

V. Audits and Compliance

A. Overview

Research & Development (R&D) expenditures at colleges and universities in all fields continue to increase, rising from \$67.0 billion in FY 2013 to \$67.2 billion in FY 2014. In FY2015, RIT was awarded \$62.0 million in research funding. Of that amount, \$403 million (65%) was provided by Federal and state governments.

Along with the increase in research funding, the development of the Federal **government's accountability and oversight** structure has changed to match the increases. Because the Federal government is by far the largest supporter of academic research, Federal laws, regulations, and award terms and conditions have a pervasive effect on how RIT manages its entire sponsored research portfolio.

Objectives:

In this chapter you will learn about:

- Internal and external environments
- Regulatory and sponsor requirements
- Audit and compliance risk areas
- Internal controls
- Federal Uniform Guidance - cornerstone for the administration of federal projects
- Compliance: What can you do?

B. Internal and External Environments

1. In conjunction with the unprecedented increase in the level of R&D funding is increased scrutiny and an increased focus on accountability for research institutions. The current environment includes the fiscal and research components below:

Fiscal	Research
Effort reporting	Export control
Cost sharing	E-verify
Cost transfers	Scientific misconduct
Direct/indirect cost allocation	Animal subject protections
Program income	Human subject protections
Foreign travel	Conflicts of interest
Service and Recharge centers	Environmental health & safety
Subaward monitoring	Invention disclosure & reporting
Participant support	Controlled substances
Cost accounting standards	Responsible & ethical conduct of research
Procurement	
Property	

2. Adherence to external requirements is important because of the negative financial and reputational impacts that non-compliance can have on an institution. The following is a list of key agencies in the federal grant oversight structure.
 - a. **Office of Management and Budget (OMB)** - In addition to overseeing the preparation of the federal budget, OMB coordinates federal procurement, financial management, and regulatory policies, including those financial management policies affecting grant recipients. OMB Uniform Guidance (previously circulars (A-21, A-110, and A-133) establishes cost, administrative, and audit requirements for Federal grant and contract recipients and is described later.
 - b. **U.S. Government Accountability Office (GAO)** – GAO is an independent Federal agency that works for the U.S. Congress. Upon request, GAO conducts independent audits to help Congress and federal executives determine how well they are doing in relation to laws, regulations, and policy goals established for their organizations. In addition, GAO’s work is not limited to the federal government. For example, in 1993, GAO conducted an audit of RIT’s National Technical Institute for the Deaf.
 - c. **Federal Offices of Inspector General (OIG)** – The Inspector General Act of 1978 established OIGs at 14 major federal agencies. Since then, Congress has amended the IG Act to establish an OIG at almost all federal agencies. Each OIG’s primary mission is to conduct audits and investigations that promote economy, efficiency, and effectiveness and prevent and detect fraud, waste, and abuse.
 - i. OIG recently introduced the use of **data analytics** to facilitate its audit process. Using computer-processed data obtained from the institutions being audited, auditors are able to identify areas of risk, select transactions for further review, and conduct detailed reviews of those transactions. This occurs for both pre- and post-award transactions.
 - ii. In addition to audit and investigation reports, every OIG issues Semiannual Reports to Congress that discuss their most significant activities and conclusions. Semiannual reports can be a valuable source of information relating to the many audit and compliance risk areas that affect academic institutions such as RIT. However, these reports can also be a great source of embarrassment because audit and investigative results are sent to Congress and made available to the public on OIG websites.
3. Legislation also exists that provide additional mechanisms to ensure compliance with federal regulations.
 - a. **Sarbanes-Oxley Act** of 2002 – The Sarbanes-Oxley Act of 2002 was enacted in response to a number of major corporate and accounting scandals. The Act established new standards for U.S. public companies and public accounting firms and contains requirements for management’s assessment and certification of internal control over financial reporting. While the Act

does not apply to non-profit organizations, college and university boards and presidents have recognized that many of the Act's key goals and concepts make good business sense and have voluntarily adopted them as a way to ensure continued compliance.

- b. **False Claims Act** – This legislation has been in place since the mid-1800s and allows private individuals to file actions against anyone they suspect of defrauding the US government. The Qui Tam Provision of the False Claims Act allows individuals to file suit on behalf of the United States against those who have falsely or fraudulently claimed federal funds. The Qui Tam Provisions are one example of the government's response to the scandals mentioned earlier.
- c. **Federal Funding Accountability and Transparency Act (FFATA)** - This act requires recipients of Federal funds to report information related to sub-award and contract funding. The intent is to empower every American with the ability to hold the government accountable for each spending decision and reduce wasteful spending in the government.
 - i. Additional compliance requirements (ex. - reporting due dates) add to the risk of being flagged as high risk.
 - ii. Reports are published at USASpending.gov
- d. **Truth in Negotiations Act (TINA)** – This act requires that a government contractor or subcontractor is required to submit costing or pricing data for contracts or subcontracts expected to exceed \$750,000. Under TINA, the government can recover for defective pricing resulting when contractors and or subcontractors do not provide accurate, complete, and current pricing data during contract negotiations.

