

UNIVERSITY OF HAWAII
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2530 Dole Street
Sakamaki D-200
Honolulu, Hawaii 96822

National Science Foundation Award Number
EEC-9731725

Financial Audit
of
Financial Schedules
and
Independent Auditors' Reports

For the Period November 1, 1998 to July 31, 2004

M.D. Oppenheim & Company, P.C.
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UNIVERSITY OF HAWAII

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UNIVERSITY OF HAWAII

Acronyms

<u>Acronym</u>	<u>Explanation of Acronym</u>
CMMED	Center for Marine Microbial Ecology and Diversity
CONUS	Continental United States
DACS	Division of Acquisition and Cost Support
DGA	Division of Grants and Agreements
ERC	Engineering Research Center
FCTR	Federal Cash Transactions Report
GPM	Grant Policy Manual
GSA	General Services Administration
MarBEC	Marine Bioproducts Engineering Center
MTDC	Modified Total Direct Costs
NSF	National Science Foundation
OIG	Office of Inspector General
OMB	Office of Management and Budget
ORS	Office of Research Services
PAR	Personnel Activity Report
PI	Principal Investigator
SOEST	School of Ocean and Earth Science and Technology
UCAL	University of California
UH	University of Hawaii

EXECUTIVE SUMMARY

BACKGROUND

The University of Hawaii (“UH”) is a public, state-supported educational institution. UH was awarded a cooperative agreement from the National Science Foundation (“NSF”) to build the foundations of engineering research and education for a 21st century marine biotechnology business devoted to high-value products destined for the chemical, pharmaceutical, nutraceutical, cosmetic, food, feed, and life sciences industries. This program was administered by the Engineering Research Center (“ERC”) for Marine Bioproducts Engineering (“MarBEC”) a department of UH. During the operations of the program, UH established a scientific working relationship with the University of California, Berkeley (“UCAL, Berkeley”) through a sub-contract, which was to assist in the marine biotechnology research. The original intent of NSF was to fund this marine biotechnology research for a period of ten years beginning in 1998. However, based upon an NSF site-review NSF decided to terminate the program after the initial five-year award that ended in 2003, and provided a phase-down of operations through July 31, 2004.

NSF awarded Cooperative Agreement No. EEC-9731725 to UH for the period November 1, 1998 to July 31, 2004. The agreement provided the initial five-year funding in the amount of \$9,852,441 with a required cost-sharing match of \$3,228,256. As of July 31, 2004, UH reported \$9,852,045 in claimed costs and \$3,228,256 in cost sharing.

UH, as a Federal awardee, is required to follow the cost principles specified in Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions* and Federal administrative requirements contained in OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

At the request of the NSF Office of Inspector General (OIG), M.D. Oppenheim & Company, P.C. conducted an audit of NSF award EEC-9731725 granted to UH for the period November 1, 1998 to July 31, 2004.

The objectives of our audit engagement were to:

1. Determine whether UH’s Schedule of Award Costs presents fairly, in all material respects, the costs claimed on the Federal Cash Transactions Reports (“FCTR”) – Federal Share of Net Disbursements and that the costs claimed, including cost sharing, are in conformity with Federal and NSF award requirements.
2. Identify matters concerning instances of noncompliance with laws, regulations, and the provisions of the award agreement pertaining to the NSF award and weaknesses in UH’s internal control over financial reporting that could have a direct and material effect on the Schedule of Award Costs and UH’s ability to properly administer, account for, and monitor its NSF awards.
3. Determine whether the costs incurred under a subcontract awarded by UH to UCAL, Berkeley were documented and allowable under the terms and conditions of the subcontract agreement, NSF and Federal regulations.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, (2003, revised) , issued by the Comptroller General of the United States, and the *National Science Foundation Audit Guide*, September 1996, as applicable. Those standards and the *National Science Foundation Audit Guide* require that we plan and perform the audit to obtain reasonable assurance about whether the amounts claimed to NSF as presented in the Schedule of Award Costs (Schedule A), are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedule of Award Costs. An audit also includes assessing the accounting principles used and significant estimates made by UH, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to satisfy ourselves as to the accuracy of \$1,741,879 of cost sharing because UH recorded estimated rather than actual labor cost sharing contributions. Failure of UH management to provide its actual labor cost sharing contributions is considered an audit scope limitation by Statement of Auditing Standards No. 85. Therefore, we have issued a qualified opinion on the Schedule of Award Costs (see finding 1 for more details).

We used non-statistical sampling to test the costs claimed by UH for compliance with Federal and NSF award requirements. Based on this sampling plan, questioned costs in this report may not represent total costs that may have been questioned had all expenditures been tested. In addition, we made no attempt to project such costs to total costs claimed, based on the relationship of costs tested to total costs.

SUMMARY OF AUDIT RESULTS

An audit was performed on the costs claimed in financial reports submitted to the National Science Foundation as well as cost sharing provided by UH on the NSF award audited. These costs are shown in the *Schedule of Award Costs* (Schedule A) and are summarized as follows:

<u>Award Number</u>	<u>Award Budget</u>	<u>Claimed Costs</u>	<u>Questioned NSF Costs</u>	<u>Questioned Cost Sharing</u>
EEC-9731725	<u>\$ 9,852,441</u>	<u>\$ 9,852,045</u>	<u>\$ 265,449</u>	
Cost Sharing	<u>\$ 3,228,256</u>	<u>\$ 4,318,471(A)</u>		<u>\$ 305,706</u>

(A) Includes \$3,228,256 of claimed cost sharing plus an additional \$1,090,215 that was not claimed, but was accounted for by UH.

