

## V. Audits and Compliance

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### A. Overview

In 2006, Research & Development (R&D) expenditures at colleges and universities totaled \$47.8 billion dollars, an almost 100 percent increase in just 10 years.<sup>1</sup> Of that amount, the Federal and state governments funded 69 percent of this research activity. Over the same period, the Federal government's accountability and oversight structure has grown to match these significant increases in R&D funding. Because the Federal government is by far the largest supporter of academic research, Federal laws, regulations, and award terms and conditions have a pervasive affect on how RIT manages our entire sponsored research portfolio.

#### Objectives:

#### In this chapter you will learn about:

- the internal and external compliance and regulatory environment
- how to ensure compliance with regulatory and sponsor requirements
- how to protect the University from audit and compliance risk
- federal circulars, the cornerstones for the administration of federal projects

### B. What is an Audit?

1. An audit is an unbiased examination of an organization or operating unit's financial statements, operational performance, or compliance with appropriate federal, state, and/or local authorities and their requirements. When complete, auditors issue a report with a conclusion that confirms or denies management's adherence to an existing set of criteria such as generally accepted accounting principles, government laws and regulations, or internal procedures.
2. For the most part, audits are conducted by independent public accounting firms, federal, state, and local government auditors, or internal auditors. In addition to financial statement audits, the professional literature describes other types of audits such as attestation engagements and performance audits.

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<sup>1</sup> Source: National Science Foundation/Division of Science Resource Statistics, Survey of Research and Development Expenditures at Universities and Colleges, FY 2006.

## C. The Audit and Compliance Environment

Adherence to external requirements is important because of the negative financial and reputational impact that serious non-compliance can have on an institution. The following is a list of key players in the Federal grant oversight structure.

1. Sarbanes-Oxley Act of 2002 – The Sarbanes-Oxley Act of 2002 (the Act) was enacted in response to a number of major corporate and accounting scandals. The Act established new standards for U.S. public companies and public accounting firms and contains requirements for management’s assessment and certification of internal control over financial reporting. While the Act does not apply to non-profit organizations, college and university boards and presidents have recognized that many of the Act’s key goals and concepts make good business sense and can be voluntarily adopted as a way to ensure future compliance.
2. Office of Management and Budget (OMB) – In addition to overseeing the preparation of the federal budget, OMB coordinates Federal procurement, financial management, and regulatory policies including those financial management policies for grant recipients. The ubiquitous OMB circulars (A-21, A-110, and A-133) establish cost, administrative, and audit requirements for Federal grant and contract recipients.

The OMB Circulars are available on the OMB website:

- ✓ [OMB A-21](#) – *Cost Principles for Educational Institutions*
- ✓ [OMB A-110](#) – *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*
- ✓ [OMB A-133](#) – *Audits of States, Local Governments, and Non-Profit Organizations*

3. U.S. Government Accountability Office (GAO) – GAO is an independent Federal agency that works for the U.S. Congress. Upon request, GAO conducts independent audits to help Congress and Federal executives determine how well they are doing in relation to laws, regulations, and policy goals established for their organizations. In addition, GAO’s work is not limited to the Federal government. For example, in 1993, GAO conducted an audit of RIT’s National Technical Institute for the Deaf.
4. Federal Offices of Inspector General (OIG) – The Inspector General Act of 1978 established OIGs at 14 major federal agencies. Since then, the Congress has amended the IG Act to establish an OIG at almost all federal agencies. Each OIG’s primary mission is to conduct audits and investigations that

promote economy, efficiency, and effectiveness and prevent and detect fraud, waste, and abuse.

In addition to audit and investigation reports, every OIG issues *Semiannual Reports to the Congress* that discusses their most significant activities and conclusions. Semiannual reports can be a valuable source of information relating to the many audit and compliance risk areas that affect academic institutions such as RIT. However, these reports can also be a great source of embarrassment because audit and investigative results are sent to the Congress and made available to the public on OIG websites.

## D. Common Audit Findings

### 1. Effort Reporting

- Faculty members who had explicitly pledged in grant proposals to contribute 1 to 20 percent of their labor time on five federal awards did not report any of this time in their labor effort reports.
- University business managers approved effort reports without verifying that the labor distribution on the effort report was reasonable in relation to the actual work performed on the grant.
- The University did not disclose in its grant proposals that the requested salaries included extra compensation for work beyond the faculty member's full-time responsibilities.
- Contrary to OMB requirements, a University charged \$1.4 million in administrative and clerical costs directly to federal awards while simultaneously recovering the costs through the application of its approved Facilities & Administrative (F&A) rate.

