



DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. 01101-2005T24010001



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SUBJECT: Report on Audit of Estimating System Internal Controls

REFERENCES: Chron No. 5-336

CONTRACTOR: Georgia Institute of Technology
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REPORT RELEASE RESTRICTIONS: See Page 6

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SUBJECT OF AUDIT

We have examined Georgia Institute of Technology/ Georgia Tech Research Corporation/ Georgia Tech Applied Research Corporation (GIT/GTRC/GTARC)'s estimating system as of September 6, 2005 to assure GIT/GTRC/GTARC's estimating system and related internal controls:

- comply with applicable laws and regulations,
- are effective over compliance with applicable laws and regulations, and
- are adequate and operating effectively.

GIT/GTRC/GTARC is responsible for establishing and maintaining an adequate estimating system. Our responsibility is to express an opinion on the adequacy of the estimating system based on our examination.

SCOPE OF AUDIT

We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we obtain a sufficient understanding of internal controls to plan financial audits and determine the nature, timing, and extent of tests to be performed. An examination of internal controls includes:

- identifying relevant system control objectives and associated control activities,
- obtaining an understanding of all applicable components of internal control for the identified control objectives and activities,
- determining if the internal controls are adequate and in operation, and
- assessing control risk to use as a basis for planning the nature, timing, and extent of substantive testing in other attestation audits.

We evaluated the estimating system using the applicable requirements contained in the:

- Federal Acquisition Regulations (FAR);
- Defense FAR Supplement (DFARS);
- Cost Accounting Standards for Educational Institutions;
- DoD Grant and Agreement Regulations (DoDGARS);
- OMB Circular No. A-21, Cost Principles for Educational Institutions; and
- OMB Circular No. A-110, Uniform Requirement for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations.

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Our examination specifically tested the estimating system's internal control procedures associated with the following control objectives:

- internal audits;
- system description;
- training;
- cost estimate development; and
- contract certification.

Test procedures were applied from August 3, 2005 to September 6, 2005.

We believe our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over the estimating system to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

RESULTS OF AUDIT

In our opinion, the estimating system and related internal control policies and procedures of GIT/GTRC/GTARC are adequate.

During the course of our examination, we noted other matters involving the estimating system and related internal controls which, although not considered to be significant deficiencies at this time, we believe should be communicated to the management of GIT. These matters are detailed in "Suggestions to Improve the System," Appendix 1, page 7 of this report. We also noted a matter which requires attention by the contracting officer prior to or during contract awards. See the Appendix 2, Other Matter to be Reported, on page 9.

As a result of control risk assessments, our audit effort will be decreased in the evaluation of contract and grant cost estimating for individual proposals.

We examined only the estimating system. Accordingly, we express no opinion on the contractor's system of internal controls taken as a whole.

We discussed the results of our examination with Mr. Duane Hutchinson, Director, Office of Sponsored Programs, in an exit conference held on September 26, 2005.

CONTRACTOR ORGANIZATION AND SYSTEM

1. Organization

Georgia Institute of Technology (GIT) is a state-owned and operated educational institution. GIT performs research and development, public service, and instruction services primarily through its units of Georgia Tech Research Institute (GTRI) and Resident Instruction (RI), using the facilities of GTRI and/or its academic departments. The other units of the institute are: Continuing Education (CE), Center for Assistive Technology & Environmental Access (CATEA), Economic Development Institute (EDI), and the Advanced Technology Development Center (ATDC). Since GIT, also known as the Institute, is an agency of the State of Georgia and is subject to various restrictions on contracting, Georgia Tech Research Corporation (GTRC) and Georgia Tech Applied Research Corporation (GTARC) were organized as separate corporations in order to assist the research program at GIT.

GTRC functions as the contracting agency of GIT's (units other than GTRI) sponsored activities. GTRC enters into contracts and grant agreements with industry, individuals and federal agencies, for services to be performed by employees and students of the Institute. GTRC further serves as a parent agency for obtaining patents on GIT's inventions and for licensing GIT's development and commercialization by industry. GTARC performs similar functions for GTRI's sponsored activities.

Total federal expenditures for the fiscal year ending June 30, 2004 were \$266 million, including research and development expenditures in the amount of \$240 million. Approximately 2,832 employees work directly on research projects.

2. Estimating System

GIT has two main divisions, Resident Instruction (RI) and Georgia Tech Research Institute (GTRI). Principal investigators at both RI and GTRI are responsible for developing the basis and rationale of estimating labor hours, material quantities, number/destination/duration of travel, and other required items for cost estimates in individual price proposals.

At RI, some of the larger academic departments have designated staff that assist principal investigators with preparing cost estimates using the rationale and basis provided by the principal investigators and the established rates of direct labor, fringe benefits, facilities and administrative expense, etc. In all other departments, the principal investigators prepare cost estimates and work with Contracting Officers in the Office of Sponsored Programs (OSP) to ensure that appropriate rates are used. These rates are developed by GIT's Grants and Contracts Accounting Office and are reviewed/approved as appropriate by campus administrators. Each department has access to the procurement agency's website. In some cases the agency proposal/grant forms are selected and completed from this site.

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During the last year, the Office of Sponsored Programs completed development of the “Budget Wizard” software tool designed to support the preparation of sponsored project budgets for proposals where the sponsoring agency does not have supporting systems. This tool, which is supported by an OSP training program, provides the capability needed to prepare project budgets including current Fringe Benefits rates, F&A rates, GSTRP rates and instructions about the types of expenses to be included in each major budget category.

