

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**THE UNIVERSITY OF CALIFORNIA
AT RIVERSIDE'S PILOT PAYROLL
CERTIFICATION SYSTEM DID
NOT PROVIDE ACCOUNTABILITY
OVER PAYROLL CHARGES TO
FEDERAL AWARDS**

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Office of Inspector General

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EXECUTIVE SUMMARY

The University's prior effort-reporting system did not always provide the information needed to confirm that payroll costs had been appropriately allocated to Federal awards, and its current pilot Payroll Certification System provided less accountability over payroll charges to Federal awards than the prior system. In addition, the University's information technology controls did not ensure the security of data used to support labor charges.

WHY WE DID THIS REVIEW

Section 4 of Presidential Executive Order 13563, dated January 18, 2011, states: "Where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public" In keeping with the Executive Order, the Federal Demonstration Partnership (FDP)—an organization dedicated to reducing the administrative burdens associated with research awards—developed a payroll certification system pilot (pilot PCS) as an alternative to after-the-fact personnel activity reporting (also called effort reports or effort reporting) for supporting salary and wage expenses charged to federally sponsored projects. In its January 2011 Payroll Certification Proposal, FDP asserted that its alternative is preferable because (1) effort is difficult to measure, (2) effort reports provide limited internal control, and (3) effort-reporting systems may be expensive to implement and maintain.

Historically, effort reports have been used as the main support for salary and wage charges to Federal grants and contracts, or other agreements (awards). Effort reporting is a person-based methodology that allocates each employee's reasonable estimate of time worked on all awards and other activities.

As an alternative to effort reporting, the pilot PCS is a project-based process that relies on the Principal Investigator's (PI) certification of a predetermined percentage of salary for each employee who is assigned to the PI's awards. The percentage of salary is determined by a finance or budget department in consultation with the Principal Investigator (PI) of an award, and the PI receives this information when certifying that all salary and wage charges are reasonable in relation to the work performed.

At the Office of Management and Budget's (OMB) request, the Department of Health and Human Services (HHS) and the National Science Foundation (NSF) Offices of Inspectors General (OIGs) agreed to conduct audits at four universities that use the pilot PCS to charge salary and wage costs to Federal projects. HHS OIG audited the University of California—Riverside (the University) and the University of California—Irvine, and NSF OIG audited Michigan Technological University and George Mason University.

In developing the audits of the pilot PCS with NSF, we decided to include testing of the information technology (IT) controls for the systems that the University used to support the pilot PCS. Our tests were designed to show whether the University's IT controls for the pilot PCS ensured that the data the University used to support labor charges were secure.

Our objectives were to determine whether (1) the University's prior effort-reporting system and pilot PCS provided accountability over payroll charges to Federal awards and (2) the University's IT controls ensured the security of data used to support labor charges.

BACKGROUND

Effort-Reporting System

Colleges and universities must support and document salary charges made to Federal awards. Historically, colleges and universities have fulfilled this requirement through an effort-reporting system. Within these effort-reporting systems, colleges and universities have used time reports and activity reports (also called after-the-fact activity records, time-and-activity reports or personnel-activity reports) as the main support for salaries charged to Federal awards. Employees generally prepare time and activity reports, which show the amount of time that the employee has charged to various activities, including Federal awards. By signing a time report or an activity report, the employee certifies the accuracy of the time spent on certain activities. Colleges and universities use time and activity reporting to document that time and activity charges to Federal awards reasonably reflect the activity for which the employee is compensated. There must also be suitable means of verification that the work was performed, and one use of these reports is to verify that an employee's total allocation of time charged does not exceed 100 percent.

University faculty generally work on multiple projects during the year and, thus, allocate time spent among these various projects, including HHS awards.

The University used this method to charge salaries to Federal awards for 15 months of our 39-month audit period: January 2, 2010, through March 31, 2011.

The Pilot Method: Payroll Certification System

Through the FDP, colleges and universities proposed an alternative method (pilot PCS) for charging salaries to Federal awards because colleges and universities considered the standard method expensive, unfocused, and confusing. Within the pilot PCS, colleges and universities use payroll certifications as the main support for salaries charged to Federal awards. Instead of requiring employees, supervisors or PIs to certify "effort," the pilot PCS requires PIs to review payroll expenses charged to their awards and to sign an annual project certification stating that certain employees worked on the award and that salaries "are reasonable in relation to work performed."

PIs on an award can access monthly award financial reports through a Web-based system called the PI Web Reporting System (PIWRS). These automatically generated financial reports list certain award financial activity, including salaries charged to the award. Separate reports are made available for each award for which the PI is the certifying official.

The FDP proposal stated that the pilot payroll certification system complied with OMB Circular A-21.

As a participant in the pilot PCS, the University used this method to charge salaries to Federal awards for 24 months of our 39-month audit period: April 1, 2011, through March 31, 2013.

University of California—Riverside

The University is a State institution located in Riverside, California, and is one of 10 universities within the University of California system. From January 2, 2010, through March 31, 2013, the University claimed \$17,204,282 in reimbursement for salary costs applicable to 221 HHS awards.

WHAT WE FOUND

The University's prior effort-reporting system did not always provide the information needed to confirm that payroll costs had been appropriately allocated to Federal awards, and its current pilot PCS provided less accountability over payroll charges to Federal awards than its prior effort-reporting system. Specifically, the pilot PCS did not comply with requirements of Circular A-21 and, as designed, limited the ability of the University and HHS to provide oversight of these funds. On the basis of our sample, we estimated that the University put at risk \$11.7 million in salaries and \$5.9 million in associated facilities and administrative costs claimed against National Institutes of Health awards.

Furthermore, the University's IT controls for systems used to support the pilot PCS did not always ensure the security of data used to support labor charges. We identified general IT control weaknesses that included unrestricted remote access, inadequate password settings, poor patch management, and expired vendor support. We promptly communicated to the University our preliminary IT findings in advance of issuing our draft report.

RECOMMENDATIONS

We recommend that the University increase its accountability over payroll charges to Federal awards by:

- ensuring that, if the University returns to its prior effort-reporting system, it updates the system to adequately account for nonsponsored activities to ensure that payroll costs are properly allocated to Federal awards;
- ensuring that suitable means exist for a PI to verify that salary charges made to an award are reasonable in relation to the work performed;
- ensuring that suitable means exist to document that salary charges represent the actual work performed on a grant and not just budget estimates;
- requiring and documenting prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government;

- requiring and documenting prior approval and justification for charging administrative and clerical salaries as direct costs;
- requiring and documenting prior approval and justification for cost transfers;
- developing payroll procedures to ensure that salaries are properly allocated and that salaries charged to all activities do not exceed 100 percent; and
- following Federal requirements for supporting payroll costs claimed.

We further recommend that the University strengthen its general IT controls for systems it used to support the pilot PCS by:

- improving restrictions for remote access,
- implementing a password setting that requires password changes periodically,
- implementing a patch management system for its desktop computers, and
- implementing procedures to ensure that vendor support does not expire on the University’s operating system.

UNIVERSITY OF CALIFORNIA—RIVERSIDE COMMENTS

The University concurred with our fourth recommendation—requiring and documenting prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government—but did not concur with our other recommendations. The University said that its internal controls and pilot PCS (which it calls the Payroll Certification process, among other names) provide accountability over payroll and other charges to Federal awards. Although the University did not agree with most of our recommendations, it described some actions it has taken or plans to take to enhance its internal controls.

The University’s written comments included three attachments and two appendixes that contained supplementary information, such as a copy of its proposal for the pilot PCS and a discussion of sample items we classified as “at-risk.” Because of the volume of the appendixes, we did not include them in this report.

OUR RESPONSE

We revised the fifth recommendation based on supplementary information provided by the University. We also made a technical change in the eighth recommendation to more accurately reflect our finding. We maintain that our remaining recommendations are valid as drafted.

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INTRODUCTION

WHY WE DID THIS REVIEW

Section 4 of Presidential Executive Order 13563,¹ dated January 18, 2011, states: “Where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, each agency shall identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public.” In keeping with the Executive Order, the Federal Demonstration Partnership (FDP)—an organization consisting of Federal agencies, including the National Institutes of Health (NIH),² and research institutions dedicated to reducing the administrative burdens associated with research awards—developed a payroll certification system pilot (pilot PCS) as an alternative to after-the-fact personnel activity reporting (also called effort reports or effort reporting) for supporting salary and wage expenses charged to federally sponsored projects. In its January 2011 Payroll Certification Proposal, FDP asserted that its alternative is preferable for many reasons, including (1) effort is difficult to measure, (2) effort reports provide limited internal control, and (3) effort-reporting systems may be expensive to implement and maintain.³

Historically, effort reports have been used as the main support for salary and wage charges to Federal grants, contracts, and other agreements (awards). Effort reporting is a person-based methodology that allocates each employee’s reasonable estimate of time worked on all awards and other activities. Time worked is then converted to salary and allocated to the various grant awards and activities (e.g., teaching, patient care) the employee worked on during the reporting period. The employee or someone responsible for the employee’s efforts certifies that the employee’s time is a reasonable estimate of the actual work performed.

As an alternative to effort reporting, the pilot PCS is a project-based process that relies on the Principal Investigator’s (PI) certification of a predetermined percentage of salary for each employee who is assigned to the PI’s awards. The percentage of salary is determined by a finance or budget department in consultation with the PI. The PI then receives this information as the basis for certifying that all salary and wage charges to the project are reasonable in relation to the work performed.

At OMB’s request, the Department of Health and Human Services (HHS) and the National Science Foundation (NSF) Offices of Inspectors General (OIGs) agreed to conduct audits at four universities that use the pilot PCS to charge salary and wage costs to Federal projects. HHS OIG audited the University of California—Riverside (the University) and the University of

¹ Executive Order 13563 is supplemental to and reaffirms the principles governing regulatory review that were established in Executive Order 12866, dated September 30, 1993.

² NIH is the Federal focal point for medical research in the United States. NIH, comprising 27 separate Institutes and Centers, is one of 8 health agencies of the Public Health Service which, in turn, is part of HHS (<http://www.nih.gov/about-nih/frequently-asked-questions>). Accessed on November 18, 2015.

³ FDP, “Payroll Certifications, A Proposed Alternative to Effort Reporting,” January 3, 2011. Available online at: http://sites.nationalacademies.org/PGA/fdp/PGA_055834. Accessed on November 10, 2015.

California—Irvine (UCI), and NSF OIG audited Michigan Technological University and George Mason University.

Although the audit plan and methodology were consistent across all pilot institutions, the results differ depending on each institution's implementation of its respective pilot system and the nature of the grants and related guidance from the awarding agency (HHS or NSF). NSF and HHS both apply the same cost principles but use different grant requirements that are specific to the awarding agency. For example, NSF's award policy document titled *Proposal and Award Policies and Procedures Guide* limits an investigator's salary charged to an award to 2 months of their annual base salary.⁴ In comparison, the NIH *Grants Policy Statement* (GPS) has a different limitation.⁵ As another example, graduate students typically do not charge their time to more than one NSF grant. Also, faculty do not generally charge NSF grants during the academic year and rarely do administrative staff charge time directly⁶ to NSF grants. For HHS grants, faculty and graduate students often work on multiple HHS grants and perform tasks such as research, teaching, and patient care. Administrative labor costs can also be charged to HHS grants. Because of the nature of HHS grants and grant requirements, a pilot PCS needs the functionality to track and report salary information that provides an audit trail⁷ for determining:

- the reasonableness of costs charged to Federal grants,
- that the employee's pay charged to Federal grants is no more than 100 percent of his or her total pay,
- the reasonableness of cost transfers between/among Federal grants, and
- the appropriateness of reclassifying administrative costs as direct costs.

In developing the audits of the pilot PCS with NSF, we decided to include testing of the information technology (IT) controls for the systems that the University used to support the pilot PCS. Our tests were designed to show whether the University's IT controls for the pilot PCS ensured that the data the University used to support labor charges were secure.

⁴ NSF, *Proposal and Award Policies and Procedures Guide*, part II (also referred to as the Award & Administration Guide), chapter V, § B.1.a.(ii)(a) (Oct. 2009, effective Jan. 4, 2010).

(http://www.nsf.gov/publications/pub_summ.jsp?ods_key=nsf101&org=NSF). Accessed on December 9, 2015.

⁵ The NIH salary cap was set at \$199,700 at the beginning of our audit period in January 2010 and was \$179,700 at the end of our audit period in March 2013 (http://grants.nih.gov/grants/policy/salcap_summary.htm). The NIH salary cap is a limit on the total compensation for an employee, of which the award can only be charged its share based on the work activity. Accessed on October 20, 2016.

⁶ NSF, *Proposal and Award Policies and Procedures Guide*, part II, chapter V, § B.1.a.(ii)(b) (http://www.nsf.gov/publications/pub_summ.jsp?ods_key=nsf101&org=NSF). Accessed on December 9, 2015.

⁷ An audit trail is paper or electronic documentation that gives a step-by-step history of a transaction. It enables an examiner or management to trace the financial data from the general ledger to the source document (invoice, receipt, voucher, etc.). The presence of a reliable and easy-to-follow audit trail is an indication of good internal controls and forms the basis of objectivity in accounting.

This report contains the results of our audit of the University. We issued a separate report on UCI,⁸ and NSF has issued separate reports on Michigan Technological University and George Mason University.

OBJECTIVES

Our objectives were to determine whether (1) the University's prior effort-reporting system and pilot PCS provided accountability over payroll charges to Federal awards and (2) the University's IT controls ensured the security of data used to support labor charges.

BACKGROUND

Effort-Reporting System

Colleges and universities must support and document salary charges made to Federal awards (Office of Management and Budget (OMB) Circular A-21 (Circular A-21), § J.10.a).⁹ Historically, colleges and universities have fulfilled these requirements through an effort-reporting system. Within these effort-reporting systems, colleges and universities have used time reports and activity reports (also called after-the-fact activity records, time-and-activity reports or personnel-activity reports) as the main support for salaries charged to Federal awards (Circular A-21, § J.10.c.(2)). Employees generally prepare time-and-activity reports, which show the amount of time that the employee charged to various activities, including Federal awards. By signing a time report or an activity report, the employee certifies the accuracy of the time spent on certain activities. Colleges and universities use time-and-activity reporting to document that time-and-activity charges to Federal awards reasonably reflect the activity for which the employee is compensated. There must also be suitable means of verification that the work was performed, and one use of these reports is to verify that an employee's total allocation of time charged does not exceed 100 percent (Circular A-21, § J.10.c.(2)(c)).

The University's effort-reporting process originates from a common University of California (UC) payroll system that captures various information, including personnel employment classifications, pay rates, and associated taxes and benefits. The University used this information, along with knowledge of all other employee workload cost categories, to establish the percentage of effort for all activities planned for the employee. The University entered this planned percentage of effort into its payroll allocation system, and the total percentage of effort had to equal 100 percent. University faculty generally work on multiple projects during the year and thus allocate time spent among these various projects, including those funded by HHS awards.

⁸ See *The University of California at Irvine's Pilot Payroll Certification System Could Not Be Assessed*, A-04-13-01027, issued December 11, 2014.

⁹ Circular A-21, *Cost Principles for Educational Institutions*, was relocated in 2 CFR part 220 and made applicable to HHS awards and subawards by 45 CFR § 74.27(a). After our audit period, OMB consolidated and streamlined its guidance, which is now located at 2 CFR part 200. HHS has implemented the guidance in regulations found at 45 CFR part 75. For the sake of simplicity, this report will cite to the cost principles in Circular A-21 rather than the codification of the guidance.

At the end of each quarter, the University's effort-reporting system generated a printout (referred to as a Personnel Activity Report) of each employee's distribution of effort, and either the employee or someone responsible for the employee's effort signed it. The certification stated, "I certify that this report represents a reasonable estimate of the actual effort expended on each sponsored project and each category of effort reported." If the actual effort reported on the Personnel Activity Report significantly differed from planned or budgeted effort, the University must adjust charges to awards and activities accordingly (Circular A-21, § J.10.c.(2)(b)).

The University used this method to charge salaries to Federal awards for 15 months of our 39-month audit period: January 2, 2010, through March 31, 2011.

The Pilot Method: Payroll Certification System

According to the FDP, colleges and universities proposed an alternative method (pilot PCS) for charging salaries to Federal awards because colleges and universities considered the standard method expensive, unfocused, and confusing. Within the pilot PCS, colleges and universities use payroll certifications as the main support for salaries charged to Federal awards. Instead of requiring employees, supervisors, or PIs to certify "effort," the pilot PCS requires PIs to review payroll expenses charged to their awards and to sign an annual project certification stating that certain employees worked on the award and that salaries "are reasonable in relation to work performed."

According to the FDP proposal:

Principal Investigators would not be certifying "effort" rather they would be certifying that salaries and wages "are reasonable in relation to work performed." This concept is taken from the Plan Confirmation portion of OMB Circular A-21, the J.10.c.1.(e) section: "At least annually a statement will be signed by ... principal investigator[s] ... stating that salaries and wages charged to sponsored agreements as direct charges ... are reasonable in relation to work performed."

The FDP proposal asserted that the pilot payroll certification system complied with Circular A-21.

According to the University's personnel, the PI prepares the proposal and scope of work, proposal budget, and budget justifications. The PI works with his or her Department's Contract and Grant Analyst to prepare a proposal budget. Within the University's Sponsored Projects Administration (SPA), a Contract and Grant Officer is assigned to the Department unit. The University accounting department establishes an account for the award. A Department administrator enters the budgeted salary into the payroll system, which automatically charges the account for that HHS award.

According to the University's proposal and policy documents, the PI on an award can access monthly award financial reports through a Web-based system called the PI Web Reporting System (PIWRS). PIWRS automatically generates reports listing all ledger activity, including salaries charged to the award. Separate reports are made available for each award for which the

PI is the certifying official. At the time of our onsite audit work, the review of these monthly reports was not mandatory. At the end of the award's budget period, an automated email is sent to the PI stating that payroll certifications are due. The PIs perform the annual payroll certifications using PIWRS, which is the same Web-based system that provides the monthly reports. The annual report lists information such as employee names, salary charges by employee, any adjustments that have occurred and a percentage of award salary to total salary for each employee. PIs perform an annual certification for each award they certify. The PI reviews the information on the annual certification report and digitally signs it, certifying that "[s]alaries and wages incurred during the certification period are appropriate and reasonable in relation to work performed on the referenced sponsored project." The University's proposal also states, "Monthly, salaries appearing on the PI Web Reporting System (PIWRS) should be reviewed for accuracy. Required corrections and adjustments must be initiated immediately and on a monthly basis to ensure the accuracy of the annual Payroll Certification report." The University uses the certifications as the supporting document for salary charges when filing its Federal Financial Report (FFR).

As a participant in the pilot PCS, the University used this method to charge salaries to Federal awards for 24 months of our 39-month audit period: April 1, 2011, through March 31, 2013.¹⁰

Facilities and Administrative Costs

Facilities and administrative (F&A) costs are those expenses that benefit common activities and therefore cannot be readily assigned to a specific cost objective¹¹ or project. At educational institutions, such costs are classified into the following categories: (1) building and equipment depreciation/use allowances, (2) operation and maintenance (including utility expenses), (3) interest associated with the acquisition of certain capital construction and equipment, (4) general administration and general expenses, (5) departmental administration, (6) sponsored projects administration, (7) library, and (8) student administration and services (Circular A-21, § F.1.)

Salaries of administrative and clerical staff should normally be treated as F&A costs and not charged directly to an award unless an extensive amount of administrative support is required to perform the award and employees involved can be specifically identified with the project or activity (Circular A-21, § F.6.b.(2)).

