AUDIT AND ADVISORY SERVICES

OMB A-21 Compliance
Audit
Project No. 11-572

July 27, 2011

Prepared by:

Jennifer E. Jones
Auditor-in-Charge

Reviewed by:

Jaime Jue
Associate Director

Approved by:

Wanda Lynn Riley
Chief Audit Executive

UNIVERSITY OF CALIFORNIA, BERKELEY

BERKELEY • DAVIS • IRVINE • LOS ANGELES • MERCED • RIVERSIDE • SAN DIEGO • SAN FRANCISCO   SANTA BARBARA • SANTA CRUZ

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

650 UNIVERSITY HALL #1170
BERKELEY, CALIFORNIA 94720-1170

July 27, 2011

John Wilton
Vice Chancellor
Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Office of Management and Budget Circular (OMB) A-21 (*Cost Principles for Educational Institutions*) Compliance as per our annual audit plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

The objectives of this audit were two-fold: (i) to evaluate the sufficiency of unit-level procedures, as well as central campus guidance and post-award monitoring to help ensure OMB A-21 compliance; and (ii) to evaluate a sample of expenses charged to federal funds with respect to their compliance with the principles of OMB A-21. Our audit approach included reviews of policies, procedures and other documentation, interviews with Extramural Funds Accounting (EFA) and unit personnel, and detailed testing of a sample of transactions.

Based on our testing, we noted campus and unit-level procedures and controls in place to help promote compliance of expenditures with OMB A-21. However, we did identify specific transactions in our testing sample that appeared to be potentially inconsistent with at least one cost principle of OMB A-21, most notably the direct charging of facilities and administrative (F&A) type costs that would normally be treated as F&A costs without sufficient explanation of the appropriateness of the costing treatment. As well, we noted variability across units regarding the robustness of procedures and tools in place to support OMB A-21 compliance. Given this and the specific exceptions noted in our testing sample, we believe there is an opportunity to further strengthen central campus compliance activities to help obtain a consistent level of understanding and effort across units in meeting their responsibilities related to OMB A-21 compliance.

The Office of Ethics, Risk and Compliance Services will work with the Controller's Office, Research Administration and Compliance, and Financial & Management Analysis to coordinate an effort to assess needs and design an action plan to improve the effectiveness and efficiency of the A-21 compliance controls across campus. As well, EFA will evaluate the specific exceptions identified through our audit to determine what further action might be warranted at the transaction or unit level.

The aforementioned and other observations with management action plans are expounded upon in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the EFA and various unit staff for their cooperative efforts throughout the audit process.

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: Director Lori Cripps
Vice Chancellor Graham Fleming
Assistant Vice Chancellor Pat Schlesinger
Senior Vice President Sheryl Vacca
Associate Chancellor Linda Morris Williams
Director Barbara VanCleave Smith
Interim Associate Vice Chancellor and Controller Delphine Regalia

University of California, Berkeley
Audit and Advisory Services
OMB A-21 Compliance

Table of Contents

OVERVIEW

Executive Summary

The Office of Management and Budget Circular (OMB) A-21 (*Cost Principles for Educational Institutions*) establishes definitions and principles for determining costs applicable to federal grants, contracts, and other agreements ("sponsored projects") with educational institutions. As described in OMB A-21, "the principles are designed to provide that the Federal Government bear its fair share of total costs, determined in accordance with generally accepted accounting principles". The circular establishes a distinction between "direct costs" (those "incident" to the performance of a sponsored project) and facilities and administrative (F&A) costs, where 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"; certain principles are applicable to both categories of cost, while others pertain mainly to one category or another. The scope of this audit was limited to an examination of transactions, procedures and controls related to those costs identified in the campus general ledger as direct costs.

The objectives of this audit were two-fold: (i) to evaluate the sufficiency of unit-level procedures, as well as central campus guidance and post-award monitoring to help ensure OMB A-21 compliance; and (ii) to evaluate a sample of expenses charged to federal funds with respect to their compliance with the principles of OMB A-21. As our sample was judgmentally selected to examine certain categories of transactions we identified as having higher risk of non-compliance and was not large enough to have statistical relevance, our audit was not designed to provide an opinion on overall campus compliance, but rather to allow for a high-level assessment of underlying control activities.

Our audit approach included reviews of policies, procedures and other documentation, interviews with Extramural Funds Accounting (EFA) and unit personnel, and detailed testing of a sample of transactions.