Our audit of the aforementioned award disclosed that the costs claimed on the NSF award by UH and subcontractor, UCAL Berkeley appear fairly stated and generally appear allowable, allocable, and reasonable, in accordance with applicable Federal and NSF requirements, except for \$265,449 of subcontract costs, \$1,741,879 of UH's cost sharing and \$305,706 of the subcontractor's cost sharing.

Specifically, we questioned \$265,449 in undocumented subcontract costs for personnel, equipment, and other non-personnel costs claimed by the UCAL, Berkeley. In addition, we questioned \$305,706 in cost sharing because of salaries, wages, related fringe benefits and indirect costs that were charged by the subcontractor, UCAL Berkeley, but were not supported with documentation.

We also identified \$1,741,879 of inadequately supported UH labor cost sharing. Although we did not question these costs, we qualified our audit opinion on the Statement of Award Costs because we could not determine the accuracy of these costs, since they were based on estimated rather than actual labor costs.

In general, UH's systems of internal controls were adequate to properly administer, account for, and monitor its NSF award in compliance with Federal and NSF requirements except for accounting for cost sharing and documentation of subcontract costs. The following is a brief description of the internal control and compliance findings that caused the qualified audit opinion and questioned costs. All the findings identified are instances of noncompliance, however, the first finding is also an internal control weakness that could have a significant impact on UH's ability to record, process, summarize and report financial data, and effectively and efficiently administer NSF funds in a manner that is consistent with Federal and NSF requirements.

- UH has not adequately documented or reported its actual cost sharing contributions in accordance with its NSF award and OMB Circular requirements. Specifically, UH used an estimate to allocate cost sharing/labor costs to NSF's award without making any adjustments to reflect changes and fluctuations in actual workload. As a result, we could not determine the accuracy of \$1,741,879 of cost sharing recorded by UH (which resulted in a limitation on the scope of our audit). In addition, UH procedures for accounting for cost sharing, (Administrative Procedures No. A8.947) do not fully explain, when and how previously allocated salaries and wages related to cost sharing should be readjusted to reflect changes in actual workload. Also, these procedures do not provide definitions for the terms "reasonable" and "significant" to clarify when adjustments to the estimated allocation are necessary.
- We also questioned \$305,706 of cost sharing and \$265,449 of direct NSF funded costs claimed by the subcontractor, UCAL, Berkeley, because of inadequate supporting documentation.

To address these internal control and compliance findings, we recommend that the NSF Directors of the Division of Institution and Award Support ("DIAS") and the Division of Grants and Agreements ("DGA") direct UH personnel to properly document and report actual as opposed to estimated cost sharing expenses to NSF. Specifically, UH staff should institute procedures to (a) track and report actual cost sharing costs incurred in its reports to NSF; (b) maintain all written after-the-fact certifications on a contemporaneous basis to support salary and wage costs reported as cost share by the subcontractor, and (c) refine the University's written policy concerning the definition of key aspects of their work distribution plan including the terms "reasonable" and "significant." Furthermore, NSF's Division Directors of DIAS and DGA should ensure that the University of Hawaii and its subcontractor, UCAL, Berkeley, for current and future NSF awards, institute procedures to maintain the necessary source documentation to support all costs reported to NSF, including cost sharing as required by Federal and NSF grant requirements.

In September 2006, UH officials provided their response to the audit findings and recommendations made in this report, generally they agreed with those findings and recommendations and stated the new procedures UH would implement to address the recommendations made. UH, however, did not provide any additional support related to the questioned costs. The findings and recommendations in the report cannot be resolved until NSF verifies that the recommendations have been adequately addressed and the proposed corrective actions have been satisfactorily implemented. UH's response has been summarized within the report and is included in its entirety in Appendix A.

For a complete discussion of these findings, refer to the Independent Auditors' Report on Compliance with Laws and Regulations and Internal Control Over Financial Reporting.

EXIT CONFERENCE

An exit conference was held on March 24, 2005 at the University of Hawaii. Findings and recommendations as well as other observations contained in this report were discussed with those attending.

Representing the University of Hawaii:



Representing M.D. Oppenheim & Company, P.C.:

Joseph J. Scudese CPA, Partner
Richard L. Sobine LPA, Audit Manager
Ambrose Umali CPA, Senior Accountant

FINDINGS AND RECOMMENDATIONS

National Science Foundation
 Office of Inspector General
 4201 Wilson Boulevard
 Arlington, Virginia 22230

INDEPENDENT AUDITORS' REPORT ON FINANCIAL SCHEDULES

We have audited the costs claimed by the University of Hawaii ("UH") to the National Science Foundation ("NSF") on the Federal Cash Transactions Reports ("FCTR") – Federal Share of Net Disbursements for the NSF award listed below. In addition, we also audited the amount of cost sharing claimed on the award. The Federal Cash Transactions Reports, as presented in the *Schedule of Award Costs* (Schedule A) are the responsibility of UH's management. Our responsibility is to express an opinion on the Schedule of Award Costs (Schedule A) based on our audit.

