DEPARTMENT OF HEALTH & HUMAN SERVICES

Office Of Inspector General
Office Of Audit Services

Region II
Jacob K. Javits Federal Building
26 Federal Plaza
New York, NY 10278

June 6, 2002

Our Reference: Common Identification No. A-02-01-02500

Jose R. Carlo, M.D.
Interim Chancellor
Medical Sciences Campus
University of Puerto Rico
P.O. Box 365067
San Juan, Puerto Rico 00936-5067

Dear Mr. Carlo:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General, Office of Audit Services' report entitled "Review of the Cash Management Procedures Used by the University of Puerto Rico – Medical Sciences Campus to Control the Funds Advanced to Federally Funded Projects." A copy of this report will be forwarded to the action official noted below for review and action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-02-01-02500 in all correspondence relating to this report.

Sincerely yours,

Timothy J. Horgan
Regional Inspector General
for Audit Services

Enclosure – as stated

Direct Reply to HHS Action Official:

Stuart J. Feldsott
Chief, University and Non-Profit Payment Branch
Division of Payment Management
Financial Management Service
Program Support Center
P.O. Box 6021
Rockville, MD 20852

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF THE CASH MANAGEMENT PROCEDURES USED BY THE UNIVERSITY OF PUERTO RICO

JANET REHNQUIST
INSPECTOR GENERAL

JUNE 2002
A-02-01-02500

Office Of Inspector General Notices

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Final determination on these matters will be made by authorized officials of the HHS divisions.

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Jose R. Carlo, M.D.
Acting Chancellor
Medical Sciences Campus
University of Puerto Rico
P.O. Box 365067
San Juan, Puerto Rico 00936-5067

Dear Dr. Carlo:

This report provides the results of our review of the cash management procedures used by the University of Puerto Rico - Medical Sciences Campus (University) to control the funds advanced to Federally funded projects. The overall objective of our review was to determine whether the University's cash management policies and procedures were in accordance with Office of Management and Budget (OMB) Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*. This required the University to: (i) minimize the time elapsing between the transfer of funds and their disbursement; (ii) maintain advances of Federal funds in interest-bearing accounts, (iii) remit any interest earned on the advances, and (iv) meet certain other financial management standards.

Our review included approximately $43 million in Federal funds received by the University during the period July 1, 1997 through June 30, 2000. Of this amount, our review determined that approximately $40.1 million had been drawn using the reimbursement methodology, and only $3.2 million had been drawn under the advance payments methodology. The reimbursement methodology is designed to draw Federal funds only after the disbursements have been made. In effect, the University incurs the expense and then seeks reimbursement from the Federal Government. The advance payments method permits the University to have Federal funds wired to the University as close as administratively feasible to meet actual disbursement of funds for sponsored program purposes.

Although the University generally used the reimbursement methodology, we found that the University did utilize the advance payments methodology for certain limited periods of time during our audit period. When the advance payments methodology was used, we found that the University was not in compliance with OMB Circular A-110 requirements. Specifically, our audit determined that the University's cash management system was inadequate because it: (i) did not have written procedures to ensure that the timing and amount of advance requests met its disbursement cycle and immediate disbursement needs, and (ii) did not calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between the date of draw-down and the date when the expenses were incurred. We identified $5,273 in interest income that was earned on advanced Federal funds that the University had not remitted to the Federal Government. We are recommending that the University refund the interest income that was earned and establish procedures that will ensure compliance with OMB Circular A-110 requirements anytime the advance payments methodology is utilized.

In the Other Matters section of this report, we also discuss a minor issue involving indirect costs which the University needs to address.

The University concurred with all of our findings and recommendations and stated that corrective actions are being implemented. The University's response is included in its entirety as an appendix.

BACKGROUND

Federal departments fund grants and contracts to educational institutions by either an advance of funds or on a cost reimbursement basis. When educational institutions receive funds through an advance, they must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the actual disbursement. Cash advances should be limited to the minimum amounts needed and timed to the actual, immediate cash necessary to carry out the purpose of approved programs or projects. When Federal departments fund educational institutions on a reimbursement basis, the educational institution uses their own funds to pay for program costs before they request reimbursement from the Federal Government.

