



AUDIT AND ADVISORY SERVICES

Sponsored Project Program Income Audit Project No. 12-594

July 9, 2012

Prepared by:

Jennifer E. Jones
Auditor-in-Charge

Reviewed by:

Approved by:

Jaime Jue
Associate Director

Wanda Lynn Riley
Chief Audit Executive

UNIVERSITY OF CALIFORNIA, BERKELEY

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SANTA BARBARA • SANTA CRUZ

AUDIT AND ADVISORY SERVICES
Tel: (510) 642-8292

611 UNIVERSITY HALL #1170
BERKELEY, CALIFORNIA 94720-1170

July 9, 2012

John Wilton
Vice Chancellor
Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Sponsored Project Program Income per our annual audit plan in accordance with the Institute of Internal Auditors, Inc. *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Attached is our audit report, including observations and management action plans. Thank you to Extramural Funds Accounting and other departmental staff for their cooperative efforts throughout our audit process.

Please destroy all copies of draft reports and related documents. Also, please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Chief Audit Executive

cc: Assistant Vice Chancellor and Controller Delphine Regalia
Senior Vice President Sheryl Vacca
Associate Chancellor Linda Morris Williams

**University of California, Berkeley
Audit and Advisory Services
Sponsored Project Program Income**

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OVERVIEW

Executive Summary

Sponsored project program income is earned as a result of activities that are fully or partially supported through sponsored project funds. Examples of potential sources of program income include: participant registration fees from conferences or symposia, income from the sale of items created with project funds, and fees for services such as laboratory tests. As is set forth in 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* (OMB Circular A-110), there are certain requirements that recipients must adhere to with respect to the use of program income.

The amount of sponsored project program income generated across campus departments cannot be quantified because it is not currently tracked at the central campus level. According to discussions with personnel from Extramural Funds Accounting (EFA) and the departments included in our audit, it is believed that program income is not significant. Since March 2012, the campus' Sponsored Projects Office (SPO) now identifies and records whether program income is anticipated on new awards, which will enable the future tracking of potential program income.

The overall objective of our audit was to assess campus-wide controls to ensure that: (i) program income is identified as such and is recorded against the related sponsored project; (ii) program income is treated according to the method required by sponsor/award terms; and (iii) program income is reported per sponsor/award requirements.

Our audit approach included reviews of documentation, including: (i) OMB Circular A-110; (ii) relevant University, campus, and sponsor policies; and (iii) examples of relevant policy/procedural documentation from a sample of peer institutions. We also interviewed personnel from central campus and department units, including: EFA, SPO, the Engineering Research Support Organization, Research Enterprise Services, the School of Public Health, Biological Sciences Divisional Services, Cal Performances, and the Lawrence Hall of Science.

We identified that procedures and controls are not sufficient to ensure campus awareness of and compliance with University and sponsor requirements related to program income. Specifically:

- Guidance and procedures to ensure that program income is treated and reported in accordance with sponsor requirements have not been communicated to the campus. Based on our discussions with various departments with significant sponsored project funding, it appears that the campus could benefit from such guidance, as we identified that at least some departments do not have a clear understanding regarding what constitutes program income and, therefore, may not be accurately accounting for and reporting it.
- In addition, the campus does not currently have standard procedures in place for accounting for program income (versus other types of revenues) in the general ledger. Absent standard procedures, there is a risk that department methods may not be adequate to ensure the complete and accurate recording of related revenues and expenses. In addition, manual methods for program income accounting that are outside of the general

ledger limit department and central campus visibility into program income, hindering potential monitoring activities.

Source and Purpose of the Audit

Audit and Advisory Services (A&AS) completed our audit of sponsored project program income as part of our annual audit plan for FY 2012. The overall objective of our audit was to assess campus-wide controls to ensure that: (i) program income is identified as such and is recorded against the related sponsored project; (ii) program income is treated according the method required by sponsor/award terms; and (iii) program income is reported per sponsor/award requirements.

Scope of the Audit

Our audit was focused on procedures and controls at the central campus and department level to ensure the appropriate treatment of program income under 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* (OMB Circular A-110), and University, campus, and federal sponsor policies. Process areas in the scope of our review were campus procedures to identify and associate program income to the sponsored project and procedures to ensure its proper use, accounting, and reporting.

Our audit approach included reviews of documentation, including: (i) OMB Circular A-110; (ii) relevant University, campus, and federal sponsor policies; and (iii) examples of relevant policy/procedural documentation from a sample of peer institutions. We also interviewed personnel from central campus and selected department research support units, including: Extramural Funds Accounting (EFA), the Sponsored Projects Office (SPO), the Engineering Research Support Organization, Research Enterprise Services, the School of Public Health, Biological Sciences Divisional Services, Cal Performances, and the Lawrence Hall of Science. Research support units were selected based on the significance of their sponsored project activity and revenues. As described below, program income is not currently tracked at the central campus level and, therefore, could not be used as basis for determining which units should be in scope.