University of California—Riverside

The University is a State institution located in Riverside, California, and is one of 10 universities within the UC system. During the period January 2, 2010, through March 31, 2013, the

¹⁰ The HHS letter approving the transition to the pilot PCS granted the University a 2-month exception period during which the University may have covered some transactions under both the effort-reporting system and the pilot PCS.

¹¹ "A cost objective may be a major function of the institution, a particular service or project, a sponsored agreement, or an F&A cost activity ..." (Circular A-21, § B.3).

University claimed \$17,204,282 in reimbursement for salary costs applicable to 232 HHS awards.

Federal Requirements

Regardless of the method used to charge salaries and wages to Federal awards, by accepting HHS awards, colleges and universities agree to comply with regulations governing the use of Federal funds and to ensure that costs charged against those funds are allowable under the cost principles established in Circular A-21.¹² The cost principles require that, to be allowable, costs must be reasonable, be allocable, and conform to any exclusions or limitations set forth in the cost principles or awards.

HHS grant regulations also require that recipients of Federal funds have financial management systems that accurately reflect the source and application of funds (45 CFR § 74.21(b)(2)).¹³ Specifically, financial management systems should have effective controls for all funds and should ensure that funds are used for authorized purposes (45 CFR § 74.21(a)(3)). These requirements also emphasize managing Federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements. NIH¹⁴ requires grantees to have accounting and internal controls that provide for the appropriate monitoring of awards (GPS, § 8.3.1 (2010–2013)).

In addition, new HHS grant regulations require non-Federal entities, including colleges and universities, to establish and maintain effective internal control over Federal awards that provide reasonable assurance that award funds are being managed in compliance with Federal statutes, regulations, and the terms and conditions of the award (45 CFR § 75.303(a)¹⁵). As such, it is important to note that if colleges and universities move forward to integrate the pilot PCS within their business operations, they will need to ensure that effective internal controls are implemented to adequately support salary and wages charged to Federal awards and protect Federal funds from misuse and abuse.

HOW WE CONDUCTED THIS REVIEW

On our behalf, NSF asked the University to reconcile costs recorded in its accounting records to those on the FFRs it used to claim costs it charged to Federal awards.

¹² For Federal contracts awarded under the Federal Acquisition Regulation to an educational institution, OMB grant cost principles are applied to determine the allowability of costs (48 CFR § 31.303).

¹³ HHS implemented OMB's common rule for grants administration for nonprofit entities (2 CFR part 215) at 45 CFR part 74. After the audit period, 45 CFR part 74 was replaced by 45 CFR part 75.

¹⁴ We limited the audit to awards between the University and NIH.

¹⁵ Effective with awards made on or after December 26, 2014.

Our audit covered approximately \$17.2 million¹⁶ in Federal salary and wage costs that the University claimed for reimbursement from January 2, 2010, through March 31, 2013¹⁷ (Appendix A).

To determine whether the University's prior effort-reporting system and pilot PCS provided accountability over payroll charges to Federal awards, we audited a stratified random sample of 180 salary and wage transactions totaling \$386,281 (Appendix B).

We used Federal National Institute of Standards and Technology guidance, reviewed University IT policies, interviewed University officials, and reviewed scans that the University performed on its payroll IT system. We reviewed the IT access controls safeguarding the payroll system. Our IT review was limited to the pilot PCS and the systems that support it. Those systems included servers used to host the pilot PCS application (PIWRS), the University's workstations used to access the pilot PCS, and the database used to house the pilot PCS data. We did not assess the effort-reporting system's IT controls.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains the details of our audit scope and methodology, Appendix B contains our sample design and methodology, and Appendix C contains our sample results and estimates.

FINDINGS

The University's prior effort-reporting system did not always provide the information needed to confirm that payroll costs had been appropriately allocated to Federal awards, and its current pilot PCS provided less accountability over payroll charges to Federal awards than its prior effort-reporting system. Specifically, the pilot PCS did not comply with certain requirements of Circular A-21 and, as designed, limited the ability of the University and HHS to provide oversight of these funds. In general, the University did not provide documentation during our audit to demonstrate that the PI or anyone in an oversight position had the necessary information to determine that salary charges made to Federal awards were reasonable in relation to the work performed. Our inability to verify the accuracy of these salary charges made to HHS awards exposed a fundamental weakness in the pilot PCS design—a lack of adequate controls enabling the PI to verify cost allocation. As noted throughout this report, we determined that the PI did not have the requisite information to support a certification that all salary charges are reasonable in relation to the work performed. This, in turn, could have impeded the University's ability to provide effective oversight of HHS funds. On the basis of our sample, we estimated that the

¹⁶ Our audit also included F&A costs associated with the \$17.2 million in salary and wage costs (Appendix C, Table 3).

¹⁷ Our audit covered 39 months: 24 months during which the University used the pilot PCS and 15 months during which the University used the prior method before the University's conversion to the pilot PCS.

University put at risk \$11.7 million in salaries and \$5.9 million in associated F&A costs claimed against NIH awards.

Furthermore, the University's IT controls did not always ensure the security of data used to support labor charges in the pilot PCS. We identified general IT control weaknesses that included unrestricted remote access, inadequate password settings, poor patch management, and expired vendor support. We promptly communicated to the University our preliminary IT findings before we issued our draft report.

INFORMATION NEEDED TO CONFIRM THAT PAYROLL COSTS WERE APPROPRIATELY ALLOCATED TO FEDERAL AWARDS WAS NOT ALWAYS AVAILABLE UNDER THE PRIOR EFFORT-REPORTING SYSTEM

The payroll distribution system must allow confirmation of (1) activity allocable to each sponsored agreement and each of the categories of activity needed to identify F&A costs and of (2) the functions to which the F&A costs are allocable (Circular A-21, §§ J.10.b.(2)(c) and J.10.c.(2)(c)-(d)). To confirm the distribution of activity is a reasonable estimate of the work performed, suitable means of verification must be available (Circular A-21, § J.10.c.(2)(c)).

We identified 83 transactions totaling \$171,157 that were supported by personnel activity reports that did not separately identify nonsponsored activities.¹⁸

The University's prior effort-reporting system did not provide the information needed to (1) demonstrate that employees' time was appropriately allocated to all activities or (2) ensure that no more than 100 percent of an employee's time was charged to Federal awards. Specifically, the form used to document an employee's effort (personnel activity report) did not break down nonsponsored activities into categories such as instruction, departmental administration, and departmental research. Instead, the personnel activity report listed all sponsored projects (e.g., Federal and State grants and contracts) and summarized all nonsponsored activities into one category labeled "all other activities."

Because nonsponsored activities were summarized into a single category on the personnel activity report, the effort an employee spent on each of these activities could not be verified, and, therefore, the percentage attributed to each federally funded research activity could not ultimately be confirmed. We could not determine that the total work performed and charged against all activities did not exceed 100 percent. Without this level of transparency, we could not confirm that the amount charged for work on federally funded research was accurate. For example, because instructional effort was not separately identified within the "all other activities" category, it could not be checked against registrar records. Likewise, departmental administrative effort could not be compared to departmental chair stipends or organization charts. Limited detail about an employee's nonsponsored work activities prevents verification

¹⁸ Generally, sponsored activities are those paid for with sources other than University funds, such as Federal or State grants and contracts. Conversely, nonsponsored or all other activities are generally paid for using University funds (UCR Accounting PAR System Overview, section 4.0, "Effort Categories"). Available online at <http://accounting.uce.edu/funds/parsys.html>. Accessed on November 10, 2015.

that the work was performed, and, therefore, we were unable to determine whether the costs claimed on Federal awards represented a reasonable estimate of costs.

THE PILOT PAYROLL CERTIFICATION SYSTEM DID NOT COMPLY WITH FEDERAL REQUIREMENTS RESULTING IN LESS ACCOUNTABILITY OVER PAYROLL CHARGES TO FEDERAL AWARDS

The pilot PCS did not comply with the requirements of Circular A-21 and, as designed, limited the ability of the University and HHS to provide oversight of these funds.

Specifically:

- The PIs did not have suitable means to verify that salary charges made to the award were reasonable in relation to the work performed.
- Salary costs charged to HHS grants may not have represented actual costs.
- PIs allowed unsupported adjustments after grant expenditures were reported to the Federal Government.
- PIs inappropriately reclassified administrative salaries as direct costs.
- PIs made cost transfers that were undocumented and unapproved by the University.
- The University did not provide documentation that salary charges did not exceed 100 percent of an employee's salary.
- Grants were charged for unsupported payroll transactions.
- Verifying salary charges under the prior effort reporting system could more readily be achieved than under the pilot PCS payroll certification system.

No Suitable Means of Verification That the Charges Were Reasonable in Relation to the Work Performed

An acceptable payroll distribution system must provide the person responsible for confirming direct cost and F&A cost activities “with suitable means of verification that the work was performed” (Circular A-21, § J.10.b.(2)(b)). In a plan confirmation methodology that relies on an annual certification that salary and wage charges are reasonable in relation to work performed, the responsible official must use “suitable means of verification that the work was performed” (Circular A-21, § J.10.c.(1)(e)).

PIs did not have suitable means to verify that salary charges made to an award were reasonable in relation to the work performed.

The University's pilot PCS generates monthly reports of expenditures, including salaries that have been charged to the grant, and this information is made available to the PI. At the time of our onsite audit work, the review of these monthly reports was not mandatory. In our interviews with PIs, they said that they used this information differently. For example, one PI said that he reviewed the information carefully, but another PI said that he did not bother with it very much.

The University's pilot PCS also provides an annual Payroll Certification form that shows the total salary charged for each employee to the award for the year. However, the salary shown on the Payroll Certification form alone was not sufficient to verify that the charge was reasonable in relation to the work performed.

The University did not provide us any other supplementary documentation that would have allowed for the verification that the salary amounts charged to the grant were reasonable in relation to the work performed. For example, the University did not provide the PI with a full salary distribution that could assist in determining the reasonableness of the salary charges made to the PI's project. If employees perform work under other awards, the PI may not be aware of this additional activity.

In addition to documentation, the person responsible for certifying that salaries charged are reasonable in relation to the work performed should document his or her participation in the project. In fact, HHS's approval letter¹⁹ required that the certification that all salary and wage charges are appropriate and reasonable must be made by a certifier who "is aware of the employee, position, and payroll amount charged to a specific award/fund."

Twelve transactions totaling \$30,187 under the pilot PCS had Payroll Certification forms certified by PIs, but the Payroll Certification forms showed that the PIs had not charged any of their own salary to the awards. The University did not provide any other evidence that these PIs had worked on these awards or had the requisite knowledge of the work performed on these awards.

Salary Costs Charged Might Not Have Represented Actual Costs

An acceptable payroll distribution system must recognize the principle of after-the-fact confirmation or determination so that costs distributed represent actual costs unless a mutually satisfactory alternative agreement is reached (Circular A-21, § J.10.b.(2)(b)). Based on our review of sample transactions and discussions with PIs, we were unable to verify that charges to HHS grants represented actual costs. Estimated salaries initially used for grant applications and budgeting were entered into the payroll system. The payroll system then automatically charged the project account. Although PIs were authorized to make changes to the account, we saw no evidence that such changes had ever been made other than cost transfers. In fact, PIs told us that making changes was difficult and in some cases they were not allowed to make changes at all. Thus, if estimates were not changed, they became actuals.

¹⁹ Page 1 of the undated letter from the HHS Director, Office of Grants Policy, Oversight, and Evaluation, to the University of California's Provost and Executive Vice President and to the University of California's Executive Vice President and Chief Financial Officer.

Unsupported Adjustments Made After Grant Expenditures Were Reported to the Federal Government

The recipient institution is responsible for ensuring that costs charged to a sponsored agreement are allowable, allocable, and reasonable (Circular A-21, § C.4.d.(1)). Furthermore, recipient financial management systems must have “[e]ffective control over and accountability for all funds” (2 CFR § 215.21(b)(3)).

Under the pilot PCS, nine transactions, totaling \$15,542, that the University identified in its accounting records as adjustments did not match the Payroll Certification forms or any other documents that the University provided. As a result, undocumented adjustments²⁰ made after grant expenditures that were reported to the Federal Government may have represented costs in excess of the work performed. Further, the University’s pilot PCS did not ensure the appropriateness of adjustments made after grant expenditures were reported to the Federal Government. PIs adjusted the amounts charged to Federal awards after Payroll Certification forms had been certified without (1) prior supervisory approval, (2) documented justification, or (3) amending the Payroll Certification forms.

Administrative Salaries Inappropriately Classified as Direct Costs

Salaries of administrative and clerical staff should normally be treated as F&A costs unless an extensive amount of administrative support is required to perform the award and employees involved can be specifically identified with the project or activity (Circular A-21, § F.6.b.(2)).

The University charged 12 salary transactions totaling \$12,436 for administrative and clerical salaries as direct costs under the pilot PCS. The University provided no evidence that the awards required an extensive amount of administrative support.

As a result, charging the salaries of administrative personnel directly to these awards allowed the University to receive reimbursement for these costs, thereby potentially avoiding the administrative indirect cost cap²¹ of 26 percent.

Undocumented and Unapproved Cost Transfers

Any costs allocable to a particular sponsored agreement may not be shifted to other sponsored agreements to meet deficiencies or other fund considerations or for other reasons of convenience (Circular A-21, § C.4.b.). Transfers must be supported by documentation that fully explains the reason for the transfer and by a certification of the correctness of the new charge by a responsible organizational official of the grantee (GPS, § 7.5 (2010–13)). An explanation merely stating that

²⁰ Adjustments are costs that were transferred after the award period ended. An example of an undocumented adjustment would be a PI moving salary amounts to an award after he or she completed the payroll certification for that award and without stating a valid reason for the adjustment.

²¹ The “Administrative” category in F&A is defined as general administration and general expenses, departmental administration, sponsored projects administration, and student administration and services and all other categories of expenses that do not fall under “Facilities” (Circular A-21, § F.1). The amount that can be charged to Federal awards for this category is capped at 26 percent of certain modified direct costs (Circular A-21, § G.8.a).

the transfer was made “to correct error” or “to transfer to correct project” is not sufficient. Transfers of costs from one project to another or from one competitive segment to the next solely to cover cost overruns are not allowable (GPS, § 7.5).

Six cost transfers under the pilot PCS totaling \$11,932 were not documented or approved by a supervisor.

Some examples:

- Two Departments associated with transactions in our sample did not require a certification of correctness on either of the cost transfers and did not require an explanation for the two transfers other than the PI’s directive that it needed to be done.
- A PI moved salary costs from one of his awards to another to cover a shortfall and subsequently certified the supporting Payroll Certification form. In another case, a PI certified an employee’s salary and then had the salary transferred to another award in the next fiscal year (FY) without justification. The PI then certified this same salary as “reasonable” on the second award.

No Documentation That Charges Did Not Exceed 100 Percent of an Employee’s Salary

Any acceptable payroll system must, among other things, “reasonably reflect the activity for which the employee is compensated by the institution” and “will allow confirmation of activity allocable to each sponsored agreement” (Circular A-21, §§ J.10.b.(2)(a) and (c)). Furthermore, financial management systems must contain “[r]ecords that identify adequately the source and application of funds for HHS-sponsored activities” (45 CFR § 74.21(b)(2)). Therefore, salary costs charged to sponsored and nonsponsored activities may not exceed 100 percent of an employee’s salary, and systems must be able to adequately support those salary charges.

The University’s Sponsored Programs Administration, the function within the University that has access to the pilot PCS, did not provide evidence that total salary and wage costs did not exceed 100 percent of employee’s salaries.

Even if the system could provide assurances that salary charges did not exceed 100 percent, the PI would need more complete information, such as a certification form for all activities to which the employee was assigned, to make the appropriate certification. Without knowledge of all of the employee’s activities, the PI might have inadvertently certified salary charges that did not reasonably reflect the work performed.

Recording Unsupported Payroll Transactions

A cost is allocable to a sponsored agreement if the goods or services benefit the cost objective in accordance with relative benefits received (Circular A-21, § C. 4.a.). These charges must be documented in accordance with the HHS grant administration regulations and university policies, where appropriate (Circular A-21, § C.4.d.(4)). According to HHS regulations, recipient

financial management systems must provide for accounting records, including cost accounting records, that are supported by source documentation (45 CFR § 74.21(b)(7)).

We identified six transactions totaling \$11,336 under the prior effort-reporting system that were not supported by an effort report and one transaction totaling \$1,907 under the pilot PCS that was not supported by a Payroll Certification form. Lack of supporting documentation created uncertainty about whether the amount charged to the award reflected the benefit to the award.

These transactions were unsupported because University personnel did not always follow Circular A-21 and 45 CFR § 74.21(b)(7).

Verifying Salary Charges Could Be More Readily Achieved Under the Prior Effort-Reporting System Than Under the Pilot Payroll Certification System

Any acceptable payroll distribution system must “reasonably reflect the activity for which the employee is compensated by the institution” and must “allow confirmation of activity allocable to each sponsored agreement” using suitable means of verification that the work was performed (Circular A-21, §§ J.10.b.(2)(a) and (c)). Furthermore, the system must provide for independent internal evaluations to ensure, among other things, that salary charges reasonably reflect the activity for which the employee is compensated (Circular A-21, § J.10.b.(2)(f)).

The University’s prior effort-reporting system often provided a clearer means of verifying direct salary charges made to HHS sponsored awards. For example, we identified two unallowable transactions under the prior effort-reporting system that could not have been identified under the pilot PCS:

- Under the prior effort-reporting system, we were able to use documentation, including personnel activity reports, to verify that charges made by a department chairperson that appeared improper were not allowable. As a general matter, Federal funds are not to be used to cover shortfalls in other activities (Circular A-21, § C.4.b). In this transaction, the chairperson, who was normally paid from State funds, was paid from an NIH grant to avoid being furloughed. The only apparent justification for the salary charge was a University policy that allowed PIs facing a State-mandated furlough to avoid lost wages by increasing the amount the time spent working on awards from external funding sources, including Federal awards. The chairperson’s effort report did not show that he devoted any additional effort to the NIH grant. If this salary charge had been made under the pilot PCS system, we would not have been able to identify this unallowable cost because employees under the pilot PCS are not required to prepare personnel activity (effort) reports. Under the pilot PCS, the University would have provided us only a dollar amount to support the charge to the award. A dollar amount without some measure of work performed, such as an effort percentage, would not have allowed us to identify this unallowable cost.
- Under the prior effort-reporting system, costs for a course buyout, including salary, fringe benefits, and F&A, were inappropriately charged to at least one NIH award. The University had a policy that allowed faculty to “buy out” of academic courses they were

required to teach. For a faculty member to continue receiving his or her regular salary, the University policy requires that a proportionate amount of salary be obtained from non-State funds. In this particular case, the cost saved by the University under the course buyout agreement was charged to the NIH grant, but the University was unable to provide any effort report to support the increased charge to the grant. Like the unallowable furlough charge discussed above, this salary charge would not have been identifiable under the pilot PCS system, because the pilot PCS does not require effort reports. The accuracy of percentages of effort on an effort report can be tested. However, testing the value of work performed expressed as a dollar value is more problematic because there is no standard upon which to measure work performed.

Under the prior effort-reporting system, we were able to identify these transactions when the effort percentages on the Personnel Activity Reports did not match the amounts charged to the awards. The pilot PCS Payroll Certification Form does not include this effort-percentage information. These two examples highlight instances in which the lack of documentation in the pilot PCS could have impeded the University's ability to provide effective oversight of HHS funds.

