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United States Department of State  
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Office of Inspector General

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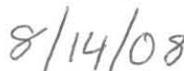
Independent Accountants' Report on the  
Application of Agreed-Upon Procedures on Indirect Cost Rates  
Proposed by  
Nacel Open Door, Inc.

Report Number AUD/CG-08-32, August 2008

L.F. Harris & Associates, P.A., Certified Public Accountants, performed the agreed-upon procedures under the Department of State, Office of Inspector General, Contract No. S-AQM-PD-04-D-0044, and by acceptance the report becomes a product of the Inspector General.



Mark W. Duda  
Assistant Inspector General  
Office of Audits



Date


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Summary

At the request of the Department of State (Department), Office of Inspector General (OIG), L.F. Harris & Associates, P.A., Certified Public Accountants, performed certain agreed-upon procedures to determine whether the indirect cost rates proposed by Nacel Open Door, Inc. (Nacel), for the years ended December 31, 2005, 2004, and 2003, complied with applicable regulations.

We found Nacel's accounting system to be inadequate for the purpose of accumulating and reporting indirect costs under the provisions of Office of Management and Budget (OMB) Circulars A-122, codified at 2 CFR Part 230, *Cost Principles for Non-Profit Organizations*, and A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*.

As a condition for receiving a grant, each grant agreement between Nacel and the Department requires that Nacel's accounting system meet the requirements of the two circulars noted, as well as of Circular A-133, *Compliance Supplement*. We found that the current Nacel accounting system did not meet the requirements of the circulars and that the Nacel accounting system has had ongoing problems for many years. A May 2004 OIG report<sup>1</sup> found Nacel's accounting system to be inadequate for the purpose of accumulating and reporting indirect costs under the provisions of the circulars. Consequently, at that time, the independent accountants were not able to express an opinion on the rates proposed by Nacel for grant years 1994 through 2001. Officials in the Department's Office of Logistics Management, Office of Acquisitions Management, International Programs Division (A/LM/AQM/IP), said that they had not approved provisional or final indirect cost rates for Nacel for the period 1998 through 2007.

Based on the results of our current review, we were unable to recompute Nacel's indirect cost rates in accordance with OMB Circular A-122. Therefore, we were unable to confirm Nacel's proposed indirect costs rates for the years ended December 31, 2005, 2004, and 2003. Nacel did not provide sufficient documentation to support its proposed indirect cost rates for the 3 years reviewed. Additionally, OMB Circular A-122 requires that expenses incurred under federal grants be adequately documented, be reasonable for the performance of the grant, and be allocable. Expenditures incurred during 2003, 2004, and 2005 were sampled. The results of the tests of disbursements found unsupported costs totaling \$94,524 for the 3 years.

We recommend that the Bureau of Educational and Cultural Affairs (ECA) require Nacel to fully comply with the OMB circulars within 60 days of the date of this report and provide ECA with verification of its compliance by an independent public accountant. Until Nacel is in full compliance with the OMB circulars, we recommend that ECA withhold funding for future grants and any payments under existing grants. Also, we recommend that ECA require Nacel to establish appropriate policies and procedures to ensure that costs under the grants are adequately documented and accounted for in accordance with the applicable OMB circulars and provide information so that ECA can make an appropriate determination on the unsupported costs of \$94,524.

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<sup>1</sup> *Application of Agreed-Upon Procedures on Indirect Cost Rates Proposed by Nacel Open Door, Inc.* (AUD/CG-04-30, May 2004).

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**Background**

Nacel is a not-for-profit organization that promotes and implements international educational exchange programs. Nacel manages programs that send American students to foreign countries, and it coordinates the hosting of foreign students coming to the United States. Nacel is funded largely by selling its services to participating affiliates or governments within the exchange programs and by grants from the Department.

In 2005, 2004, and 2003, the Department awarded grants that subject Nacel to the requirements of OMB Circulars A-110, A-122, and A-133 as follows:

| <u>Grant Number</u>   | <u>Period of Grant</u>  | <u>Grant Amount</u> |
|---|-------------------------|---------------------|
| <b>Future Leaders Exchange</b>                              |                         |                     |
| S-ECAPY-02-GR-107   | 05/13/2002 - 08/31/2003 | \$751,756           |
| S-ECAPY-03-GR-106   | 04/25/2003 - 08/31/2004 | 782,139             |
| S-ECAPY-04-GR-100   | 04/25/2004 - 08/31/2005 | 561,974             |
| S-ECAPY-05-GR-090   | 05/25/2005 - 08/31/2006 | 535,600             |
| <b>Congress Bundestag Youth Exchange Program</b>            |                         |                     |
| S-ECAPY-02-GR-170   | 09/26/2002 – 08/31/2003 | 73,200              |
| S-ECAPY-03-GR-047   | 01/03/2003 – 08/31/2004 | 74,723              |
| S-ECAPY-04-GR-073   | 03/12/2004 – 07/31/2005 | 84,680              |
| S-ECAPY-04-GR-073   | 03/10/2005 – 08/31/2006 | 89,655              |
| <b>Partnerships for Learning Youth Exchange &amp; Study</b> |                         |                     |
| S-ECAPY-04-GR-045   | 01/15/2004 – 12/31/2005 | 934,181             |
| S-ECAPY-05-GR-045   | 04/01/2005 – 08/31/2006 | 220,000             |
|   |                         | <u>\$4,107,908</u>  |

**Purpose, Scope, and Methodology**

Our primary purpose of this agreed-upon procedures engagement was to determine whether Nacel’s indirect cost structure for 2005, 2004, and 2003 complied with applicable regulations. In agreement with OIG, we performed the procedures identified below.

