Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

THE UNIVERSITY OF CALIFORNIA AT IRVINE'S PILOT PAYROLL CERTIFICATION SYSTEM COULD NOT BE ASSESSED

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

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December 2014
A-04-13-01027

Office of Inspector General

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EXECUTIVE SUMMARY

We could not determine whether the University of California—Irvine's (the University) pilot payroll certification system provided data that supported labor charges that it made to its Federal awards because it could not reconcile its accounting records to its Federal financial reports. As a result, we cannot determine whether the University certified, reported, or claimed labor costs and associated fringe benefits that accurately reflected the actual effort its personnel devoted to Federal awards.

WHY WE DID THIS REVIEW

The Office of Management and Budget (OMB) requested that the Department of Health and Human Services (HHS) and the National Science Foundation (NSF) Offices of Inspectors General (OIGs) conduct labor-effort reporting audits at four universities. OMB requested these audits to assess the payroll certification system pilot (pilot PCS) that the Federal Demonstration Partnership (FDP) had developed. HHS OIG agreed to perform audits at the University of California—Irvine (the University) and the University of California—Riverside (UCR), and NSF OIG agreed to conduct similar audits at Michigan Technical University and George Mason University. HHS and NSF OIGs planned to use statistical sampling to select salary and wage costs for review. This report contains the results of our review at the University. We will issue a separate report on UCR, and NSF OIG will issue separate reports on Michigan Technical University and George Mason University.

Our objectives were to determine whether data from the University's pilot PCS supported labor charges that the University made to its Federal awards and whether the University certified, reported, and claimed labor costs and associated fringe benefits that accurately reflected the actual work its personnel devoted to the Federal awards.

BACKGROUND

Effort-Reporting System

Colleges and universities must support and document salary charges made to Federal grants and contracts (2 CFR part 220). The customary way to fulfill this requirement has been through an effort-reporting system. Within these effort-reporting systems, colleges and universities have used time reports and activity reports (time and activity reports) as the main support for salaries and wages charged to Federal awards (2 CFR part 220, Appendix A, § J.10.c). 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. This method provides auditors and others with the means to determine whether salaries and wages charged to Federal grants and contracts are adequately supported. This method also provides documentation to support the activity for which the employee is compensated.

Federal Demonstration Partnership

The FDP is an organization of 10 Federal agencies and more than 120 research institutions dedicated to reducing the administrative burdens associated with research grants and contracts. College and university effort-reporting is the subject of one of the FDP's current demonstration projects. In 2011, HHS gave the University and UCR approval to pilot a PCS as a replacement for its effort-reporting process.

Under the pilot PCS, the Principal Investigator on an award obtains a "Payroll Expense Report" showing the names of the employees that have salaries and wages charged to the award. The Principal Investigator reviews the report after the award's budget period ends and certifies to the appropriateness and reasonableness of the salary and wage charges.

Federal Requirements

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 2 CFR part 220, Appendix A. The cost principles require that, to be allowable, costs must be reasonable, allocable, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements.

Grantees use the Federal Financial Report (FFR) for collecting and reporting financial data. Reports of expenditures are required as documentation of the financial status of awards according to the official accounting records of the grantee organization. Before submitting FFRs, grantees must ensure that the information on the report is accurate, complete, and consistent with the grantees' accounting systems. The regulations also require that recipients of Federal funds have financial management systems that accurately reflect the source and application of funds (2 CFR part 215). The University's participation in the pilot PCS did not nullify the Federal requirements that the University collect and accurately report financial data and that the University employ a financial management system that accurately reflects the source and application of funds.

WHAT WE FOUND

We could not determine whether the University's pilot PCS provided data that supported labor charges that it made to its Federal awards because it could not reconcile its accounting records to its FFRs. Specifically, the University's reconciliation showed a total variance of approximately $3.8 million for the 666 Federal awards, totaling $491 million, that the University received during the audit period. As a result, we could not determine if the University had a valid list of labor transactions from which we could select a statistical sample for review. At the time of our audit, the University did not have a process in place to reconcile its accounting records to its FFRs. Without a reconciliation of accounting records to the FFRs and a valid list of transactions from which to sample, we could not express an opinion on whether the University certified, reported, or claimed labor costs and associated fringe benefits that accurately reflected the actual effort its personnel devoted to Federal awards.