THE UNIVERSITY'S INFORMATION TECHNOLOGY CONTROLS DID NOT ENSURE THE SECURITY OF DATA USED TO SUPPORT LABOR CHARGES

The Federal National Institute of Standards and Technology (NIST) publishes studies, investigations, research, standards, and guidance to the public²² on security issues affecting IT. NIST publishes these as SPs, NIST Internal Reports, and IT Laboratory Bulletins. Although only Federal agencies are required to follow NIST guidelines, the guidelines represent industry standards for good business practices when developing and performing compliance activities to secure an organization's information systems data.

Based on these guidelines, the University did not always provide adequate assurances that the information technology controls for the systems that the University used to support the pilot PCS ensured that the data used to support labor charges were secure. The University's general IT control weaknesses for securing the data in those systems included:

- unrestricted remote access,
- inadequate password settings,
- poor patch management,²³ and
- expired vendor support.

²² NIST Special Publications (SPs) 800 Series are available online at: <http://csrc.nist.gov/publications/PubsSPs.html>.

²³ Patch management is the process of using a strategy to plan what software update to apply to which systems at a specified time.

We promptly communicated to the University our preliminary IT findings before we issued our draft report.

Unrestricted Remote Access

Remote access is access to organizational information systems by users (or processes acting on behalf of users) communicating through external networks (e.g., the Internet) (NIST SP 800-53, Appendix F-AC-17, *Remote Access*).

The University had inadequate system security controls over remote access into its pilot PCS. For example, there were no restrictions or configuration requirements that ensured a secure remote connection, such as a virtual private network, to protect the disclosure of a system user's login credentials. PIs that accessed the certification system remotely from an unsecured connection risked the theft of their login credentials, which could be used to access the system and edit fund allocations.

Inadequate Password Settings

Systems are successfully attacked as a result of poor administrative practices, such as not changing default passwords or applying vendor patches (NIST SP800-70-rev 2, section 2.2 (effective Feb. 2011, archived). Microsoft²⁴ recommends that users change passwords at least every 90 days when security is a concern.

The University had not implemented a maximum password age on its network to force password changes on a periodic basis. The maximum password age determines how many days a password can be used before the user is required to change it; setting it too high or disabling it gives potential attackers more time to determine the password. Without setting a maximum password age, an employee may set an initial password and never change it, thus increasing the time that an attacker can use a stolen password to access a user's account.

Poor Patch Management

A patch is a piece of software designed to update a computer program, or its supporting data, to fix or improve it. Patches enable additional functionality or address security flaws that can be exploited by an attacker to gain greater access or privileges than what is authorized on a computer system.

“Timely patching of security issues is generally recognized as critical to maintaining the operational availability, confidentiality, and integrity of IT systems. However, failure to keep operating system and application software patched is the most common mistake made by IT professionals” (NIST SP 800-40, version 2.0, *Creating a Patch and Vulnerability Management Program*”).

²⁴ Microsoft, “Best Practices for Enforcing Password Policies.” Available online at: <http://technet.microsoft.com/en-us/magazine/ff741764.aspx>. Accessed on September 9, 2014.

The University did not have a patch management program in place for its workstations to help ensure that patches were applied in a timely manner. University officials said that they expected their staff who had been issued workstations to know the importance of patches and install them as necessary, although there were no policies and procedures instructing staff to do so. Without a patch management program, it is possible that patches would not be applied in a timely manner. Failure to apply patches in a timely manner may allow an attacker to gain unauthorized access and harm the University's computer network.

Expired Vendor Support

NIST recommends that the organization install within its established time limits all "security-relevant software and firmware updates" (NIST SP 800-53, Revision 4, *Security and Privacy Controls for Federal Information Systems and Organizations*, Appendix F, SI-2 c., "Flaw Remediation" (April 2013)).

The University used an operating system on servers that supported the pilot PCS that had reached its end of life and was no longer supported by the vendor without an extended service agreement. University officials were not aware that the operating system was at its end of life and did not have an extended service agreement with the vendor at the time of our audit. Therefore, the pilot PCS's information was vulnerable to potential attacks. After we informed University officials about its operating system's vulnerabilities, the University upgraded the operating system to a version supported by the vendor.

CONCLUSION

We identified problems in the University's prior effort-reporting system and its current pilot PCS. These vulnerabilities increased the risk that unallowable salary costs were charged to HHS awards. On the basis of our sample results, we estimated that the University put at risk \$17.6 million of salary and associated costs (\$11.7 million in salaries and \$5.9 million in F&A) claimed against NIH awards during our audit period.

We have serious concerns with the University's pilot PCS because there were inadequate controls in place, especially those controls enabling the PIs to verify that salary and wage charges made to a Federal grant were reasonable in relation to the work performed. Although the University's pilot PCS relieves administrative burden by requiring only one certification per award each year, the characteristics of the system limit its usefulness in providing accountability over the use of Federal funds and therefore put Federal funds at risk. The pilot PCS places extraordinary responsibility on PIs with little to no oversight, resulting in a system that fails to properly monitor payroll costs charged to HHS awards. The University's monthly reports and the annual certifications did not provide the necessary information for a PI to certify to the reasonableness of salary charges. These reports also failed to provide the University or Federal auditors with the necessary information to verify the reasonableness of salary costs charged to HHS awards. Without the necessary information, the University could neither ensure nor affirm that charges to Federal awards were reasonable in relation to work performed.

In addition, general IT controls over the pilot PCS-related systems at the University were inadequate to protect the system and ensure the reliability of data contained in it. The University's general IT controls did not restrict remote access, had inadequate password settings, poor patch management, and expired vendor support. As a result, the University did not always provide adequate assurances of the security of the data used to support labor charges or the data's traceability for systems used to support the pilot PCS.

If the University continues to use the pilot PCS, it needs strong internal controls to ensure that the payroll charges are adequately supported. Additionally, having a transparent view of each employee's full payroll allocation, including percentage allocations assigned to other awards or projects, is necessary for a PI to ensure the salary charged to his or her project is reasonable in relation to the work performed. Accounting for full allocations of an employee's time could be an important control to help ensure that overcharges and inaccurate charges do not occur.

RECOMMENDATIONS

We recommend that the University strengthen oversight of payroll charges to Federal awards by:

- ensuring that, if the University returns to its prior effort-reporting system, it updates the system to adequately account for nonsponsored activities to ensure that payroll costs are properly allocated to Federal awards (recommendation 1);
- ensuring that suitable means exist for a PI to verify that salary charges made to an award are reasonable in relation to the work performed (recommendation 2);
- ensuring that suitable means exist to document that salary charges represent the actual work performed on a grant and not just budget estimates (recommendation 3);
- requiring and documenting prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government (recommendation 4);
- requiring and documenting prior approval and justification for charging administrative and clerical salaries as direct costs (recommendation 5);
- requiring and documenting prior approval and justification for cost transfers (recommendation 6);
- developing payroll procedures to ensure that salaries are properly allocated and that salaries charged to all activities do not exceed 100 percent (recommendation 7); and
- following Federal requirements for supporting payroll costs claimed (recommendation 8).

We further recommend that the University strengthen its general IT controls for systems used to support the pilot PCS by:

- improving restrictions for remote access (recommendation 9),

- implementing a password setting that requires password changes periodically (recommendation 10),
- implementing a patch management system for its desktop computers (recommendation 11), and
- implementing procedures to ensure that vendor support does not expire on the University’s operating system (recommendation 12).

UNIVERSITY OF CALIFORNIA—RIVERSIDE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

The University concurred with our fourth recommendation—requiring and documenting prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government—but did not concur with our other recommendations. The University said that its internal controls and Payroll Certification²⁵ (PRC) process provide accountability over payroll and other charges to Federal awards. Although the University did not agree with most of our recommendations, it described some actions it has taken or plans to take to enhance its internal controls.

We revised Recommendation 5 on the basis of supplementary information that the University provided. We also made a technical change in Recommendation 8 to more accurately reflect our finding. However, we maintain that our remaining recommendations are valid as drafted.

The University’s written comments included three attachments and two appendixes that contained supplementary information, such as a copy of its proposal for the pilot PCS and a discussion of sample items we classified as at-risk. Because of the volume of the appendixes, we did not include them in this report. The University’s comments, excluding the two appendixes, are included as Appendix D.

Recommendation 1

University Comments

The University did not concur with our recommendation to ensure that, if the University returns to its prior effort-reporting system, it updates the system to adequately account for nonsponsored activities. The University said that it did not believe that it was necessary to return to its prior effort-reporting system to comply with Federal requirements.

The University said that its prior effort-reporting system complied with “Criteria for Acceptable Methods” (Circular A-21, § J.10.b (2)(c)) and that Circular A-21 allowed it to use an effort-reporting format that did not specifically identify each nonsponsored activity, although the effort report did confirm nonsponsored activity in total. The University said that, consistent with Circular A-21, it subsequently distributed the nonsponsored activities’ F&A costs to the

²⁵ In its comments, the University refers to the pilot PCS as the Payroll Certification process, PRC process, or Payroll Certification system (PRC).

appropriate cost pools when developing the University's F&A rates using payroll distributions and direct cost equivalents. According to the University, this reasonable method of distributing costs to cost pools was agreed upon during its F&A rate negotiation with HHS's Cost Allocation Services.²⁶

The University said that because it did not receive any feedback on documentation it submitted to support the 83 transactions we classified as at-risk and because the University's former effort reporting system complied with Circular A-21 requirements, the number of at-risk transactions identified in the audit and subsequent extrapolation amounts was overstated.

OIG Response

Our concern was not related to how the University ultimately distributed F&A costs or the agreement between the University and HHS's Cost Allocation Services. Rather, our concern was about having enough information to verify that salaries are reasonable in relation to the work performed. Summarizing nonsponsored activities into a single category on the University's personnel activity form does not provide the transparency needed to verify the percentage of effort spent on nonsponsored activities such as instruction, departmental administration, and departmental research. Therefore, we do not agree that the University's former effort-reporting system complied with OMB Circular A-21 requirements or that the number of at-risk transactions we identified are overstated.

Recommendation 2

University Comments

The University did not concur with our recommendation to ensure that suitable means exist for a PI to verify that salary charges made to an award are reasonable in relation to the work performed. The University asserted that its PIs have suitable means to verify that salary charges to awards are reasonable in relation to the work performed. The University said that it provides PIs with readily accessible information on their contract and grant activities. The University mentioned various sources of information that it believes ensures that suitable means exist for a PI to verify that salary charges are reasonable in relation to the work performed, including the Proposal and Award Management Information System (PAMIS), monthly PI Web Reporting System (PIWRS), and PRC.

The University said that, in June 2013, it enhanced its PAMIS portal. In its comments, the University also described how PAMIS works and how PAMIS interacts with other grant and contract applications that the University uses (Appendix D, Attachment B).

The University said that it recently completed specifications and started programming to enhance its PIWRS by including not only contract and grant funds but also all funding sources associated with a PI, such as gifts, department allocations, and sales and service activities. According to the

²⁶ Cost Allocation Services is located within HHS's Program Support Center. HHS is designated by OMB as the cognizant Federal agency for reviewing and negotiating, among other things, facility and administrative (indirect) cost rates.

University, these enhancements will allow the PI to easily access payroll details across all of their funding sources, including funds for which a PI is designated as the Co-PI.

The University said that it delayed implementing major enhancements to the PRC until feedback was received from this audit. The University said that, in the exit conference²⁷ that we conducted with it at the end of our audit in September 2014, we did not identify issues with the PRC process, nor did we discuss concerns about the PRC process. However, after receiving our findings in the draft of this report, the University said that, by June 2017, it planned to enhance the PRC system. These enhancements include providing PIs the ability to:

- drill down and access an individual's full payroll distribution for the certification period;
- view payroll details including the payroll distribution percentage for each funding source used to pay the employee's salary;
- add the option to request a subcertification from a Co-PI or employee supervisor; and
- consolidate into the PRC report all (salary and nonsalary) mandatory, committed cost share reporting.

The University said that, as these enhancements to the PRC are developed and implemented, additional support, site materials, and training will be provided to its campus users.

The University asserted that PIs, with the assistance of administrative staff, have suitable means to verify that salaries charged to Federal awards are reasonable in relation to the work performed as confirmed by the completion of the PRC on their awards.

The University also described how the preparation of progress and final reports for NIH require reporting on accomplishments, products, participants, impact, changes, and special items. This reporting requires information on the level of effort of the individuals that have worked on the project.

The University also commented (Appendix D, Attachment C) on our finding that under the pilot PCS, 12 transactions totaling \$30,187 had Payroll Certification forms certified by PIs, but the forms showed that the PIs had not charged any of their own salary to the awards. The University said that each PI relative to the 12 transactions provided voluntary, uncommitted cost sharing that was not quantified in the submitted award proposal nor the resulting award. The University also said that documentation, such as lab notes, seemed irrelevant because NIH guidance states that a PI has authority and responsibility for leading and directing the project. Finally, the University said that the PI's participation is documented through the payroll certification and the project reports.

²⁷ An exit conference is a formal meeting that the auditors conduct with the auditee at the end of their onsite work. At the exit conference, the participants discuss, among other things, the audit's preliminary findings, and the auditee provides, if it chooses, comments or additional documentation relevant to the preliminary findings. Auditors normally conduct an exit conference before issuance of the draft audit report. Auditors conduct other informal discussions or conferences with an auditee as needed.

OIG Response

The PAMIS portal and most of the systems that the University described as interacting with PAMIS have little to do with determining actual work performed on an award and whether the cost of the work is reasonable. Instead, the PAMIS portal and most of the systems that the University described as interacting with PAMIS largely aid the University in developing award proposals and budgets.

PIWRS and the PRC system relate to salary costs on awards. However, these two systems provide limited means of verifying the reasonableness of work performed. For example, the University provided no method by which a PI could value work performed. The PRC system is not based on time or percentage of effort and does not provide a determination of the reasonableness of salary costs charged by the PI.

During our September 2014 exit conference with the University, in addition to discussing each of the transactions that we classified as at-risk, we discussed our concerns about the PRC system. We also discussed inadequate controls and areas where control processes did not exist.

In regard to planned enhancements to its PRC system, the University did not provide enough information about those enhancements that would allow us to opine on their adequacy. The GAO Green Book²⁸ provides that management may evaluate and incorporate recommendations by external auditors and OIG, but responsibility for an entity's internal control system resides with management. Choosing to delay the implementation of major enhancements to the PRC until feedback has been received from this audit is no basis for the University to neglect its responsibility for overseeing the design, implementation, and operation of an internal control system.²⁹

In regard to the University's comments about reports to NIH, the University did not provide any progress reports as support for its assertion that NIH-required progress and final reports demonstrate that salaries charged to Federal awards are reasonable in relation to the work performed.

In regard to the 12 at-risk transactions, the PRC system includes cost sharing information, which the department enters and includes on the PRC report. However, the University did not provide any evidence to show that the PIs for these 12 transactions performed voluntary, uncommitted cost sharing. In regard to the University's comments that NIH guidance says that a PI has the authority and responsibility for leading and directing the project, NIH guidance also states that a PI must devote measurable effort to the project, whether or not salaries or compensation are requested. According to the guidance, "zero percent effort" or "as needed" are not acceptable levels of involvement. Contrary to the University's assertion, the act of PIs completing PRCs on their awards does not demonstrate measurable effort and does not, in itself, confirm that salaries charged to Federal awards are reasonable in relation to the work performed.

²⁸ GAO-14-704G, *Federal Internal Control Standards* (Green Book), page 12. Available online at <http://www.gao.gov/assets/670/665712.pdf>. Accessed on September 22, 2016.

²⁹ GAO-14-704G, page 11.

Recommendation 3

University Comments

The University did not concur with our recommendation to ensure that suitable means exist to document that salary charges represent the actual work performed on a grant and not just budget estimates. The University said that it does have suitable means. It further said that, although the award budget is developed based on estimated personnel needs and initial appointments and although payroll distributions may be based on these estimates and the approved award budget, sufficient evidence indicates that payroll distribution changes and salary adjustments are made to reasonably represent actual work performed.

According to the University, Circular A-21, § J.10.b(1)(c) (and the Uniform Guidance) recognizes that “in an academic setting, teaching, research, service, and administration are often inextricably intermingled and that a precise assessment of factors that contribute to costs is not always feasible, nor is it expected. Reliance, therefore, is placed on estimates in which a degree of tolerance is appropriate.” The University said that this concept has been recognized at the Federal level for many years, and it would be inappropriate for HHS OIG to effectively hold the University to higher and different standards than the plain meaning found in Circular A-21.

PIs are provided with standard monthly reports for all activities on their contracts and grants in addition to the annual PRC report. The PIWRS provides summary views of contract and grant balances with the ability to see detailed transactions.

Every department on campus is required to perform and document ledger reconciliations using the University’s Ledger Reconciliation and Storage System (LRSS). The University said that:

The campus internal control guidance on the ledger reconciliation process (200-97) include requirements for:

- all salary transactions be verified by thoroughly reviewing of the Distribution of Payroll Expense, and the review cannot be performed by the Payroll Personnel System (PPS) Transactor;
- all transactions against contract and grant funds be reviewed for adherence to the award terms, conditions, and OMB Circular A-21 principles (e.g. allowability, reasonableness, allocability and consistency); and
- certification that these actions list above have been performed.

The University said that many departments create supplemental financial reporting using data extracts from the University’s campus financial system to provide information to their PIs in formats customized for the particular PI or department. PIs are encouraged to review their monthly reports to confirm the appropriateness of expenditures on their awards and to report any errors to their department contract and grant analyst so that they can be promptly corrected.

According to the University, adjustments to salary expenses occur, which demonstrates that salary costs charged to awards are not solely based on budget estimates.

OIG Response

We agree that—in an academic setting—teaching, research, service, and administration are often intermingled and that a precise assessment of factors that contribute to costs is not always feasible. While we agree that adjustments to salary expenses can be an indicator that salary costs charged to awards are not solely based on budget estimates, we saw no salary adjustments other than cost transfers. Also, the University did not provide any documentation showing examples in which salary adjustments had been made because of normal changes in work activity. Without any additional evidence to the contrary, we are unable to conclude that the University's payroll distribution reflected the principle of after-the-fact confirmation or determine that the salary expenses charged to HHS grants represented actual costs, in accordance with the requirements of Circular A-21, § J.10.b.(2)(b). The University also did not contend or provide any evidence that a mutually satisfactory alternative agreement had been reached, as allowed by the regulation.

We do not believe that the University's system meets the requirements of the Uniform Guidance at 2 CFR part 200, codified by HHS at 45 CFR part 75. The regulations state in the following quote that budget estimates (i.e., estimates determined before the services are performed) alone do not qualify as support for charges to Federal awards, but they may be used for interim accounting purposes, provided that:

- (A) The system for establishing the estimates produces reasonable approximations of the activity actually performed;
- (B) Significant changes in the corresponding work activity (as defined by the non-Federal entity's written policies) are identified and entered into the records in a timely manner. Short term (such as one or two months fluctuation between workload categories) need not be considered as long as the distribution of salaries and wages is reasonable over the longer term; and
- (C) The non-Federal entity's system of internal controls includes processes to review after-the-fact, interim charges made to a Federal awards based on budget estimates. All necessary adjustments must be made such that the final amount charged to the Federal award is accurate, allowable, and properly allocated [45 CFR § 75.430 (i)(1)(viii)].

At the time of our audit, the University did not demonstrate, nor did we observe, how it met any of the above requirements. In addition, the University did not provide evidence that showed that every department on campus was required to perform and document ledger reconciliations using the University's LRSS.