We performed this engagement in accordance with attestation standards established by the American Institute of Certified Accountants and guidance from OMB. The procedures performed are summarized as follows:

- Determined whether charges to cost pools used in calculating indirect cost rates were mathematically accurate and supported by the grantee’s accounting records and audited financial statements.
- Assessed the allowability and allocability of indirect costs by testing selected transactions to supporting documentation and by inquiring about the nature and functions of activities included in the indirect cost pool.

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- Assessed the causal and beneficial relationship between indirect costs and cost activities.
- Analyzed the allowability and allocability of accounts that make up Nacel's fringe benefit pool.
- Reviewed Nacel's general ledger to determine whether the ledger had income and credits and, if so, whether they were credited to the indirect cost or fringe benefit pools as appropriate.
- Inquired about applicable fiscal year operations and assessed the impact of changes on the indirect cost rate structure.

Our approach to addressing the procedures is as follows:

- We obtained an understanding of internal control over the subject matter of this engagement through inquiry and observation and by performing an assessment of risk and testing internal controls.
- For direct costs, we determined whether Nacel complied with the provisions of OMB Circular A-122 by:
  - a. testing direct charges to federal awards for allowability and
  - b. verifying that unallowable costs determined to be direct costs were included in the allocation base for the purpose of computing an indirect cost rate.
- We tested indirect costs to determine whether:
  - c. the base used to distribute the approved allowable indirect cost was appropriate and reasonable and in accordance with the requirements of OMB Circular A-122;
  - d. the calculated indirect cost rate is
    - i. consistent with policies and procedures that apply uniformly to both federally funded and other activities of Nacel and
    - ii. applied consistently to the proper allocation bases; and
  - e. Nacel complied with the provisions of OMB Circular A-122 in that
    - i. charges to indirect cost pools were for allowable costs,
    - ii. the base used to distribute indirect costs included both allowable and unallowable costs, and
    - iii. the cost allocation methodology provides equitable and consistent allocation of indirect costs to benefiting awards or activities.

The scope of detail testing of individual accounts, internal controls, direct costs, indirect costs, regulation compliance, and other applicable records is a matter of judgment. Auditors cannot assume responsibility for fraud detection or prevention. Auditors are expected to maintain an alertness that will permit adequate inspection of the financial records, as well as of the internal controls, internal accounting, and administrative controls. As such, the auditors were

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alert to the possibility of intentional wrongdoing, errors and omissions, inefficiency, waste, ineffectiveness, and conflicts of interest.

### Results

#### Accounting System

As a condition for receiving a grant, each grant agreement between Nacel and the Department requires that Nacel's accounting system meet the requirements of OMB Circulars A-122, A-110, and A-133. We found that the current Nacel accounting system did not meet the requirements of the circulars. The Nacel accounting system was not adequate to properly identify and segregate direct and indirect costs, as well as allowable and unallowable costs, under the provisions of OMB Circular A-122 for the years ended December 31, 2005, 2004, and 2003. In that regard, we selected a sample of disbursements made during the 3 years reviewed to test the propriety of the classification as shown in the general ledger and the disbursements' allocability and allowability under Circular A-122. As discussed in Table 1, Nacel did not provide sufficient documentation to support its proposed indirect cost rates for 2005, 2004, and 2003.

Nacel's accounting system has had ongoing problems for many years. In a May 2004 OIG report, the independent accountants found Nacel's accounting system to be inadequate for the purpose of accumulating and reporting indirect costs under the provisions of the circulars. The report stated:

*Nacel representatives were generally unable, except in a few limited instances, to reconcile the amounts presented as general and administrative costs for its government grants to its books and records or its financial statements. Further, we were unable to validate the amounts presented as student days.*

As a result, the independent accountants were not able to express an opinion on the rates proposed by Nacel for grant years 1994 through 2001.

Information from A/LM/AQM/IP indicates that no actions were taken by Nacel to address the findings contained in OIG's May 2004 report. Specifically, in February 2008, an official from A/LM/AQM/IP said that the office had not approved provisional or final indirect cost rates for Nacel during the period 1998 through 2007.

We concluded that Nacel's accounting system was not in compliance with applicable OMB circulars for the years ended December 31, 2005, 2004, and 2003. Furthermore, based on prior OIG work and information from the Department, Nacel's accounting system problems may extend to prior years. We believe that the Department needs to direct Nacel to bring its accounting system into conformance with the applicable OMB circulars. Furthermore, the Department should withhold any funding for future grants and payments under ongoing grants until Nacel has provided independent documentation that its accounting system conforms to OMB requirements.