Our procedures did not include detailed testing of program income activity because we determined that documentation reviews and interviews provided a sufficient basis for our observations presented herein.

Background Information

Sponsored Project Program Income Information

Sponsored project program income is, as described on the campus SPO website, “the gross income earned by a recipient/grantee of an award that is directly generated by a supported activity or earned as a result of the award. Such income is subject to the terms and conditions of the sponsor examples of potential sources of program income include fees from participants at conferences or symposia, sale of items created or fabricated with project funds, and fees for services performed such as laboratory tests.” Whether or not program income is identified in the sponsored project proposal, compliance with sponsor terms and conditions is required.

Under the University of California Contracts and Grants Manual and campus EFA’s *Post Award Management Responsibilities* document, it is primarily the principal investigator’s responsibility to ensure “adherence to externally imposed sponsor terms and conditions including reporting and record keeping requirements contained in the award document”. However, department

management and EFA also share in the responsibility to support post-award compliance with sponsor and award requirements through the development of appropriate procedures and controls, and through monitoring and training.

Although program income is recorded in the campus general ledger, the exact amount of sponsored project program income generated across campus departments cannot be directly quantified because a uniform tracking mechanism within the general ledger has not been developed. According to discussions with personnel from EFA and the departments included in our audit, it is believed that program income is not significant; EFA personnel estimate that as few as 1% of awards involve program income. In March 2012, SPO updated its procedures to identify whether program income is anticipated on new awards. This information is then communicated to the principal investigator, department, and EFA via the notice of award, which going forward will provide an initial basis for the tracking of potential program income across campus.

Relevant Policies

OMB Circular A-110, Section 215.24 sets forth standards governing the use of income earned by assistance recipients from the federally supported activities. Basic principles include that program income earned during the project period shall be retained by the recipient and used in accordance with sponsor rules and award terms and conditions. There are three options for the recipient's use of program income funds, including that funds may be: (i) added to the funds committed to the project by the agency and used to further eligible project objectives (additive method), (ii) used to finance the non-federal share of the project (matching method), or (iii) deducted from the total project allowable cost in determining the net allowable costs on which the federal share of costs is based (deductive method). Unless otherwise specified by the awarding agency, the recipient has no use or reporting obligations with respect to program income earned after the award period or income generated from license fees, royalties, patents, trademarks, or inventions made under an award. The specific treatment method required, as well as record-keeping and reporting requirements, are established by individual sponsor rules and specific award terms and conditions.

These requirements are incorporated into the University of California Contract and Grant Manual (C&G Manual), Chapter 6, Section F03. No additional or supplemental campus policies or procedures have been developed.

Summary Conclusion

We identified that the current design of procedures and controls is not sufficient to ensure campus awareness of and compliance with University and sponsor requirements related to program income. Specifically:

- Guidance and procedures to ensure that program income is treated and reported in accordance with sponsor requirements have not been communicated to the campus. At present, EFA relies solely on individual department-level procedures to identify and track program income and to ensure its proper use and reporting. However, based on our discussions with various departments with significant sponsored project funding, it appears that there are at least some departments that do not have a clear understanding regarding what constitutes program income and, therefore, may not be accurately accounting for and reporting it. The failure to properly treat and report program income could potentially

result in errors in sponsor financial reporting and in the amount of sponsor funds drawn down.

- In addition, the campus does not currently have standard procedures in place for accounting for program income (versus other types of revenues) in the general ledger. Departments are responsible for developing their own methods for recording program income and may consult with EFA to obtain input on their approach. However, absent standard procedures, there is a risk that department methods may not be adequate to ensure the complete and accurate recording of related revenues and expenses. In addition, manual methods for program income accounting that are outside of the general ledger limit department and central campus visibility into program income, hindering potential monitoring activities.

Our specific observations, along with management's responses, follow in descending order of significance.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Program Income Guidance and Procedures

Observation

Guidance and procedures to ensure that department revenues associated with sponsored projects (i.e., program income) are treated and reported in accordance with sponsor requirements have not been communicated to help ensure awareness across the campus regarding program income definitions and requirements. At present, the campus relies solely on individual department-level procedures to identify and track program income and to ensure its proper use and reporting to Extramural Funds Accounting. However, based on our discussions with selected departments with significant sponsored project funding, it appears that there are at least some departments that do not have a clear understanding regarding what constitutes program income and, therefore, may not be accurately accounting for and reporting it. Specifically, we identified two departments that have not been reporting conference registration fees associated with federally sponsored projects as program income. The units assert that the collected fees were spent along with sponsor funds to support the related conference; however, because the fees were not considered to be program income, they were not evaluated to ensure compliance with sponsor rules for program income treatment. Absent the communication of clear guidance and procedures to the campus, there is a risk that units may not properly identify and, therefore, treat and report program income, which could potentially result in errors in sponsor financial reporting and in the amount of sponsor funds drawn down.