For those salary adjustments that we observed (cost transfers), salaries claimed on awards could be recorded twice when cost transfers were made: once in the grant period in which the salary

costs were incurred and a second time in the following grant period in which transferred salary costs were often recorded. The University did not demonstrate that it conducted any kind of trend or variance analysis to determine whether salaries were only claimed once. Absent a process or audit trail to compare the originating grant period and subsequent grant period of a cost transfer during the annual certification of salary costs, there is an increased risk that a duplication error would not be prevented or detected.

The University also did not provide us with any information on how it verified that PIs are providing timely and accurate feedback on the percentage of salary being charged. The monthly reports only provide a monthly fraction of the annual salary and the nonsalary expenditures appearing on department ledgers. The University stated that PIs may, but are not required to, review their monthly report (PIWRS or department provided) to confirm the appropriateness of expenditures on their awards and report errors to their department contract and grant analyst. But the University did not describe how a PI would use the standard monthly reports to determine the appropriateness of salary expenditures, such as a trend analysis of monthly activity.

We did not see any instances in which a PI requested a review of the Payroll Certification report from Co-PIs, project directors, or others with direct knowledge of the project activities. Also, the University did not provide policies and procedures related to making adjustments to payroll, other than cost transfers, for changes in work performed.

In addition, the University did not describe how any management official above the PI would be aware that the PI was not providing the necessary feedback about changes in work activity or salary that should be charged. One way management officials could obtain such feedback would be through a process in which they could compare actual to budgeted performance and analyze significant differences. The University should clearly document transactions and other significant events in a manner that allows the documentation to be readily available for examination.

Recommendation 4

University Comments

The University concurred with our recommendation to require and document prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government. The University described actions it planned to take to enhance its internal controls. For example, it said that the University's Leaders of Excellence and Distinction (LEAD) Committee, in coordination with the University's Office of Research and Economic Development, is actively working on expanding and enhancing training regarding the administration of contracts and grants. This training is planned for FY 2017.

OIG Response

The actions that the University described should aid in enhancing its internal controls. However, the University did not comment—and was not required to comment—on or describe steps that it may have taken to correct the nine transactions that were adjustments made after grant

expenditures had been reported to the Federal Government. If the FFRs relating to these nine transactions were not corrected, the University may have overclaimed its reimbursement for the applicable awards.

Recommendation 5

University Comments

The University did not concur with our recommendation to require and document prior approval and justification for the classification of administrative positions as direct costs. The University said that the PRC process flags payroll title codes in the administrative and clerical job series. Department coordinators are instructed that charging clerical and administrative salaries to a Federal fund is an exception, and these types of salaries should have been proposed in the award budget and explicitly approved by the funding agency. The University further said that PIs are asked to specifically certify that individuals performing clerical and administrative activities on their awards meet the Federal exception criteria, and exceptions are documented.

The University said (Appendix D, Attachment C) that of the 12 sample transactions we identified as administrative or clerical, only 1 position was performing administrative or clerical activities, and that position met the major project definition in Circular A-21. The University stated that this one exception was documented in the award proposal justification, and the proposal was funded without excluding that position. The University also stated that its internal auditors had confirmed that the remaining 11 sample transactions were directly involved in the research and that 5 of the 11 positions were clearly research positions.

According to the University, award proposals are routed through its Research and Economic Development—Sponsored Programs Administration (RED-SPA³⁰) system for review, approval, and submission by the Authorized Organizational Representative. Administrative or clerical positions not included in the funded proposal require prior agency approval, which is coordinated through RED-SPA. Thus, the University believes that it has adequate internal controls over the reclassification of administrative positions.

OIG Response

Based on the information the University provided about the RED-SPA system, we revised the finding to focus solely on charging administrative salaries as direct costs. Although the University said that only 1 salary transaction related to administrative or clerical activities, we identified 12 in which the University charged administrative or clerical salaries as direct costs under the pilot PCS. For example, one employee who was classified as administrative or clerical had duties that included keeping inventory, washing dishes, and general lab upkeep. The payroll

³⁰ SPA is a department within UCR's Office of Research and Economic Development that supports and advises campus researchers and their staffs with a variety of extramural endeavors and funding transactions. Dedicated staff in SPA serve as the UCR officials responsible for the review and submission of proposals to extramural sponsors for research, training, and instructional and other activities. SPA is also responsible for award negotiation and acceptance on behalf of The Regents for projects funded by Federal and State agencies, foundations, corporations, and other public and private sources.

certification contained cost notes for the employee showing that he performed administrative or clerical work but had more than 90 percent of his salary claimed as a direct cost on Federal awards. These notes should have alerted the PI that certain requirements, such as being a major project and having unlike circumstances, have to be met before the PI's certification. The University provided no evidence that the project was a major project, which would have supported the charges.

The University provided limited and conflicting evidence in support of charging administrative or clerical salaries as direct costs for the one transaction that it argues meets the major project definition. The University provided an email from the PI stating that two employees did not perform clerical work, even though the cost note on the employees' PRC showed that the University classified these individuals' positions as administrative and clerical. In this case, the PRC flagged the individuals' PRC form as being administrative and clerical, as the University described in its comments. The University was put on notice through the cost notes that the employee's position was administrative and apparently took no action to support the cost being charged as a direct cost.

Regarding the one position the University said was performing administrative and clerical support, listing a position in an award proposal does not in itself justify charging an administrative or clerical salary to an award as a direct cost. Salaries of administrative and clerical staff should normally be treated as F&A costs unless an unusual degree of administrative support is justified as necessary to perform the award (Circular A-21, § F.6.b.(2)). Also, Circular A-21 defines major projects as projects that require "an extensive amount of administrative or clerical support which is significantly greater than the routine level of such services provided by academic departments" (§ F.6.b.(2)). The University provided no evidence that the award required an extensive amount of administrative support from this individual.

The University did not provide any evidence, including the internal audit it referenced in its comments that showed how it determined that the salaries of the 12 individuals should have been directly charged to awards rather than treated as F&A costs.

Therefore, we continue to believe that these 12 transactions should not have been directly charged to Federal awards.

Recommendation 6

University Comments

The University did not concur with our recommendation to require and document prior approval and justification for cost transfers. The University said that it has clear policies regarding cost transfers that have been broadly communicated on the campus (University of California Business and Finance Bulletin A-47, effective June 30, 2012). The University said that its online training and in-person PPS training sessions clearly described the approval and justification requirements for Federal cost transfers.

The University further stated that “currently, the administration over department expenditures is decentralized.” In its decentralized environment, the campus provides standard guidance, systems, and business rules to drive compliance, but departments have the ability and flexibility to implement their own procedures within the framework provided. It also said that although department processes may vary, post-audit notifications (PAN) are generated on changes affecting the PPS, so there is a secondary review of all transactions. The University said that it would continue to reinforce throughout the campus the University of California policies regarding cost transfer requirements.

OIG Response

The University’s comments did not directly address our recommendation to require and document prior approval and justification for cost transfers. The University of California Business and Finance Bulletin A-47, III.3.B.4, states that when the purpose of an adjustment to expenditures is to transfer a cost to a restricted fund such as a grant, the transfer must be “fully explained, justified, and approved by the unit administrator(s) involved in the transaction. (An explanation which merely states that the adjustment ... is ‘to correct an error’, ‘to transfer to correct project’, ‘or expenditure inadvertently charged to incorrect account/fund’ is not sufficient ...).” Bulletin A-47 also states that justification for adjustments involving Federal awards must be signed by the PI, department head, or other academic official.

Our audit showed that PI’s did not always follow the system-wide cost-transfer policy, and six cost transfers under the pilot PCS were not documented or approved by a supervisor other than the PI who initiated the transfer. Allowing a PI to initiate and approve a cost transfer without documenting an explanation or justification for the transfer indicates that the University did not follow its own policy. In addition, allowing PIs to initiate and approve a cost transfer demonstrates a lack of separation of duties.³¹ We discussed this issue with the University in a May 2016 teleconference. The University could enhance its cost transfer policy by ensuring that the responsibility for authorizing transactions is separate from processing and recording them. If the PI initiated or processed the transaction, an independent person should authorize it. Segregation of duties helps to prevent fraud, waste, and abuse in an internal control system.

Recommendation 7

University Comments

The University did not concur with our recommendation to develop payroll procedures to ensure that salaries are properly allocated and that salaries charged to all activities do not exceed 100 percent. The University said that the PPS has both preventive and detective controls to prevent salary charges in excess of 100 percent. The University added that, consistent with many institutions, its PPS control environment contains edits to alert the person initiating the

³¹ Management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. Segregation of duties includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event. *GAO-14-704G*, page 47.

transaction if the total distribution exceeds 100 percent. The University further stated that at a research university, this edit is a warning rather than a hard-stop to accommodate a summer salary for 9-month faculty appointments paid over 12 months. Before an individual can be granted system access to update PPS, they must complete a 3-day PPS training program, and trainees are provided specific instructions to ensure payroll appointment and distributions do not exceed 100 percent. The University also said that post-audit notifications are generated on changes affecting its PPS, providing a secondary review of the transaction by another individual. In addition, the central payroll office performs a monitoring control by reviewing a monthly report of salaries appearing to exceed 100 percent distribution to ensure that transactions are appropriate, initiate corrections, and pursue repayment. The University said that no instances were identified in the audit in which salaries at the University exceeded 100 percent.

OIG Response

The University's response relates to controls to prevent an employee from receiving a salary in excess of his or her approved rate of pay. However, the controls that the University described may not prevent the University from claiming more than 100 percent of an employee's salary. The GAO Green Book encourages non-Federal agencies to use it as a framework to design, implement, and operate an internal control system.³² One of the five components of internal controls is monitoring activities.³³ The University could benefit from ongoing monitoring activities, including regular management and supervisory activities, comparisons, and reconciliations of amounts paid to employees recorded in the general ledger to amounts claimed on FFRs.

Recommendation 8

University Comments

The University did not concur with our recommendation to follow Federal requirements for supporting costs claimed. (In a May 2016 email, we notified the University that we might make a technical edit to the recommendation to focus on the University's failure to follow Federal requirements, rather than its failure to follow University policy, which is required by Federal regulation.) The University said that it consistently followed University policy on payroll certifications and effort-reporting and that it follows Federal requirements to support costs claimed.

Regarding the prior-effort reporting system, the University acknowledged that payroll adjustments processed after the quarterly effort reports were generated required the University department to initiate manual revisions to effort reports after the fact. The University did not provide supporting documentation for the six transactions that we identified as lacking documentation under the prior-effort reporting system. Instead the University provided a general

³² GAO-14-704G, page 7.

³³ GAO-14-704G, page 65.

list of the kinds of documentation that it provided to us in support of its payroll charges under both systems.

Regarding the pilot PCS, the University stated that the annual cycle resulted in the need for fewer payroll adjustments; it allowed for the department analyst to annotate pending payroll adjustments with automated reversals generated for the next reporting cycle to ensure payroll costs were not reported more than once. According to the University, adjustments initiated after a certification period would be picked up automatically in the next reporting cycle because reports are based on when the transaction posts and not on the pay period end date. So cost transfers crossing reporting periods were consistently certified.

The University commented (Appendix D, Attachment C) that the transaction totaling \$1,907 under the pilot PCS that was not supported by a Payroll Certification form related to a cost transfer. The University said that the cost transfer was processed after the annual certification period, and the transaction was reflected in the next annual PRC cycle and certified.

OIG Response

Our finding showed that the University did not follow Federal requirements and University policy for documenting payroll transactions. Internal controls should require management to clearly document all transactions in a manner that allows the documentation to be readily available for examination. In addition, documentation and records should be properly managed and maintained.

The University did not comment on the six transactions that were not supported by an effort report. The University acknowledged that payroll adjustments processed after the quarterly effort reports were generated required the University department to initiate manual revisions to effort reports after the fact. But the University did not clarify why effort reports were not available, as required by University policy, for the six transactions. University policy in regard to documenting effort reporting states that: “To accomplish this monthly ‘after the fact’ review of employee time charged to federal/federal flow through contracts or grants, departments will be provided with a Personnel Activity Report (PAR) form....” (UCR Policies and Procedures 200-48).

Regarding the one unsupported transaction under the pilot PCS, the University cited its policy that stated that “Payroll Certification[s] are required for salaries of all employees of the University, including hourly employees, part-time employees, adjunct faculty, and students on the University payroll who are paid from federal and federal flow-through funds” (UCR Policy 200-40, “Payroll Certification on Federally Sponsored Projects,” dated August 1, 2011).

The University’s comments (Appendix D, Attachment C) concerning the \$1,907 “cost transfer” under the pilot PCS that was not supported by a Payroll Certification form further demonstrates a need for stronger controls over salary cost adjustments after a certification period to ensure that salary amounts reported on FFRs are correct. While the University provided some insight into the circumstances surrounding the \$1,907 “cost transfer,” the University did not explain why a

Payroll Certification form was not available for our review or explain how its controls enabled it to ensure that FFRs were corrected for this type of transaction.

The University did not provide supporting documentation for its assertion that cost transfers crossing reporting periods are consistently certified based on when the transaction posts and not the pay period end date. Salary charges should be based on when the employee performed the work. The University's position that salaries claimed on awards can be separated from the period when the employee earned the salary could allow the University to potentially claim costs twice: once in the current payroll certification period and again in the following payroll certification period.

Recommendation 9

University Comments

The University did not concur with our recommendation to strengthen its general IT controls for systems used to support the pilot PCS by improving restrictions for remote access. The University said that this finding is not factually correct. The University said that, at the time of the audit, PI access to its PRC system was allowed via the University's Central Authentication Services (CAS). CAS encrypts credentials from the user's desktop, and they are never transmitted in clear text across any network. Moreover, after a user logs in via CAS, the CAS server never shares client credentials with any other system; rather, a secure service ticket is used instead. Additionally, systems administrator access to the University's servers requires a secure (encrypted) tunnel, and credentials are never exposed in clear text.

The University said that, since the audit, these controls have been further strengthened. System administrator access to campus servers now requires the use of a Virtual Private Network (VPN), as well as multifactor authentication. The University also said that, consistent with industry best practices, it is deploying multifactor authentication to the general user community. The University said that its goal was to deploy multifactor authentication to all users during the 2017–18 academic year; therefore, PIs will be required to use multifactor authentication to access the University's PRC system, and this would provide additional, significant improvements to overall campus cyber-security.

OIG Response

During our audit, University officials explained that users with remote access to the Web interface could use any computer to connect to the network, and the University did not use a VPN to secure the flow of traffic between the user's computer and the Web interface. After our audit concluded, the University stated that controls had been improved for remote access. We plan to review the University's specified enhancements during the audit followup process.

Recommendation 10

University Comments

The University did not concur with our recommendation to strengthen its general IT controls for systems used to support the pilot PCS by implementing a password setting that requires password changes periodically. The University said that there is industry disagreement concerning the effectiveness of mandating password changes.

According to the University, mandating password changes, in many environments, leads to poor user behavior (e.g., writing down passwords, sharing passwords). Thus, the University said it can be argued that selecting strong passwords that are not changed frequently but are well protected (i.e., not written down) is a preferred route to enhance security. The University said that there was a broad consensus that multifactor authentication is a far superior method of reducing the risk of compromised accounts than mandated password aging.

The University further stated that it is committed to enhanced cyber-security and privacy protection, and it has formed a standing Cyber-security Risk committee that has endorsed multifactor authentication as a key IT control. The University said that it had implemented multifactor authentication within its various systems in this area. All central technology staff, as well as all employees within Business and Financial Services/Controller's Office use multifactor authentication. The University said that it is deploying multifactor authentication with the goal of full implementation during the 2017–18 academic year.

OIG Response

The University did not have a maximum password age setting in place that forces users to periodically change passwords. As a vendor best practice, Microsoft³⁴ recommends that users change passwords at least every 90 days. If an attacker gains unauthorized access to a password, an attacker would have access to the network until the password expires.

Although the University did not agree with our recommendation, we made our recommendation with the intent of strengthening the University's IT controls. To that end, the University acknowledged that it was developing multifactor authentication as a key IT control and was planning to deploy multifactor authentication with the goal of full implementation during the 2017–18 academic year. The University's plan to implement multifactor authentication would strengthen their security. Until then, the University should require periodic password changes.

Recommendation 11

University Comments

The University did not concur with our recommendation to strengthen its general IT controls for systems used to support the pilot PCS by implementing a patch management system for its

³⁴ Microsoft, "Best Practices for Enforcing Password Policies." Available online at: <http://technet.microsoft.com/en-us/magazine/ff741764.aspx>. Accessed on September 9, 2014.

desktop computers. The University said that it has a managed desktop environment that ensure operating system updates (patches) occur regularly. For PIs who choose not to use this managed desktop environment, the University offers no-cost faculty support to ensure automated operating system updates (patches) occur regularly, and the campus also provides anti-virus and anti-malware software and support. The University said that it had published “minimum standards” for connecting to the campus network, and faculty are provided support to meet these standards, which include operating system updates. Moreover, all central servers and services are protected by a series of firewalls (network, server farm, and host based) that provide “defense in depth” against attacks on the University’s core servers. The University said that this approach to faculty desktop support and the protection of campus servers is entirely consistent with approaches found throughout higher education.

OIG Response

The University did not have a patch management program in place for all of its workstations. As the University said in its comments, the PIs were not required to use the University’s managed desktop environment. Accordingly, the University relied on the PIs to manually patch their workstations, which may or may not happen. If the patch management process is automated, patching will occur in a timely manner, which reduces the risk of a security breach. Therefore, the information on University workstations was at risk if the PIs did not patch their workstations in a timely manner. NIST 800-40, version 2, also recommends using automated patch management tools to be consistent, efficient, and effective. Without adequate patch management policies and procedures, an attacker could gain unauthorized access to the University’s computer network.

Recommendation 12

University Comments

The University did not concur with our recommendation to strengthen its general IT controls for systems used to support the pilot PCS by implementing procedures to ensure that vendor support does not expire on the University’s operating system. The University said that, during the time of the OIG audit, an incompatibility existed between the versions of the Oracle database, Web Logic application server, and the latest supported version of the Solaris operating system. To support the University’s production environment, it had to run an older (out-of-support) version of the operating system. The University further said that, during this time, Oracle continued to release operating system security patches that greatly reduced the risk associated with this situation. Additionally, the University said that it deployed mitigating controls, including placing the server in question behind load balancers, using host-based firewalls, and limiting access to the zones running the PRC application. The University said that its approach recognized operational exigencies, mitigated risks, and followed industry best practices. The University also said that, since the audit, the operating system has been upgraded and all University centrally managed servers are running current vendor support operating systems.

OIG Response

Once an operating system reaches its “end of life,” it is no longer supported by the vendor, and system updates are not available. This lack of vendor support presents a potentially serious vulnerability to the network. In its response, the University acknowledged the risk and stated that a number of steps had been taken to mitigate the vulnerability. The assumption of risk is a part of the security-control process, and each Chief Information Officer has the authority to make risk-based decisions. The justification of risk acceptance must be documented and should be certified by the appropriate technical and managerial personnel (NIST 800-37, *Guide for Applying the Risk Management Framework to Federal Information Systems*, chapter 3, pages 35 and 36). We plan to review the University’s risk acceptance documents as part of our audit followup process.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered \$17,204,282 in salary costs that the University claimed for reimbursement from January 2, 2010, through March 31, 2013. Our audit also included F&A costs associated with the \$17,204,282 in salary costs (Appendix C, Table 3.) We limited the audit to awards between the University and NIH. NSF asked the University to reconcile costs recorded in its accounting records to those on the FFRs it used to claim costs it charged to Federal awards. The University was able to reconcile its accounting records to its FFRs for the audit period.