Federal agencies are required by OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,* to pay universities in advance for grant and contract costs. In return, the universities shall:

- Have written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes. [A-110, Subpart C, Section 21(b)(5)];

- Apply cash management procedures that assure the timing and amount of cash advances are as close as is administratively feasible to actual disbursement for program purposes [A-110, Subpart C, Section 22(b)];

- Maintain advances of Federal funds in interest bearing accounts [A-110, Subpart C, Section 22(k)];

Maintain financial management systems for their Federal awards that provide, among other requirements, accurate financial records pertaining to interest earnings [A-110, Subpart C, Section 22(b)(2)]; and

Remit the interest earned (less a yearly allowance of $250 for administrative expenses) while the advanced funds are in the university account(s) [A-110, Subpart C, Section 22(l)].

Advances of Federal funds are provided to the University by the Department of Health and Human Services (HHS) Program Support Center (PSC), Division of Payment Management through an electronic fund transfer system known as Smartlink II. For each letter of credit, the University determined the amount of cash needed to reimburse the expenses for each Federal agency's grants and contracts, using its FBM 955 monthly expense report, and requested funds from the Division of Payment Management. The electronic funds transfer occurred generally one day after the request.

The University's Division of Financial Administration (DFA) performed the cash management procedures for all the letters of credit with the HHS PSC. As part of these procedures, DFA, based on the FBM 955 report received from the University's Finance Department, determined the timing and the request amounts of Federal funds on letter of credit agreements.

OBJECTIVES, SCOPE & METHODOLOGY

The objectives of our review were to determine whether the University was requesting advance payments and whether the OMB Circular A-110 requirements were met. Specifically, we determined for the period July 1, 1997 through June 30, 2000 whether the University:

Had written cash management procedures that minimized the time elapsing between the transfer of funds and their disbursement for program purposes;

Reconciled the amount reported on *Federal Cash Transaction Reports* (PSC 272) to its accounting records;

- Maintained advances of Federal funds in interest-bearing accounts and remitted the interest to PSC; and

- Maintained financial management system for their federal awards that provide, among other requirements:
    - Accurate financial records pertaining to interest earnings;
    - Records that identified adequately the source and application of funds for federally-sponsored activities.

To accomplish the objectives, we:

- Reviewed the University's OMB Circular A-133 audit report for the University's Fiscal Year (FY) ending June 30, 2000;

- Reviewed the University's cash management procedures;

- Obtained an understanding of the major expenses incurred on grants and contracts, including accounts payable, payroll, and indirect costs;

  Held discussions with University officials.

- Reviewed and verified the reasonableness of the adjustments used to complete the reconciliation between the amounts reported on the PSC 272 and the University's accounting records.

- Analyzed the bank account in which draw down amounts were deposited to determine whether it was an interest bearing account. We also requested the University to provide us a report showing the daily disbursements for the FY ending June 30, 2000. We compared the draw-downs with the daily disbursements to identify any positive daily cash balances. We calculated interest on the positive balances based on the rates provided by the University.

- Selected on a judgmental basis, three grants with the highest disbursement amounts to verify that the University was indeed using the reimbursement methodology. To that end, we tested disbursement transactions such as: payroll, equipment, and travel. We also tested the computation of indirect costs for eight grants on the same basis.

Our review was performed in accordance with generally accepted government auditing standards. We did not evaluate the internal control structure at the University because the objectives of this limited scope review did not require a complete understanding or assessment of the internal control structure. We conducted our review at the University's offices from June 2001 through December 2001.

FINDINGS AND RECOMMENDATIONS

Although the University generally used the reimbursement methodology, we found that the University did utilize the advance payments methodology for certain limited periods of time during our audit period. When the advance payments methodology was used, we found that the University was not in compliance with OMB Circular A-110 requirements. Specifically, our audit determined that the University's cash management system was inadequate because it: (i) did not have written procedures to ensure that the timing and amount of advance requests met its disbursement cycle and immediate disbursement needs, and (ii) did not calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between the date of draw-down and the date when the expenses were incurred.

