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**HEW Audits of Federal Grants and Contracts Administered by Institutions of Higher Education. March 22, 1978. 11 pp.**

**Testimony before the Senate Committee on Appropriations: HUD-Independent Agencies Subcommittee; by Donald L. Scantlebury, Director, Financial and General Management Studies Div.**

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Organization Concerned: Department of Health, Education, and Welfare.**

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Federal grants and contracts administered by institutions of higher education were reviewed to determine whether the audit coverage provided by the Department of Health, Education, and Welfare's (HEW's) Audit Agency is sufficient to provide reasonable assurance that Federal funds are being spent for their intended purpose. The audit work was performed at the 20 institutions which received the most Federal support during 1975 and for which HEW was assigned responsibility. These 20 institutions received \$1.1 billion of Federal support during fiscal year 1975. Although firm conclusions have not been reached, it was tentatively concluded that HEW's audits of Federal grants and contracts administered by colleges and universities are not as effective as they could be and cannot be relied upon to provide reasonable assurance that Federal funds are being spent for their intended purposes. HEW has not established a cycle for auditing the institutions for which it has cognizance; as a result, HEW's audits of the institutions are not timely, and some institutions are not audited at all. Some of HEW's audits of funds administered by the institutions do not comply with standards prescribed by GAO for all Government audits. In some cases, HEW does not audit in sufficient depth to determine whether costs charged to Federal grants and contracts are allowable. Instead, the audits identify weaknesses in accounting systems; once an accounting system weakness is noted, HEW simply does not render an opinion on that segment of the accounting system. (RRS)

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UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF

Donald L. Scantlebury, Director

FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION  
BEFORE THE  
SUBCOMMITTEE ON HUD/INDEPENDENT AGENCIES  
COMMITTEE ON APPROPRIATIONS  
SENATE  
CONCERNING HEW AUDITS OF FEDERAL  
GRANTS AND CONTRACTS ADMINISTERED  
BY INSTITUTIONS OF HIGHER EDUCATION

Mr. Chairman and Members of the Committee:

We are pleased to be with you today to discuss the preliminary results of our review of the Department of Health, Education and Welfare's audit coverage of Federal grants and contracts administered by institutions of higher education. We understand that you are interested in this area because the National Science Foundation provides funds by both grants and contracts to such institutions. In most cases, HEW audits those funds for the Foundation. With me are Mr. George Egan and Mr. Robert Raspen, both from the Financial and General Management Studies Division of GAO.

FEDERAL SUPPORT

Currently the Federal Government provides financial support to over 2,500 institutions of higher education under one

or more of the following categories:

- research and development
- facilities and equipment for instruction in the sciences and engineering
- fellowships, traineeships, and training grants
- general support for science, and
- support for nonscience activities excluding loans.

During fiscal year 1975, such Federal support amounted to \$4.5 billion and was provided by HEW, the National Science Foundation (NSF), the Department of Agriculture, the Department of Defense, the Energy Research and Development Administration (now the Department of Energy), and the National Aeronautics and Space Administration.

#### ACCOUNTABILITY AND AUDIT RESPONSIBILITY

The institutions of higher education and the Federal Government are accountable for Federal funds provided to the institutions. The institutions are responsible for establishing financial management systems to account for and report on the use of Federal funds while the Federal Government is responsible for auditing the expenditure of these funds. In order to avoid confusion and duplication at institutions which receive grants and contracts from more than one Federal agency, a single agency has been assigned the responsibility for auditing all Federal funds administered by each institution.

The agency responsible for the audit is also responsible for providing the results of the audit to other agencies concerned. The HEW Audit Agency has been assigned responsibility for auditing approximately 98 percent of the institutions which receive Federal grants and contracts. For this service, HEW is reimbursed by the participating agencies.

#### TYPES OF AUDITS

The HEW Audit Agency performs a variety of audits at colleges and universities such as:

##### Audits of Indirect Cost Proposals

--each institution is required to submit an indirect cost proposal for each of the fiscal years in which it performs a Federal grant or contract providing for the reimbursement of indirect costs.