### 2. Subaward Monitoring

- The University did not establish a risk-based monitoring program to ensure that costs invoiced or claimed and certified as cost sharing by its subawardees were accurate, allowable, allocable, and properly documented per NSF regulations and OMB Circulars.

### 3. Cost Transfers

- The University did not transfer costs on a timely basis or comply with Federal requirements for fully explaining and documenting the errors that necessitated the transfer of costs to the grant. The absence of a detailed and documented explanation prevented the auditors from determining

**Key  
Words:**

*Effort  
Reporting*

*F&A Rate*

*Subaward*

*Cost  
Transfers*

whether the costs transferred to the grant were allocable, allowable, and reasonable.

## **E. Risks of Noncompliance**

### **1. Repayment of Grant Funds**

The potential repayment of grant or contract funds most frequently occurs when Federal or State auditors “question” costs in an audit report. Auditors will question costs when they believe and report on:

- An alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds;
- A finding that, at the time of the audit, the questioned cost is not supported by adequate documentation; or,
- A finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

When auditors report a finding and question costs in an audit report, the award’s grant or contract officer must review the merits of the finding and auditor’s conclusions and make a final determination on repayment.

### **2. Damaged Reputation**

Negative audit findings or criminal investigations of alleged wrong-doing can damage our reputation and result in reduced grant and contract funding and increased regulatory oversight by sponsoring agencies.

### **3. Federal Lawsuits**

The False Claims Act allows any person with knowledge of a false or fraudulent claim against the Federal government to sue on behalf of the government and share in any award or settlement. Commonly referred to as qui tam lawsuits, the Act provides the person between 15% and 30% of the proceeds of the action or settlement amount. In addition, the Act provides an award of attorney’s fees, making qui tam actions popular.

In recent years there have been a number of high profile qui tam lawsuits at major research institutions resulting in excess of \$24 million in payments to the U.S. to settle allegations that these institutions submitted false claims to the government. The following is a partial list of the allegations that were made against these institutions. It is noteworthy that these large settlements are directly connected to

faculty effort and whether salary costs and other expenses are related to a particular project's funded purpose.

- Government was charged for research unrelated to the grants it received
- Government was billed for salaries and expenses unrelated to federal grants
- Faculty time and effort devoted to grants was overstated
- Researchers spent less time on sponsored projects than they reported

## F. Compliance with Regulatory and Sponsor Requirements

1. Internal Control – Internal control refers to a process, affected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of organizational objectives. The three primary objectives of internal control are: 1) effectiveness and efficiency of operations; 2) reliability of financial reporting; and, 3) compliance with applicable laws and regulations.<sup>2</sup> Underlying these overall objectives, however, are much simpler concepts including how does the University...

- protect its assets?
- ensure that its financial reports and records are accurate?
- promote efficient and effective operations?
- encourage adherence to laws, regulations, and RIT policy?

We establish controls to ensure that our financial, operational, and compliance goals are achieved. A complete framework for internal control consists of the following essential elements:

- **Control Environment** – The control environment is the organizational structure and culture created by management and employees to sustain organizational support for effective internal control.
- **Risk Assessment** – Management should identify internal and external risks that may prevent the organization from meeting its objectives.
- **Control Activities** – Control activities include policies, procedures and mechanisms in place to help ensure that institutional objectives are met.
- **Information and Communication** – Information should be communicated to relevant personnel at all levels within an organization.

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<sup>2</sup> Source: the Committee of Sponsoring Organizations of the Treadway Commission

- **Monitoring** – Monitoring the effectiveness of internal control should occur in the normal course of business by staff, managers, and internal auditors.

We have internal controls in our daily lives. For instance, how do we ensure that our children achieve and maintain good grades at school? We create an environment in our homes that says education is important; we assess the strengths and weaknesses of the local school district; we communicate with our children about school activities; and, we monitor their success by attending teacher-parent meetings and reviewing report cards. Internal controls are no different in the workplace.

What does all of this mean for sponsored research? There are recommended systems of internal control that promote adherence to laws, regulations, and requirements of sponsored agreements called compliance programs. If properly designed and implemented, compliance programs can help to prevent or mitigate many of the problems noted in the aforementioned sections.