While we determined that the University needed to improve its cash management, our analysis indicated that it did not have significant positive cash balances because it had generally used the reimbursement methodology. Therefore, there was no significant financial impact caused by the University's failure to identify and report interest earned during our audit period. In addition, the University was able to reconcile the amount reported on the *Federal Cash Transaction Report* to its accounting records.

The details on the results of our review are, as follows:

Advance Payment Requests

We determined that the University was generally following the reimbursement methodology for the draw down of Federal funds. However, we found that in some isolated instances funds were requested in advance and positive balances were accumulated for a period of 65 days during FY 2000. This happened because there was no reconciliation between the expenses reported and the funds drawn down.

The University used its monthly report FBM 955 as the basis for its draw down and the monthly report FBM 092 for the disbursements reported to the Federal Government. The FBM 955 represented transactions solely affecting the University cash account, while the FBM 092 represents all disbursement transactions. Although both the draw-down amounts and the disbursements reported on the PSC 272 were based on expenditures, there was no reconciliation between the two sources of the information. As a result, the University drew down excess funds on four different occasions during the period July 1, 1999 through June 30, 2000.

As illustrated below, for the period July 1, 1999, through November 29, 1999, we calculated cash balances that ranged from a negative balance of $556,616 to a positive balance of $1,045,122.

Period	Beginning Balance	Funds Drawn	Funds Disbursed	Ending Balance
07-01 to 07-26-99	($294,173)	$1,813,292	$473,997	$1,045,122
07-27 to 08-19-99	1,045,122	916,522	1,129,940	831,704
08-20 to 09-15-99	831,704	1,482,449	1,337,151	977,002
09-16 to 11-01-99	977,002	1,019,429	2,553,047	(556,616)
11-02 to 11-29-99	(556,616)	1,837,876	880,749	400,511

Positive cash balances are defined as the excess of drawn amounts over disbursements on a given day. We also noted that the University did not have written procedures on the request of draw-down amounts to the PSC which, we believe contributed to the inadvertent request of advance payments. The OMB Circular A-110 requires the University to have written procedures to minimize the time elapsing between the transfer of funds to the recipient from the U.S. Treasury and the issuance or redemption of checks, warrants or payments by other means for program purposes.

Recommendation

We recommend that the University comply with OMB Circular A-110, anytime the advance payments methodology is used, by establishing specific written procedures on the timing and amount of requests to meet its disbursement cycle and immediate disbursement need.

Interest Earned on Advance of Federal Funds

The University did not identify and annually remit interest earned on Federal cash balances to the HHS Division of Payment Management (DPM). According to OMB Circular A-110, advance payments on deposits shall be maintained in interest-bearing accounts until spent for program costs and any interest earned while the advanced funds are in university accounts (less a yearly allowance of $250 for administrative costs) shall be remitted to DPM.

As noted earlier, the University used the expense report FBM 955 as the basis for its draw down of Federal funds. However, it used the expense report FBM 092 to record disbursements on the Federal PSC 272 report. We found the University did not identify why there were different amounts listed on the FBM 955 and the FBM 092 reports. The use of two separate expense reports caused the University to draw down excess funds on four separate occasions during the period July 1, 1999 through November 30, 1999. We calculated, for the 65 days in which the University had positive cash balances, the interest earned as illustrated in the chart below.

Period	Average Daily Positive Cash Balance	Number of Days	Actual Interest Earned
07-26 to 08-16-99	$574,725	22	$1,718
08-19 to 08-30-99	673,521	12	1,102
09-15 to 10-04-99	656,285	20	1,839
11-19 to 11-29-99	536,026	11	864
	Total	65	$5,523

The University believed that since it was using the reimbursement methodology it was not necessary to have procedures to analyze daily disbursements and draw-down amounts to determine cash balances. The lack of procedures related to the timing of draw downs resulted in excess daily cash balances for a limited period of time. Using the interest rates earned by the University, we calculated $5,273 (after deducting $250 for administrative expenses) of interest accrued on those positive balances during the period July 1, 1999 through June 30, 2000. According to a decision by the Department of Health and Human Services, Departmental Appeals Board dated November 29, 2000, the universities can not offset any interest earned on advances of Federal funds against interest lost when universities funds were advanced to cover grant expenditures.