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
EEC-9731725	November 1, 1998 to July 31, 2004	November 1, 1998 to July 31, 2004

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* (June 2003 Revision) issued by the Comptroller General of the United States, and the *National Science Foundation Audit Guide* (September 1996), as applicable. Those standards and the *National Science Foundation Audit Guide* require that we plan and perform the audit to obtain reasonable assurance about whether the amounts claimed to the National Science Foundation as presented in the *Schedule of Award Costs* (Schedule A), are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the *Schedule of Award Costs* (Schedule A). An audit also includes assessing the accounting principles used and significant estimates made by UH's management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As detailed in finding number 1 in the findings and recommendations section of this report, we were unable to satisfy ourselves as to the accuracy of \$1,741,879 of claimed cost sharing contributions reported by the University of Hawaii.

National Science Foundation
Office of Inspector General

The *Schedule of Questioned Costs* (Schedule B) explain the claimed costs totaling \$265,449 that are questioned as to the cost allowability under the NSF award agreement. Questioned costs are (1) costs for which there is documentation that the recorded costs were expended in violation of the laws, regulations or specific conditions of the award, (2) costs that require additional support by the awardee, or (3) costs that require interpretation of allowability by the National Science Foundation, Division of Institution and Award Support (DIAS). The National Science Foundation will make the final determination as to whether such costs are allowable. The ultimate outcome of this determination cannot presently be determined. Accordingly, no adjustment has been made to costs claimed for any potential disallowance by NSF.

In our opinion, except for \$265,449 of questioned NSF-funded costs, \$305,706 of unsupported cost sharing contributions claimed by the subcontractor, and \$1,741,879 of unauditible cost sharing contributions, the *Schedule of Award Costs* (Schedule A) referred to above presents fairly, in all material respects, the costs claimed on the FCTRs and cost sharing claimed for the period November 1, 1998 to July 31, 2004 in conformity with the *National Science Foundation Audit Guide*, *NSF Grant Policy Manual*, and the terms and conditions of the NSF award and on the basis of accounting described in the Notes to the Financial Schedules. This schedule is not intended to be a complete presentation of financial position in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* and the provisions of the *National Science Foundation Audit Guide*, we have also issued a report dated March 24, 2005 on our tests of the University of Hawaii's compliance with certain provisions of laws, regulations, the NSF award terms and conditions, and our consideration of the University of Hawaii's internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of the University of Hawaii's management, the National Science Foundation, the cognizant Federal Audit Agency, the Office of Management and Budget, and the Congress of the United States and is not intended to be and should not be used by anyone other than these specified parties.

M.D. Oppenheim & Company, P.C.

March 24, 2005

National Science Foundation
 Office of Inspector General
 4201 Wilson Boulevard
 Arlington, Virginia 22230

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

We have audited the costs claimed as presented in the *Schedule of Award Costs* (Schedule A), which summarizes the financial reports submitted by the University of Hawaii ("UH") to the National Science Foundation ("NSF") and claimed cost sharing, for the award listed below and have issued our report thereon dated March 24, 2005.

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
EEC-9731725	November 1, 1998 to July 31, 2004	November 1, 1998 to July 31, 2004

We conducted our audit of the Schedule of Award Costs as presented in Schedule A-1 in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* (June 2003, Revision) issued by the Comptroller General of the United States, and the *National Science Foundation Audit Guide* (September 1996), as applicable. These standards and the *National Science Foundation Audit Guide* require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement.

COMPLIANCE WITH LAWS AND REGULATIONS

Compliance with applicable Federal laws, regulations, and the NSF award terms and conditions is the responsibility of UH's management. As part of obtaining reasonable assurance about whether the financial schedule is free of material misstatement, we performed tests of UH's compliance with certain provisions of laws, regulations, and the NSF award terms and conditions, noncompliance with which could have a direct and material effect on the determination of the financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed two instances of noncompliance that are required to be reported under *Government Auditing Standards* and the *National Science Foundation Audit Guide*, *See Finding Nos. 1 and 2 presented in the Findings and Recommendations section of this report.*

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of Schedule of Award Costs (Schedule A) for the period November 1, 1998 to July 31, 2004, we considered UH's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedule and not to provide an opinion on the internal control over financial reporting. Accordingly, we do not express such an opinion.

However, we noted a certain matter involving internal control over financial reporting and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect UH's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial schedule. **The reportable condition noted is described in Finding No. 1 presented in the Findings and Recommendations section of this report.**

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition noted in Finding 1 above is a material weakness.

We considered these instances of noncompliance and the internal control weakness in forming our opinion of whether the Schedule of Award Costs (Schedule A) present fairly in all material respects, the costs claimed by UH on the Federal Cash Transactions Report – Federal Share of Net Disbursements and cost sharing claimed, for the period November 1, 1998 to July 31, 2004, in conformity with the *National Science Foundation Audit Guide (September 1996)*, *NSF Grant Policy Manual*, the Federal Laws and Regulations, and NSF award terms and conditions, and determined that this report does not affect our report dated, March 25, 2005, on the Financial Schedules.

This report is intended solely for the information and use of UH's management, the NSF, the cognizant Federal Audit Agency, the Office of Management and Budget, and the Congress of the United States and is not intended to be and should not be used by anyone other than these specified parties.

M.D. Oppenheim & Company, P.C.