Based on our testing, we noted campus and unit-level procedures and controls in place to help promote compliance of expenditures with OMB A-21, such as multiple references to OMB A-21 on EFA's and the campus Sponsored Projects Office's (SPO) websites and periodic reviews of expenses within units for compliance. However, we did identify specific transactions in our testing sample that appeared to be potentially inconsistent with at least one cost principle of OMB A-21, most notably the direct charging of facilities and administrative (F&A) type costs that would normally be treated as F&A costs without sufficient explanation of the appropriateness of the costing treatment. As well, we noted variability across units regarding the robustness of procedures and tools in place to support OMB A-21 compliance. Given this and the specific exceptions noted in our testing sample, we believe there is an opportunity to further strengthen central campus compliance activities to help obtain a consistent level of understanding and effort across units in meeting their responsibilities related to OMB A-21 compliance.

Source and Purpose of the Audit

Audit and Advisory Services (A&AS) completed our audit of OMB A-21 Compliance as part of our annual audit plan for FY 2011. The objectives of this audit were two-fold: (i) to evaluate the sufficiency of unit-level procedures, as well as central campus guidance and post-award monitoring to help ensure OMB A-21 compliance; and (ii) to evaluate a sample of expenses charged to federal funds with respect to their compliance with the principles of OMB A-21. Our primary source against which we evaluated the compliance of transactions with OMB A-21 was the circular itself; however, we also referred to University and campus policies, procedures, and guidance. University and campus sources referred to in connection with the audit included, but are not specifically limited to, the University of California Contract and Grant Manual, Section 7 (Budgets and Expenditures), the "Cost Accounting Standards Board Disclosure Statement", a statement of campus accounting practices required to be prepared and filed with the federal government by OMB A-21, the campus' "Cost Principles for Sponsored Agreements" policy, EFA's "Post Award Management Responsibilities" and "Cost Principles for Sponsored Projects FAQs" documents, and "A Guide to Major Projects and Charging Administrative Costs to Sponsored Projects" issued by SPO.

Scope of the Audit

The scope of this audit was limited to an examination of transactions, and campus- and unit-level post-award procedures and controls related to direct charges on federal contracts and grants. Given the focus of our audit, only certain sections of OMB A-21 were germane to our procedures. Specifically, the context and criteria for our procedures were derived from Section C *(Basic Considerations)*, Section D *(Direct Costs)*, Section F.6 *(Identification and Assignment of F&A Costs - Departmental Administration Expenses)*, and Section J *(General Provisions for Selected Items of Cost)*.

Our audit approach included reviews of policies, procedures and other documentation, interviews with EFA and unit personnel, and detailed testing of a sample of transactions, as follows:

- We interviewed EFA and unit personnel and reviewed documentation to identify and evaluate procedures related to transaction approvals and monitoring as well as training and guidance provided to staff and faculty regarding OMB A-21.
- We reviewed a sample of 62 transactions across 38 funds and 9 campus units. Transactions selected were from the period July 2010-March 2011, and included original charges and costs transfers related to payroll and a variety of non-payroll expenses. The units and funds in our sample were those with a higher relative percentage of direct charges in FY 2011 to the following expense account categories that we deemed to carry a higher potential risk of non-compliance: (i) "miscellaneous", (ii) entertainment-related, and (iii) (for projects not declared as a "major project"[1]) account codes and/or title codes in

[1] "Major project" is defined in OMB A-21 "as a project that required an extensive amount of administrative or clerical support, which is significantly greater than the routine level of such services provided by academic departments".

the general ledger that per OMB A-21 "shall normally be treated as F&A costs". We also selected a sample of cost transfers (irrespective of expense category) from a sub-set of those units selected.

Units included in our audit were: Engineering Research Support Office, College of Natural Resources, Center for Educational Partnerships, Space Sciences Laboratory, Biological Sciences Divisional Services, Lawrence Hall of Science, Physics, Chemistry, and School of Public Health. Those research units supported by Research Enterprise Services (RES) during our audit period were excluded from our audit sample given that a review of RES by Audit and Advisory Services was completed on May 12, 2011.

As part of our testing and for each transaction, we verified that the transaction was approved by the Principal Investigator (PI), and that the expense appeared to be allowable under OMB A-21, UC, and campus policies; appeared to be reasonable and in conformance with any limitations or exclusions described in OMB A-21 Section J; was expended during the performance period; and was verifiable from records.

