

AUDIT SURVIVAL GUIDE (February 2007)

Webster's Dictionary defines the noun "audit" as "a methodical examination and review." As a verb, it means "to examine with intent to verify." The fact is - audits of one type or another are a regular part of the administrative process. No matter where you work at Stanford, you can expect to encounter audits.

The ability of faculty and department staff to contribute efficiently and effectively will play a big role in the outcomes. This Guide has been prepared to help staff in academic departments understand what an audit requires and how to provide the necessary support with the least intrusion into ongoing work.

The best way to assure that audits go smoothly is to create and maintain good records. Stanford relies on central databases and records whenever possible. However, often the information needed, e.g., the back-up documentation for an expense transfer or the certification of a Monthly Expenditure Statement, resides in a department, and complete, orderly departmental records can prove the truth of the old saying "*An ounce of prevention is worth a pound of cure.*"

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Links to selected Stanford policies and other documents

Questions, suggestions and comments should be sent to Ann George, Assistant Dean of Research and Compliance Support Officer (3-9721 or ann.george@forsythegeo@leland.stanford.edu).

Other Web Sites

In addition to the links to Stanford policies found in Section 8, look for related information at the following sites:

GOVERNMENT DOCUMENTS

[Office of Management and Budget Circular A-21](#), *Cost Principles for Educational Institutions*

[Office of Management and Budget Circular A-110](#), *Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*

[CASB Standards](#), Cost Accounting Standards for Educational Institutions, described in OMB Circular A-21, referenced above

STANFORD LOCATIONS

[Research Policy Handbook](#)

[Administrative Guide](#)

[Administrator's Toolkit](#)

[Internal Audit Department](#), which includes:

[Revised Stanford University Procedures for Supplying Information and Documents to Government Auditors](#)

[Departmental Compliance Audit Program \(Helpful for Self Review\)](#)

[Sponsored Projects Office](#)

Forms Related to Research (Stanford forms)

OTHER LOCATIONS

[NIH Home Page](#)

[NSF Home Page](#)

1. Terms And Concepts

In almost any audit involving proposed or actual costs, whether direct or indirect, auditors will be looking for evidence to answer these questions:

Are the costs allowable?

Are they allocable?

Are they reasonable?

ALLOWABILITY

Allowability for costs related to government-funded sponsored projects is determined by the provisions of the governing sponsored agreement, or by cost principles established by the federal government in OMB Circular A-21. For example, A-21 defines certain types of expenses, e.g., alcohol, lobbying, or entertainment, as categorically unallowable. Other costs may be unallowable per the specific terms of an award, e.g., unapproved foreign travel or capital equipment purchases, or patient care, or administrative costs. These types of expenses are therefore, by definition, unallowable. Auditors are always alert to the possibility that unallowable costs might have been charged, and may devote considerable energies to testing specific transactions to see if they fall into an unallowable category.

A reminder about allowability: A cost which is unallowable for a sponsored project may be an appropriate expense for Stanford University. For example, fund-raising is a very appropriate Stanford activity. Fund-raising expenses, however, are unallowable, i.e., they may not be charged to the government directly or indirectly.

ALLOCABILITY

An expense is allocable to a project if the material or service being charged benefits that project. Allocability is not the same as allowability; an otherwise allowable cost, e.g., salary or travel, may be unallocable to a particular account if the project supported by that account did not benefit from the cost. Note that a cost can be allocable to a project or activity as either a direct or an indirect cost, depending on whether the cost can be specifically identified to the project or activity.

REASONABLENESS

Reasonableness is a subjective quality that requires application of the "prudent person" test. An auditor may legitimately question a cost that is clearly allocable and not otherwise unallowable if, in the auditor's judgment, the cost exceeds what a reasonable person would have paid in similar circumstances.

2. Things to Know About Audits at Stanford

The Stanford Internal Audit Department has developed a protocol for dealing with audits and auditors, presented and discussed later in this Guide. To help understand the rationale behind Stanford's procedures, here is some general information about audits at Stanford :

Auditors review transactions and documentation.

An audit typically consists of a review of existing financial records and often requires additional information about the transactions being reviewed. The objectives of an audit can be accomplished by means of personal interviews with University personnel, written responses to questions posed by the auditors, or the provision of other documentation. Departmental staff are typically involved in interviews and responses to questions. Central offices (e.g., the Controller's Office, Government Cost and Rate Studies Office of Research Administration, Internal Audit) coordinate audits, sometimes attend interviews, and often prepare written responses to auditors' questions.