We conducted our audit work between September 2013 and June 2014.

METHODOLOGY

To accomplish our objectives, we:

- coordinated with NSF on the scope and methodology of our review;
- reviewed applicable Federal regulations and NIH guidelines;
- reviewed the University's proposal for the pilot PCS and interviewed University officials to gain an understanding of key controls;
- reviewed the University's policies and procedures for charging costs to Federal awards;
- reviewed the University's Cost Accounting Standards Board Disclosure Statement;³⁵
- obtained through NSF OIG a reconciliation between the amounts the University recorded in its accounting records and the amounts the University reported on its FFRs;
- obtained from NSF OIG a list of salary transactions totaling \$17,204,282 that the University charged directly to HHS awards;
- selected a random sample of 180 salary transactions (Appendix B);
- interviewed PIs and other employees whose salary or wages were charged to the Federal awards from which our sample was selected;
- computed the F&A costs related to the transactions we determined to be at risk;
- estimated the at-risk amounts that the University charged to HHS awards (Appendix C);

³⁵ Educational institutions that receive sponsored agreements totaling \$25 million or more must disclose their cost accounting practices by filing a Disclosure Statement (DS-2).

- reviewed the IT access controls safeguarding the systems used to support the pilot PCS;
- reviewed IT policies, interviewed University IT officials, and reviewed scans that the University performed on its payroll IT system; and
- discussed our findings with the University and OMB officials.

We initially evaluated the sample transactions on the basis of documentation provided by the University. For transactions not adequately supported, we asked the University and the PIs on the related awards to submit additional information. We interviewed nine PIs and other employees whose salary or wages were charged to the Federal awards from which we selected our sample.

We gained an understanding of both payroll certification processes (the pilot PCS and the prior effort-reporting system) used at the University, how these processes related to the labor costs in the University's general ledger, and how the University charged labor costs to a federally sponsored award.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: SAMPLE DESIGN AND METHODOLOGY

POPULATION

Our population consisted of all salary and wage transactions that the University charged to its HHS NIH awards for the period January 2, 2010, through March 31, 2013.

SAMPLING FRAME

The University provided two original comma-delimited text files of its accounting system general ledger and payroll subledger for the period January 2, 2010, through March 31, 2013. From these ledgers, we identified 9,355 individual payroll transaction (transactions) records totaling \$16,156,330. The NSF OIG Data Analytics Team imported the original comma-delimited text files into its data analytics software tool. We then removed all transactions equal to or less than \$100, including all negative dollar transactions. This removal resulted in a sample frame consisting of 7,516 transactions totaling \$17,204,282 plus associated F&A costs.³⁶

SAMPLE UNIT

The sample unit was an individual payroll transaction.

SAMPLE DESIGN

We divided the sampling frame into five strata on the basis of the results of data analytics testing. All transactions were unduplicated, appearing in only one stratum and only once in the sampling frame as shown in Table 1.

Table 1: Sampling Frame by Stratum

Stratum		Record Count	Value of Transactions
1	Charges to Expired Awards	65	\$159,619
2	Excess Salary	797	2,041,688
3	High-Risk Adjustments	268	559,013
4	Administrative Salaries	1,406	1,837,189
5	All Other Transactions	4,980	12,606,773
	Total	7,516	\$17,204,282

³⁶ We calculated the F&A costs by multiplying the applicable F&A cost rate to each salary sample item determined to be in error.

SAMPLE SIZE

We selected a sample size of 180 transactions (Table 2).

Table 2: Sample Size by Stratum

Stratum	Number of Sample Items
1	30
2	30
3	30
4	30
5	60
Total	180

SOURCE OF RANDOM NUMBERS

We used the OIG, Office of Audit Services (OAS), statistical software to generate the random numbers.

METHOD OF SELECTING SAMPLE ITEMS

We consecutively numbered the transactions within each stratum. After generating random numbers for each stratum, we selected the corresponding frame items.

ESTIMATION METHODOLOGY

We used the OIG/OAS statistical software to estimate the amount of at-risk salary and wage costs claimed to the University's HHS NIH awards for the audit period. We also estimated the F&A costs at risk associated with the sample items at risk and estimated the error rate for errors identified as "prior effort-reporting system" and "pilot PCS."

APPENDIX C: SAMPLE RESULTS AND ESTIMATES

Table 3: Sample Results

Stratum	Frame Size	Value of Frame³⁷	Sample Size	Value of Sample	Number of At-Risk Transactions	Value of At-Risk Transactions	Value of F&A Associated With At-Risk Transactions
1	65	\$159,619	30	\$75,783	20	\$43,287	\$21,959
2	797	2,041,688	30	55,557	20	26,716	13,470
3	268	559,013	30	54,527	25	49,308	21,935
4	1,406	1,837,189	30	38,207	21	19,863	9,186
5	4,980	12,606,773	60	162,207	43	115,323	58,288
Total	7,516	\$17,204,282	180	\$386,281	129	\$254,497	\$124,838

Table 4: Estimated Value of At-Risk Salary Transactions
(Limits Calculated for a 90-Percent Confidence Interval)

	<u>At-Risk Transactions</u>	<u>At-Risk F&A</u>
Point estimate	\$11,746,751	\$5,869,794
Lower limit	9,877,072	4,919,602
Upper limit	13,616,429	6,819,985

³⁷ The frame values shown in this table for each stratum do not include associated F&A costs.

APPENDIX D: UNIVERSITY OF CALIFORNIA—RIVERSIDE COMMENTS



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June 20, 2016

Department of Health and Human Services
Office of Inspector General
Office of Audit Services, Region IV
Attn: Lori S. Pilcher
61 Forsyth Street, SW, Suite 3T41
Atlanta, GA 30303

RE: University of California, Riverside Response to Draft Audit Report Number A-04-13-01026

Dear Ms. Pilcher:

Thank you for the opportunity to review and respond to the Department of Health and Human Services Office of the Inspector General's (HHS OIG) draft audit report number A-04-13-01026.

The University of California (UC) is a long-standing member of the Federal Demonstration Partnership (FDP) and is committed to the FDP's mission of streamlining the administration of federally sponsored research without compromising stewardship responsibilities. As one of four institutions participating in the Payroll Certification Pilot, the University of California, Riverside (UCR) believes our campus successfully demonstrated and achieved the FDP pilot goals. Specifically, the pilot improved Principal Investigator (PI) accountability over their awards while reducing administrative burden. As a result, UCR's enhanced environment enables PIs to spend more time on research by simplifying the salary confirmation process for salaries/wages charged to federal funds.

As with any pilot program, there are opportunities to make improvements to our Payroll Certification (PRC) system and processes. UCR is committed to enhancing the PRC. Additionally, UCR firmly believes institutions must have sound internal controls and processes to ensure appropriate charging of cost to federal and other sponsored awards.

Given UCR's achievement in meeting the FDP pilot objectives and commitment to continuous improvement of our processes and controls, UCR strongly disagrees with HHS OIG's assessment of our PRC system. The pilot outcomes clearly demonstrate that the payroll certification methodology is an effective method to confirm salaries/wages charged to sponsored awards are reasonable and allocable.

The major concern raised by HHS OIG during and after the fieldwork related to UCR's prior effort-reporting system. UCR was extremely disappointed with the opinions expressed in the draft report. To better understand HHS OIG's interpretation of the information provided during

the audit, UCR was afforded the opportunity to ask questions during a May 2016 conference call. During this conversation, UCR was provided additional background regarding the report's findings and recommendations which primarily related to an alleged lack of data confirming UCR's internal controls. Importantly, the draft report was the first specific feedback UCR received from HHS OIG regarding internal controls. UCR would have readily provided clarification and/or information had it been requested.

UCR's asserts its internal controls and PRC process provide accountability over payroll and other charges to federal awards which will be further demonstrated in our responses to the HHS OIG's recommendations and accompanying attachments.

Thank you for confirming that HHS OIG is not seeking remuneration, repayment, financial penalties, debarment from federal grants, or disgorgement related to the results of the audit.

Recommendation #1: "Ensuring that, if the University returns to its prior effort-reporting system, it updates the system to adequately account for nonsponsored activities to ensure that payroll costs are properly allocated to Federal awards."

Response to Recommendation #1: UCR does not concur with this recommendation and does not believe it is necessary to return to its prior effort-reporting system to comply with federal requirements.

As outlined in UCR's November 4, 2014 letter to HHS OIG (see Attachment A)¹, UCR's prior effort reporting system complied with OMB Circular A-21 section J.10.b (2)(c) Criteria for Acceptable Methods.² As explained in the correspondence and allowed per OMB A-21, the previous effort-reporting format did not specifically identify each non-sponsored activity, although it did confirm non-sponsored activity in total. Consistent with OMB Circular A-21, UCR subsequently distributed the non-sponsored activity facilities and administrative (F&A) costs to the appropriate cost pools when developing our F&A rates using payroll distributions and direct cost equivalents (DCE). This reasonable method was in fact agreed upon during UCR's F&A rate negotiation. UCR's effort-reporting format has been subject to the annual A-133 audit and numerous agencies audits, including a review by HHS OIG in 1998; the format has never been raised as a concern in any of these prior reviews. In addition, the FDP agrees through a statement in their Payroll Certifications: A Proposed Alternative to Effort Reporting dated January 3, 2011

http://sites.nationalacademies.org/cs/groups/pgasite/documents/webpage/pgas_055994.pdf): "Effort reporting is a holdover from the 1980's and earlier when effort reports served two purposes — support for direct charges and the mechanism used to develop administrative and instructional cost pools. Since the establishment of the 3.6% administrative allowance and standard usage of direct charge equivalents, effort report information is not needed for developing administrative and instructional cost

¹ All attachments referenced in our response should be included as part of UCR's official response to the draft audit report.

² The payroll distribution system will allow confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify F&A costs and the functions to which they are allocable. The activities chargeable to F&A cost categories or the major functions of the institution for employees whose salaries must be apportioned (see subsection J.10.b (1)(b) of this Appendix), if not initially identified as separate categories, may be subsequently distributed by any reasonable method mutually agreed to, including, but not limited to, suitably conducted surveys, statistical sampling procedures, or the application of negotiated fixed rates.

pools (p.4).” It is important to note, of the 129 “at-risk” transactions noted in Appendix C of the draft audit report, 83 relate to UCR’s effort-reporting system not breaking out non-sponsored activities regardless of the other documentation provided to support the payroll charges to federal funds. Because no other feedback was received on the documentation provided and UCR’s former effort reporting system does comply with OMB Circular A-21 requirements, the number of “at-risk” transactions identified in the audit and subsequent extrapolation of amounts are overstated due to HHS OIG’s count of at risk incident was more dependent on its own underlying assumptions of UCR’s effort-reporting system and F&A rate negotiation than the substantive facts and evidence.

Prior to submitting our request to participate in the pilot payroll certification program, UCR embarked upon a new effort-reporting system implementation to replace the existing paper-based process; however, concerns were raised with investing resources in a method of confirming salaries charged to federal funds that was difficult to understand and administratively burdensome. With the support of the University of California Office of the President, UCR joined UC Irvine in discussions with HHS to pilot the FDP’s proposed [Payroll Certifications: A Proposed Alternative to Effort Reporting](#). UCR’s PRC process is consistent with the FDP’s proposed process. UCR successfully demonstrated the goals of the pilot by implementing a new methodology to confirm salary/wage charges to federal funds; the new method has been determined to be easier to understand while providing greater accountability, accuracy, efficiency, and transparency (See UC’s Payroll Certification Proposal in Appendix 1 and HHS Pilot Approval Appendix 2). Since the initial 18-month pilot began in April 2011 and through multiple extensions of the pilot (currently approved for use through December 31, 2016), UCR has issued approximately 3,800 PRCs, compared to the over 22,000 effort reports UCR would have issued for the same time period.

The workload associated with coordinating PRCs is distributed over 12 months, while effort reports required intense coordination four times per year with a much higher volume of transactions. The PRC process better aligns with award budgets, monthly reviews of transactions, and reinforces federal costing policy through the use of certification statements. Therefore, UCR will continue to utilize the PRC process to certify salaries charged to federal funds as allowed under the Uniform Guidance §200.430 Compensation—personal services.

Recommendation #2: “Ensuring that suitable means exist for a PI to verify that salary charges made to an award are reasonable in relation to the work performed.”

Response to Recommendation #2. UCR does not concur with Recommendation #2.

UCR PIs currently have suitable means to verify that salary charges to awards are reasonable in relation to the work performed. As previously discussed and reviewed with the auditors, UCR provides PIs with readily accessible information on their contract and grant activities. In June 2013, UCR enhanced the Proposal and Award Management Information System (PAMIS) portal. PAMIS allows for an easy and effective method of accessing existing campus contract and grant related applications and information, such as our proposal routing and approval system (eCAF), pre-award request system, proposal development and submission system (Cayuse424), award system (eAward), monthly PI web reporting system (PIWRS), PRC system, and reports of expiring/expired funds as well as links to policy, procedures, and campus informational websites such as our campus Research and Economic Development, Extramural Funds Accounting, and UC Research Administration. In addition, PAMIS generates a series of automated e-mail notifications to the PI, contract and grant department analyst, central offices and others with oversight responsibilities with information on actions required throughout the life cycle of

the award. Information entered in one system automatically flows to the next system mitigating the risk of errors due to the re-keying of data and ensuring consistency of information across all contract and grant related applications and UCR's financial system. Please see Attachment B for an overview of the UCR's PAMIS system diagram and related internal controls.

Working with PIs and department administrators, specifications have recently been completed and programming has commenced to enhance the PIWRS by including all funding sources associated with a PI, such as gifts, department allocations and sales & service activities, not just contract and grant funds. These enhancements will allow the PI to easily access payroll details across all of their funding sources including funds where they are designated as the Co-PI. As these enhancements to PIWRS are developed, additional support site materials and training will be provided. UCR plans to implement these enhancements no later than June 2017.

The PRC was developed in 2011; UCR delayed implementing major enhancements to the PRC until feedback was received from HHS OIG based on their audit that began in 2013. The audit exit conference in September 2014 did not identify issues with the PRC process nor were concerns with the PRC process discussed.

However, based on feedback contained in the April 2016 draft audit report, UCR plans by June 2017 to enhance the system and provide the ability for PIs to:

- Drilldown and access an individual's full payroll distribution for the certification period;
- View payroll details including the payroll distribution percentage for each funding source used to pay the employee's salary;
- Add the option to request a sub-certification from a Co-PI and/or employee supervisor; and
- Consolidate all (salary and non-salary) mandatory, committed cost share reporting into the PRC report.

As these enhancements to the PRC are developed and implemented, additional support site materials and training will be provided to our campus users.

To ensure all PIs are able to monitor their award activity, access to the PAMIS applications described in Attachment B are automatically granted to all faculty based upon characteristics of their payroll appointment. Faculty are restricted to view and take action on proposals and awards where they are specifically identified as the PI. Other PAMIS roles are assigned by the department System Access Administrator; this approach provides departments with the ability to easily adjust access based on department needs while ensuring accountability for access controls exist with those most familiar with staff training and job responsibilities. Based on a user's system access, automated e-mail notifications of required actions throughout the award life cycle are generated.

Lastly, UCR PIs are actively performing research and preparing technical progress and final reports to our sponsoring agencies discussing the outcomes of the research project. These reports such as the National Institutes of Health (NIH) Research Performance Project Report (RPPR) requires reporting on accomplishments, products, participants, impact, changes and special items. The participants reporting requires information on the level of effort of the individuals that have worked on the project.

Based on the discussion above, UCR asserts that our PIs, with the assistance of administrative staff, do in fact have suitable means to verify salaries charged to federal awards are reasonable in relation to the

work performed as confirmed by the completion of the PRC on their awards. The points above are consistent with the description in the [FDP Payroll Certifications: A Proposed Alternative to Effort Reporting](#) that the utility of effort reporting as a means of achieving internal controls is limited in part because “the actual controls are built into the broader charging system.” (p. 4)

Recommendation #3: “Ensuring that suitable means exist to document that salary charges represent the actual work performed on a grant and not just budget estimates.”

Response to Recommendation #3: UCR does not concur with Recommendation #3.

Suitable means exist to document that salary charges represent the actual work performed on a grant and not just budget estimates. Although the award budget is developed based on estimated personnel needs and initial appointments/payroll distributions may be based on these estimates and the approved award budget, there is sufficient evidence to indicate that payroll distribution changes and salary adjustments are made, and have indeed been made, to reasonably represent actual work performed. OMB Circular A-21 J.10.b(1)(c) (and the Uniform Guidance) recognizes “in an academic setting, teaching, research, service, and administration are often inextricably intermingled. A precise assessment of factors that contribute to costs is not always feasible, nor is it expected. Reliance, therefore, is placed on estimates in which a degree of tolerance is appropriate.” This concept has been recognized at the federal level for many years, and it would be inappropriate for HHS OIG to effectively hold UCR to higher and different standards than the plain meaning found in OMB Circular A-21.

PIs are provided with standard monthly reports for all of their contract and grant activity in addition to the annual PRC report; both reports are accessible via the PAMIS portal (discussed in Attachment B). The PIWRS provides summary views of contract and grants balances with the ability to see detailed transactions. The PIWRS includes automated projections of payroll expenditures based on appointment distributions in the UCR Payroll System as well as non-salary encumbrances. Department contract and grant analysts have the ability to review this information in advance of the reports being released to the PI to add comments, add non-contract and grant funding sources, and adjust projections. PIWRS contains the ability for the PI to drill into payroll details for every fund listed on the report. The PI has the ability to share information on the report with project collaborators. The PIWRS was demonstrated to the auditors on September 5, 2013.

Please note that the FDP whitepaper and UC’s pilot proposal were based on the reasonableness of salary charges in relation to the work performed, not effort. If the PI has questions regarding the certification, they are first directed to their department administrators to answer questions and/or initiate corrections; organizational chief administrative and financial officers and the central Accounting Office are also readily available to assist with questions and/or concerns. If PRCs are not completed within 45 days of distribution, campus policy is to transfer the salary expenses to an unrestricted funding source. Importantly, UCR has not had to transfer any salary charges because a PI refused to perform the PRC process or could not be provided with sufficient information to perform the certification.

Every department on campus is required to perform and document ledger reconciliations using our Ledger Reconciliation and Storage System (LRSS). The system requires the System Access Administrator to designate reconcilers and certifiers. Separation of duties is enforced via system edits that prevent a reconciler from being the certifier for a particular department/accountability structure. The campus internal control guidance on the ledger reconciliation process (200-97) include requirements for:

- all salary transactions be verified by thoroughly reviewing of the Distribution of Payroll Expense, and the review cannot be performed by the Payroll Personnel System (PPS) Transactor;
- all transactions against contract and grant funds be reviewed for adherence to the award terms, conditions, and OMB Circular A-21 principles (e.g. allowability, reasonableness, allocability and consistency); and
- certification that these actions list above have been performed.

The monthly LRSS process supplements the PIWRS reporting to ensure the appropriateness of the expenditures appearing on department ledgers. The LRSS support site is available at: <http://cnc.ucr.edu/lrss/>. In addition, many departments create supplemental financial reporting using data extracts from our campus financial system to provide information to their PIs in formats customized for the particular PI or department. These reports may include other funding the PI has responsibility for overseeing, such as gifts, departmental allocations, and sales & service funds. PIs are encouraged to review their monthly reports to confirm the appropriateness of expenditures on their awards and to report any errors to their department contract and grant analyst so they can be promptly corrected. Departments frequently meet with PIs to review reports.