WHAT WE RECOMMEND

We recommend that the University:

- reconcile the $491,291,290 it reported on its FFRs to its accounting records and
- modify its financial management system to ensure that amounts it reports on its FFRs can be supported by amounts recorded in its accounting records.

UNIVERSITY OF CALIFORNIA–IRVINE COMMENTS AND OUR RESPONSE

In written comments on our draft report, the University did not agree with either of our recommendations.

University of California–Irvine Comments

University officials said that they reconciled the $491,291,290 reported on the University's FFRs to its accounting records using a manual process and completed this reconciliation a few days after an agreed upon deadline of November 1, 2013. The University also said that it had shifted resources to make sure its processes were as effective as possible.

University officials added that they reconcile the University's FFRs to the general ledger (accounting records) quarterly using an "inception-to-date" methodology that is a generally accepted accounting practice and that is required by the HHS Payment Management System (PMS) for certification of FFRs. University officials further stated that the University's reconciliation process only reports allowable charges to Federal grants, and, therefore, the accounting records may include current expenditures that are not yet available to report, expenditures from previous quarters that are now appropriate to report, or both. University officials wished to make clear that its "inception-to-date" process allowed for variances and the $3.8 million variance addressed in the report represented expenses in its accounting records that were not claimed on its FFRs.

Our Response

HHS and NSF OIGs met with the University and other pilot schools on January 29, 2013, to discuss the audit approach, including data and supporting information that we would need for the audit. On June 6, 2013, we sent the University an engagement letter requesting a list of information for the University to submit to us by a deadline of June 14, 2013. Included in this list was a request that the University provide a reconciliation of its accounting records to its FFRs for the audit period. This reconciliation would have provided us with assurance that the University's accounting records correctly reflected the costs it claimed, thus allowing our audit to proceed. On October 24, 2013, we presented the University with another deadline of November 1, 2013, which it did not meet. Because the University could not provide what should have been readily available information by the November 1, deadline, we discontinued fieldwork on the audit. This is the same reconciliation information that the University would have used to prepare its FFRs.

The University submitted its reconciliation on November 8, 2013. The information provided included a database of general ledger transactions, which should have supported the FFRs, and an Excel file with reconciliations for 28 quarters. However:

- The database of general ledger transactions still included a $3.8 million variance when reconciled to the FFR.

- Some of the quarterly reconciliations also had reconciling differences, and the University did not adjust its database of general ledger transactions to reflect these reconciling differences.

Therefore, neither NSF nor HHS OIGs could ensure that the database of general ledger transactions, which we were going to use for sampling purposes, was accurate and complete.

Rather than showing identical amounts for what the University recorded and what it reported, the reconciliation showed that the University recorded in its accounting records $3.8 million more costs than it reported on its FFRs. While the $3.8 million may appear to be in the Government's favor, we cannot confirm this because the University made numerous adjustments to its general ledger each quarter and did not document quarterly reconciliations that track such adjustments. In addition, we intended to use the general ledger for sampling purposes to ensure that only allowable labor costs were charged to Federal awards. Without a general ledger that reconciled to the FFRs, we had no assurance our sampling frame would have been accurate and complete.

Regarding the University's comment that PMS requires it to use an "inception-to-date" reconciliation methodology for certification of its FFRs, a PMS official told us that all reconciliation requirements should be outlined by the awarding agency within a grant's Notice of Award. The University did not provide any evidence that showed that its inception-to-date methodology was a requirement in any of its Notices of Award. In addition, the HHS Grants Policy Statement says, "It is the recipient's responsibility to reconcile reports submitted to PMS and to the [operating division]. Reconciliation consists of ensuring that disbursements equal obligations and drawdowns or making any adjustments as necessary…." The policy statement does not specify a frequency for a reconciliation.