March 24, 2005

UNIVERSITY OF HAWAII
Findings and Recommendations
NSF Award Number EEC-9731725
From November 1, 1998 to July 31, 2004

Material Weakness

FINDINGS AND RECOMMENDATIONS

1. Unrealistic Percentages for Allocating Labor Costs Related to Cost Sharing Contributions

During our audit of UH's claimed cost-sharing contributions (claimed cost sharing consists of direct labor, fringe benefits, and indirect costs) of \$3,228,256, we noted that the grantee's allocated labor costs were based on estimated and not actual costs. This practice is contrary to OMB Circular A-21, Section J, item 8 (c) (1), which provides for the distribution of salaries and wages of professionals and professional staff applicable to sponsored agreements based on budget, planned, or assigned work activity, **updated to reflect any significant changes in work distribution**. As a result, we were unable to satisfy ourselves as to the accuracy of \$1,741,879 (██████████) of the cost sharing claimed by the University of Hawaii on its NSF award. Accordingly, we issued a qualified opinion on the Schedule of Award Costs. Failure of UH to record actual labor costs could have a significant impact on UH's ability to record, process, and report accurate labor and related fringe and indirect cost sharing on NSF awards.

UH used the budgeted work plan included in its award proposal to NSF as the basis to allocate its direct labor costs for cost-sharing contributions, without taking into consideration the normal fluctuations and unexpected changes in actual workload that might have occurred during the five-year performance period of the grant. For instance, if UH proposed that a professional employee would be devoting 50 percent of his or her time to work on the subject NSF grant for cost-sharing purposes, UH used this estimated percentage throughout the 5-year life of the grant to claim labor cost sharing without adjusting for actual work effort that would likely occur over a multiyear period. On the other hand, UH employees who worked exclusively on the subject NSF grant were properly charged for their entire salary plus fringe benefits and indirect costs to cost sharing contributions.

Moreover, during our audit we reviewed UH's policies and procedures for Accounting for Cost Sharing to determine their adequacy and compliance with OMB Circular A-21. Our review disclosed that UH's cost sharing policies and procedures are incomplete and need clarification. Specifically, UH's Administrative Procedure No. A8.947, Accounting for Cost Sharing, did not explain when and how previously allocated labor costs/cost sharing contributions would be adjusted to reflect significant changes in actual

workload as required by OMB Circular A-21. Also, these procedures do not provide definitions for the terms “reasonable” and “significant” to clarify when adjustments to the estimated allocation are necessary. As such, UH has been using budgeted efforts/hours to distribute payroll expenses without making any adjustments to reflect changes in actual workload.

Recommendation No. 1

NSF’s Division Directors of DIAS and DGA should ensure that UH management updates the budgeted percentages used to allocate direct labor costs/ cost sharing contributions to reflect actual work distribution and fluctuations as required by OMB Circular A-21 requirements.

Recommendation No. 2

NSF’s Division Directors of DIAS and DGA should ensure that UH management clarifies and updates its policies and procedures (Administrative Procedure No. A8.947) for accounting for cost sharing to comply with OMB Circular A-21 requirements. Specifically, UH policy should explain when and how previously allocated labor costs/cost sharing contributions would be updated and redistributed based on the fluctuations in actual workload and provide definitions for key aspects of its work distribution plan, including the terms “reasonable” and “significant.”

Auditee’s Response

UH officials in their September, 2006 response letter generally concurred with the recommendations and plan to amend their Administrative Procedure No. A8.947. UH’s proposed amendment would incorporate language to clarify fluctuations in allocation percentages between short-term and long-term allocation fluctuations.

Auditors’ Comment

Overall UH’s comment appears responsive to the recommendations. However, the finding cannot be resolved until NSF verifies that the proposed corrective action has been satisfactorily implemented.

Non-Material Compliance Deficiency

2. Inadequate Supporting Documentation for Subcontract Costs

Our audit of the subcontract costs reported by UCAL, Berkeley to UH disclosed questioned costs totaling \$265,449 or 2.6 percent of total NSF funded costs and \$305,706 or 7 percent of total claimed cost sharing due to the lack of adequate supporting documentation. OMB Circular A-110, Subpart C, Section .21 (b) (7) requires accounting records, including cost accounting records, be supported by source documentation. In addition, the subcontract agreement between UH and UCAL, Berkeley, Subpart 2, requires the subcontractor to conform to all aspects of the Cooperative Agreement and other Federal rules and regulations that may apply to the subagreement.

UCAL, Berkeley could not locate source documentation to support personnel costs, including salaries and wages and applicable fringe benefits, in the amount of \$46,950 plus applicable indirect costs of \$14,587 for a total of \$61,537. Also, of 72 Personnel Activity Reports (time certification statements for each employee) selected for testing 7, or ■■■■■, totaling \$15,964, including applicable fringe benefits, could not be located. In addition, ■■■■■ of the 19 paid payroll checks totaling \$30,986, including applicable fringe benefits, selected for testing could not be provided.

UCAL, Berkeley also could not locate source documentation to support \$152,510 or ■■■■■ percent of total equipment costs. Of the 14 items selected for testing, 6 vendor invoices totaling \$134,712 could not be located. In addition, one paid check in the amount of \$17,798 could not be provided.

UCAL, Berkeley also could not locate source documentation to support other non-personnel costs in the amount of \$51,402 (\$34,590 plus applicable indirect costs of \$16,812). Of the 56 items selected for testing 8, or ■■■■■, of the vendor invoices totaling \$36,285, including applicable indirect costs, could not be located (\$24,271 plus indirect costs of \$12,014). In addition, 7 paid checks totaling \$15,117 selected for testing could not be provided (\$10,319 plus indirect costs of \$4,798).

Finally UCAL, Berkeley could not adequately document their allocations of level of effort for personnel costs, including salaries and wages and applicable fringe benefits, reported for cost sharing in the amount of \$305,706 including applicable indirect costs (\$203,262 plus indirect costs of \$102,444). Twenty-seven or ■■■ percent of the 32 Personnel Activity Reports (time certification statements for each employee) selected for testing contained incomplete information to document/certify time spent on NSF program related cost sharing activities totaling \$203,262 (\$173,728 plus fringe benefits of \$29,534).