Stanford management reviews draft audit reports.

All audit reports, including those by non-Stanford auditors, are typically prepared in draft form then submitted to Stanford management for review and comment. This gives Stanford management the opportunity to correct misconceptions and to respond for the record in cases where auditors and Stanford cannot agree on the appropriateness or accuracy of a finding.

Auditors question, but do not disallow, costs.

If auditors identify financial transactions that they believe to be inappropriately classified, unreasonable, unallocable, or unallowable, they will question that transaction. Final decisions about the ultimate allowability of a questioned cost are made by a cognizant contracting official taking into account the auditor's report and Stanford's response. That final resolution can sometimes take a considerable amount of time. Immediate corrective action may be necessary only if Stanford concurs with the finding. You will be notified by the Controller's Office or Government Cost and Rate Studies (GCRS) the Office of Research Administration if that is necessary.

Auditors may project from a sample.

Auditors typically select small samples of transactions for testing, and may project any errors identified to an entire population of expense, e.g., within a general ledger code or fund class. In such cases, auditors may must test every transaction sampled, no matter how small or inconsequential it may appear to be. The disallowance of even a minor cost can therefore have a substantial impact.

3. Auditors Working At Stanford

Auditors at Stanford can be grouped on the basis of their organizational affiliation. You may encounter:

auditors from sponsors and funding agencies, including the Defense Contract Audit Agency (DCAA) and other federal organizations

external certified public accountants, including the firm of PricewaterhouseCoopers LLP (PWC), Stanford University's independent public accountant
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members of the Stanford University Internal Audit Department
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FEDERAL AUDITORS

The federal government sponsors a great deal of research and instruction at Stanford and provides considerable additional funding in the form of student grants and loans. As a result, federal agencies have legitimate audit interests which are defined in the provisions of award documents. The agency that is responsible for establishment of indirect cost rates for all federal agencies sponsoring work at Stanford is the Office of Naval Research (ONR). Most federal audits are conducted by the DCAA, which is the audit organization of the Department of Defense (DoD). DCAA maintains an office on the Stanford campus. While DCAA's primary focus is on DoD contracts and grants and direct and indirect costs, other federal sponsors, including NASA, NIH, and NSF, may also rely on DCAA to perform audits related to their funding.

OTHER SPONSOR AUDITORS

Occasionally, other federal sponsors will perform their own audits at Stanford rather than retain DCAA. In addition, visits from auditors representing the State of California are not uncommon. Non-government sponsors also retain the right to send auditors to Stanford, although they rarely do.

INDEPENDENT PUBLIC ACCOUNTANTS

Stanford regularly contracts with external Independent Public Accounting firms to perform several types of audits. Since 1991, the firms of C&LPWC and Arthur Andersen & Company, L.L.P. (AA&Co) have performed projects in the capacity of both independent auditors and management consultants. Some of these audits have been required by federal regulations, and some are carried out in conjunction with federal auditors.

STANFORD INTERNAL AUDITORS

The Internal Audit Department (IAD) is staffed by Stanford employees. IAD's office is in the 651 Serra Building. maintains offices in 857 Serra, at Stanford Management Company, and in the Hoover Pavilion at Stanford Health Services (SHS). The Director of Internal Audit reports to the Chief Financial Officer and also has a direct reporting relationship to the Audit Committees of both the Stanford University Board of Trustees and the SHS Board of Directors. IAD's charter guarantees access to all pertinent University and SHS data.

IAD carries out a regular audit program aimed primarily at testing and strengthening the University's system of internal controls. IAD also coordinates the activities of all other auditors working on campus.

4. Kinds Of Audits

All audits carried out at Stanford can be grouped into one of five distinct types. Each type focuses on specific questions, discussed later in this Guide.

CLAIMED COST AUDITS

Sponsors may request their auditors to verify the allowability, allocability, and reasonableness of direct costs that have been charged and billed by Stanford, especially in connection with cost-reimbursable grants and contracts. Audits of claimed direct costs are most commonly carried out at the completion of a sponsored project, when Stanford presents a close-out bill to the sponsor.

INDIRECT COST AUDITS

Stanford recovers its facilities and administration costs associated with sponsored projects, i.e., its indirect costs, through the application of indirect cost rates to sponsored project billings. Periodically, Government Cost and Rate Studies (GCRS) prepares proposals and incurred cost studies to serve as the basis for negotiating these rates with ONR. DCAA audits these proposals and cost studies to advise ONR on the allowability, allocability, and reasonableness of proposed and incurred indirect costs. Similarly, GCRS establishes a staff benefit rate to be applied to salaries charged to sponsored projects. DCAA audits these studies and ONR then determines the appropriate benefit rate to be charged.