Adjustments to salary expenses occur demonstrating that salary costs charged to awards are not solely based on budget estimates. It is clearly stated in our local policy and procedure 200-40: "...the Prime PI is responsible for the monthly review of project financial reports via the PIWRS (or equivalent) and promptly reporting discrepancies to the department contract and grant administrator for correction. The PI may request the review of the Payroll Certification report from Co-PIs, project directors, and others with direct knowledge of the project activities. However, the Prime PI is responsible for certifying the Project Payroll Certification Report."³

Recommendation #4: "Requiring and documenting prior approval and justification for adjustments made after grant expenditures have been reported to the Federal Government"

Response to Recommendation #4: UCR concurs with the recommendation.

The [UC Contract and Grant Manual](#) clearly articulates financial management responsibilities and the timely recording of transactions. UCR's Leaders of Excellence And Distinction (LEAD) Committee, in coordination with the Office of Research and Economic Development, is actively working on expanding and enhancing training regarding the administration of contracts and grants for implementation in FY2017. In addition, the UC is migrating to a single instance of the PeopleSoft Human Capital Resource Management (HCRM) for our payroll, academic personnel, timekeeping, and human resources (UCPATH) processes. UCR is one of the pilot campuses that will be implementing UCPATH in August 2017. As part of this implementation, UCR is in the process of designing a shared services model that will serve the entire campus population using common standards for communicating, documenting, and processing human resource, academic personal and payroll changes.

Recommendation #5: "Requiring and documenting prior approval and justification for the reclassification of administrative positions as direct costs"

Response to Recommendation #5: UCR does not concur with this recommendation.

³ The Prime PI is defined as the designated lead investigator on the campus award.

UCR asked HHS OIG to provide the specific samples related to this recommendation and received the following reply from HHS: “We do not have sample items related to this issue. This issue is an absence of controls to prevent the PI from reclassifying employees from indirect positions to direct positions without supervisory approval or justifications. This conclusion was reached after various interviews with University and departmental personnel. The departments have been empowered and have been given the responsibility to ensure that they are meeting University and award agency requirements. The PI has full authority within his department to reclassify an employee.”

In fact, at UCR PIs do not have the authority to reclassify an employee; all reclassification action must be routed through the department’s administration and ultimately approved by our central Human Resources unit. When the direct charging of an administrative/clerical position is required for a project, the project must meet the OMB Circular A-21 definition of a “Major Project” or requirements list in the Uniform Guidance. A major project requires an extensive amount of administrative/clerical personnel support, which is significantly greater than the routine level of such services provided by academic departments. The administrative/clerical position is identified and included in the proposal budget and budget justification submitted to the funding agency. Proposals are routed through our Research and Economic Development- Sponsored Programs Administration (RED-SPA) for review, approval and submission by the Authorized Organizational Representative. Administrative/clerical positions not included in the funded proposal, would require agency prior approval and such approval would be coordinated through RED-SPA. OIG’s recommendation #5 is based on misplaced speculation about reclassification of employees at UCR, and is not anchored to the underlying facts of the matter, which reflect a sufficient level of built-in internal controls.

UCR’s PRC process has improved controls over administrative and clerical salary charges to sponsored awards. The PRC process flags payroll title codes in the administrative/clerical job series. Department coordinators are instructed that charging clerical and administrative salaries to a federal fund is an exception, and these type of salaries should have been proposed in the award budget and explicitly approved by the funding agency. Department coordinators indeed ensure exceptional approval is available for audit purposes or explain why exceptional approval is not necessary (i.e. all undergraduate student assistant title codes are flagged as potentially administrative/clerical, but in the majority of cases their specific job responsibilities are consistent with a direct cost). Additionally, PIs are asked to specifically certify that individuals performing clerical and administrative activities on their award meet the federal exception criteria, and exceptions are documented.

Recommendation #6: “Requiring and documenting prior approval and justification for cost transfers”

Response to Recommendation #6: UCR does not concur with the recommendation.

UC has clear policies regarding cost transfers (see [UC Business & Finance Bulletin A-47](#)) that have been broadly communicated on the campus. UCR’s on-line training and in person PPS training sessions clearly articulate approval and justification requirements regarding federal costs transfers. At UCR, currently the administration over department expenditures is decentralized. In our decentralized environment, the campus provides standard guidance, systems and business rules to drive compliance, but departments have the ability and flexibility to implement their local procedures within the framework provided. Although department processes may vary, post-audit notifications (PAN) are generated on changes affecting our PPS, so there is a secondary review of all transactions. However, UCR will continue to reinforce UC Policy regarding cost transfer requirements to the campus.

Recommendation #7: “Developing payroll procedures to ensure that salaries are properly allocated and that salaries charged to all activities do not exceed 100 percent”

Response to Recommendation #7: UCR does not concur with this recommendation.

As previously discussed with HHS OIG in September 2013, PPS has both preventive and detective controls to prevent salary charges in excess of 100 percent. Consistent with many institutions, UCR’s PPS control environment contains edits to alert the transactor if the total distribution exceeds 100 percent. At a research university, this edit is a warning rather than a hard stop to accommodate summer salary for nine-month faculty appointments paid over 12 months. Before an individual can be granted system access to update PPS, completion of a three-day PPS training program is required; individuals are provided specific instruction to ensure payroll appointment/distributions do not exceed 100 percent. As previously discussed in Response to Recommendation #6 (and Attachment B), PANs are generated on changes affecting our PPS, providing a secondary review of the transaction by another individual. In addition, the central Payroll office performs a monitoring control by reviewing a monthly report of salaries appearing to exceed 100 percent distribution to ensure transactions are appropriate, initiate corrections, and/or pursue repayment. It is important to note there were *no instances* identified in the audit where salaries at UCR exceeded 100 percent.

Recommendation #8: “Following its policy for documenting salaries.”

Response to Recommendation #8: UCR does not concur with this recommendation.

Based on the May 2016 conference call, UCR was informed the referenced policies were UCR’s local policy and procedure 200-40 Payroll Certification on Federally Sponsored Projects and 200-48 Federal Contract & Grant Administration-Substantiating Salary Expenses & PAR Forms (i.e. effort reports). UCR was subsequently notified the recommendation might be modified to “following Federal requirements for supporting costs claimed.” UCR consistently followed policy on payroll certifications, 200-40, and effort-reporting policy 200-48. However, UCR does acknowledge payroll adjustments processed after the generation of quarterly effort report required the department to initiate manual revisions to effort reports after-the-fact. With PRC, the annual cycle results in the need for fewer adjustments and allows for the department analyst to annotate pending payroll adjustments directly on pending PRC reports with automated reversals generated for the next reporting cycle to ensure payroll costs are not reported more than one time; adjustments initiated after a certification period will automatically be picked up in the next reporting cycle as reports are based on when the transaction posts and not the pay period end date, so cost transfers crossing reporting periods are consistently certified.

UCR follows federal requirements to support costs claimed. As stated in Response #1, UCR’s former effort-reporting process complied with OMB Circular A-21 and provided sufficient information to confirm payroll costs were appropriately allocated to federal awards. UCR’s current PRC process is compliant with OMB Circular A-21 and the Uniform Guidance as outlined in Response #2.

During the course of the HHS OIG Audit, UCR was asked to provide documentation to support payroll charges for the audit selections, and the auditor advised that the following types of specific documentation were expected to support salary/wage charges:

- Personnel Action forms
- Copy of terms and conditions of the award

- Budget for the award
- Signed labor report of the period
- Individual's Payroll Run for the yearly period
- Individual's Travel for the yearly period
- Faculty teaching assignments for the yearly period

In general, UCR provided the auditors with the following documentation to support payroll charges to federal awards for each sample:

- personnel action form/request
- identification of the position in the award/proposal budget
- cost transfer documentation (if applicable)
- timesheets (if applicable)
- NIH Salary Cap calculations (if applicable)
- Effort Reports and/or Payroll Certifications
- Faculty teaching assignments
- Course Buy Out Agreements (if applicable)
- Faculty Furlough Exchange Agreement (if applicable)
- listing of all funding sources/Distribution of Payroll Expense (DOPE) for the yearly period
- listing of travel expenditures for the yearly period
- job descriptions
- monthly reports provided to PI
- award documents
- other documentation, such as union agreements documenting lump sum payments, sabbatical documents, etc.

UCR disagrees with many of the samples identified as "at-risk". UCR believes if discussions of issues occurred during the audit and prior to issuance of the draft report, a more balanced draft report would have been issued. UCR attempted to initiate dialog on the effort-reporting system preliminary findings, but there was no response; see UCR's correspondence dated November 4, 2014 (Attachment A). As stated earlier, UCR became aware of HHS OIG's internal control issues for the first time during a May 2016 conference call.⁴ Many of the at-risk items could have been resolved prior to the issuance of the draft audit report had HHS OIG initiated communications contemporaneous with the audit field work process. Attachment C discusses some of UCR's concerns with the classification of samples as "at-risk."

Recommendation #9 (IT): "improving restrictions for remote access"

Response to Recommendation #9: UCR does not concur with this recommendation.

The draft audit report states that UCR has deployed inadequate/inappropriate controls relating to user (PI) access to the PRC web interface and to systems administrator access to servers hosting the PRC

⁴ Given the paucity of formal and informal information requests to UCR during the course of its audit that were directly germane to the internal control issues now flagged in the draft audit report, this response marks OIG's first real opportunity to seriously consider the University's proffered evidence related to OIG's concerns.

system. In particular, the audit cites risks associated with compromised credentials (e.g. due to passing of credential in clear text). This finding is not factually correct.

At the time of the audit, PI access to the PRC system was enabled via UCR's Central Authentication Services (CAS). CAS encrypts credentials from the user's desktop and they are never transmitted in clear text across any network. Moreover, after a user logs in via CAS, the CAS server never shares client credentials with any other system; rather, a secure service ticket is used instead. Additionally, systems administrator access to UCR's servers required a secure (encrypted) tunnel and credentials were never exposed in clear text.

Moreover, since the audit, these controls have been further strengthened. System administrator access to campus servers now requires Virtual Private Network (VPN) utilization as well as multi-factor authentication. And consistent with industry best practices, UCR is deploying multi-factor authentication to the general user community. UCR's goal is to universally deploy multi-factor authentication to all users during the 2017-18 academic year; therefore, PIs will be required to utilize multi-factor authentication to access UCR's PRC system and this will provide additional, significant improvements to overall campus cyber-security.

Recommendation #10 (IT): "implementing a password setting that requires password changes periodically"

Response to Recommendation #10: UCR does not concur with this recommendation.

The draft audit report states that UCR has a control deficiency relating to changing passwords. However, there is industry disagreement concerning the efficacy of mandating password changes. Mandating password changes, in many environments, leads to poor user behavior (e.g. writing down passwords, sharing passwords, etc.).⁵ Thus, UCR is not confident in the empiricism underlying OIG's position about how to affect a net decline in security risk; it can be argued that selecting strong passwords that are not changed frequently but are well protected (e.g. not written down) is a preferred route to enhance security.

The aforementioned issues have led to broad consensus that multi-factor authentication is a far superior method of reducing the risk of compromised accounts compared to mandated password aging.⁶

UC is committed to enhanced cyber-security and privacy protection, and UC has formed a standing Cyber-security Risk committee that has endorsed multi-factor authentication as a key IT control. UCR has implemented multi-factor authentication within its various systems and is a higher education leader in this area. Currently, all central technology staff as well as all employees within Business & Financial Services/Controller's Office utilize multi-factor authentication. UCR's is universally deploying multi-factor authentication with the goal of fully implementing with all campus users during the 2017-18 academic year.

⁵ Safa, N.S., Sookhak, M., Von Solms, R., Furnell, S., Ghani, N.A. and Herawan, T., "Information security conscious care behaviour formation in organizations," *Computers & Security, Volume 53*, September 2015 pp.65-78, Science Direct: <http://www.sciencedirect.com/science/article/pii/S0167404815000863>

⁶ Hutchins, B., "Why passwords won't keep you safe without MFA," October 6, 2015, KSL.com: <http://tinyurl.com/mfabackground>

Recommendation #11 (IT): “implementing a patch management system for its desktop computers”

Response to Recommendation #11: UCR does not concur with this recommendation.

The draft audit report states that UCR does not have a patch management program for workstations (user desktops) and this introduces risk within UCR’s overall IT environment. It is important to note that UCR does indeed have a managed desk top environment that ensures operating system updates (patches) occur regularly and that anti-virus / anti-malware software is installed / functioning. However, PIs are not required to utilize this managed desktop environment. As a result, UCR offers no-cost faculty support to ensure automated operating system updates (patches) occur regularly, and the campus also provides anti-virus / anti-malware software and support (again, at no charge). Please note that UCR has published “minimum standards” for connecting to the campus network and faculty are provided support to meet these requirements (which include operating system updates).

Additionally, UCR has deployed sophisticated intrusion detection, intrusion prevention, and other alerting systems to notify campus security personnel when a workstation has been compromised. Moreover, all central servers / services are protected by a series of firewalls (network, server farm, and host based) that provide “defense in depth” against attacks to UCR’s core servers. Importantly, this approach to faculty desktop support and the protection of campus servers is entirely consistent with approaches found throughout higher education. Finally, please note that all central servers supporting the PRC system are regularly patched.

Recommendation #12 (IT): “implementing procedures to ensure that vendor support does not expire on the University’s operating system”

Response to Recommendation #12: UCR does not concur with this recommendation.

As noted in the response to #11 concerning patch management, UCR regularly patches/updates its centrally maintained systems. However, during the time of the OIG audit in 2013, an incompatibility existed between the versions of the Oracle database, Web Logic application server, and the latest supported version of the Solaris operating system. In order to support UCR’s production environment, this issue required running an older (out-of-support) version of the operating system.

Importantly, during this time, Oracle continued to release operating system security patches and this greatly reduced the risk associated with this issue. Additionally, UCR deployed mitigating controls including placing the server in question behind load balancers, using host-based firewalls, and limiting access to the zones running the PRC application. UCR’s approach recognized operational exigencies, mitigated risk, and followed industry best practices. Finally, since the audit, the operating system has been upgraded and this server (indeed all UCR centrally managed servers) are running current vendor support operating systems.

Again, thank you for the opportunity to provide UCR’s views on the validity of the facts and reasonableness of the recommendations contained in the draft audit report. The goals of our feedback are to address and resolve concerns raised prior to the issuance of the final report. Please contact Bobbi McCracken, bobbi.mccracken@ucr.edu, with questions.

Sincerely,

/Kim A. Wilcox/

Kim A. Wilcox, Chancellor
University of California at Riverside

cc: Senior VP Sheryl Vacca (UC Office of President)
UCR Campus Counsel David Bergquist
UCR Associate Vice Chancellor Bobbi McCracken

Attachments

**APPENDIX D: UNIVERSITY OF CALIFORNIA - RIVERSIDE COMMENTS
ATTACHMENT A**

University of California, Riverside Response to
Draft Audit Report Number A-04-13-01026
Attachment A



Accounting Office - 002

November 4, 2014

U.S. Department of Health and Human Services
Office of the Inspector General
Office of Audit Services
Sam Nunn Atlanta Federal Center
Attn: Nick Lomax
61 Forsyth Street, S.W.
Suite 3T41
Atlanta, GA 30303-8909

900 University Avenue
Riverside, CA 92521
www.ucr.edu

Re: University of California at Riverside (UCR) Payroll Certification Tentative Audit Finding on Effort Reporting

Dear Nick,

Thank you for taking the time to provide UCR with an audit exit conference telephone call on September 9, 2014. During the exit conference, one of the most significant tentative findings communicated related to the Effort Report format used by UCR since the early 1990's (83 selections). Given our past conversations and my November 12, 2013 e-mail explaining UCR's basis for our former Effort Reporting format, listing past reviews by HHS where the Effort Report format was not questioned, and inviting you to contact me if there were additional concerns (see Attachment #1), it was surprising to hear the Effort Report format is a possible finding for the Payroll Certification audit. In light of this tentative finding, however, it is now understood our original response may not fully have answered your concerns. The purpose of this letter today is to provide additional information supporting the propriety of UCR's former Effort Reporting format and to request a meeting with you and Lori Pilcher, so UCR may answer any remaining questions. We believe it is in each of our organization's best interests to resolve any factual misunderstandings prior to the issuance of the draft audit report.

After our exit conference, your initial written inquiry dated September 18, 2013 requesting "approval to transition to sponsored and non-sponsored activities" and subsequent clarification received on September 19, 2013 (see Attachment #2) was re-reviewed in an effort to identify missed opportunities to provide relevant information to address the concern. If the Code of Federal Regulation (CFR) cited in your e-mail (2

CFR part 220, App. A, § J.10.b (2)(c)¹) is the basis for the tentative audit finding classified as “systemic problems identified” under the label “effort report with no F&A breakout”, then the following information may be responsive and allay concerns regarding UCR’s former Effort Reporting format. We respectfully provide this information for your consideration in advance of the issuance of the draft audit report.

Prior to the Payroll Certification Pilot, the UCR Effort Report was used to confirm the effort of individuals with salaries charged directly to federally sponsored agreements. The Effort Report forms were generated on a quarterly basis. An example of the Effort Report form is included under Attachment #3. The upper portion of the Effort Report form (Payroll Distribution for Report Period) was used to identify the payroll distributions associated with the individual for the quarter. This section of the report provided a breakdown by Full Accounting Unit (FAU) of salaries charged to “Sponsored Activities” and “All Other Functions”. FAUs associated with “Sponsored Activities” were identified based on unique funds assigned to sponsored agreements. In addition, the FAU contains a data element called the “function code” that identifies the purpose of the sponsored agreement. For example, function code “40” indicates “instruction”, function code “44” indicates “research”, function code “62” indicates “public service”, etc. The “All Other Functions” section contains FAUs not associated with sponsored activities, such as State General Fund support.

The lower portion of the Effort Report form provided the person performing the effort certification with two categories to classify the individual’s effort for the quarter: “Sponsored Activities” and “All Other Activities”. The “Sponsored Activities” section included all of an individual’s direct effort associated with all sponsored agreement(s) (including federally funded) in consideration of the FAU distribution listed in the Payroll Distribution portion of the report described above; therefore, the “Sponsored Activities” effort was comprised of all sponsor funded instruction, research, public service, etc. The “All Other Activities” section included the rest of an individual’s effort not directly associated with “Sponsored Activities”, such as teaching and other departmental activities that made up the employee’s total effort.