The University should have anticipated that both NSF and HHS OIGs would request a quarterly reconciliation because the University reports its Federal grant expenditures to PMS on a quarterly basis. To ensure that it claimed only allowable costs, the University's accounting records and FFRs should have already been reconciled and documented at the time it submitted its quarterly FFRs to the awarding agencies.

Therefore, we maintain that our recommendations are valid.

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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…."[2] 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 activity reporting and plan confirmations for supporting salary and wage expenses charged to federally sponsored projects.

The pilot PCS varies from current standard activity reporting in two ways: (1) the pilot PCS is a project-based (grant or contract) methodology (versus a person-based methodology) and (2) the pilot PCS is based on the concept that "charges are reasonable in relation to work performed" (versus "effort").

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 labor-effort-reporting 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—Irvine (the University) and the University of California—Riverside (UCR), and NSF OIG audited Michigan Technical University and George Mason University. This report contains the results of our audit on the University. We will issue a separate report on UCR, and NSF OIG will issue separate reports on Michigan Technical University and George Mason University. We intended to review the labor-certification process, labor-effort recording and reporting, and accountability for labor costs charged to Federal awards.

OBJECTIVES

Our objectives were to determine whether data from the University's pilot PCS supported labor charges that the University made to its Federal awards and whether the University certified, reported, and claimed labor costs and associated fringe benefits that accurately reflected the actual work its personnel devoted to the Federal awards.

BACKGROUND

The Standard Method: Effort-Reporting System

Colleges and universities must support and document salary charges made to Federal awards (2 CFR part 220). The customary way to fulfill this requirement has been through an effort-

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

[2] See Appendix A for more information on Presidential Executive Order 13563 and other criteria.

reporting system. Within these effort-reporting systems, colleges and universities have used time reports and activity reports (time and activity reports) as the main support for salaries and wages charged to Federal awards (2 CFR part 220, Appendix A, § J.10.c). 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. Employee time and activity reporting provides auditors and others with the means to determine whether salaries and wages charged to Federal awards are adequately documented. 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.

Federal Demonstration Partnership

The FDP is an organization of 10 Federal agencies and over 120 research institutions dedicated to reducing the administrative burdens associated with research grants and contracts. College and university effort-reporting is the subject of one of the FDP's current demonstration projects. In 2011, HHS gave UCR and the University approval to use the pilot PCS as a replacement for their effort-reporting processes.

The Pilot Method: Payroll Certification System

Through the FDP, colleges and universities proposed an alternative method for charging salaries and wages to Federal awards. They proposed[3] this alternative method, which we refer to here as the pilot PCS, because colleges and universities considered the standard method expensive, unfocused, and confusing. The pilot PCS is more project-oriented and less focused on effort. Instead of certifying "effort," the pilot PCS requires Principal Investigators to review payroll expenses and sign an annual project certification stating that certain individuals worked on the award and that salaries and wages "are reasonable in relation to work performed."[4]

As described in HHS's letter that approved the University's use of the pilot PCS, the Principal Investigator on an award obtains a "Payroll Expense Report" showing the names of the employees that have salaries and wages charged to the award. The Principal Investigator reviews the report after the award's budget period ends and certifies to the appropriateness and reasonableness of the salary and wage charges. The certification is based on individual salaries incurred by an award over a specific period. The HHS approval letter also states that the certifier is aware of the individual, position, and payroll amounts charged to a specific award.

As a participant in the pilot PCS, the University used this method to charge salaries and wages to Federal awards for 18 months of the 30-month audit period.

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[3] "Payroll Certifications, A Proposed Alternative to Effort-Reporting," prepared by the FDP January 3, 2011. Available online at http://sites.nationalacademies.org/PGA/fdp/PGA_055834. Accessed on April 16, 2014.

[4] According to page 3 of the FDP proposal referenced in footnote 3 above, "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.'"

Federal Requirements

Cost Principles for Salary and Wage Charges

Regardless of which method a university uses 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 2 CFR part 220, Appendix A (the Circular).[5] 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 sponsored agreements.

The regulations also require that recipients of Federal funds have financial management systems that accurately reflect the source and application of funds (2 CFR part 215).