PREAWARD AUDITS

Preaward audits are typically conducted by DCAA and other sponsor auditors to verify the estimated costs submitted in proposals for large sponsored research projects. Preaward audits are generally less common than audits of claimed or indirect costs. However, since sponsor contracting officers require these audits to be completed before they will negotiate an award, auditors give preaward audits scheduling priority over other types of audits.

COMPLIANCE AND GENERAL CONTROLS AUDITS

Stanford is required to comply with a large and constantly changing array of government rules and regulations. Auditors of all types depend on Stanford's internal controls to achieve compliance, and they periodically undertake separate audits to test the effectiveness of our controls. Our independent public accountants, assisted by the Stanford Internal Audit Department, annually conduct a single federal compliance audit as required by the provisions of OMB Circular A-133; such audits are required of all major research universities. In addition, DCAA undertakes a series of regular internal control audits. University Mandatory Annual Audit Requirements (UMAARs). Finally, for the last several years, the Stanford Internal Audit Department has conducted regular departmental management and compliance audits.

FINANCIAL STATEMENT AUDITS

Annually, the independent public accountants for Stanford University (C&LPWC) conduct audits to assess the accuracy and fairness of the University's year-end financial statements.

In general, departmental staff are not contacted in connection with these annual audits, although the independent accountants may use the results of general control reviews (described above) to verify their understanding of the existence and effectiveness of Stanford's internal accounting controls.

5. Working with Auditors

No matter what department you call home, chances are that you will at some time be asked to participate in an audit. Following are some suggestions designed to help you understand what assistance is required and how to provide it quickly and easily, with the least intrusion into your normal work.

As a general rule, all external audits being conducted at Stanford are reviewed by and coordinated with Stanford's Internal Audit Department. The IAD review assures an understanding of the objectives and scope of the audit, and assists the auditors in achieving legitimate objectives with the least impact on University operations. Wherever possible, IAD will schedule an opening conference with the auditors and Stanford staff most likely to be involved in the audit, to facilitate full communication of audit objectives, schedule, and protocol.

FIRST QUESTIONS

When you are contacted by an auditor, you should first ask and obtain satisfactory answers to the following questions:

1. Which audit organization do you represent?
2. What type of audit is this?
3. Has this audit been properly coordinated through Stanford IAD?

If your department has identified an individual as an audit contact point, that person should be advised. It is also appropriate to advise your supervisor or manager if you are contacted by an auditor.

The earlier sections of this Guide provide information to help you assess the answers to questions 1 and 2. Auditors who are unable to provide a clear description of their affiliation and the purpose of their audit should be referred immediately to an audit liaison representative in Stanford's Internal Audit Department (listed below).

In addition, all auditors working at Stanford should also be able to assure you of prior review and coordination with Stanford's Internal Audit Department. If their answer to question #3 above is "no," or "I don't know," they should be referred immediately to the appropriate IAD audit liaison representative. No further departmental involvement is needed until that coordination takes place!

INTERNAL AUDIT DEPARTMENT CONTACTS

Stanford Audit Liaison Representatives

School of Engineering and SMC	Peggy Wiley (6-8196)
School of Medicine	Daisy Asinas (3-8070)
SLAC	Myra McGill (4-7024)
School of Humanities and Sciences	Mahshid Parsi (3-7202)

Information Technology	Ranjita Chakravarty (5-4428)
Institutional Compliance	Michelle Fortnam (5-8692)
Hospitals	Karen Corday (4-8857)
All other University units	Rick Moyer (6-1201)

AUDIT GROUND RULES

Assuming the auditor can provide adequate assurances that the audit has been properly coordinated, a protocol for providing information has been established. The fundamental principle is that Stanford has agreed to provide all available information pertinent to the scope of approved audits in a reasonable period of time. In return, Stanford requests observance of the following conventions:

1. All information that is thought to be contained in central sources will be sought from those sources before any efforts are made to obtain the data from departmental sources. This should prevent unnecessary intrusions on departmental staff. Stanford IAD provides assistance to all external auditors in tapping central data sources.
2. Copies of published or publicly available information may be provided to auditors upon request. No permanent record needs to be made of these transmissions.
3. If a government auditor requests information which will require more than just providing copies of generally available, existing documents, or which involves confidential or other sensitive information, you should request the auditor to prepare a written request (action item) describing the information needed and the time by which it is required. Stanford's Director of Internal Audit receives copies of all written action items prepared by government auditors. This ensures that:
 - (a) the desired information is clearly described so that time and effort will not be spent supplying the wrong information,
 - (b) there is clear understanding about when the information is needed, and
 - (c) Stanford can track when the requested information was provided; and
 - (d) requests for confidential information are identified and modified as necessary..
4. Stanford requires The Director of Internal Audit may request that copies of responses to written action items (or any previously unpublished or confidential or sensitive information) be retained in GCRS central location., along with a serially-numbered transmittal memo. Sometimes confidential information must be deleted prior to production. If deemed necessary, IAD will collect the responses, prepare the copies, and the memos and transmit the original responsesm to GCRS, or, if prior arrangements have been made with GCRS, the office supplying the information may do so.the requesting external auditors.

6. Typical Questions About Audits

What questions are appropriate?

Auditors are free to interview Stanford personnel and seek additional documentation in accordance with the protocol described above. IAD cannot prescreen all audit questions, nor does it wish to slant information provided to auditors. However, questions that go beyond the scope of an audit, e.g., that inquire into matters which appear unrelated to the auditor's purpose, or that appear inappropriate, should be questioned. You should feel free to request immediate assistance from IAD if you are asked what you believe to be inappropriate audit questions. If you feel legal advice is necessary, or if the auditors indicate the possibility of criminal liability or fraud, you should also contact the Office of the General Counsel.

What should I do if an auditor insists on my cooperation, and I do not believe the audit has been properly coordinated? Can I "just say no"?

If an auditor makes a request to which, for any reason, you do not feel comfortable responding, you may tell the auditor that you will look into the request. Then contact the Stanford IAD.

Some auditors ask questions which indicate a basic lack of knowledge about Stanford policies, and this seems to be leading toward erroneous conclusions. How should I respond?

You are expected to respond in a friendly and helpful way, but you are not expected to provide extensive remedial education. If you do not think that an auditor can proceed to do his or her job without an extensive orientation, contact the Stanford IAD and request assistance.

How quickly should I respond to audit questions?

Auditors should understand that responding to their questions is not the primary responsibility of most Stanford employees, and that any special efforts will take time. Technically, Stanford is only required to provide copies of existing documents to DCAA, but to be cooperative and to assist in expediting the process, Stanford often prepares new documents and explanations for auditors. If auditors are working under time constraints, they will make those constraints known when requesting information. Ideally, you and the auditor will agree on a reasonable time schedule. If such agreement cannot be reached, the Stanford IAD will assist.

What if I get overlapping requests from different auditors?

Different groups of auditors may be carrying out related audit procedures at the same time. Stanford IAD seeks to minimize overlapping audits by encouraging federal and independent auditors to rely upon each other's work and on the work of IAD. However, this is not always possible, and you may occasionally receive requests that appear uncoordinated and overlapping. In such cases, Stanford IAD may be able to improve coordination among the involved auditors. When contacting IAD with a concern about overlapping requests, it is important to notify the audit liaison representative of the specific types of auditors and audit engagements which appear redundant (better yet, give IAD the names of the involved auditors and the specific questions that appear overlapping).

I have received a request from my sponsor agency for Stanford's "A-133 report." What should I do with this request?

Stanford IAD handles all requests for information about OMB Circular A-133 audits. Forward this request to Michelle Fortnam at IAD, and she will ensure a timely response.

7. Questions You May Be Asked During an Audit

The tables on the following pages contain some of the questions typically asked during the different types of audits occurring at Stanford, along with an indication of the kinds of information which should be supplied in response. It is important to note that this is not an exhaustive list of all questions which might be asked or the kinds of information which might be requested.

CLAIMED COST AUDITS

	<u>Typical Auditor's Question</u>	<u>Information Needed</u>	<u>Where and How to Find It</u>
1	Have any unallowable or unallocable costs been included in sponsor billings?	Support for the allowability and allocability of specific expenses sampled from billed costs (usually from sponsored function 1 and 2 accounts)	Descriptions of the reasons the expenses were incurred (which should be included in the on-line transaction records); documentation that the PI has certified the expense as appropriate for charging to the sponsor (i.e., <u>certified</u> monthly expenditure statements) at the departmental level
2	Has all promised cost sharing been provided?	Match between proposed cost sharing and expenses captured in associated cost sharing accounts	On-line description of business purpose for all costs captured in cost sharing accounts; PI certification of monthly expenditure statements
3	Has Cost Accounting Standard (CAS) 502 been followed (i.e., consistent treatment of indirect and direct costs)?	Support that costs generally treated as indirect (e.g., administrative expenses) have not been direct-charged to award unless the project is "major" and the expenses were specifically budgeted and not disallowed by the sponsor	Properly documented and charged administrative costs either on-line or at departmental level
4	Have all expense transfers been processed in a timely manner and are costs allocable to account being charged?	Reasonable explanation of any late transfers and rationale for allocability to receiving account	Explicit documentation that PI has determined transferred expense to be an appropriate charge to receiving account; PI certified monthly expenditure statement at departmental level