It is important to note the completed Effort Report form’s primary purpose was to provide an after-the-fact confirmation of effort associated with salaries charged to federal awards. The information contained on the Effort Report form was not directly used in the F&A rate calculation, but rather the F&A cost pools were developed using the fund source and function code associated with expenditures. An excerpt from UCR’s F&A most recent rate proposal is

¹ 2 CFR part 220, App. A, § J.10.b (2)(c) Criteria for Acceptable Methods. The payroll distribution system will allow confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify F&A costs and the functions to which they are allocable. The activities chargeable to F&A cost categories or the major functions of the institution for employees whose salaries must be apportioned (see subsection J.10.b (1)(b) of this Appendix), if not initially identified as separate categories, may be subsequently distributed by any reasonable method mutually agreed to, including, but not limited to, suitably conducted surveys, statistical sampling procedures, or the application of negotiated fixed rates.

attached (see Attachment #4). The proposal discusses the Instruction & Department Research (I&R), Sponsored Instruction (SI), Organized Research (OR), Other Sponsored Activities (OSA), and Other Institutional Activities (OIA) direct cost pools as follows:

- The Instruction & Department Research (I&R) cost pool consists of expenses associated with non-sponsored instructional and non-sponsored research activities. The I&R cost pool contains all non-sponsored FAUs associated with function 40 (instruction) and most non-sponsored FAUs associated with function 44 (research).
- The Sponsored Instruction (SI) cost pool consists of expenses associated with sponsored direct instructional activities. The SP cost pool contains all FAUs in function 40 (instruction) sponsored by extramural contract, grants, cooperative agreements or federal appropriations.
- The Organized Research (OR) cost pool consists of expenses associated with all research and development activities sponsored by any external organization (sponsored research), as well as research and development activities that are separately budgeted and accounted for under an internal application of institutional funds (university research).
- The Other Sponsored Activities (OSA) cost pool consists of expenses associated with all sponsored projects not categorized as SI or OR.
- The Other Institutional Activities (OIA) consists of non-sponsored direct cost other than I&R.

Therefore, UCR believes our Effort Report format did comply with 2 CFR part 220, App. A, § J.10.b (2)(c) Criteria for Acceptable Methods. Our payroll distribution system and FAU allow for the “confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify F&A costs and the functions to which they are allocable” as well as provide for the initial identification of the separate categories used in our F&A rate calculation. The Effort Report is not required to contain and explicitly breakout F&A costs since the data is initially identified in UCR’s FAU coding of salary expense transactions via our payroll distribution system.

As you know, UCR has been a good partner with HHS OIG in the audit of Payroll Certifications by promptly providing data requests, obtaining requested documentation, and scheduling interviews/meetings. In addition, UCR effectively demonstrated the Payroll Certification pilot objectives of improved accountability, accuracy, efficiency, transparency, and federal financial reporting. The tentative Effort Reporting audit finding and related documentation have been discussed with UC’s Compliance Officer, Sheryl Vacca, UCR’s General Counsel, David Bergquist, and others. UC and UCR would like to continue our productive and collegial work with HHS OIG by the promptly resolving this tentative audit finding prior to the issuance of the draft Payroll Certification Audit Report. In order to expedite a positive determination, we

respectfully request a meeting (preferably in-person) to address any outstanding questions or concerns with you and Lori Pilcher. Please contact me at your earliest convenience to discuss at (951) 827-3303 or via e-mail at bobbi.mccracken@ucr.edu.

Sincerely,



Bobbi McCracken
Associate Vice Chancellor, Financial Services & Controller

Cc:

Lori Pilcher, HHS-OIG, Regional Inspector General
Sheryl Vacca, UCOP Senior Vice President and Chief Compliance and Audit Officer
David Bergquist, UCR Chief Campus Counsel
Ron Coley, UCR Vice Chancellor, Business & Administrative Services
Michael Pazzani, UCR Vice Chancellor, Research & Economic Development
Charles Greer, UCR Associate Vice Chancellor, Research
Pauline Librenjak, UCR Assistant Controller
Joao Pires, UCOP Director of Cost Policy & Analysis
Matt Hull, UCR Associate Vice Chancellor, Resource Planning & Budget
Greg Moore, UCR Director of Audit & Advisory Services
Spencer Turnbull, Senior Counsel, UCLA Health System

Bobbi A McCracken

From: Bobbi A McCracken
Sent: Tuesday, November 12, 2013 1:00 PM
To: Lomax, Nick N (OIG/OAS)
Subject: Payroll Certification Audit Follow Up

Dear Nick,

Hope all is well with you. I am following up on our November 7, 2013 telephone conversation on the Payroll Certification Audit. One of the preliminary issues mentioned involved UCR's effort reporting process that was used prior to the pilot of Payroll Certifications. Concerns were expressed that the effort reporting process did not "meet federal requirements" and written approval of the effort reporting format was not on file with the DHHS Office of Grants Policy Oversight & Evaluation. Without understanding the specific concerns, it is necessary to respectfully disagree with this preliminary opinion.

Since the early 1990's, the University of California (UC) began using the Comprehensive Rate Information System (CRIS) in the development of campuses Facilities & Administration (F&A) rate proposals. CRIS uses the Direct Charge Equivalent/Departmental Administration (DCE/DA). This formula-driven methodology calculates the DA portion of the F&A rate WITHOUT using effort reports. The 1986 revisions to OMB Circular A-21 recognized that effort reports were not the most efficient means for calculating DA, and as a result, the 3.6 percent faculty administrative allowance (FAA) was instituted. In the 1991, the revisions to A-21 implemented the administrative cap of 26%. All of UCR F&A rate proposals have included a complete description of the DCE methodology. HHS/DCA has reviewed and has not questioned the DCE method for identifying and supporting personnel costs in the indirect cost pools. Moreover, UCR's DS-2 clearly states the University uses the DCE method; again DCA has not questioned this methodology, which has been interpreted by UC as a form of approval by HHS. In accordance with guidance from UC Office of the President, in the early 1990's the effort report format was simplified by including all indirect costs related categories (i.e. Department Administration) in All Other Activities, leaving the categorization to Sponsored Projects and All Other Activities for those individuals paid directly from federal or federal flow through funds.

Annually, a consolidated A-133 audit is conducted of UC. The compliance of the effort report format has never been questioned by our external auditors. In 1998, HHS OIG conducted an audit of UCR's DS-2. The audit included a review of section 2.5.0 including "forms used" for completing after-the-fact activities; the effort report format was not questioned during the audit nor included as a finding. In reviewing OMB Circular A-21, the requirement for cognizant agency approval of changes to the "after-the-fact" report format of a previously approved methodology cannot be located. Per A-21, section J.10.c.(2)(d): "The system will reflect activity applicable to each sponsored agreement and to each category needed to identify F&A costs and the functions to which they are allocable. The system may treat F&A cost activities initially within a residual category and subsequently determine them by alternate methods as discussed in subsection b.(2)(c)." The UCR effort reporting format used is consistent with this guidance. Therefore, UCR asserts the effort report format used prior to the implementation of the payroll certification process was compliant with federal regulations and formal written approval of the report format by HHS was not required.

Please let me know if any other information is necessary to eliminate the concerns with UCR's effort reporting process. If necessary, I am willing to set up a conference call with leadership at UC's Office of the President to discuss specific questions.

I look forward to seeing you on November 18th to conduct interviews and finalize the audit. Please provide the names of the individuals to be interviewed as soon as possible, so the meeting dates/times can be arranged during the week of your site visit.

Sincerely,

Bobbi

University of CA, Riverside
Assoc. Vice Chancellor-Financial Services & Controller
(951) 827-3303
bobbi.mccracken@ucr.edu

Bobbi A McCracken

From: Lomax, Nick N (OIG/OAS) <Nick.Lomax@oig.hhs.gov>
Sent: Thursday, September 19, 2013 11:00 AM
To: Bobbi A McCracken
Subject: RE: Approval of 2007/2008 Change in Effort reporting.

Bobbi,

2 CFR part 220, App. A, § J.10.B.2.c Criteria for Acceptable Methods. The payroll distribution system will allow confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify F&A costs and the functions to which they are allocable. The activities chargeable to F&A cost categories or the major functions of the institution for employees whose salaries must be apportioned (see subsection J.10.b.(1)(b) of this Appendix), if not initially identified as separate categories, may be subsequently distributed by any reasonable method mutually agreed to, including, but not limited to, suitably conducted surveys, statistical sampling procedures, or the application of negotiated fixed rates.

Nick Lomax, C.I.A., C.F.E.
Senior Auditor
(404) 562-7807
(404) 562-7795 fax
nick.lomax@oig.hhs.gov

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From: Bobbi A McCracken [<mailto:bobbi.mccracken@ucr.edu>]
Sent: Thursday, September 19, 2013 1:30 PM
To: Lomax, Nick N (OIG/OAS)
Subject: RE: Approval of 2007/2008 Change in Effort reporting.

Hi Nick,

In order to respond appropriately to the assertion that UCR's effort reports deviate from costing policy, please provide the policy reference that outlines the required effort reporting categories.

Thanks,

Bobbi

From: Lomax, Nick N (OIG/OAS) [<mailto:Nick.Lomax@oig.hhs.gov>]
Sent: Wednesday, September 18, 2013 2:52 PM
To: Bobbi A McCracken
Subject: Approval of 2007/2008 Change in Effort reporting.

Bobbi,

Do you have a copy of the approval for the change for the effort report in 2007/2008? We are looking for approval to transition to sponsored and non-sponsored activities. Your help will be deeply appreciated.

Nick Lomax, C.I.A., C.F.E.
Senior Auditor
(404) 562-7807
(404) 562-7795 fax
nick.lomax@oig.hhs.gov

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UNIVERSITY OF CALIFORNIA PERSONNEL ACTIVITY REPORT

CAM	Attachment #3
PAR NO.	[REDACTED]

EMPLOYEE NAME: [REDACTED]
 TITLE: 3266 GRAD STDNT RES- NO REMISSION
 DEPARTMENT: Q01052 Plant Pathology & Microb

EMPLOYEE NUMBER: [REDACTED]
 REPORT PERIOD: WINTER 2010

NOTES

PAYROLL DISTRIBUTION FOR REPORT PERIOD	PERCENT
BY ACTIVITY FUND FUNCTION	SALARY
SPONSORED PROJECTS	
A01094-30020-44 FDP5R01A1078885 BRNMN/ETL	45
ALL OTHER FUNCTIONS	
A01067-19900-64 GENERAL FUNDS	55

53-5

This is the fund number that identifies whether the salary relates to a sponsored agreement or non-sponsored sources.

This is the function code that identifies the type of activity, e.g. "40" = instruction; "44" = research; "62" = public service

100%

TO BE COMPLETED BY EMPLOYEE OR RESPONSIBLE OFFICIAL

ESTIMATED DISTRIBUTION OF EFFORT FOR REPORT PERIOD: PERCENT

- 1. SPONSORED PROJECTS 45
- 2. ALL OTHER ACTIVITIES 55

CONFIRMATION BY Employee Responsible Official TOTAL 100%

I certify that this report represents a reasonable estimate of the actual effort expended on each sponsored project and each category of effort for the period reported.

Signature
Professor

Title

6-4-10

Date

UCSA 0001-5 (R12/91)

ORIGINAL FOR ACCOUNTING

RETR: DEPARTMENT COPY - 5 YEARS SUBJECT TO CONTRACT AND GRANT REQUIREMENTS
ACCOUNTING - 5 YEARS

J. Rate Computation Bases

1. **Narrative Description of Cost Pool Composition**
2. **Schedule of Included Costs by Cost Pool**
 - 2.1. **Cost Group 91 – Instructions**
 - 2.2. **Cost Group 92 – Research**
 - 2.3. **Cost Group 93 – Other Sponsored Activities**
 - 2.4. **Cost Group 94 – Other Institutional Activities**
3. **Listing of On-/Off-Campus Organized Research**

Cost Pool Group 91 – Instruction & Departmental Research

The Instruction & Departmental Research direct cost pool group is comprised of two cost pools as described below.

910 Instruction & Departmental Research

Composition: The Instruction & Departmental Research cost pool consists of expenses associated with nonsponsored instructional activities and research activities not separately budgeted and accounted for. This pool contains the following:

- all nonsponsored accounts in function 40 (instruction);
 - most nonsponsored accounts in function 44 (research);
- Some costs mapped to this pool are transferred to other pools as follows:
- specific amounts in nonsponsored departmental administration and department-paid operations & maintenance are transferred to F&A pools;
 - cost sharing amounts are transferred to other direct pools;
 - costs incurred in function 40 accounts that are A-21 unallowable activities are reclassified to OIA.

911 Sponsored Instruction

Composition: The Sponsored Instruction cost pool consists of expenses associated with sponsored direct instructional activities. This pool contains all accounts in function 40 (instruction) sponsored by extramural contracts, grants, cooperative agreements or federal appropriations. This pool is *not* a source of departmental administration, department-paid operations & maintenance, or cost sharing.

Cost Pool Group 92 – Organized Research

The Organized Research direct cost pool group is comprised of one cost pool as described below.

920 Organized Research

Composition: The Organized Research cost pool consists of expenses associated with all research and development activities sponsored by any external organization (sponsored research), as well as all research and development activities that are separately budgeted and accounted for under an internal application of institutional funds (university research). Organized research training activities are included in this cost pool. Accounts in function 44 (research) are the primary source of this cost pool. Also included are transfers of University's committed cost sharing amounts. Non-sponsored projects funded

**APPENDIX D: UNIVERSITY OF CALIFORNIA—RIVERSIDE COMMENTS
ATTACHMENT B**

University of California, Riverside Response to
Draft Audit Report Number A-04-13-01026
Attachment B

Attachment B

Proposal & Award Management Information System and Other Internal Controls Overview

This document discusses the University of California Riverside's (UCR) contract and grant management related systems. The purpose of this information is to outline the information available to Principal Investigators (PI) and the related controls to validate that sufficient information exists to confirm salary/wage charges to federal awards. UCR's Proposal and Award Management Information System (PAMIS) portal allows for an easy and effective method of accessing existing campus contract and grant related applications and information, including:

- proposal approval system (eCAF)
- pre-award request system
- proposal development and submission system
- award system (eAward)
- monthly reporting system (PIWRS)
- payroll certification system
- inception to date and expiring/expired fund reports
- links to policy, procedures, and campus informational websites such as:
 - UCR Research and Economic Development (RED)
 - UCR Extramural Funds Accounting
 - University of California (UC) Office of the President Research Administration.

Additional information on specific applications and controls follows as well as a process flow diagram.

Proposals. For extramurally funded proposals, the electronic Campus Approval Form (eCAF) system is used for the routing, approval, and transmission of the proposal to the UCR Authorized Organizational Representative (AOR). The eCAF system requires the completion of mandatory questions and fields necessary for a proposal to be reviewed and endorsed by the University and contains business rules to ensure:

- PI/Co-PI(s) complete financial disclosures as required by the funding agency, e.g. PHS Financial Conflict of Interest disclosure;
- PI/Co-PI(s) complete required information and certifications in accordance with UC/UCR policies and procedures;
- all required information is captured in accordance with UC and UCR's policies and procedures; and
- budgets, budget justifications, and other required documents are included as applicable

Once all the required information has been entered, the eCAF and the proposal are routed to the department chairs, deans and others (as applicable), for review and approval. Once approvals have been documented, the eCAF is routed to the AOR in RED-Sponsored Program Administration (RED-SPA) for review and endorsement of the proposal prior to submission to the funding agency. Department contract and grant analysts assist PIs with the development of proposal budgets and budget justifications. Links to a proposal development and submission system containing proposal validations/checks and system-to-system capabilities for the majority of federal proposals are also readily available. A PI's eCAF submissions are searchable and retrievable by the PI and others with

system access. The eCAF support site is available at: <http://cnc.ucr.edu/ecaf/>. Additional guidance is available under the RED webpage under the Contract and Grant Lifecycle PreAward Administration at: <https://research.ucr.edu/spa/lifecycle/proposal-preparation-submission.aspx>

Pre-awards. Pre-awards are requested using the campus Pre-Award Request system. Pre-awards can be initiated based on information contained in the eCAF system; all relevant information from the eCAF is automatically populated in the Pre-Award request. The system includes business rules to ensure all required information and attachments are completed before the system allows the pre-award to be routed for approval by the department, dean, and RED-SPA. Once approved, pre-award budgets provide explicit expenditure limits. The use of pre-awards is encouraged where appropriate to meet project objectives and allow expenditures to be recorded in the appropriate Full Accounting Unit (FAU) in order to reduce the need for future cost transfers. The system also detects when a pre-award has expired, automatically generating an e-mail notifying the PI and the department of required actions. The UCR Policy and Procedure governing pre-awards is 550-80 available at: <http://fboapps.ucr.edu/policies/index.php?path=viewPolicies.php&policy=550-80>. The related support site is available at: <http://cnc.ucr.edu/preaward/>. Additional guidance is available under the RED webpage under the Contract and Grant Lifecycle PreAward Administration at: <https://research.ucr.edu/spa/lifecycle/pre-award-administration.aspx>

Awards. When an agency makes a funding decision, awards are negotiated and accepted through RED-SPA. Once the award is finalized, UCR's campus award system (eAward) provides notifications to the PI, department contract and grant analysts, the central Accounting Office, and others as appropriate. The eAward system contains links to the award documents including the terms and conditions. The system allows for the central Accounting Office to set up a unique fund in our financial system automatically populating common information from the eCAF and eAward; in addition, the department contract and grant analyst establishes the budgetary allocations in accordance with the approved award budget. The eAward information is readily retrievable by the PI, department analyst and central offices and contains links to standard Inception to Date reports providing a summary of the entire award's allocations and expenditures. Additional guidance is available under the Research and Economic Development webpage under the Contract and Grant Lifecycle-Award Negotiation at: <https://research.ucr.edu/spa/lifecycle/award-negotiation-and-setup.aspx> and Contract and Grant Lifecycle-Post-Award Administration at: <https://research.ucr.edu/spa/lifecycle/post-award-administration.aspx>

PI Reports. Once an award's fund number and budget are established, expenditures can be incurred. PIs are provided with standard monthly financial reports of all of their contract and grant activity; automated notifications are produced informing PIs of the availability of these reports. The reports are accessible via PAMIS under the Principal Investigator Web Reporting System (PIWRS). The PIWRS provides the PI with summary views of contract and grants balances with a variety of other user customized view options (e.g. by allocation, expenditures, agency categories, UCR budget categories, UCR summary level accounts, etc.) based on the need and/or preference of the specific PI. The PIWRS includes automated projections of payroll expenditures based on appointment distributions in the UCR Payroll Personnel System (PPS) as well as non-salary encumbrances. Department contract and grant analysts have the ability to review this information in advance of the reports being released to the PI so the analyst may add comments, input non-contract and grant funding sources, and adjust projections. PIWRS contains the ability for the PI to drill into payroll details for every fund listed on the report as well

Attachment B Page 2 of 6

as into purchase order details and travel expense vouchers. The PI has the ability to share information on the report with project collaborators. The PIWRS was included in the demonstration provided to the HHS OIG auditors on September 5, 2013. Links to the Inception to Date reports and Notice of Award are readily available to the PI. As an award's expiration date approaches, the PI and department administrator receive automated notifications with instructions on required actions. The support site for PIWRS is available at: <http://cnc.ucr.edu/piwrs/>

Payroll Certifications. Based on an award's budget year/period, annual payroll certifications (PRC) are generated. Department contract and grant analysts are notified in advance of an upcoming certification so they may begin gathering information to validate the certification information and document mandatory, committed cost shared salaries. Once the accounting period is closed, PRCs are generated for awards with budget periods ending in the recently closed accounting period; and department contract and grant analysts are notified via e-mail to begin their review. The PRC complements the PI's review of their monthly financial reports (PIWRS and/or department prepared). Our current PRC process contains the following features:

- web-based reporting (paperless) and electronic notification of due dates;
- listing of all employees paid on the award for the reporting period;
- ability to drill into payroll details;
- ability to enter pending payroll adjustments;
- ability to enter salary related mandatory, committed cost sharing;
- ability to upload supporting documentation; and
- reminders of fund restrictions and identification of potentially unallowable costs (i.e. cost notes)

After reviewing the employee listing, the payroll certification process requires the lead PI on an award to certify/confirm two standard statements that appear on every payroll certification:

- 1) salary and wage charges are reasonable in relation to the work performed, and
- 2) proposal preparation activities were not charged to the award.