Specific to those transactions in our sample that, per OMB A-21 Section F.6 and UC and campus policy and guidance, "shall normally be treated as F&A costs" versus direct costs, we sought to verify compliance with the guidance documented in SPO's "A Guide to Major Projects and Charging Administrative Costs to Sponsored Projects". Specifically, we sought to verify that the cost treatment decision was supported in the proposal budget justification, and that it could be demonstrated that the costs were necessary to achieve the project's technical objectives, were above and beyond the normal support provided by the unit, and could be specifically tracked and identified with the sponsored project in question.

- In addition, we queried the general ledger to identify charges to general ledger account codes directly corresponding to cost categories identified by OMB A-21 and the campus' "Cost Accounting Standards Board Disclosure Statement" as strictly unallowable. These accounts include: "Advertising - Fed Unchargeable", "Social Activities & Entertainm", "Fines & Penalties", "Cost of Other Legal Proceeding", "Donations & Contributions", "Memberships: Federally Unchrg".

As our sample was judgmentally selected to examine certain categories of transactions we identified as having higher risk of non-compliance and was not large enough to have statistical relevance, our audit was not designed to provide an opinion on overall campus compliance, but on underlying controls.

Background Information

OMB A-21 Compliance Coordination

Accountability for ensuring compliance with OMB A-21 on campus is shared by various central campus units including the Controller's Office, through EFA, and SPO, as well as unit-level business and research support office personnel, and PIs, with specific responsibilities outlined in the campus' "Cost Principles for Sponsored Agreements" policy. In brief, primary accountability for ensuring the appropriateness and compliance of specific expenditures resides with the PI and unit-level personnel, while accountability for ensuring a sufficient level of policy interpretation and guidance, training, and monitoring of costs for compliance and consistent treatment resides with central campus units.

Related Policies

Our primary source against which we evaluated the compliance of transactions with OMB A-21 was the circular itself. Given the focus of our audit, only certain sections of OMB A-21 were germane to our procedures. Specifically, the following sections provided the context and criteria for our audit procedures:

- Section C *(Basic Considerations)* establishes and defines "factors affecting allowability of costs" including the principles of reasonableness, allocability, consistency in treatment, and conformance to "any limitations of exclusions set forth in (OMB A-21) or in the sponsored agreement as to types or amounts of cost items".
- Section D *(Direct Costs)* establishes the definition of direct costs as "those costs that can be identified specifically with a particular sponsored project...relatively easily with a high degree of accuracy" and further establishes that "where an institution treats a particular type of cost as a direct cost... all costs incurred for the same purpose in like circumstances shall be treated as direct costs of all activities of the institution".
- Section F.6 *(Identification and Assignment of F&A Costs-Departmental Administration Expenses)* establishes that "the salaries of administrative and clerical staff should normally be treated as F&A costs" and that "items such as office supplies, postage, local telephone costs, and memberships shall normally be treated as F&A costs". The section provides that "direct charging of these costs may be appropriate where a major project or activity explicitly budgets for administrative or clerical services and individuals...can be specifically identified with the project or activity."
- Section J *(General Provisions for Selected Items of Cost)* establishes specific principles regarding the allowability of certain categories of costs.

We also referred to University and campus policies, procedures, and guidance both in connection with evaluating the specific transactions in our sample, but also to evaluate the sufficiency of information provided by the campus to support A-21 compliance. University and campus sources referred to in connection with the audit included, but are not specifically limited to, the University of California Contract and Grant Manual, Section 7 (Budgets and Expenditures), the

"Cost Accounting Standards Board Disclosure Statement", a statement of campus accounting practices required to be prepared and filed with the federal government by OMB A-21, the campus' "Cost Principles for Sponsored Agreements" policy, EFA's "Post Award Management Responsibilities" and "Cost Principles for Sponsored Projects FAQs" documents, and "A Guide to Major Projects and Charging Administrative Costs to Sponsored Projects" issued by SPO.

Summary Conclusion

Based on our testing, we noted campus and unit-level procedures and controls in place to help promote compliance of expenditures with OMB A-21, such as multiple references to OMB A-21 on EFA's and SPO's websites and periodic reviews of expenses within units for compliance. However, we did identify specific transactions in our testing sample that appeared to be potentially inconsistent with at least one cost principle of OMB A-21, most notably the direct charging of facilities and administrative (F&A) type costs that would normally be treated as F&A costs without sufficient explanation of the appropriateness of the costing treatment. As well, we noted variability across units regarding the robustness of procedures and tools in place to support OMB A-21 compliance. Given this and the specific exceptions noted in our testing sample, we believe there is an opportunity to further strengthen central campus compliance activities to help obtain a consistent level of understanding and effort across units in meeting their responsibilities related to OMB A-21 compliance.