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**Recommendation 1:** We recommend that the Department’s Bureau of Educational and Cultural Affairs require Nacel Open Door, Inc., to bring its accounting system into full compliance with the applicable OMB circulars within 60 days of the date of this report and that it provide ECA with verification of its compliance by an independent public accountant.

**Recommendation 2:** We recommend that the Department’s Bureau of Educational and Cultural Affairs withhold funding for future grants and payments under existing grants until Nacel Open Door, Inc., is in full compliance with applicable OMB circulars.

**Indirect Cost Rates**

OMB Circular A-122 requires that expenses incurred under federal grants be adequately documented, be reasonable for the performance of the grant, and be allocable. We sampled Nacel’s expenditures for 2005, 2004, and 2003, and the results of our tests of disbursements are shown in Table 1.

**Table 1. Results of Tests of Documentation Supporting Expenditures**

| <b>For the Year Ended December 31:</b>                                  | <b>2005</b> | <b>2004</b> | <b>2003</b> |
|---|-------------|-------------|-------------|
| Number of Items Selected for Testing                                    | 49          | 49          | 42          |
| Number of Selected Items With Insufficient Documentation Provided       | 24          | 20          | 17          |
| Percentage of Selections With Insufficient Documentation Provided       | 49%         | 40.80%      | 40.50%      |
| Dollar Value of Selections  | (b) (4)     | (b) (4)     | (b) (4)     |
| Dollar Value of Items Selected With Insufficient Documentation Provided | (b) (4)     | (b) (4)     | (b) (4)     |

**Timesheets.** Nacel does not require its employees to complete timesheets as required by OMB Circular A-122. Accordingly, we were unable to identify the distribution of salaries and wages and were therefore unable to test the allocation of direct and indirect salaries and wages. Consequently, because of the impact that questioning the entire payroll expense has on computing Nacel’s indirect cost rates, we were unable to compute Nacel’s indirect cost rates for 2005, 2004, and 2003.

**Segregation of Direct and Indirect Costs.** Nacel’s accounting system was not adequate to properly identify and segregate direct and indirect costs, as well as allowable and unallowable costs, under the provisions of OMB Circular A-122 for 2005, 2004, and 2003.

**Allocability and Allowability of Disbursements.** We sampled disbursements made during 2005, 2004, and 2003 to test the propriety of the classification of the selected disbursements in the general ledger and the disbursements’ allocability and allowability under OMB Circular A-122. Nacel did not provide adequate documentation to support the allocability and allowability of disbursements made during the periods under review.

Based on our review, Nacel did not provide sufficient documentation to support its proposed indirect cost rates for 2005, 2004, and 2003. Therefore, we were unable to confirm

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Nacel's proposed indirect cost rates for the 3 years. We concluded that Nacel needs to establish a policy, in conformance with OMB Circular A-122, requiring supporting documentation for expenses sufficient to determine the business purpose of the expenses and to determine whether the expenses are appropriately accounted for and authorized under provisions of the grant agreements. In addition, Nacel needs to provide information so that ECA can make an appropriate determination on the unsupported costs of \$94,524: \$43,411 for 2005, \$19,497 for 2004, and \$31,616 for 2003.

**Recommendation 3:** We recommend that the Department's Bureau of Educational and Cultural Affairs require Nacel Open Door, Inc., to (a) establish appropriate policies and procedures to ensure that costs under the grants are adequately documented and accounted for in accordance with the applicable Office of Management and Budget circulars and (b) provide information so that ECA can make an appropriate determination on the unsupported costs of \$94,524.

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L.F. Harris & Associates, CPA, P.A.  
Certified Public Accountants

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INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON  
PROCEDURES

U.S. Department of State  
Office of Inspector General  
Office of Audits  
1700 North Moore Street  
Arlington, VA 22209

We have performed certain agreed-upon procedures (Procedures), as summarized in the Purpose, Scope and Methodology section of this report. The Procedures, which were agreed to by the Office of Inspector General, U.S. Department of State, were performed solely to assist the Office of Inspector General, U.S. Department of State in evaluating Nacel Open Door, Inc.'s (Nacel) computations of their indirect cost rates in accordance with OMB Circular A-122, for the years ended December 31, 2005, 2004, and 2003.

Nacel's management is responsible for compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and guidance from the Office of Management and Budget. The sufficiency of these Procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the Procedures as described in the Purpose, Scope and Methodology section of this report, either for the purpose for which this report has been requested or for any other purpose. Our test Procedures revealed two findings. The findings and the associated recommendations are presented in the "Results" section of this report.

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on the total costs claimed. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the Office of Inspector General U.S. Department of State, and should not be used by those who have not agreed to the Procedures, and taken responsibility for the sufficiency of the Procedures for their purposes.

A handwritten signature in cursive script that reads "L.F. Harris &amp; Associates".

L.F. Harris & Associates, CPA, P.A.  
July 21, 2007