C. Regulatory and Sponsor Requirements

Government expectations of award recipients' compliance with **sponsor requirements** include the following:

- True statements in proposals and reports
 - Performance of the proposed scope of work
 - Costs charged are reasonable, allowable, verifiable costs
 - Monitoring of expenditures for allowability
 - Following all applicable compliance requirements
 - Ensuring flow-down to subrecipients
1. While questioned costs is a common outcome of the audit process, and even in situations which don't result in the repayment of funds, awardees spend extensive time and resources justifying to auditors and sponsors that costs are allowable. **Audit findings** due to error, lack of process, or other issues may require repayment of grant funds, damage an institution's reputation, or result in federal lawsuits. Audit findings may also result in increased oversight by sponsoring agencies and may impact future awards across campus and across sponsors.
 - a. **Repayment of Grant Funds** - The potential repayment of grant or contract funds most frequently occurs when federal or state auditors question costs in an audit report. Auditors will question costs when they believe and report on:

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

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

- b. Damaged Reputation - Negative audit findings or criminal investigations of alleged wrong-doing can damage the university's reputation resulting in reduced grant and contract funding and increased regulatory oversight by sponsoring agencies.
- c. Federal Lawsuits - As mentioned above, the **False Claims Act** allows any person with knowledge of a false or fraudulent claim against the Federal government to sue on behalf of the government and share in any award or settlement. The Qui Tam Provisions allows private citizens to file lawsuits on behalf of the United States against those who have falsely or fraudulently claimed federal funds. The Provisions provide the citizen an award of attorney's fees and recovery of 15 to 30 percent of the proceeds of a successful suit if the United States intervenes in the Qui Tam action.

In 2015, over \$3.5B was recovered in lawsuits filed under the False Claims Act's qui tam provisions. The following is a partial list of the allegations that were made against institutions. It is noteworthy that these large settlements are directly connected to faculty effort and whether salary costs and other expenses were related to a particular project's funded purpose.

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

D. Audit and Compliance Risk Areas

1. What is an Audit?

- a. An **audit** is an unbiased examination of an organization's or operating unit's financial statements, operational performance, or compliance with appropriate federal, state, and/or local authorities and their requirements. When

completed, auditors issue a report with a conclusion that confirms or denies management's adherence to an existing set of criteria such as generally accepted accounting principles, government laws and regulations, or internal procedures.

For the most part, audits are conducted by independent public accounting firms, federal, state, and local government auditors, or internal auditors. In addition to financial statement audits, the professional literature describes other types of audits such as attestation engagements and performance audits.

2. Institutions may also conduct their own **internal audits**. As noted in the *Winter 2013* issue of RIT's Internal Audit, Compliance, and Advisement (IACA) newsletter "Internal auditors are charged with examining and evaluating the policies, procedures, and systems which are in place to provide an opinion on: the reliability and integrity of information; compliance with policies, laws, and regulations; the safeguarding of assets; and the economical and efficient use of resources."¹
3. Auditors select a variety of transactions to review. The following lists common audit areas and some findings that have been reported at various institutions in those areas.
 - a. Effort Reporting
 - i. Faculty members who had explicitly pledged in grant proposals to contribute one to 20 percent of their labor time on five federal awards did not report any of this time in their labor effort reports.
 - ii. University business managers approved effort reports without verifying that the labor distribution on the effort report was reasonable in relation to the actual work performed on the grant.
 - iii. The University did not disclose in its grant proposals that the requested salaries included extra compensation for work beyond the faculty member's full-time responsibilities.
 - iv. Contrary to OMB regulations, a University charged \$1.4 million in administrative and clerical costs directly to federal awards while simultaneously recovering the costs through the application of its approved Facilities & Administrative (F&A) rate.
 - b. Subaward Monitoring
 - i. The University did not establish a risk-based monitoring program to ensure that costs invoiced or claimed and certified as cost sharing by its subawardees were accurate, allowable, allocable, and properly documented per NSF regulations and OMB Circulars.

¹ http://www.rit.edu/fa/iaca/sites/rit.edu/fa.iaca/files/publications/Newsletter_Winter%202013.pdf

c. Cost Transfers

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

d. Non-financial Findings

- i. Contrary to export control regulations, a Principal Investigator transported classified documents about technical data to China on his laptop.

E. Internal Controls

To ensure compliance with regulatory and sponsor requirements, universities incorporate **internal control processes** into their daily activities. When organizations, and not individuals, get into trouble the government usually mandates that it establish a compliance program. Mandated programs are based on U.S. sentencing guidelines. However, the government recommends that recipients of Federal funds voluntarily establish a compliance program because such a program, if properly implemented, offers an integrated approach to compliance with all the laws and regulations. In addition, in the event of an audit finding, having a compliance program in place serves as a mitigating factor with the Department of Justice.