At GTRI, the Management and Project Support (MAPS) department is responsible for preparing cost estimates using the rationale and basis provided by the principal investigators and the established rates of direct labor, compensated absences, fringe benefits, laboratory overhead, G&A, cost center charges, cost of money factors, etc. GTRI’s Rates Management Department develops these rates. MAPS is also responsible for preparing contract financial reports and monitoring variances between budgeted and actual cost. MAPS uses a standalone computer program to compute cost estimates. MAPS maintains a current budget-estimating template. The MAPS software has current rates and salaries, updated from a central location. User ID and passwords are required to access programs and files. The system includes self help features, pre-selected formats menu selections and operator prompting. The person that prepares the cost estimate controls Data Entry/Input/Output, and Computer Operations. System development, system maintenance, and system programming are control by the group unit manager.

Cost estimates prepared by the MAPS and academic department staff are reviewed by the principal investigators and approved by heads of departments and laboratories, Deans, and the director of GTRI.

The Office of Sponsored Programs (OSP) is responsible for submitting all proposal and grant applications for sponsored research and instruction from GIT. OSP’s Contracting Officers review proposals and cost estimates for compliance with sponsor requirements and Institute policies and prepare the business portion of proposals. Detailed estimating policies and procedures are described in GIT’s Office of Sponsored Programs Policies and Procedures Statement: 3.0 and Georgia Tech Research Institute’s Fiscal Services Procedure Number 2.8C, which are available on GIT’s Intranet Homepage.

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AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

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2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.
3. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

SUGGESTIONS TO IMPROVE THE SYSTEM**Internal Audit Should Perform Periodic Reviews Of System**

Discussions with the contractor and a review of the contractor's past, current and future internal audit plans determined that the contractor does not perform periodic management reviews of the Estimating System. The contractor indicated that they rely on DCAA's periodic reviews of the system in lieu of internal management reviews. As indicated in the Subject of Audit section of this report the contractor is responsible for establishing and maintaining an adequate estimating system. An inherent part of any financial system is periodic management reviews to determine that the system is functioning according to system design, management directives and Government regulations.

Section 9.1.5 of GIT's Business and Finance Manual states that "Operational, or performance audits conducted by the department generally relate to economy and efficiency of operation, whether resources are being used economically and efficiently, whether good management practices are being followed, and whether there has been compliance with applicable policies, laws, and regulations." This statement indicates that GIT internal auditors have authority to perform reviews of various contractor financial systems, including the estimating system.

The contractor should be conducting on-going, self-initiated reviews of various aspects of its estimating system in a timely and periodic manner. The lack of internal audits or a structured internal audit plan results in increased risk that GIT estimating functions do not comply with sound financial controls as well as Government regulations. The use of internal auditors to review the estimating system recognizes the contractor's commitment to self governance and its contractual responsibility for system and accounting controls.

We suggest that the internal audit organization plan and complete internal reviews of the estimating system and implement an internal audit plan of scheduled audits. Reliance on external reviews conducted by DCAA does not recognize managements' responsibility to design, implement and monitor sound financial systems. The results of internal reviews can be used by DCAA to properly plan the scope of planned system reviews. This could result in decreased audit effort by DCAA if internal reviews are properly planned and executed on a timely and periodic basis.

SUGGESTIONS TO IMPROVE THE SYSTEM

Proposal Submission Policies and Procedures

Georgia Institute of Technology, through the Office of Sponsored Projects (OSP), has established comprehensive estimating policies and procedures. Internal controls have been implemented throughout the estimating process. Georgia Technology Research Institute (GTRI) has a centralized department that reviews all proposals before submission to the requestor and management has established a requirement that GTRI estimators comply with OSP Policies and Procedures. In contrast, Resident Instruction (RI) is decentralized with individual departments responsible for proposal preparation. Also, there is no established requirement that RI estimators comply with OSP policies and procedures.

Our review did not note any significant RI noncompliances with OSP's estimating policies and procedures. However, to promote consistency and strengthen controls within the proposal preparation and submission process we suggest that a written requirement be established that requires RI comply with OSP estimating policies and procedures. Since OSP, GTRI and RI are all organizationally aligned under the Office of Vice Provost for Research this should not be a significant administrative or management issue.

OTHER MATTER TO BE REPORTED

Government and Contractor Monitoring Hours

During our review, we noted proposed hours were materially different from those incurred among differing job functions. Generally, more hours were proposed for higher paid labor categories than lower paid categories, but when the effort was performed, the opposite occurred. Principal Investigators or Principal Directors (PI/PD) propose hours based on prior history given the statement of work. However, we noted where the PI/PD estimated hours for higher paid employees which were materially higher than the incurred hours for the project. Conversely, the PI/PD estimated hours for lower paid employees which were materially less than the incurred hours. The contractor claims during the performance of the contract, the PI/PD may determine effort, originally estimated to be performed by a higher paid employee, can be performed by lower paid employees without sacrifice to the quality of the project.

Although our review did not disclose instances where the Government was significantly affected by this practice in terms of price, the above described practice could, from a price standpoint, harm the government if firm-fixed-price or time-and-material contracts with complex labor mixes are involved. Additionally, there should be increased monitoring in this area by Government technical personnel to ensure the Government receives the quality of services for which it contracts, as well as the price it pays for the services. Furthermore, the contractor should practice proper budgeting, planning, and management to accomplish realistic budgets to ensure Government funds are not prematurely exhausted which could jeopardize completion of any necessary Government grant or contract. The contractor's methodology of proposing hours could harm the government with unrealistic budgeted amounts. This could cause the government not to acquire other needed work effort for the budget year due to limitations in funds.