Federal Financial Reports

Federal awarding agencies require grantees to submit reports of expenditures as documentation of the financial status of grants according to the grantee's official accounting records (2 CFR § 215.21). Grantees use the SF425, the Federal Financial Report (FFR),[6] for collecting financial data and reporting it to the awarding agencies. Before submitting an FFR, a grantee must ensure that the information on the FFR is accurate, complete, and consistent with data in the grantee's accounting system. Nothing in the FDP proposal or the HHS PCS pilot approval letter nullified the Federal requirements that the University: (1) collect and accurately report financial data and (2) employ a financial management system that accurately reflects the source and application of funds.

HOW WE CONDUCTED THIS REVIEW

Our audit covered approximately $491 million in costs that the University claimed for reimbursement from January 1, 2010, through June 30, 2013.[7]

We planned to gain an understanding of both payroll certification processes (the pilot PCS and the old effort-reporting system) used at the University, how these processes related to the labor costs in the University's general ledger, and how the labor costs were charged to a federally sponsored award. We planned to review calendar year 2010 data to compare the standard payroll and labor-effort reporting and certification processes with those processes changed under the pilot PCS. To determine whether the University had supporting documentation for its labor charges, we also planned to use statistical sampling as the basis for selecting salary and wage costs for review.

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

[6] Previously, cost data were submitted using two separate forms, the SF269 and the SF272. Form SF425 replaced these two forms.

[7] Our audit covered 30 months: (1) 18 months during which the University used the pilot PCS, plus (2) 1 year under the old method just prior to the University's conversion to the pilot PCS.

On our behalf, NSF OIG 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. However, the University was unable to reconcile its accounting records to its FFRs for the audit period.

We discussed our tentative findings with the University and OMB representatives.

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 lists the Federal requirements related to awards, and Appendix B contains the details of our audit scope and methodology.

FINDINGS

We could not determine whether the University's pilot PCS provided data that supported labor charges that it made to its Federal awards because it could not reconcile its accounting records to its FFRs. Specifically, the University's reconciliation showed a total variance of approximately $3.8 million for the 666 Federal awards, totaling $491 million, that the University received during the audit period. As a result, we could not determine if the University had a valid list of labor transactions from which we could select a statistical sample for review. At the time of our audit, the University did not have a process in place to reconcile its accounting records to its FFRs. Without a reconciliation of accounting records to the FFRs and a valid list of transactions from which to sample, we could not express an opinion on whether the University certified, reported, or claimed labor costs and associated fringe benefits that accurately reflected the actual effort its personnel devoted to Federal awards.

RECOMMENDATIONS

We recommend that the University:

- reconcile the $491,291,290 it reported on its FFRs to its accounting records and

- modify its financial management system to ensure that amounts it reports on its FFRs can be supported by amounts recorded in its accounting records.

UNIVERSITY OF CALIFORNIA–IRVINE COMMENTS

In written comments on our draft report, the University did not agree with our recommendations to reconcile its FFRs to its accounting records or to modify its financial management system so that its accounting records support amounts it reports on FFRs.

University officials said that they reconciled the $491,291,290 reported on the University's FFRs to its accounting records using a manual process and completed this reconciliation a few days after an agreed upon deadline of November 1, 2013. The University also said that it had shifted resources to make sure its processes were as effective as possible.

University officials added that they reconciled the University's FFRs to the general ledger (accounting records) quarterly using an "inception-to-date" methodology that is a generally accepted accounting practice and that is required by the HHS Payment Management System (PMS) for certification of FFRs. University officials further stated that the University's reconciliation process only reports allowable charges to Federal grants, and, therefore, the accounting records may include current expenditures that are not yet available to report, expenditures from previous quarters that are now appropriate to report, or both. University officials wished to make clear that its "inception-to-date" process allowed for variances and the $3.8 million variance addressed in the report represented expenses in its accounting records that were not claimed on its FFRs. The University's comments are included in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

HHS and NSF OIGs met with the University and other pilot schools on January 29, 2013, to discuss the audit approach, including data and supporting information that we would need for the audit. On June 6, 2013, we sent the University an engagement letter requesting a list of information for the University to submit to us by a deadline of June 14, 2013. Included in this list was a request that the University provide a reconciliation of its accounting records to its FFRs for the audit period. This reconciliation would have provided us with assurance that the University's accounting records correctly reflected the costs it claimed, thus allowing our audit to proceed. On October 24, 2013, we presented the University with another deadline of November 1, 2013, which it did not meet. Because the University could not provide what should have been readily available information by the November 1, deadline, we discontinued fieldwork on the audit. This is the same reconciliation information that the University would have used to prepare its FFRs.