HEW audits indirect cost proposals submitted by the colleges and universities for which it has been assigned audit cognizance.

##### Direct Cost Audits

--These are comprehensive audits of the various classifications of cost such as salaries and wages, fringe benefits, materials and services, travel, equipment, consultants and stipends. The purpose of the audits is to determine the over-all reliability of total costs charged to Federal grants and contracts and the

adequacy of the accounting system for subsequent cost determinations.

#### System Audits

--These are reviews of a single classification of cost such as salaries.

#### Closeout Audits

--These are reviews performed to determine the acceptability of total charges against a grant or contract.

#### REVIEW--PURPOSE, SCOPE, RESULTS

Our review was initiated because the total amount of Federal grants and contracts administered by colleges and universities is large. The objective of this review was to determine whether the audit coverage provided by the HEW Agency Agency of Federal grants and contracts administered by institutions of higher education is sufficient to provide reasonable assurance that Federal funds are being spent for their intended purpose. To provide a basis for this determination, we reviewed the audit work performed at the 20 institutions which received the most Federal support during fiscal year 1975 and for which HEW was assigned auditing responsibility. These 20 institutions received \$1.1 billion of Federal support during fiscal year 1975. We reviewed

HEW's audit reports, working papers and correspondence files relating to its audits of the 20 institutes. In addition, we held discussions with officials of HEW's Audit Agency both in Washington, D.C., and in eight regional offices, college and university officials, and officials of the Certified Public Accounting (CPA) firms hired by the institutions to audit their financial operations.

The field work on our audit has been finished and we are currently analyzing and summarizing the data obtained. Because our work is not completed, we have not reached firm conclusions nor have we formulated any recommendations for corrective action. We have, however, reached the tentative conclusion that HEW's audits of Federal grants and contracts administered by colleges and universities are not as effective as they could be and cannot be relied upon to provide reasonable assurance that Federal funds are being spent for their intended purpose. Specifically, we found that HEW has not established a cycle for auditing the institutions for which it has cognizance. As a result, HEW's audits of the institutions are not timely. In some cases, institutions may not be audited at all. Furthermore, some of the audits that HEW does perform do not comply with GAO's Standards for Audits of Governmental Organizations, Programs, Activities & Functions. As a result, these audits

do not provide reasonable assurance that Federal funds were used for their intended purpose. In addition, we are concerned with the adequacy of HEW's audit reports which do not render an opinion on large cost categories such as salaries. I would like to discuss each of these concerns in detail.

#### Timeliness of Audits

In regard to timeliness, HEW has not established a cycle for auditing the colleges and universities under its cognizance. As a result, many institutions are not audited in a timely manner and some may not be audited at all.

For example, we looked at the quantity of direct cost audits performed by three of the Audit Agency's regional offices during the three fiscal years ended September 30, 1976. In one region which is responsible for auditing 300 institutions, less than half of the institutions had had a direct cost audit. At the two other regions, HEW performed direct cost audits at only 28 and 7 percent of the assigned institutions.

#### QUALITY OF AUDITS

Concerning quality, we found that some of HEW's audits of Federal funds administered by the institutions do not comply with the standards prescribed by GAO for audits of all government programs. For example, they do not determine the effects of many of their findings and thus their reporting

to other agencies is incomplete. Because some of these audits do not comply with the Standards, they do not provide reasonable assurances that such funds were used for their intended purposes. Furthermore, the Federal agencies which rely on these audits may be misled.