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

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Coordination of Campus Compliance Activities

Observation

Accountability for compliance with OMB A-21 on campus is shared across various central campus functions and individual units. There is regular communication between EFA and SPO, as well as with individual units to help ensure that roles and responsibilities related to compliance activities are clearly delineated and coordinated. However, there is not currently one central point of oversight and coordination to ensure that end-to-end compliance activities are appropriately designed and implemented to consistently and satisfactorily mitigate the risks of non-compliance. Based on our assessment of current procedures and controls, we believe there is an opportunity to further strengthen central campus compliance activities to help promote a consistent level of understanding and effort across units to meet their responsibilities related to OMB A-21 compliance. Specifically, we noted that:

- Per management, EFA conducts various reviews related to post-award compliance throughout the lifecycle of a fund, including the timeliness of effort reporting, American Reinvestment and Recovery Act (ARRA) reporting, and cost transfers; however, current post-award monitoring specific to the OMB A-21 cost principles occurs only at close-out. Monitoring only at close-out can affect the timeliness of the close-out process and can result in funds being returned to the sponsor that, had the disallowable expenses been identified and removed earlier, might have been used for other allowable project expenses. As well, it appears that there is currently no post-award monitoring related to the concern of whether costs are being given consistent treatment (e.g., whether F&A-type expenses are being direct charged in like circumstances or whether certain other expense types are being given consistent interpretation and treatment relative to policy). Absent such monitoring for consistency in treatment, there is a risk of campus non-compliance regarding the consistency principle defined in OMB A-21, Section C.11. Effective May 2011, EFA has hired a Compliance Coordinator to enhance monitoring activities.
- EFA and SPO have issued multiple sources of guidance related to the factors that should be considered in determining the appropriateness of direct charging F&A-type costs. We believe consideration should be given as to whether there are other OMB A-21 principles that can be challenging to comply with given the complexity of the related UC and campus policies and/or standard practices that would also warrant additional guidance at the campus level to support unit compliance in their day-to-day processing of transactions. One unit in our sample, via their review and monitoring of unit activity, has identified and documented internal guidance related to such areas, including the handling of GSR fee remission on federal projects and visiting scholar stipends. Absent similar assessment activities and guidance provided at the campus-level, there is

the risk that units will not be alert to potential issues, resulting potentially in both the unallowable and/or inconsistent handling of transactions.

- There is not currently a comprehensive training program for unit research administrative and compliance staff to help ensure an appropriate and/or minimum level of knowledge of OMB A-21 or campus policies. All but one of the units in our sample identified the availability and provision of training as an area for improvement. Absent a formal and comprehensive training program, there is a risk that personnel may not be adequately prepared to identify and correct instances of non-compliance with OMB A-21.
- There is variability across units regarding the procedures and tools in place to support compliance; for example, one of the units in our sample has developed and offers standard tools, guidance, and routine training to research administration staff, while another unit has only recently undertaken standardization of compliance activities. There is currently no formal review by central campus of the adequacy of unit-level compliance procedures or their capacity to support compliance, creating a risk that problems with unit post-award management may not be identified and corrected on a timely basis.

Management Response and Action Plan

The Compliance, Accountability, Risk and Ethics (CARE) Committee approved its 2012 Compliance Program Plan on May 20, 2011. Strengthening controls for A-21 compliance is identified as one of three major initiatives that the committee will focus on during FY 2012. The Office of Ethics, Risk and Compliance Services (OERCS) will coordinate the efforts that will be required to assess needs and design an action plan to improve the effectiveness and efficiency of the A-21 compliance controls. OERCS will work with the Controller's Office, Research Administration and Compliance, Financial & Management Analysis, and various units across campus. The needs ("gap") analysis will be completed by July 1, 2012.