The University submitted its reconciliation on November 8, 2013. The information provided included a database of general ledger transactions, which should have supported the FFRs, and an Excel file with reconciliations for 28 quarters. However:

- The database of general ledger transactions still included a $3.8 million variance when reconciled to the FFR.

- Some of the quarterly reconciliations also had reconciling differences, and the University did not adjust its database of general ledger transactions to reflect these reconciling differences.

Therefore, neither NSF nor HHS OIGs could ensure that the database of general ledger transactions, which we were going to use for sampling purposes, was accurate and complete.

Rather than showing identical amounts for what the University recorded and what it reported, the reconciliation showed that the University recorded in its accounting records $3.8 million more costs than it reported on its FFRs. While the $3.8 million may appear to be in the Government's favor, we cannot confirm this because the University made numerous adjustments to its general ledger each quarter and did not document quarterly reconciliations that track such adjustments. In addition, we intended to use the general ledger for sampling purposes to ensure that only allowable labor costs were charged to Federal awards. Without a general ledger that reconciled to the FFRs, we had no assurance our sampling frame would have been accurate and complete.

Regarding the University's comment that PMS requires it to use an "inception-to-date" reconciliation methodology for certification of its FFRs, a PMS official told us that all reconciliation requirements should be outlined by the awarding agency within a grant's Notice of Award. The University did not provide any evidence that showed that its inception-to-date methodology was a requirement in any of its Notices of Award. In addition, the HHS Grants Policy Statement[8] says, "It is the recipient's responsibility to reconcile reports submitted to PMS and to the [operating division]. Reconciliation consists of ensuring that disbursements equal obligations and drawdowns or making any adjustments as necessary…." The policy statement does not specify a frequency for a reconciliation.

The University should have anticipated that both NSF and HHS OIGs would request a quarterly reconciliation because the University reports its Federal grant expenditures to PMS on a quarterly basis. To ensure that it claimed only allowable costs, the University's accounting records and FFRs should have already been reconciled and documented at the time it submitted its quarterly FFRs to the awarding agencies.

Therefore, we maintain that our recommendations are valid.

[8] Available online at www.hhs.gov/asfr/ogapa/aboutog/hhsgps107.pdf. Accessed on October 10, 2014.

APPENDIX A: FEDERAL REQUIREMENTS

FEDERAL REGULATIONS

HHS grant administration rules require recipients of grant awards to comply with regulations governing the use of Federal funds and to ensure that costs charged to those awards are allowable under the applicable cost principles (45 CFR § 74.27(a)). The cost principles for educational institutions are established in 2 CFR part 220, Appendix A (the Circular). These cost principles require that, to be allowable, costs must be reasonable, be allocable, be treated consistently, and conform to any exclusions or limitations set forth in the cost principles or sponsored agreements (the Circular § C.2). Uniform administrative requirements for grants and agreements with institutions of higher education are established in 2 CFR part 215. HHS contracts awarded under the FAR to educational institutions are subject to the Circular to determine the allowability of costs (48 CFR § 31.303(a)).

Activity reports, after-the-fact activity reports, or plan confirmation reports are explained in 2 CFR part 220, Appendix A § J.10.c. Time and activity reports are generally prepared by an employee and show the amount of time charged to various activities, including one or more Federal grants or contracts. The employee, by signing a time report or an activity report, certifies the accuracy of the time spent on certain activities. This process provides auditors and others with the means to determine whether salaries and wages charged to Federal grants and contracts are adequately supported. This methodology also provides documentation to support the notion that the charges reasonably reflect the activity for which the employee is compensated.