We were informed by UCAL staff that the location for the unlocated documentation was at an off-site storage facility which was temporarily closed to employee access due to environmental health concerns.

Recommendation No. 1

NSF's Division Directors of DIAS and DGA should ensure that the University of Hawaii and its subcontractor, UCAL, Berkeley staff, for current and future NSF awards, institute procedures to maintain the necessary source documentation to support all costs reported to NSF, including documentation for cost sharing as required by the appropriate *OMB Circulars* and the *NSF Grant Policy Manual*.

Auditee's Response

UH officials in their September 2006, response letter concurred with the recommendation and would be examining and revising all subrecipient agreements related to record retention policies. UH did not provide any additional documentation related to the questioned costs.

Auditors' Comment

Overall UH's comment appears responsive to the recommendation. However, the finding cannot be resolved until NSF verifies that the proposed corrective action has been satisfactorily implemented. Finally, since UH did not provide any documents related to the questioned costs, they remain as stated.

**FINANCIAL SCHEDULES AND
SUPPLEMENTAL INFORMATION**

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Schedule of Award Costs
From November 1, 1998 to July 31, 2004
Final

Cost Category	Approved Budget	(A) Claimed Costs	Adjustments and Reclassifications	Claimed Costs After Adjustments and Reclassifications	Questioned NSF Costs and Questioned Cost Sharing	
					Amount	Schedule Reference
Direct costs:						
Salaries and wages					\$	
Fringe benefits						
Permanent equipment						
Travel						
Participant support						
Other direct costs:						
Materials and supplies						
Publication costs						
Consultant services						
Computer services						
Subcontracts					265,449	B
Other						
Total direct costs	8,396,646	8,488,417	-0-	8,488,417	265,449	
Indirect costs (C)	1,525,955	1,363,628		1,363,628		
Residual funds (B)	(70,160)					
Total	<u>\$ 9,852,441</u>	<u>\$ 9,852,045</u>	<u>\$ -0-</u>	<u>\$ 9,852,045</u>	<u>\$ 265,449</u>	
Cost sharing	<u>\$ 3,228,256</u>	<u>\$ 3,228,256</u>	<u>²\$ 1,090,215</u>	<u>\$ 4,318,471</u>	<u>\$ 305,706</u>	C,D, D-1

(A) The total representing costs claimed agreed with the expenditures reported on the Federal Cash Transactions Report – Federal Share of Net Disbursements as of the quarter ended September 30, 2004. Claimed costs reported above are taken directly from the University of Hawaii’s books of accounts.

(B) In Amendment Number 6 to the cooperative agreement, NSF allowed UH to carry forward residual funds remaining on an old grant in the amount of \$70,160.

See accompanying notes to this financial schedule.

(C) Indirect costs are calculated on the modified total direct cost basis (“MTDC”), which is total direct costs less equipment, participant support costs and subcontract costs in excess of \$25,000 per subcontract. The Awardee utilized predetermined MTDC indirect cost rates as follows:

Period	Federally Approved Rate	
	On-Campus	Off-Campus
November 1, 1998 to June 30, 2000	34.9%	20.4%
July 1, 2000 to July 31, 2004	36.3%	20.6%

¹This amount represents a recommended upward adjustment to the cost-sharing amount claimed by UH, and it consists of \$798,000 reported by UCAL/Berkeley (sub-contractor) to UH as cost sharing, and \$292,215 of graduate student tuition which was waived by UH for students that performed work on the audited NSF grant.

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Schedule of Questioned Costs
From November 1, 1998 to July 31, 2004

Subcontract Costs:

We are questioning \$265,449 of subcontract costs as follows:

- a) UCAL, Berkeley could not locate source documentation to support personnel costs, including salaries and wages and applicable fringe benefits, in the amount of \$46,950 plus applicable indirect costs of \$14,587 for a total of \$61,537. Specifically, personnel Activity Reports (time certification statements for each employee) selected for testing could not be located totaling \$12,874 with applicable fringe benefits of \$3,090. In addition, [REDACTED] of the 19 paid payroll checks selected for testing could not be provided totaling \$24,989 with applicable fringe benefits of \$5,997.
- b) UCAL, Berkeley could not locate source documentation to support \$152,510 of equipment costs. Vendor invoices could not be located for a total of \$134,712. In addition, one paid check in the amount of \$17,798 could not be provided (Two paid checks also could not be provided for two of the missing invoices indicated above. However, these costs are included in the missing invoices total above and are not questioned twice.).
- c) UCAL, Berkeley could not locate source documentation to support other non-personnel costs in the amount of \$34,590 plus applicable indirect costs of \$16,812 for a total of \$51,402. Vendor invoices could not be located for a total of \$24,271 with applicable indirect costs of \$12,014. In addition, 7 paid checks selected for testing could not be provided totaling \$10,319 plus applicable indirect costs of \$4,798 (Three paid checks also could not be provided for three of the missing invoices indicated above. However, these costs are included in the missing invoices total above and are not questioned twice.).