F&A Expenses as Direct Costs

Observation

OMB A-21 and various sources of UC and campus policy and guidance specify cost categories that should normally be treated as F&A rather than as a direct charge, except when the cost treatment decision is (i) supported in the proposal budget justification, and where it can be demonstrated that the costs were (ii) necessary to achieve the project's technical objectives, (iii) are above and beyond the normal support provided by the unit, and (iv) can be specifically tracked and identified with the sponsored project in question. Further, OMB A-21 requires that there must be consistent treatment of expenses as F&A versus direct charge under similar circumstances. Through our audit procedures, we selected a sample of F&A-type expenses charged to non-"major" federal awards and identified direct charges for items such as basic telephone charges, office furniture and supplies, and computer equipment that did not appear to meet at least one of the specified criteria for allowability. Additionally, we noted inconsistency across the units in our sample regarding the circumstances in which typically F&A expenses are charged through as direct costs to the project; for example, one unit stated that as a matter of practice they do not charge basic telephone charges to projects that are not declared as major project because of the difficulty in identifying usage to a particular project, whereas other units appear to routinely charge basic telephone charges to non-major project federal funds. The specific charges identified through our testing have been communicated to both EFA and unit management for their further evaluation and, as warranted, corrective action.

Management Response and Action Plan

In 2006, the campus formed a working group consisting of central office and department personnel to strengthen the campus' understanding and awareness of the OMB A-21 requirements and the cost principles related to federally sponsored agreements. This effort resulted in the issuance of a revised policy, Cost Principles for Sponsored Agreements (Contracts and Grants), in March 2007. Since the issuance of the revised policy, over 140 campus personnel have attended training courses on the campus policy and the cost principles related to federally sponsored agreements. In addition to the policy, the working group developed a list of "Frequently Asked Questions" to provide further clarification and guidance to the campus.

To clarify the identification of awards as "major projects," SPO recently revised their "Guide to Major Projects and Charging Administrative Costs to Sponsored Projects." The revised Guide provides information on the cost principles and the requirements for the treatment of costs as F&A versus direct charges. It also defines a major project and clarifies when costs may be considered administrative or technical in nature. This effort resulted in further strengthening the campus' understanding and awareness of the OMB A-21 requirements.

EFA will examine the specific charges identified by A&AS and follow-up with the administering departments, as appropriate, to promote the consistent treatment of expenses as F&A versus direct charge under similar circumstances. If there appears to be patterns regarding the treatment of certain cost categories, additional guidance will be provided to campus through the EFA web site. These actions will be completed by February 1, 2012.

Unallowable Expenses

Observation

As referenced in the campus Cost Accounting Standards Board Disclosure Statement, Item 1.3.0 Unallowable Costs, and as named in the UC Accounting Manual, Chapter A-115-2 (Accounting Codes: General Ledger), there are six general ledger account codes that are intended to be used to identify and segregate costs that are not allowed on federal funds. However, we identified that during FY 2010 and through March FY 2011 approximately $230,000 in expenses had been charged to these account codes on federal funds, with approximately $180,000 of this total charged to one of the named unallowable accounts, "Social Activities & Entertainm". Based on our sampling of this account, it appears that it is somewhat broadly used by campus units to record expenses that may be considered allowable such as meals related to conferences and meetings, or events that are central to the award purpose, suggesting that the intent of this general ledger account is not well understood across the campus. The other five account codes, however, are for expense categories that it seems unlikely would be similarly misunderstood. We have provided the relevant general ledger details to EFA and unit management for their further evaluation and, as warranted, corrective action. Management from four of the five units in our sample identified to have expenses in these accounts indicated that they believe, based on their preliminary review, at least some portion of these charges were likely due to account miscoding (i.e., were not in fact unallowable charges).

Through our detailed testing procedures, we also identified a limited number of transactions representing approximately 20% of our sample that included charges that might potentially be disallowed under OMB A-21 principles due to the nature of the expense (e.g., alcohol) or insufficient documentation to specifically identify the nature of the charge or support the allocability of the charge to the specific project (e.g., lack of documented PI approval). These specific transactions and our observations related to the units' needs for improvement to documentation practices have been communicated to EFA and unit management.

Management Response and Action Plan

EFA will examine the expenditures charged to the six general ledger account codes and coordinate with the administering departments regarding the appropriateness of the expenditures. EFA also will examine the specific charges identified by A&AS and follow-up with the administering departments, as appropriate, to ascertain the allowability of the expenditure and to strengthen departmental documentation practices. If there appears to be patterns regarding the use of certain account codes, additional guidance will be provided to campus through the EFA web site. These actions will be completed by February 1, 2012.