



# AUDIT AND ADVISORY SERVICES

## Cost Transfers Audit Project No. 14-623

June 16, 2014

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June 16, 2014

John Wilton  
Vice Chancellor—Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Cost Transfers per our annual service 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.

Our 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 staff of Contracts & Grants Accounting and Campus Shared Services—Research Administration 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: Chief Operating Officer Thera Kalmijn  
Director of Research Administration Karen Wilson  
Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae  
Assistant Vice Chancellor and Controller Delphine Regalia  
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**University of California, Berkeley  
Audit and Advisory Services  
Cost Transfers**

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# OVERVIEW

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## Executive Summary

The purpose of the audit was to assess the current state of controls in place to assure cost transfers are accurate, authorized, allowable, allocable, reasonable, and timely charged to the appropriate chartstring.

In the context of federal, state, or private contracts and grants, a cost transfer is typically defined as the reassignment of an expenditure item to a sponsored project fund after the expenditure was initially incurred somewhere else or the removal of an expenditure item to another fund, which may be another sponsored project fund or any other campus fund.

We observed that the initiative to move research administration support to Campus Shared Services for most units provides an opportunity to enhance and standardize control activities related to contract and grant compliance, including cost transfers. This opportunity could increase assurance to management of compliance with cost transfer requirements if the root causes associated with cost transfers are addressed during the standardization process. In the absence of preventative controls that address the root causes of cost transfers, the campus likely faces continued elevated risks with respect to cost transfer activity to the extent that varying legacy department practices exist in the interim. However, we do not believe that the overall risk level for the campus has necessarily increased in the CSS environment. There is opportunity to systematically reduce risks through the consistent application of preventative controls focused on accuracy, authorization, allowability, allocability, reasonableness, and timeliness.

In addition, Contracts & Grants Accounting (CGA) performs periodic reviews of cost transfer transactions to assess ongoing compliance. The effectiveness of these efforts relies upon the ability to identify and extract the complete population of cost transfers in the accounting system.

During our fieldwork we noted that a preparer of a journal entry to transfer non-payroll costs would need to select "cost transfer" as a value in the Journal Class field associated with the entry. However, a selection of a journal class is not required when preparing the journal entry. If no selection is made, the Journal Class field defaults to a blank/empty value being recorded. Based upon our discussions with CGA, and our efforts to extract journal entries from the general ledger, we noted that journal entry preparers are recording non-payroll cost transfers, but are not reliably selecting the "cost transfer" value as the journal class. As a result, CGA cannot be reasonably assured of identifying the complete population of cost transfers from which to extract a sample for periodic review and assessment of compliance.

Management has acknowledged the observations identified above and has proposed action plans to improve controls over the cost transfer process.

## **Source and Purpose of the Audit**

The purpose of the audit was to assess the current state of controls in place to assure cost transfers are accurate, authorized, allowable, allocable, reasonable, and timely charged to the appropriate chartstring.

## **Scope of the Audit**

The scope of the audit included the following:

- Review of campus cost transfer procedures and external compliance requirements such as Office of Management and Budget Circular A-21: Cost Principles for Educational Institutions (OMB Circular A-21);
- Inquiry and corroboration with CGA and Campus Shared Service personnel regarding the current state of preventative and detective controls that govern cost transfers; and
- Extraction and review of potential cost transfer transactions recorded in the campus accounting system for May and June 2013.

We completed fieldwork for this audit in March 2014.

## **Background Information**

In the context of federal, state, or private contracts and grants, a cost transfer is typically defined as the reassignment of an expenditure item to a sponsored project fund after the expenditure was initially incurred somewhere else or the removal of an expenditure item to another fund, which may be another sponsored project fund or any other campus fund.

Cost transfers may include salary or non-salary expenditure items. When an expense charge is originally charged to a grant fund, the campus implicitly certifies that it is allowable, reasonable, consistent and directly beneficial to a project. OMB Circular A-21 specifically states that costs assigned to grant awards from federally sponsored organizations should be allowable, reasonable, allocable (directly benefit the award charged), consistent, and timely. A cost transfer may call into question the original implicit certification of allowability, reasonableness, allocability, consistency or timeliness with respect to the award. By definition, a cost transfer is a transaction that corrects an error with respect to those attributes.

The principal investigator is the primary individual responsible for managing the grant award and the appropriateness of expenditures charged to the award. In practice, a research administrator often works closely with the principal investigator and handles the day-to-day administration of the award, including the application of expenditures against the award and prevention of expenditures being charged to the award that are not allowable, reasonable, allocable, consistent or timely.

In addition to the ongoing responsibility of the principal investigator and supporting research administrator to prevent inappropriate expenditures on the award, according to the campus cost transfer procedures, CGA is responsible for conducting post audit reviews of cost transfers. CGA began the implementation of post audit reviews in January 2014. These reviews are intended to detect practices that are inconsistent with the campus cost transfer procedures and

trigger corrective action to align practices with external and internal policies. CGA has a pending management action plan from a prior audit to implement a monitoring mechanism for cost transfers.

Effective July 1, 2010, the campus implemented a practice of disallowing payroll cost transfers in the Payroll/Personnel System (PPS) greater than 120 days after the original transaction. In FY 2013, exceptional approval was granted for 44 payroll transfers. However, there is residual risk that payroll-related expenses are transferred directly through a financial journal entry in the campus general ledger, as with non-payroll cost transfers, rather than through PPS.

The allowance of cost transfers up to 120 days post the award end date may impede the campus' ability to produce timely and accurate financial reports and invoices as such are typically due on federal awards 90 days after the end of the award period.