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Schedule of Adjustments and Reclassifications
From November 1, 1998 to July 31, 2004

The following are the recommended upward adjustments to the cost sharing amount reported by the University of Hawaii to NSF:

<u>Explanation of Adjustment</u>	<u>Amount of Adjustment</u>
1. To record the amount of cost sharing as reported by UCAL, Berkeley (the subcontractor under this award) for salaries and wages and the related fringe benefits and indirect costs to UH. This amount was not reflected in the final report of cost sharing that UH submitted to NSF.	\$ 798,000
2. To record graduate student tuition which was waived by UH for those students who performed work related to this NSF award.	<u>292,215</u>
Total adjustments to cost sharing	<u>\$ 1,090,215</u>

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Schedule of Cost Sharing
From November 1, 1998 to July 31, 2004

<u>Cost Sharing Required</u>	<u>Cost Sharing Claimed</u>	<u>Adjustments and Reclassifications</u>	<u>Cost Sharing Claimed After Adjustments and Reclassifications</u>	<u>Questioned Costs</u>	<u>Schedule Reference</u>
<u>\$ 3,228,256</u>	<u>\$ 3,228,256</u>	<u>\$ 1,090,215</u> (Schedule C)	<u>\$ 4,318,471</u>	<u>\$ 305,706</u>	D-1

The accompanying schedule referenced to explain questioned costs is an integral part of this financial schedule.

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Schedule of Questioned Cost Sharing
From November 1, 1998 to July 31, 2004

Questioned cost sharing of \$305,706 is comprised of the following:

<u>Explanation</u>	<u>Amount</u>
The cost sharing reported by UCAL, Berkeley included \$173,728 of salaries and wages, which were questioned because they were not supported by time and effort reporting to document the amount of time charged to this NSF award. In addition, we questioned the fringe benefits costs totaling \$29,534 at a rate of [REDACTED] and indirect costs of \$102,444 at a rate of [REDACTED].	<u>\$ 305,706</u>

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Summary Schedule of Award Audited and Audit Results
From November 1, 1998 to July 31, 2004

Summary of Award Audited

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
EEC-9731725	11/01/98-07/31/04	11/01/98-07/31/04

Summary of Questioned and Unresolved Costs

<u>NSF Award Number</u>	<u>Award Budget</u>	<u>Claimed Costs</u>	<u>Questioned Costs</u>	<u>Questioned Cost Sharing</u>	<u>Unresolved Costs</u>	<u>Unsupported Costs</u>
EEC-9731725	<u>\$ 9,852,441</u>	<u>\$ 9,852,045</u>	<u>\$ 265,449</u>	<u>\$ 305,706</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

Summary of Questioned Costs by Explanation

<u>Condition</u>	<u>Questioned Cost Amount</u>	<u>Internal Control Finding</u>	<u>Noncompliance Finding</u>
Subcontract Costs – costs claimed by UCAL, Berkeley without adequate supporting documentation for salaries and wages, equipment and other costs.	<u>\$ 265,449</u>		X

Summary of Questioned Cost Sharing by Explanation

<u>Condition</u>	<u>Questioned Amount</u>	<u>Internal Control Finding</u>	<u>Noncompliance Finding</u>
Lack of time and effort documentation for salaries and wages cost sharing reported by UCAL, Berkeley (a subcontractor) along with the applicable fringe benefits and indirect costs.	<u>\$ 305,706</u>		X

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Summary Schedule of Award Audited and Audit Results (Cont.)
From November 1, 1998 to July 31, 2004

Summary of Noncompliance and Internal Control Findings

<u>Condition</u>	<u>Noncompliance or Internal Control?</u>	<u>Material, Reportable or Other</u>	<u>Amount of Questioned Cost Effected</u>	<u>Amount of Claimed Costs Effected</u>
• Cost sharing accounting deficiencies	Noncompliance and Internal Control	Material	\$ 305,706	\$ 4,318,471
• Lack of adequate supporting documentation for subcontract costs	Noncompliance	Reportable	\$ 265,449	\$ 3,156,289

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Notes to Financial Schedules
From November 1, 1998 to July 31, 2004

1. Summary of significant accounting policies:

Accounting basis

The accompanying financial schedules have been prepared in conformity with National Science Foundation (“NSF”) instructions. Schedule A has been prepared from the reports submitted to NSF. The basis of accounting utilized in preparation of these reports differs from accounting principles generally accepted in the United States of America. The following information summarizes these differences:

a. Equity

Under the terms of the award, all funds not expended according to the award agreement and budget at the end of the award period are to be returned to NSF. Therefore, the awardee does not maintain any equity in the award and any excess cash received from NSF over final expenditures is due back to NSF.

b. Equipment

Equipment is charged to expense in the period during which it is purchased instead of being recognized as an asset and depreciated over its useful life. As a result, the expenses reflected in the statement of award costs include the cost of equipment purchased during the period rather than a provision for depreciation.

The equipment acquired is owned by the University of Hawaii while used in the program for which it was purchased or in other future authorized programs. However, NSF has the reversionary interest in the equipment. Its disposition, as well as the ownership of any proceeds there from, is subject to Federal regulations.

c. Inventory

Minor materials and supplies are charged to expense during the period of purchase. As a result, no inventory is recognized for these items in the financial schedules.

d. Income taxes

The University of Hawaii is a private nonprofit corporation, incorporated under the laws of the State of Hawaii. The University of Hawaii is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. It is also exempt from Hawaii income tax.