INDIRECT COST (IDC) AUDITS

	<u>Typical Auditor's Question</u>	<u>Information Needed</u>	<u>Where and How to Find It</u>
1	Have unallowable or unallocable costs been included in any IDC pools in which the government participates?	Support for the allowability and allocability of specific costs sampled from claimed pool costs (usually from function 1, or functions 3-9 accounts)	Information about the business purpose of costs, which should be included in on-line transaction records
2	Have space-related IDCs been properly allocated?	Support to demonstrate that organized research usage of space is correctly coded	SUFED, records of annual space usage inventory and GCRS validation, documenting the actual usage of rooms and buildings
3	Has all cost-sharing been reflected in the University research base?	Support that all committed cost-sharing (mandatory and voluntary) including as well as project overruns, have been captured in cost-sharing accounts	Clear justification for all cost transfers from function 2 accounts to accounts in a cost sharing series (fund class 127 or function 2 departmental cost sharing)
4	Has any government-financed equipment been included in depreciation costs charged to the Government?	Documentation to show source of funding for claimed capital equipment depreciation	On-line and departmental procurement records showing correct use of capital equipment General Ledger (GL) codes

PREAWARD AUDITS

	<u>Typical Auditor's Question</u>	<u>Information Needed</u>	<u>Where and How to Find It</u>
1	Have the correct staff benefit and indirect cost (IDC) rates been applied?	Currently approved benefit and IDC rates	SPO, or on-line in the Research Policy Handbook
2	Are the salary rates for the proposed staff and students current and accurate?	Current salary rates for proposed staff and students	CHRIS
3	If salaries are proposed for unnamed staff or students, can the proposed rates be supported?	Analyses of current salary rates for job class	Salary ranges for job classifications from HR or actual salaries being paid to staff or students in same classification
4	Do non-salary direct costs appear justified and reasonable?	Support for all non-salary costs proposed, in the form of price lists, prior experience on similar projects or the judgment of the PI	Written documentation in the files of the person(s) preparing the proposal budget

COMPLIANCE AND GENERAL CONTROLS AUDITS

	<u>Typical Auditor's Question</u>	<u>Information Needed</u>	<u>Where and How to Find It</u>
1	Are all important internal controls exercised at the departmental level in place and operating as intended?	IAD Departmental Compliance Audit Program	Self-Check version of this audit program is available from the Stanford IAD Home Page, or contact IAD
2	Is Stanford's labor billing system properly controlled?	Evidence of timely review of labor charges incurred through Lab Time Card and PAF systems	Signed and dated copy of Lab Time Card System Run One report; properly approved on-line PAFs; PI certified Monthly Expenditure Statements at departmental Level
3	Are subcontractor expenses properly reviewed?	Evidence of review of allowability, allocability, reasonableness of subcontractor billings	Documentation of review of subcontractor billings; PI certified Monthly Expenditure Statements at departmental level
4	Are all expenses to State of California awards allowable per the terms of the award document (note that State awards sometimes have different award provisions)	Evidence of compliance with specific provisions of California awards (e.g., travel reimbursement limits may be lower than federal and Stanford limits; line item budget restrictions)	Specific mention in on-line transaction comments that California award provisions have been noted and observed

8. References to Selected Stanford Policies

SUBJECT

REFERENCE

Administrative Expenses

[Research Policy Handbook 3.6](#)

Allocations from Clearing Accounts

[Administrative Guide Memo 38.1](#)

Cost Sharing

[Research Policy Handbook 3.5](#)

Cost Transfers (error corrections)

[Administrative Guide Memo 38](#)

PI Certification of Monthly

[Research Policy Handbook 3.1](#)

Expenditure Statements

[Administrative Guide Memo 36](#)

Salary Caps

[Research Policy Handbook 3.8](#)

[Payroll Manual, Paying Faculty Checklist](#)

Travel

[Administrative Guide Memo 36.7](#)

Equipment purchases and

[Property Administration Manual](#)

management