### **Summary Conclusion**

The initiative to move research administration support to Campus Shared Services for most units provides an opportunity to enhance and standardize control activities related to contract and grant compliance, including cost transfers. This opportunity could increase assurance to management of compliance with cost transfer requirements if the root causes associated with cost transfers are addressed during the standardization process. At this time, CSS–Research Administration is conducting training and implementing other control activities to strengthen the control environment. In the absence of standardized procedures and controls that address the root causes of cost transfers, the campus likely faces continued elevated risks with respect to cost transfer activity to the extent that varying legacy department practices exist in the interim. However, we do not believe that the overall risk level for the campus has necessarily increased in the CSS environment. There is opportunity to systematically reduce risks through the consistent application of preventative controls focused on accuracy, authorization, allowability, allocability, reasonableness, and timeliness.

In addition, CGA performs periodic reviews of cost transfer transactions to assess ongoing compliance. The effectiveness of these efforts relies upon the ability to identify and extract the complete population of cost transfers in the accounting system.

During our fieldwork we noted that a preparer of a journal entry to transfer non-payroll costs would need to select “cost transfer” as a value in the Journal Class field associated with entry. However, a selection of a journal class is not required when preparing the journal entry. If no selection is made, the Journal Class field defaults to a blank/empty value being recorded. Based upon our discussions with CGA and our efforts to extract journal entries from the general ledger, we noted that journal entry preparers are recording non-payroll cost transfers, but are not reliably selecting the “cost transfer” value as the journal class. As a result, CGA cannot be reasonably assured of identifying the complete population of cost transfers from which to extract a sample for periodic review and assessment of compliance.

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## **SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN**

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### **Development and Implementation of Standardized Campus Shared Services–Research Administration Processes and Procedures**

#### **Observation**

Campus cost transfer procedures outline a framework to assist principal investigators, research administrators, and other grant and award personnel to comply with OMB Circular A-21 and other federal requirements pertaining to federally sponsored awards. The procedures aim to reduce the occurrence of cost transfers, define criteria that should be used to identify cost transfers, and outline the steps to adequately record and document cost transfers.

In the past, the campus assumed a decentralized approach to research administration compliance and allowed for each department to develop their own internal practices for compliance, which resulted in variations in the effectiveness of control activities. The initiative to move research administration support to Campus Shared Services for most units provides an opportunity to enhance and standardize control activities related to contract and grant compliance, including cost transfers. This opportunity to standardize control activities could increase assurance to management of compliance with cost transfer requirements if the root causes associated with cost transfers are addressed during the standardization process.

CSS–Research Administration is conducting training and other control activities to strengthen the control environment. In the absence of preventative controls that address the root causes of cost transfers, the campus likely will continue to face elevated risks with respect to cost transfer activity to the extent that varying legacy department practices exist in the interim. However, we do not believe that the overall risk level for the campus has necessarily increased in the CSS environment. There is opportunity to systematically reduce risks through the consistent application of preventative controls focused on accuracy, authorization, allowability, allocability, reasonableness, and timeliness.

#### **Management Response and Action Plan**

The CGA compliance team will be monitoring the non-payroll cost transfer activities and provide the departments/CSS (on a rotation basis) with the monitoring results and action items to be taken. The monitoring process will include selecting a sample of non-payroll cost transfers on a quarterly basis and requesting backup from units/CSS since they are the department of records. CGA will also keep monitoring any payroll related cost transfers processed through the GL and report them to the departments/CSS periodically.

Before the monitoring begins, CSS will prepare and implement cost transfer procedures that include adequate controls in place to ensure proper processing, approval, and complete documentation of transactions. CSS also shall provide adequate training on the new policy and business process. CSS will also have similar procedures and training for payroll related cost transfers to ensure they are processed through the proper payroll system, and not the general

ledger, in a timely manner. The target for implementation is FY2015 with completion of process, training and implementation by October 1, 2014 for those units currently within CSS and by February 1, 2015 for those units not yet on-boarded into CSS.

## **Current Accounting Practices to Identify Cost Transfers Limit Monitoring Efforts**

### **Observation**

Campus cost transfer procedures state that CGA will perform periodic reviews of cost transfer transactions to assess ongoing compliance. According to the procedures, one of the reviews involves extracting a sample of all cost transfers recorded in the accounting system. The effectiveness of these efforts relies upon the ability to identify and extract the complete population of cost transfers in the accounting system.

During our fieldwork we noted that a preparer of a journal entry to transfer non-payroll costs would need to select "cost transfer" as a value in the Journal Class field associated with entry. However, a selection of a journal class is not required when preparing the journal entry. If no selection is made, the Journal Class field defaults to a blank/empty value being recorded.

Based upon our discussions with CGA and our efforts to extract journal entries, we noted that journal entry preparers are recording non-payroll cost transfers in the general ledger, but are not reliably selecting the "cost transfer" value as the journal class. As a result, CGA cannot be reasonably assured of identifying and extracting the complete population of cost transfers for periodic review and assessment of compliance.

Given this limitation, we considered the procedures CGA is currently in the process of developing with respect to ongoing monitoring of cost transfers that have been appropriately flagged via the Journal Class field. CGA management is developing and refining such a program in response to a prior audit observation and the current monitoring procedures they are currently developing appear reasonable to us. However, it remains to be seen as to whether CGA will have the responsibility or the resources to follow-up on all potentially unsupported cost transfers or whether the overall responsibility for monitoring will remain with the principal investigator with support from research administration, now with Campus Shared Services.

### **Management Response and Action Plan**

The Controller's Office agrees with the observation and will work to ensure that selection of an entry in the Journal Class field is required at the time a financial journal entry is made in BFS. We expect to complete this action plan by July 1, 2014.