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Notes to Financial Schedules
From November 1, 1998 to July 31, 2004

2. NSF cost sharing and matching:

The following represents the cost sharing requirements and actual cost sharing from November 1, 1998 to July 31, 2004:

	<u>Cost Sharing Required</u>	<u>Actual Cost Sharing Claimed</u>	<u>Questioned Cost Sharing</u>	<u>Net Cost Sharing</u>	<u>Over/ (Under)</u>
Award No. EEC-9731725:					
Year 1	\$ 458,556	\$ 458,556	\$	\$ 458,556	\$ -0-
Year 2	843,136	843,136		843,136	-0-
Year 3	884,591	884,591		884,591	-0-
Year 4	491,829	491,829		491,829	-0-
Year 5	<u>550,144</u>	<u>550,144</u>	_____	<u>550,144</u>	<u>-0-</u>
Sub-total	3,228,256	3,228,256	-0-	3,228,256	-0-
Plus: Additional cost sharing provided and not claimed:					
• Univ. of California, Berkeley	798,000	798,000	305,706	492,294	(305,706)
• UH – graduate students tuition waiver	<u>292,215</u>	<u>292,215</u>	<u>-0-</u>	<u>292,215</u>	<u>-0-</u>
Total	<u>\$ 4,318,471</u>	<u>\$ 4,318,471</u>	<u>\$ 305,706</u>	<u>\$ 4,012,765</u>	<u>\$ (305,706)</u>

APPENDIX A – AUDITEE’S COMMENTS TO REPORT

UNIVERSITY OF HAWAII

Office of Research Services

September 12, 2006

Mr. Joseph J. Scudese
M.D. Oppenheim & Company, P.C.
485 U.S. Highway One, Building C
P.O. Box 4100
Iselin, NJ 08830

Dear Mr. Scudese:

Attached per your request are the University of Hawaii's responses to your audit findings for National Science Foundation award no. EEC-9737125. Should you have any questions, please call me at [REDACTED].

Sincerely,

[REDACTED]

Attachments

c: [REDACTED]

University of Hawaii
Response to Draft Audit Report
for National Science Foundation Award No. EEC-9737125

Finding No. 1

The University of Hawaii has a policy to reflect differences between budgeted and actual effort, which is described under Administrative Procedure A8.948, Section 4.h. The policy states that:

“An individual’s FTE percentage contribution towards a project should be adjusted when there is a variance between estimated and actual FTE of more than 5%. For example, if 50% FTE is estimated, corrections should be noted when the percent of effort is less than 45% or greater than 55%.”

The University plans to modify A8.947 to incorporate this requirement and to address the issue through periodic training. However, it believes that the recordation of fluctuations as envisioned by the auditors is not feasible.

A-21, Section J.10.c.(1) states that:

“(d) The system will provide for modification of an individual's salary or salary distribution commensurate with a significant change in the employee's work activity. **Short term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term, such as an academic period.** Whenever it is apparent that a significant change in work activity that is directly or indirectly charged to sponsored agreements will occur or has occurred, the change will be documented over the signature of a responsible official and entered into the system.”

This section qualifies the directive that “the distribution of salaries and wages of professional staff applicable to sponsored agreements is... [to be] updated to reflect any significant changes in work distribution.” The University believes that the intent of this statement is to prevent undue administrative burden on the part of the recipient.

Thus, it is conceivable that no adjustment would occur for an academic period such as a semester (three to four months) and perhaps an academic year. However, the University acknowledges that a five-year period without fluctuation might not be realistic.

University of Hawaii
Response to Draft Audit Report
for National Science Foundation Award No. EEC-9737125

Finding No. 2

The University has record retention policies for grants and contracts, which are described under UH Administrative Procedure A8.926, Section 6.h. The policy states in part:

“Financial records, supporting documents, statistical records, and all other records pertaining to sponsored agreements shall be retained for a period of three years...”

“The retention period for grants and other agreements starts from the date of the submission of the final expenditure report...”

“Pertinent books, documents, papers, and records of the University and its subrecipients shall be made available and accessible to the sponsoring agency and the Comptroller General of the United States or any of their duly appointed representatives for audits, examinations, transcripts, and excerpts.”

The University agrees that staff should be instructed on and reminded of the record retention policies and will address the issue through periodic training. In addition, it will be examining and revising the boilerplate subrecipient agreement to ensure that record retention requirements are included.

UNIVERSITY OF HAWAII

**NATIONAL SCIENCE FOUNDATION AWARD NUMBER
EEC-9731725**

**DETAILED (PERSONAL IDENTIFYING INFORMATION) ON
SCHEDULE B**

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Personal Identifying Information to Schedule of Questioned Costs
From November 1, 1998 to July 31, 2004

Subcontract Costs (Personnel) – UCAL, Berkeley:

Pay Date	Name of Employee	Payroll Alloc. %	Job Description	Questioned Salaries	Questioned Fringe Ben. (at [REDACTED])	Indirect Cost Rate	Questioned Indirect Costs	Total Questioned Costs
<u>Missing PAR's for the following employees:</u>								
07/01/00	[REDACTED]	100%	Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	\$ 720	\$ 3,820
09/01/99	[REDACTED]	50%	Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	619	2,169
07/01/01	[REDACTED]	100%	Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	1,058	4,386
07/01/01	[REDACTED]	100%	Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	985	4,085
07/01/01	[REDACTED]	25%	Admin. Specialist	[REDACTED]	[REDACTED]	[REDACTED]	328	1,361
07/01/01	[REDACTED]	10%	Assistant Level I	[REDACTED]	[REDACTED]	[REDACTED]	39	162
07/01/02	[REDACTED]	100%	Assistant Specialist	[REDACTED]	[REDACTED]	[REDACTED]	1,257	4,987
				[REDACTED]	[REDACTED]	[REDACTED]	<u>5,006</u>	<u>20,970</u>
<u>Missing paid payroll checks for the following employees:</u>								
09/01/99	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	683	2,394
09/01/99	[REDACTED]		Graduate Student - Research	[REDACTED]	[REDACTED]	[REDACTED]	743	2,603
07/01/00	[REDACTED]		Graduate Student - Research	[REDACTED]	[REDACTED]	[REDACTED]	432	2,292
09/01/99	[REDACTED]		Graduate Student - Research	[REDACTED]	[REDACTED]	[REDACTED]	421	1,475
09/01/99	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	1,237	4,337
07/01/00	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	720	3,820
09/01/99	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	273	956
07/01/00	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	816	4,329
09/01/99	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	720	3,820
(A) 09/01/99	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	619	2,169
09/01/99	[REDACTED]		Laboratory Assistant	[REDACTED]	[REDACTED]	[REDACTED]	127	446
09/01/99	[REDACTED]		Laboratory Assistant	[REDACTED]	[REDACTED]	[REDACTED]	54	190
09/01/99	[REDACTED]		Clerk	[REDACTED]	[REDACTED]	[REDACTED]	46	162
09/01/99	[REDACTED]		Laboratory Helper	[REDACTED]	[REDACTED]	[REDACTED]	24	85
07/01/00	[REDACTED]		Laboratory Helper	[REDACTED]	[REDACTED]	[REDACTED]	31	165
07/01/01	[REDACTED]		Associate Specialist	[REDACTED]	[REDACTED]	[REDACTED]	1,853	7,684
07/01/01	[REDACTED]		Associate Specialist	[REDACTED]	[REDACTED]	[REDACTED]	1,401	5,809
(A) 07/01/01	[REDACTED]		Post Doctoral	[REDACTED]	[REDACTED]	[REDACTED]	985	4,085
(A) 07/01/01	[REDACTED]		Assistant Level I	[REDACTED]	[REDACTED]	[REDACTED]	39	162
				[REDACTED]	[REDACTED]	[REDACTED]	11,224	46,983
(A) Elimination of duplication for missing PAR's				[REDACTED]	[REDACTED]	[REDACTED]	<u>1,643</u>	<u>6,416</u>
				[REDACTED]	[REDACTED]	[REDACTED]	<u>9,581</u>	<u>40,567</u>
Totals				[REDACTED]	[REDACTED]	[REDACTED]	<u>\$ 14,587</u>	<u>\$ 61,537</u>

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Personal Identifying Information to Schedule of Questioned Costs (Cont.)
From November 1, 1998 to July 31, 2004

Subcontract Costs (Equipment) - UCAL, Berkeley:

<u>Name of Vendor:</u>	<u>G/L Acct.</u>	<u>Check Date</u>	<u>Amount</u>
<u>Missing Invoices:</u>			
Dell Computer	9900	Not avail.	██████████
(A) Main Street Technologies	9900	Not avail.	██████████
Hewlett Packard	9000	08/19/99	██████████
AVIV Associates	9000	10/27/99	██████████
(A) Fisher Scientific	9000	Not avail.	██████████
Artificial Sensing Instruments	9000	03/10/00	██████████
			██████████
<u>Missing Cancelled Checks:</u>			
New Brunswick Scientific Co., Inc.	54210	10/08/01	██████████
Total questioned equipment costs			██████████

(A) These two missing invoices also had the cancelled check missing.

UNIVERSITY OF HAWAII
National Science Foundation Award No. EEC-9731725
Personal Identifying Information to Schedule of Questioned Costs (Cont.)
From November 1, 1998 to July 31, 2004

Subcontract Costs (Other Costs) - UCAL, Berkeley:

<u>Name of Vendor:</u>	<u>G/L Acct.</u>	<u>Check Date</u>	<u>Direct Cost Questioned</u>	<u>Indirect Cost Rate</u>	<u>Indirect Costs Questioned</u>	<u>Total Questioned Costs</u>
<u>Missing Invoices:</u>						
(A) VKI	8020	Not avail.	██████████	██████████	\$ 352	\$ 1,063
Marsh Biomedical	8040	06/24/99	██████████	██████████	468	1,414
Rainin Instruments	8040	04/25/00	██████████	██████████	377	1,138
(A) Fisher Scientific	8040	Not avail.	██████████	██████████	1,005	3,035
Rainin Instruments	8040	06/12/00	██████████	██████████	627	1,893
B Braun Biotech	8000	04/15/99	██████████	██████████	8,006	24,180
National Instruments	8000	08/23/99	██████████	██████████	654	1,976
(A) Fisher Scientific	8000	Not avail.	██████████	██████████	525	1,586
			██████████		<u>12,014</u>	<u>36,285</u>
<u>Missing Cancelled Checks:</u>						
Diners Club	2905	Not avail.	██████████	██████████	336	1,015
Diners Club	2905	Not avail.	██████████	██████████	494	1,494
Diners Club	2915	Not avail.	██████████	██████████	633	1,911
██████████	56639	06/07/01	██████████	██████████	432	1,932
██████████	57214	Not avail.	██████████	██████████	396	1,195
Fisher Scientific	55016	Not avail.	██████████	██████████	480	1,449
Agilent Technologies, Inc.	56290	Not avail.	██████████	██████████	2,027	6,121
			██████████		<u>4,798</u>	<u>15,117</u>
Total questioned other costs			██████████		<u>\$ 16,812</u>	<u>\$ 51,402</u>

(A) These three missing invoices also had the cancelled check missing.

HOW TO CONTACT
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