Compliance programs normally consist of the following key elements:

- Develop written standards of conduct, including policies and procedures
- Designate a chief compliance officer
- Conduct effective education and training
- Maintain an anonymous complaint process
- Develop a system to respond to allegations of improper activities
- Use compliance monitoring techniques such as audits
- Investigate and remediate identified systemic problems

## 2. What can you do to ensure compliance?

- Attend RIT accounting and compliance training workshops
- Review your grant and contract statements and payroll reports at least monthly to ensure that costs charged are related, allowable, accurate, and consistent with the purpose of the award and the sponsor-approved budget
- Pay special attention to faculty effort. Charges to sponsored agreements should reflect their actual effort on the project. Do not charge more than the actual effort of faculty, staff, and students.

**Key Words:**

*Unobligated  
balances*

*Indirect costs*

- Adequately document the reason(s) for cost transfer journal entries. Do not shift cost from grant to grant to use up unobligated balances.
- Do not charge indirect costs directly to a federally-funded project. Typical indirect costs are salary of department administrative staff, postage, photocopy charges, and office supplies.
- Coordinate all external requests for financial-related information with Sponsored Programs Accounting (SPA) and/or Controller's Office staff before submitting to a sponsor.
- If you have any questions or concerns, contact SPA immediately.

## **G. OMB Circulars**

1. Single Audit Act and OMB Circular A-133 – The purpose of the Single Audit Act of 1984, as amended in 1996, is to establish standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards. Single audits are conducted primarily by independent public accounting firms, although some institutions have components of their audit conducted by Federal auditors.

- a. Key requirements of an A-133 Audit

- Non-Federal entities (State, local government, or non-profit organizations) that expend \$500,000 or more in a year in Federal awards must have an audit conducted for that year in accordance with the A-133 provisions.
- Requires an audit of the institution's financial statements, a report on internal control related to the financial statements and major federal programs, a report on compliance with laws, regulations, and the terms and conditions of grant agreements; and a schedule of findings and questioned costs.
- Every grantee is assigned a cognizant Federal agency that is responsible for providing technical advice to auditors and auditees; coordinating the resolution of audit findings; and reviewing the quality of the audit.
- Does not prevent other Federal audits; however, the Federal auditors have to build on the work performed under the A-133 audit.

- b. Quality of A-133 Audits – In June 2006/07, the Inspector General (IG) community conducted an audit to assess the quality of A-133 audits

**Key Word:**

*Cognizant  
agency*

nationwide. In the final report, the auditors concluded that approximately 55% of the entire universe of single audits were of limited reliability or unacceptable. However, the auditors also noted that these substandard audits represented only a very small percentage of Federal awards in the audits reviewed. The IG community made a number of recommendations including: 1) revise OMB Circular A-133; 2) establish requirements for auditor training; and, 3) review and enhance processes for addressing unacceptable audits including sanctions on audit firms. While the government has yet to take any official action, the reported results will most likely prompt changes in the way auditors prepare for and conduct A-133 audits.

c. Tips for Working with A-133 and Other Government Auditors

- Answer questions honestly and directly
- Give the auditors the documents and reports they ask for after coordinating your response with SPA
- Do not tamper with or manufacture records
- Limit your response to the question being asked
- Call SPA if you have any questions or concerns

2. OMB Circular A-21 – OMB Circular A-21 establishes principles for determining if costs charged to Federal grants and contracts awarded to educational institutions are allowable. To be considered allowable, costs must be: 1) reasonable; 2) allocable; 3) consistently treated; and, 4) conform to any limitations or exclusions identified in the Circular or in the sponsored agreement. These principles apply whether the cost is directly or indirectly charged to sponsored projects.

A-21 consists of three primary sections: 1) provides background information on the general principles surrounding allowability; 2) provides requirements for identifying, determining, and negotiating Facilities & Administrative (F&A) cost rates; and, 3) provides general allowability provisions for selected cost items such as travel, equipment, etc...

3. OMB Circular A-110 – OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, establishes standards for the administration of Federal awards such as financial, procurement, and property management systems.

4. OMB Circular A-50 – OMB Circular A-50 provides the policies and procedures for use by Federal agencies when reviewing reports issued by the Inspectors General, other executive branch audit organizations, the General Accounting Office, and non-Federal auditors where follow-up on audit findings is required. So, when RIT has audit findings in the A-133 audit report, our cognizant agency is required to contact us and review the adequacy of our corrective actions.

## **H. Conclusion**

- Compliance is common sense
- Be familiar with the regulations
- There are common requirements across all agencies/sponsors
- Management within each college, department or division is responsible for establishing and maintaining effective business practices and internal controls.
- There are experts on staff to assist you