The Circular goes on to state that to confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, the reports will be signed by the employee, principle investigator, or responsible official using suitable means of verification that the work was performed (the Circular § J.10 c.(2)(c)).

Pursuant to 2 CFR § 215.21(b), recipients' financial management systems shall provide for the following, quoted here:

> (1) Accurate, current and complete disclosure of the financial results of each federally-sponsored award or program in accordance with the reporting requirements set forth in § 215.52. If a Federal awarding agency requires reporting on an accrual basis from a recipient that maintains its records on other than an accrual basis, the recipient shall not be required to establish an accrual accounting system. These recipients may develop accrual data for its reports on the basis of an analysis of the documentation on hand.
>
> (2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(3) Effective control over and accountability for all funds, property, and other assets….

(4) Comparison of outlays with budget amounts for each award. Whenever appropriate, financial information should be related to performance and unit-cost data….

(5) Written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(6) Accounting records including cost accounting records that are supported by source documentation.

Presidential Executive Order 13563:

Sec. 4. *Flexible Approaches.* 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. These approaches include warnings, appropriate default rules, and disclosure requirements as well as provision of information to the public in a form that is clear and intelligible.

APPENDIX B: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered costs applicable to HHS awards that the University recorded in its accounting records for the period January 1, 2010, through June 30, 2013. NSF OIG requested that the University reconcile $495,083,712 of costs recorded in its accounting records to the $491,291,290 of costs reported on its FFRs for the audit period.

We limited our assessment of internal controls to the University's policies and procedures for charging costs to Federal awards. We conducted our audit work between September 2013 and March 2014.

METHODOLOGY

To accomplish our objectives, we:

- coordinated with NSF OIG on the scope and methodology of our review,
- reviewed applicable Federal regulations and NIH guidelines,
- reviewed the University's policies and procedures for charging costs to Federal awards,
- attempted to obtain through NSF OIG a reconciliation between the amounts the University recorded in its accounting records and the amounts the University reported on its FFRs, and
- discussed our findings with the University and OMB officials.

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 C: UNIVERSITY OF CALIFORNIA–IRVINE COMMENTS

UNIVERSITY OF CALIFORNIA, IRVINE

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July 22, 2014

Ms. Lori S. Pilcher
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Report Number: A-04-13-01027

Dear Ms. Pilcher:

On behalf of University of California President Janet Napolitano I am responding to the audit report, "The University of California at Irvine's Pilot Payroll Certification System." The audit was conducted by the Department of Health and Human Services (HHS) and the National Science Foundation (NSF) Offices of Inspectors General (OIG) at the request of the Office of Management and Budget (OMB).

The University of California, Irvine (UCI) believes that the goals of the Federal Demonstration Partnership's (FDP) Payroll Certification pilot were met. The record demonstrates that the payroll certification process provides greater accountability, accuracy, efficiency, and transparency, and better coordinates the timing of certifications with federal financial reporting. There is widespread consensus at UCI – among principal investigators, support staff, and administrators – that payroll certification is a superior method to support labor charges made to federal awards and has led to improved internal controls over the process.

We have reviewed the report and understand that the audit team was unable to express an opinion on whether UCI's certified, reported, or claimed labor costs accurately reflected the actual effort of personnel devoted to federal awards. In our view, this understandable inability to express an opinion is not the result of faulty processes and systems associated with our current payroll certification process. Instead, it reflects: (a) UCI's failure to meet an agreed-upon deadline to submit validation data based on quarter-by-quarter methodology; and (b) an apparent misunderstanding that led the audit team to inaccurately imply that our reconciliation showed a variance of $3.8 million that UCI received from the federal government. We hope to show that UCI does have a process in place to reconcile accounting records to the Federal Financial Reports

(FFR), and that the apparent $3.8 million variance is easily explained and reconciled; in fact, this apparent discrepancy can be used to illustrate the strength of UCI's financial process and system. Consequently, we do not concur with the recommendations in the report.

Below are our responses to the specific recommendations included in the report, which elaborate on these points.

RECOMMENDATION #1

We recommend that the University reconcile the $491,291,290 it reported on its Federal Financial Reports (FFR) to its accounting records.