We examined guidance and procedures made available at other UC campuses and peer institutions. Examples of information noted that we believe could help support the consistency and appropriateness of program income handling on campus include, but are not limited to: (i) definition of program income; (ii) explanation of the relationship between program income and other requirements, such as cost sharing, recharge costing, cost allowability, etc.; (iii) examples of types of program income; (iv) explanation of methods for treating program income under OMB Circular A-110; (v) explanation of specific federal sponsor policies for program income treatment; and (vi) delineation of specific campus procedures for handling program income from receipt to expenditure to reporting (e.g., the establishment of a program income fund, procedures for transferring costs from the sponsored project fund to the program income fund, procedures for reporting program income to the sponsor).

Management Response and Action Plan

EFA currently has internal guidelines with regards to program income, and EFA staff have been trained on them. Additionally, EFA staff have communicated these guidelines verbally or through email to principal investigators and other campus staff when they have questions regarding program income. EFA will review these guidelines to assess their adequacy, and develop them into policies and procedures, which we anticipate will be ready by January 1, 2013. The policies and procedures will be published on the EFA website and communicated to the campus through training workshops and email newsletters.

Program Income Accounting

Observation

In the absence of campus guidance on recording program income, we have identified at least three different methods for recording program income in the general ledger. Given the expected move to a shared services platform for research administration, we noted opportunities to proactively identify and implement better practices to promote consistent accounting treatment and allow for periodic monitoring through direct queries to the general ledger. Absent standard procedures and mechanisms for accounting for program income in the general ledger, there is a risk that department methods may not be adequate to ensure the complete and accurate recording of related revenues and expenses. In addition, manual ad hoc methods for program income accounting limit department and central campus visibility into program income, hindering potential monitoring activities.

The three current ad hoc methods to record program income we have identified are:

1. Expected program income is greater than \$50,000 and a separate revenue fund is set up by general accounting. Program income is deposited to the fund.
2. Program income is deposited directly to the specific sponsored project fund, potentially complicating analysis and reporting for the fund as expenses and revenues are co-mingled.
3. Program income is deposited to a combination of existing general fund and general ledger revenue accounts, likely in the 46XXX (Sales & Services of Educational Activities) or 48XXX (Other Operating Revenues) range, but also potentially in the 421XX/422XX range (U.S. Government Contracts & Grants). A department may additionally use a Chartfield 1 or Chartfield 2 code to identify program income, which would otherwise be indistinguishable from other types of income in the general ledger.

Each method has potential advantages and disadvantages and we noted other UC campuses and peer institutions have adopted different approaches.

In the first method, program income can be readily tracked and monitored because it is captured and segregated into a specific fund. However, the relationship between the revenue and expense funds for specific sponsored projects would need to be tracked.

In the second method, the program income is recorded alongside expenses and other transactions in one fund account. All transactions are captured in one place, but any performance analysis of the project would require disaggregation of the component transactions since the net fund balance at any given time would include program income that offsets accumulated expenses.

In the third method, the program income is co-mingled with other revenue transactions in general revenue accounts and departmental funds. As a result, any tracking of program income for specific sponsored projects must be done manually through the use of specific chartstrings or outside of the general ledger.

Although we recognize that the primary responsibility for fund administration lies with individual principal investigators, we note that it is not currently possible for departments, schools, or the campus to identify program income recorded in the general ledger in the absence of the use of

specific chartstrings which can be cumbersome to maintain or via manual tracking outside of the general ledger, such as through spreadsheets.

As the Sponsored Projects Office has started identifying projects in COEUS that are likely to have program income, we believe that a similar method to segregate and identify program income transactions in the general ledger would promote greater transparency and accuracy in reporting to sponsors as research administration becomes centralized.

Management Response and Action Plan

EFA currently has internal guidelines with regards to program income, and EFA staff have been trained on them. Additionally, EFA staff have communicated these guidelines verbally or through email to principal investigators and other campus staff when they have questions regarding program income. EFA will review these guidelines to assess their adequacy, and develop them into policies and procedures, which we anticipate will be ready by January 1, 2013. The policies and procedures will be published on the EFA website and communicated to the campus through training workshops and email newsletters.