicago

Reemphasize cost transfer policies and procedures with the Comptroller's and departmental staff.

UChicago's audit response

- Committed to meeting compliance requirements
- Will enhance long-offered training programs for sponsored programs throughout Univ. using web-based training technology
- Will reemphasize existing policies & procedures on direct cost allocations and cost transfers
- “We appreciate and extend our gratitude to the OIG for the professionalism exhibited by the auditors during the conduct of this audit.”

Other schools' settlements

Harvard, Northwestern, Cornell, JHU, UAB, and Mayo Clinic have paid a total of more than \$24 million in the last 3 years “to settle allegations that it overstated how much time and effort its scientists had devoted to certain federal grants.”

-- “U.S. Rules on Accounting for Grants Amount to More Than a Hill of Beans,” *Science*, Vol. 311, 13 Jan 2006, p. 168

Lessons #1, 2, and 3

Document, document, document

- Expenditures' grant-related purpose
- Cost relatedness among grants
- Cost allocation basis & methodology
- Cost transfers' rationale
- Direct-knowledge basis for effort certification
- Signature authorities on the grant

Lessons #4, 5, and 6

To avoid cost transfers,

- Use advance accounts for pending awards
- Understand grant terms and determine expenditure's allowability before processing
- Direct-charge expenses to grants whenever possible

Lesson #7

Involve the PI in financial matters

- Transaction approval
- Effort certification report sign-off
- Monthly accounting reports' review
- Monthly labor distribution reports' review
- Subcontractor invoices' review

Lesson #8

“Audits are like a box of chocolates...”

- ‘Luck of the draw’ has relevance in:
 - audit site selection
 - sampling
 - assigned audit personnel
- Range of outcomes:
 - isolated exceptions & limited return of money
 - expanded scope & additional findings
 - extrapolation, \$\$ penalties, job loss, damaged reputations (institutional and personal)

Lesson #9

Accountability

- Federal grants provide taxpayers' money to universities
- Universities are publicly accountable for how they spend it
- Tax-exempt status → public accountability for mission-relevant expenditures
- Federal reports are posted for all to see

Lesson #10

Cooperate and maintain integrity

- Adhere to policies in Sponsored Projects Handbook
 - Ensure cost transfers occur within 90 days
 - Provide detailed explanations and justification for cost transfers
 - Provide back-up documentation (e.g., copy of original request for check) for audit trail to original charge
- Help comply with regulations by cooperating with RA & OSP in their efforts to protect us from negative consequences of non-compliance

Lesson #10 (continued)

- “All employees must cooperate fully with any audit, inquiry or investigation undertaken at Brown’s direction ...
- “In addition, employees should not:
 - **Destroy or alter any documents in anticipation of a request for those documents from any government agency or a court**
 - **Lie or make any misleading statements to any government investigator or University representative.”**
- “Employees’ responsibilities in an audit or investigation are limited to responding to auditors honestly and supplying requested information and documents without fabrication.”

(from Brown’s new Employee Responsibilities & Rights handbook)