In addition, based on business rules certain salary expenditures generate cost notes. If cost notes are generated, the PI will be asked to certify additional statements to confirm the costs were in compliance with federal policy. Cost notes are generated to ensure:

- senior project personnel receiving salary payments from NSF projects adhered to the two month restriction
- individuals with over 90 percent of their salaries charged to sponsored projects were involved in minimal non-sponsored project activities, like instruction, department committees, etc.
- individuals flagged as "Clerical and Administrative" met the federal exception criteria, and exceptions are documented; or comments are entered to explain their activities
- individuals that may have been paid at a rate in excess of NIH's approved rate had their salary charges adjusted to comply with NIH's salary cap requirements.

Please note the Federal Demonstration Partnership (FDP) whitepaper and UC's pilot proposal were based on the reasonableness of salaries charged in relation to the work performed, not effort. Payroll

certification data along with the monthly financial reports as well as knowledge of project activities provide the PI with sufficient information to confirm salaries charged to federal funds. If the PI has questions regarding the certification, they are encouraged to first contact their department administrators to answer questions and/or initiate corrections. Organizational chief administrative and financial officers and the central Accounting Office are also available to assist with questions and/or concerns. If payroll certifications are not performed within 45 days of distribution, campus policy requires the uncertified salary expenses be moved to an unrestricted funding source. UCR has not had the need to move any salary charges because it has not encountered the situation where a PI refused to perform the payroll certification process and/or could not be provided with sufficient information to perform the certification.

Access. To ensure all PIs are able to monitor their award activity, access to the PAMIS applications described in this document are automatically granted to all faculty based upon characteristics of their payroll appointment. Faculty are restricted to view and take action on proposals and awards where they are specifically identified as the PI. Other PAMIS roles are assigned by the department System Access Administrator (SAA); this approach provides departments with the ability to easily adjust access based on department needs while ensuring accountability for access controls exists with those most familiar with staff training and job responsibilities. Based on a user's system access, automated e-mail notifications of required actions throughout the award life cycle are generated. Although the PAMIS application contains a wealth of information regarding contract and grant funds, the campus has other systems and processes to ensure the integrity of information contained in our financial system.

Department Processes. Every department is required to perform and document monthly ledger reconciliations using our Ledger Reconciliation and Storage System (LRSS). The LRSS requires the SAA to designate reconcilers and certifiers. Separation of duties are enforced via system edits that prevent a reconciler from being the certifier for a particular department/accountability structure. The campus internal control guidance for the ledger reconciliation process requires (UCR Policy & Procedures 200-97):

- all salary transactions be verified by thoroughly reviewing of the Distribution of Payroll Expense, and the review cannot be performed by the PPS Transactor;
- all transactions against contract and grant funds be reviewed for compliance with award terms, conditions, and federal cost principles (e.g. allowability, reasonableness, allocability and consistency); and
- certification that the actions listed above have been performed.

The monthly LRSS process supplements the PIWRS reporting to ensure the appropriateness of the expenditures appearing on department ledgers. The LRSS support site is available at: http://lrss.ucr.edu/lrss/lrss_help.help_main

In addition to PIWRS, many departments create supplemental financial reporting using data extracts from our campus financial system to provide information to their PIs in formats customized for the particular PI or department. These reports may include other funding the PI has responsibility for overseeing, such as gifts, departmental allocations, and sales & service funds. PIs are encouraged to review their monthly reports (PIWRS and/or department provided) to confirm the appropriateness of

expenditures on their awards and to report any errors to their department contract and grant analyst so the errors can be promptly corrected in accordance with UC Policy Business and Finance Bulletin A-47. Department contract and grant analysts regularly meet with Pls to review award activity and reports.

At UCR, currently the administration over department expenditures is decentralized. In a decentralized environment, the campus provides standard guidance, systems and business rules to ensure basic internal controls standards are in place to reinforce compliance with federal and university requirements. Departments have the ability and flexibility to implement unit specific procedures within the established internal control framework. In relation to payroll charges, departments are expected to ensure:

- for contract and grant funded positions,
 - the position is included in the approved budget;
 - if the position is not included, confirm that re-budgeting is allowed and the scope of the project has not changed; or coordinate with the RED-SPA to obtain approval;
- salary rates conform to UC and UCR policy and agency requirements
- review of payroll transactions is conducted as part of the monthly ledger reconciliation process

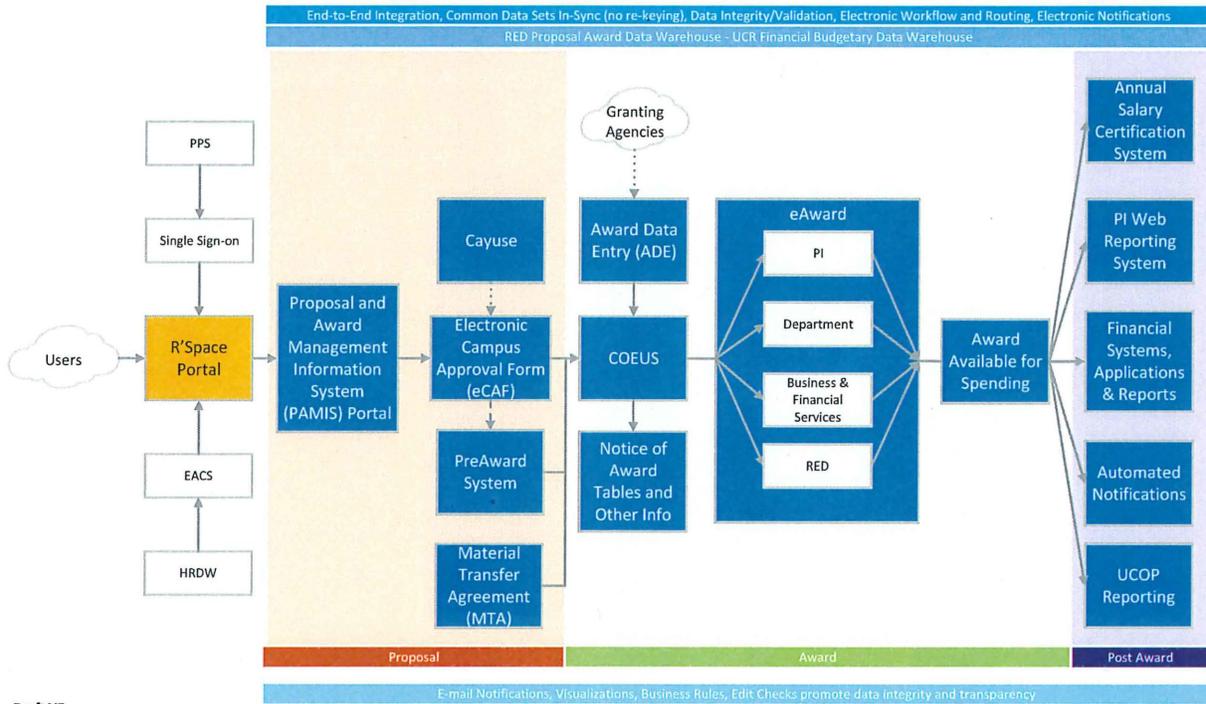
Other Controls. Although department processes may vary, the UCR control environment enforces separation of duties via the post-audit notifications (PAN) and access control management processes. As changes are made in PPS by authorized and trained transactors, notifications are sent to designated mandatory and non-mandatory reviewers. Access to PPS is updated by the Central Payroll Office and assigned based on completion of required training and knowledge of the campus organizational structure. Users may only possess one type of role; users with the ability to update PPS cannot perform PPS-PAN reviews. As previously communicated to HHS OIG, PPS has both preventive (system edits/business rules) and detective controls to prevent salary charges in excess of 100 percent. In order to enhance our control environment and improve efficiencies, it is important to note, several organizational units within UCR have formed shared services centers to perform payroll updates resulting in more uniform, compliant processes.

Annually UCR's Audit & Advisory Services department conducts risk assessment interviews with organizational heads and units with compliance and control responsibilities. Based on the results of these discussions and other procedures (e.g. data analytics), the annual audit plan is developed, approved and conducted in coordination with the UC Office of the President and approved by the campus Ethics, Compliance, Risks and Audit Committee (ECRAC). In addition, the Enterprise Risk Workgroup conducts its own annual risk assessment to identify activities planned for the next fiscal year. Progress on activities are reported to the ECRAC and the UC Chief Compliance Officer.

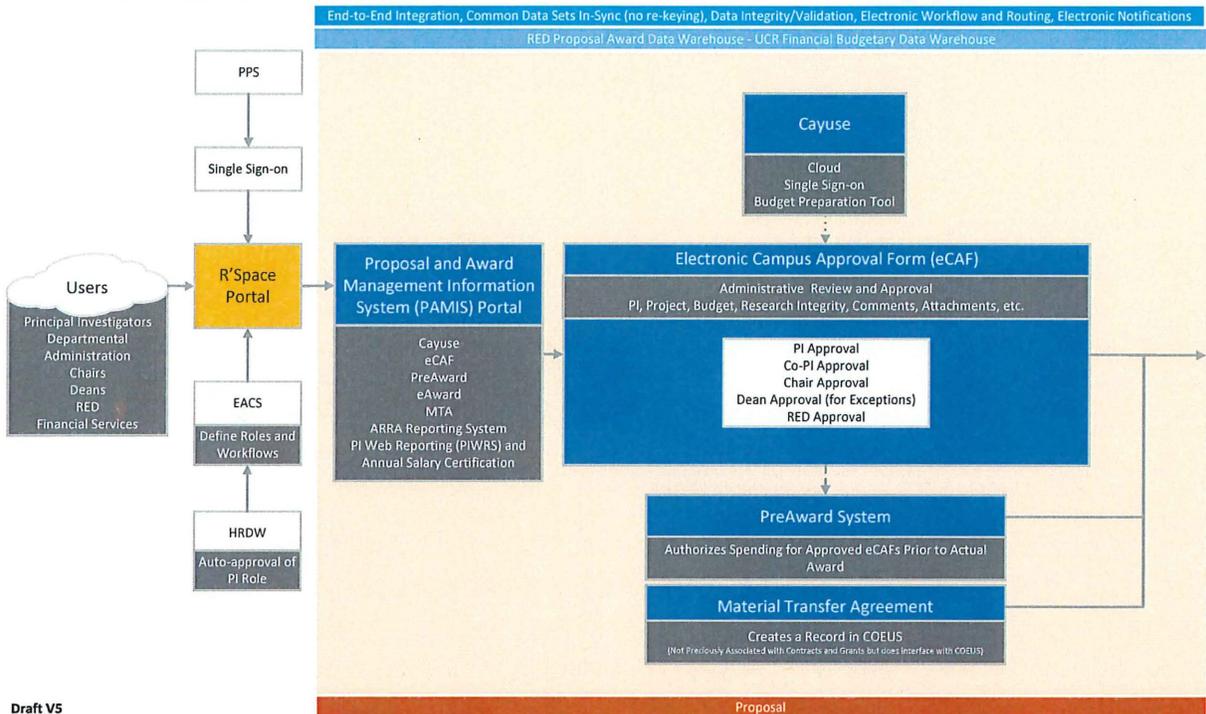
In addition, all UC employees are required to complete the UC Ethics and Compliance briefing discussing the UC's Statement of Ethical Values and UC's standards of ethical conduct. All campuses have designated Chief Ethics and Compliance Officers (CECO). The UC Contract and Grant Manual provides clear guidance on expectations regarding the administration of contracts and grants.

As discussed throughout this document, UC and UCR have comprehensive internal controls at all levels of the organization covering operations, reporting and compliance objectives by creating a robust

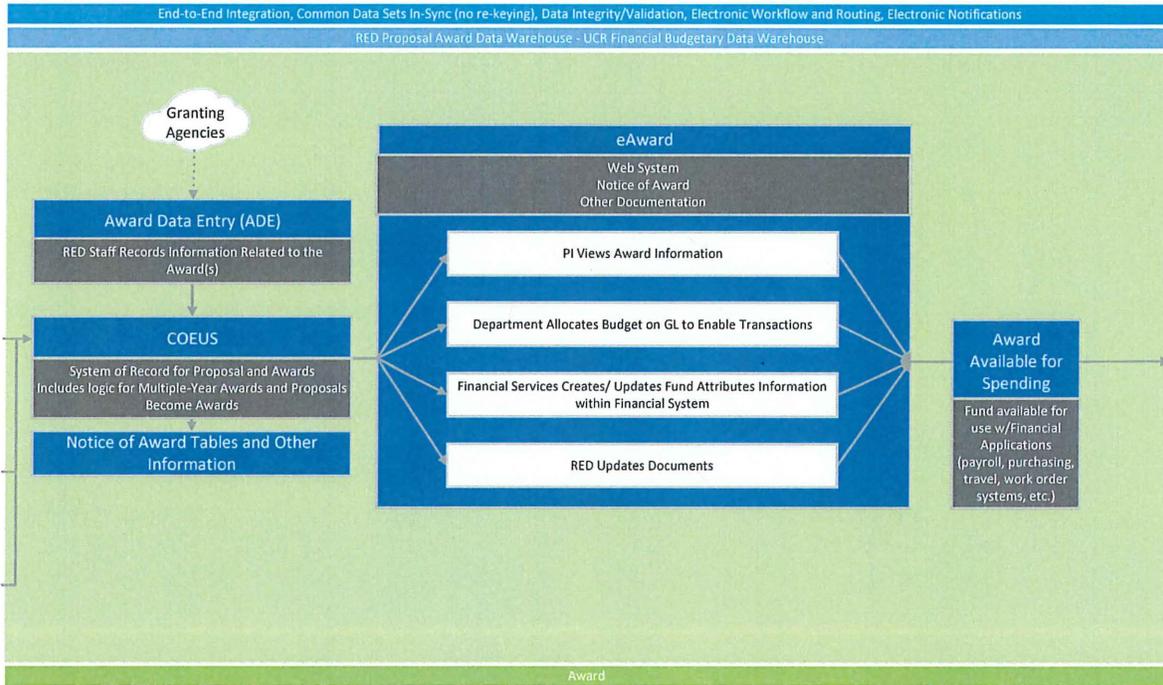
control environment, conducting risk assessments, providing information on contract and grant activities, communicating expectations, and performing monitoring activities.



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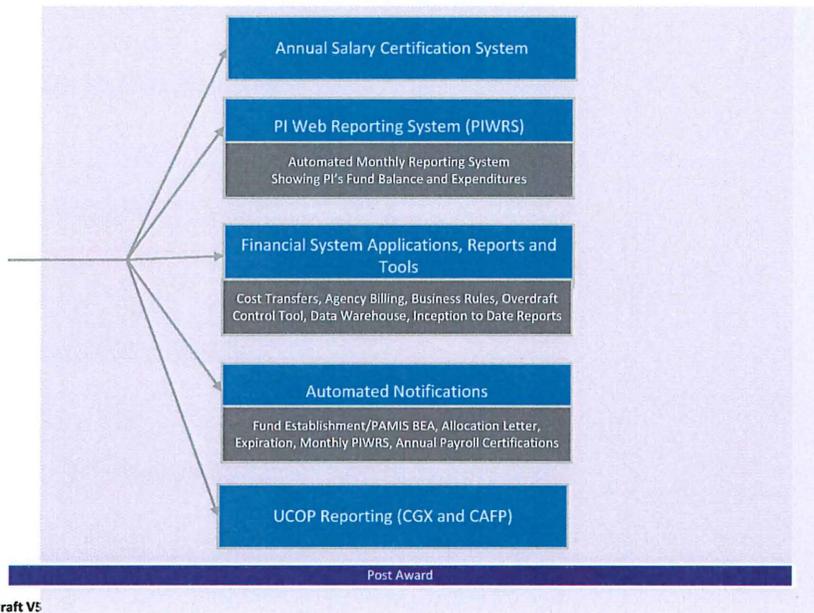


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End-to-End Integration, Common Data Sets In-Sync (no re-keying), Data Integrity/Validation, Electronic Workflow and Routing, Electronic Notifications
 RED Proposal Award Data Warehouse - UCR Financial Budgetary Data Warehouse



Draft V5

**APPENDIX D: UNIVERSITY OF CALIFORNIA—RIVERSIDE COMMENTS
ATTACHMENT C**

University of California, Riverside Response to
Draft Audit Report Number A-04-13-01026
Attachment C

Attachment C:

Discussion of samples erroneously classified as "at-risk" in HHS OIG Draft Audit Report

1. Effort-Reporting format: Eighty-three of the 129 at-risk transactions are related to UCR's prior effort-reporting system ("We identified 83 transactions totaling \$171,157 that were supported by personnel activity reports that did not separately identify nonsponsored activities."). As discussed in UCR's response to draft Recommendation #1 and Attachment A, the system does comply with OMB Circular A-21. UCR explained the rationale and format of our prior effort-reporting system. UCR requested meetings to discuss HHS OIG's concerns on at least two occasions and received no response.
2. PIs Did Not Charge Their Own Salary to Awards: Twelve of the at-risk transactions are related to voluntary uncommitted cost sharing. ("Twelve transaction totaling \$30,187 under the pilot PCS had Payroll Certification forms certified by PIs, but the Payroll Certification forms showed that the PIs had not charged any of their own salary to the awards. The University did not provide any other evidence that these PI had worked on these awards or had the requisite knowledge of the work performed on these awards.") According to OMB Memoranda 01-06 (located at https://www.whitehouse.gov/omb/memoranda_m01-06), voluntary uncommitted cost sharing is defined as "university faculty (including senior researchers) effort that is over and above that which is committed and budgeted for in a sponsored agreement." In the 12 awards sampled, the Principal Investigators did not have payroll charges, as each of their effort dedicated to their respective project was accomplished with voluntary uncommitted cost sharing that was not quantified in the submitted proposal nor resulting award. During the May 2016 conference call, the HHS OIG auditors mentioned there was no evidence provided to confirm the PI provide time on grants, such as lab notes. At no time were lab notes requested by the auditor, but this type of documentation seems irrelevant given the NIH Guide states an individual designated as the PI has authority and responsibility for leading and directing the project, intellectually and logistically. In addition, UC policy, Contract and Grant Manual Chapter 1 (<http://www.ucop.edu/research-policy-analysis-coordination/resources-tools/contract-and-grant-manual/chapter1/chapter-1-500.html>) requires the PI to personally participate in the project, but does not require the direct charging the PI's salary to the award. The PI's participation is documented via the payroll certification and the project reports.
3. Administrative/Clerical: Twelve of the samples were determined to be administrative and clerical salaries ("The University charged 12 salary transactions totaling \$12,436 for administrative and clerical salaries as direct costs under the pilot PCS. The University provided no evidence that the awards required an extensive amount of administrative support.") Of the 12 samples noted, only one position was performing administrative/clerical activities and the position met the major project requirement under OMB Circular A-21, the exception was documented in the proposal justification, and the proposal was funded without excluding the position. The other 11 samples were directly involved in the research based on the documentation provided as reviewed and confirmed by UCR's internal auditors; five of the 11 were clearly academic research positions.

4. No PCS: One payroll transactions was determined to be unsupported by a Payroll Certification (PRC) (“...one transaction totaling \$1,907 under the pilot PCS that was not supported by a Payroll Certification form.”). However, the transaction in question was related to a cost transfer processed after the annual certification period; the transaction was reflected in the next annual PRC cycle and certified. The PRC system is based on the general ledger transaction date not the pay period end date. This is considered a feature of the PRC system versus the more rigid effort-reporting system. Since the pilot began, UCR has obtained 100 percent completion of PRCs.