Recommendations

We recommend that the University remit the $5,273 related to the interest earned to the Federal Government. We also recommend that the University establish procedures to calculate and remit any interest earned on positive cash balances to the Federal Government.

OTHER MATTERS

Unallowable Indirect Cost

During our review of indirect costs from a sample of eight grants, we noted the University drew down excess funds for unallowable indirect costs totaling $52,072 for the period July 1, 1999 through June 30, 2000. We were advised by University officials that the excess draw down related to these indirect costs was corrected when the final Financial Status Reports (FSR) were submitted to the Federal Government. We expanded our tests to the entire audit period and verified the University had corrected the problem via several adjustments in the amount of $52,072. However, as a result of our expanded tests, we identified an additional $2,531 of unallowable indirect costs for which funds had been drawn down, but for which an adjustment was not made. We discussed this matter with the University officials who agreed with our finding.

The University drew down excess funds for indirect costs because in some instances it did not consider exclusions of certain direct costs as stipulated in the indirect cost agreement. University officials attributed this condition to a failure of its Financial Record System (FRS) which should have considered the exclusions when calculating the indirect costs to be charged to the grants. However, we were told that these exclusions are not always made. Therefore, at the end of a grant budget period the University manually revises the indirect costs charged to the grant to reduce any amount charged in excess. We found one isolated instance where the adjustment was not made due to a clerical oversight. The AIDS Clinical Trial Unit program exclusions totaling $8,341 were not considered during the period from January 1, 1998 through December 31, 1999. This omission resulted in unallowable indirect costs totaling $2,531 claimed by the University. Further, by waiting until the end of the grant period to make manual adjustments and reduce the total indirect costs claimed, the University was using Federal monies to which it was not entitled.

Recommendations

We recommend that the University refund the $2,531 improperly claimed for reimbursement. In addition, we recommend the University make manual adjustments for excluded cost items when drawing down Federal funds until the FRS capabilities are reviewed and the problem is solved.

Auditee Comments

The University fully concurred with our findings and recommendations. The University stated that it has developed and is implementing procedures for the timing and amount of requests. It is also implementing procedures to determine interest payable to the Federal Government, if the requested funds are in advance. The University also agreed to remit the interest earned and the unallowable indirect cost claimed to the Federal Government. Finally, it will make manual adjustments while exclusions are programmed in its computerized accounting system. The University's response is included in its entirety as an appendix.

OIG Response

We are pleased to note the University agreed with our findings and recommendations.

APPENDIX

UNIVERSIDAD DE PUERTO RICO, RECINTO DE CIENCIAS MÉDICAS
UNIVERSITY OF PUERTO RICO, MEDICAL SCIENCES CAMPUS

UPR

OFICINA DEL RECTOR
OFFICE OF THE CHANCELLOR

May 16, 2002

Timothy J. Horgan
Regional Inspector General for Audit Services
Department of Health & Human Services
Region II
Jacob K. Javits Federal Building
28 Federal Plaza
New York, NY 10278

Re: A-02-01-02500

Dear Mr. Horgan:

We have reviewed your report dated April 17, 2002 regarding the cash management procedures used by us to request federal funds.

The first of your three findings indicate that we generally followed the reimbursement methodology for the draw down of federal funds, but in some isolated instances funds were requested in advance. Your recommendation concerning this finding is the establishment of written procedures on the timing and amount of requests. We are pleased to inform you that the procedure was written and is under implementation. The procedure is available for your perusal upon your request.

The second finding establishes that we did not compute and remit the interest earned on federal cash balances to the HHS Division of Payment Management (DPM). You recommend that we remit the $5,273 related to interest earned to the Federal Government. We will do so immediately upon receipt of your final report. As we implement the procedure for the reconciliation of funds requested with the PCS 272, we will be able to determine interest payable to the Federal Government if the requested funds are in advance.

We will also remit to you the $2,531 of drawn down funds for unallowable indirect costs. This resulted from a situation in our computerized accounting system which did not consider certain exclusions while computing indirect costs. We have requested our Office of Management Information Systems to program such exclusions in the applicable routine. Meanwhile we will make manual adjustments.

Cordially,

José Hawayek, MD
Acting Chancellor