1. Internal Control – Internal control refers to a process, affected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of organizational objectives. The three primary objectives of internal control are: 1) effectiveness and efficiency of operations; 2) reliability of financial reporting; and, 3) compliance with applicable laws and regulations.² Underlying these overall objectives, however, are much simpler concepts including how does the University...
 - protect its assets?
 - ensure that its financial reports and records are accurate?
 - promote efficient and effective operations?
 - encourage adherence to laws, regulations, and RIT policy?

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

² Source: the Committee of Sponsoring Organizations of the Treadway Commission

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

F. Uniform Guidance

The Office of Management and Budget publishes administrative policy documents that give instruction to Federal agencies on a variety of topics, including the administration of Federal grants and cooperative agreements. Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, OMB Uniform Guidance, contains the rules pertaining to grants and contracts and describes what can or can't be charged to an award and what awardees have to understand to remain in compliance

Uniform Guidance is codified in 2 CFR (Code of Federal Regulations), Chapter 2 Part 200. Uniform Guidance is broken down into subparts.

- Subpart A – Acronyms and Definitions
- Subpart B – General Provisions (Section 200.1xx)
- Subpart C – Pre-Federal Award Requirements and Contents of Federal Awards (Section 200.2xx)
- Subpart D – Post Federal Award Requirements (Section 200.3xx - establishes standards for the administration of Federal awards such as financial, procurement, and property management systems.
- Subpart E – Cost Principles (Section 200.4xx) - establishes principles for determining if costs charged to Federal grants and contracts awarded to educational institutions are allowable. To be considered allowable, costs must be: 1) reasonable; 2) allocable; 3) consistently treated; and, 4) conform to any limitations or exclusions identified in the Uniform Guidance or in the sponsored agreement. These principles apply whether the cost is directly or indirectly charged to sponsored projects.
- Subpart F – Audit Requirements (Section 200.5xx) – establishes standards for uniformity of audits across Federal agencies. 2 CFR 200.513 provides the policies and procedures for use by Federal agencies when reviewing reports issued by the Inspectors General, other executive branch audit organizations, and non-Federal auditors where follow-up on audit findings.
- Appendices I - XI

Uniform Guidance is available on the U.S. Government Publishing Office website:

✓ [Uniform Guidance](#) – *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, OMB Uniform Guidance*

1. Single Audit Act– The purpose of the Single Audit Act of 1984, as amended in 1996, is to establish standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards. Single audits are conducted primarily by independent public accounting firms, although some institutions have components of their audit conducted by Federal auditors.
 - a. Key requirements of a Single Audit
 - i. Non-Federal entities (State, local government, or non-profit organizations) that expend \$750,000 or more in a year in Federal awards must have an audit conducted for that year in accordance with the provisions of 2 CFR 200.300.
 - ii. Requires an audit of the institution’s financial statements, a report on internal control related to the financial statements and major federal programs, a report on compliance with laws, regulations, and the terms and conditions of grant agreements; and a schedule of findings and questioned costs.
 - iii. Every grantee is assigned a cognizant Federal agency that is responsible for providing technical advice to auditors and auditees; coordinating the resolution of audit findings; and reviewing the quality of the audit.
 - iv. Does not prevent other Federal audits; however, the Federal auditors have to build on the work performed under the Single Audit.
 - b. Tips for Working with Single Audit and Other Governmental Auditors
 - Notify SPA of any request for a site visit, desk audit, or financial review. SPA will assist and coordinate all visits and meetings.
 - Answer questions honestly and directly
 - Give the auditors the documents and reports they ask for after coordinating your response with SPA
 - Do not tamper with or manufacture records
 - Limit your response to the question being asked
 - Call SPA if you have any questions or concerns

G. Federal Acquisition Regulation

The Federal Acquisition Regulation (FAR) is the principle set of rules in the Federal Acquisition Regulations System. The FAR is contained within Chapter 1 of Title 48 of the Code of Federal Regulations and generally governs the acquisition of goods and services by executive agencies of the US government.

H. Compliance: What Can You Do?

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

Compliance programs normally consist of the following key elements:

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

What can you do to ensure compliance?

- Attend RIT accounting and compliance training workshops
- Review your grant and contract statements and payroll reports at least monthly to ensure that costs charged are related, allowable, accurate, and consistent with the purpose of the award and the sponsor-approved budget
- Pay special attention to faculty effort. Charges to sponsored agreements should reflect their actual effort on the project. Do not charge more than the actual effort of faculty, staff, and students.
- Complete the RIT required annual Conflict of Interest disclosure
- Adequately document the reason(s) for cost transfer journal entries timely. Do not shift cost from grant to grant to use up unobligated balances.
- Do not charge indirect costs directly to a federally-funded project. Typical indirect costs are salary of department administrative staff, postage, photocopy charges, and office supplies.
- Coordinate all external requests for site visits, desk audits, or financial-related information with Sponsored Programs Accounting (SPA) and/or Controller's Office staff before submitting to a sponsor.
- If you have any questions or concerns, contact your SPA representative.

NOTE: Definitions for each of the key words mentioned throughout this document can be found in the [Glossary](#) on the Sponsored Programs Accounting website.