HEW's most recent direct cost audit of a large mid-western university is an example of an audit which we believe does not meet the reporting requirements of the GAO standards. The standards require that audit reports be clear and complete enough to be understood by all users and to identify and explain issues and questions needing further study and consideration by the auditor or others. HEW performed a direct cost audit of the university covering the period between July 1, 1971, and June 30, 1973. As a result of this audit, the HEW Audit Agency reported to HEW and NSF that a continuing need exists for strengthening controls over retroactive transfers of payroll cost and included details pertaining to these transfers in the report. Based upon the report, NIH, which resolves many of the HEW audit reports on institutions of higher education, gathered additional data and negotiated a refund for HEW of \$225,000 of retroactive transfers of payroll cost. This apparently worked out fine so far as HEW was concerned but the Audit Agency also prepared audit reports for 19 other Federal agencies which provided funds to the university. The reports to these agencies did not contain the statement about salary

transfers; but simply stated that the university's accounting system and internal controls are generally acceptable for the allocation, identification and recording of costs incurred under Government contracts. None of the other Federal agencies made recoveries similar to those of HEW. Had the Audit Agency provided the salary transfer information to all Federal agencies, that provided funds to the University, the reports would have been more useful to the other agencies and it is conceivable that further recoveries could have been made. Because this report was incomplete it does not meet GAO's standards.

#### NON-DOLLAR AUDIT FINDINGS

Another of our concerns is that HEW, in some cases, does not audit in sufficient depth to determine whether costs charged to Federal grants and contracts by institutions, are in fact allowable; rather the audits identify weaknesses in accounting systems. Once an accounting system weakness is noted, HEW simply does not render an opinion on that segment of the accounting system and does not determine the amount of the unallowable charges.

For example, after performing a direct cost audit of a large university, the HEW Audit Agency reported that it could not render an opinion on the allowability of over \$50 million of personnel service charges to Federal grants and contracts. During the audit period the University administered nearly \$112 million of Federal grants and contracts. According to the report, the University could not adequately support

personal service charges because such charges were based primarily on budget estimates and anticipated efforts rather than on after-the-fact certification by knowledgeable personnel as required by Federal regulations. In order to recover funds the various Federal agencies need to know the specific amount of charges that are not allowable. Thus, to make recoveries based upon audit reports which disclose accounting system weaknesses, additional audit work must be done.

Within HEW, the National Institutes of Health has had the role of performing this additional auditing while resolving HEW audit reports assigned to it. Such responsibility extends to resolving audit findings for all HEW constituent agencies but does not extend to other Federal agencies for which the Audit Agency does work. In resolving HEW audit findings, NIH identifies the amount of unallowable costs and recovers them. The process used by NIH consists primarily of testing transactions in the same manner that auditors would test them. This process usually begins with the receipt of an HEW audit report on a particular institution. If the audit report questions costs and cites weaknesses in a particular system or procedures used by the grantee institution, NIH usually contacts the institution and requests that it supply on a test basis the necessary documentation to

support the allowability of the questioned costs. If costs are determined to be unallowable, projections are made to determine the total unallowable costs. Negotiations between NIH and the institution are then held to arrive at an amount to be returned to HEW. This technique can essentially be applied to any institution to determine the amount of recoverable funds. During the past 3-years NIH has recovered over \$4.2 million of unallowable costs from 56 institutions for HEW.

During the early stages of our review, we recommended to the Inspector General of HEW that the Audit Agency determine, at those institutions where NIH has recovered HEW funds, the amount of unallowable costs that were charged to the grants and contracts of the other Federal agencies and notify them of the dollar amounts of such improper charges. We also informed him it appeared to be more appropriate for the audit agency, during its regular audits of direct costs charged to grants and contracts of educational institutions, to establish the dollar value of unallowable costs charged to all Federal grants and contracts and to notify each agency accordingly.

We were recently informed that HEW and OMB are working out a procedure so that HEW can resolve audit findings on a government-wide basis. Although we have not been able to evaluate the impact of this change, it seems like a step in

the right direction. However, in regard to our major concern that the HEW Audit Agency is not determining unallowable costs when it identifies an accounting system weakness, HEW audit officials maintain that they have satisfied their audit objectives when they identify the accounting system weakness. The auditors contend that they do not have to determine the amount of unallowable costs. In our opinion, it is the Audit Agency's responsibility to audit the institutions' records in sufficient depth to identify the unallowable costs and make this information available to the agencies for which it is doing audit work.

This concludes my statement, Mr. Chairman, I would be pleased to answer any questions you may have.