University Response

UCI has already implemented this recommendation. We have reconciled this amount to our accounting records as we reconcile all federal grant funds on a quarterly basis. As part of the UCI Pilot Payroll Certification System audit by HHS and NSF, UCI was informed that NSF wanted to use the FFR-to-general ledger reconciliation process as a means of validating the completeness of UCI's general ledger data submitted to NSF. After a discussion of various alternative approaches to completing the reconciliation, the audit team decided that all of the reconciliations be re-created using a quarter-by-quarter methodology. UCI was given a deadline of Friday, November 1, 2013, and while we expressed concern about the heavy manual workload associated with this approach, we agreed to provide the requested data by the deadline date.

Unfortunately, UCI failed to meet the deadline, even after adding extra resources to the effort. We had underestimated the complexity of the quarter-by-quarter approach because it did not conform to our regular process, and we did not commit enough resources to meet the deadline. On November 1 we informed HHS and NSF that we would have the work done by Monday, November 4, or Tuesday, November 5, at the latest. On that Tuesday we received a call from the auditor stating that the audit was terminated. We nevertheless sent the data to the NSF, and we were told that, because HHS had canceled the audit, the NSF was not allowed to work on it.

UCI is entirely at fault for missing the critical audit deadline, and we would like to reassure you that this will not happen again; we have shifted resources and committed extra time and effort to making sure our processes are as effective as possible. However, we must point out that we did complete and submit the required manual quarter-by-quarter reconciliation only a few days after the deadline. The audit could have been resurrected at that point; alternatively, the HHS draft report could have acknowledged that UCI did submit the requested reconciliation,

albeit late. Should HHS wish to re-engage in this audit, or follow up in any way, UCI will cooperate fully.

RECOMMENDATION #2

We recommend that the University modify its financial management system to ensure that amounts it reports on its FFRs can be supported by amounts recorded in its accounting records.

University Response

UCI has long had a financial management system that ensures that the amounts we report on our FFRs can be supported by amounts recorded in our accounting records. We reconcile the FFRs to the general ledger quarterly, using "inception-to-date" amounts. In this process, we only report allowable charges to federal grants, and therefore the UCI general ledger may include current expenditures which are not yet available to report and/or expenditures from previous quarters that are now appropriate to report. The unreported expenditures include such items as unresolved overdrafts, costs not yet authorized, and pre-award expenditures. Through this process, UCI confirms that amounts reported on our FFRs are supported by our accounting records; therefore, financial management system modifications are unnecessary.

We also wish to correct an apparent misconception by the HHS audit team. The draft report states that "the University's reconciliation showed a total variance of approximately $3.8 million for the 666 Federal awards, totaling $491 million, that the University received during the audit period. As a result, we could not determine if the University had a valid list of labor transactions from which we could select a statistical sample for review."

This statement implies at least an accounting failure on UCI's part, and further, that UCI somehow inappropriately charged federal grants in this amount. This is not correct. UCI's "inception to date" process allows for such a variance while a determination of the appropriateness of charges is made. The $3.8 million represents expenses on the UCI general ledger that were not claimed on the FFRs for the three-year, six-month audit period, and therefore this variance is in the favor of the federal government, not UCI. UCI only includes expenditures on the FFR that are currently allowable, although other expenses may be included in the ledger. Our process is therefore highly accurate and it prevents inappropriate charges to federal grants. UCI has used the "inception to date" methodology successfully for many years. It is a generally accepted accounting practice, utilized by all University of California campuses, and is in fact required by the HHS Payment Management System for certification of FFRs. In combination with our automated accounting system, this process allows UCI to maintain high standards for financial accounting related to federal grants. Therefore we do not believe that a modified system is required.

We will be happy to discuss our financial systems and our methodology so that we can resolve any outstanding issues raised by the draft report. Again, we appreciate the opportunity to participate in the FDP Payroll Certification pilot. If you have any questions regarding this response, please do not hesitate to contact UCI's controller, Bent Nielsen, at (949) 824-8987.

Sincerely,

/Howard Gillman/

Howard Gillman, Ph.D.
Interim Chancellor