



AUDIT AND ADVISORY SERVICES

Service (Recharge) Centers

Audit

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April 15, 2015

John Wilton
Vice Chancellor
Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Service (Recharge) Centers as per our annual service plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Our observations with management action plans are expounded upon in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the staff of Campus Shared Services, the College of Chemistry, the College of Engineering, the Division of Biological Sciences, and the Office of the Vice Chancellor for Research for their cooperative efforts throughout the audit process. Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Chief Audit Executive

cc: Executive Vice Chancellor and Provost Claude Steele
Vice Chancellor Graham Fleming
Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae
Dean Douglas Clark
Dean Steven Martin
Dean Shankar Sastry
Director Susan Marqusee
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University of California, Berkeley
Audit and Advisory Services
Service (Recharge) Centers

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OVERVIEW

Executive Summary

Audit and Advisory Services (A&AS) completed our audit of Service (Recharge) Centers as part of our annual service plan for FY 2015. The objective of our audit was to assess the adequacy of selected internal controls related to the oversight and management of campus recharge center activities. Our audit included an assessment of individual facility, school/college, and central campus procedures and controls. Procedures were designed to assess how well risks associated with recharge activities are managed across the campus as a whole, not to provide an opinion regarding the adequacy of procedures and controls of any one individual recharge unit.

Units and departments that participated in our audit included: Campus Shared Services (CSS), the College of Chemistry (Chemistry Shops), the College of Engineering (Nanofabrication Laboratory), the Division of Biological Sciences (Molecular and Cell Biology Stockroom), and the QB3 Genomic Sequencing Laboratory and the Office of Laboratory Animal Care under the Vice Chancellor for Research.

As defined by University policy, service (recharge) centers are “departments which provide a specific type of service to various institutional departments...and which have operating costs supported by recharges to the departments receiving the services.” As of December 2014, there were approximately 90 recharge centers operating across campus, with approximately \$120 million in recharge income recorded in fiscal year 2014. Campus recharge centers include both technical facilities that provide research-related services (e.g., genomic sequencing) and administrative departments that provide services to other departments (e.g., mail services).

Based on our work performed, procedures and tools appear to be in place to help ensure that individual recharge units are aware of and generally comply with relevant policies and regulations. However, the campus policy is outdated and we noted that current policy and central campus oversight procedures do not provide adequate assurance that campus priorities and process risks are addressed. Specifically, we noted the following observations:

- Central campus oversight processes and structures are no longer functioning as established by the campus recharge policy. Recharge activities are currently overseen by CSS, which typically provides transactional services to the campus and does not appear positioned to ensure the alignment of recharge processes with campus strategies.
- There is a significant administrative and compliance burden associated with recharge rate development and recharge billing. Related to this, we noted an opportunity to evaluate and potentially further clarify policy and criteria for when it is appropriate to recover costs on a recharge basis.
- Current procedures and tools related to rate review could be strengthened to better ensure consistent policy interpretation and compliance by units and to facilitate risk-based central monitoring.

Management agrees with our observations, and has provided action plans. Plans include the transition of oversight and coordination responsibility for the recharge activity to the Campus Budget Office, and the re-assessment and potential revision of recharge policies and processes.

Source and Purpose of the Audit

A&AS completed our audit of Service (Recharge) Centers as part of our annual service plan for FY 2015. The objective of our audit was to assess the adequacy of selected internal controls related to the oversight and management of campus recharge center activities.

Procedures were designed to assess how well risks associated with recharge activities are managed across the campus as a whole, not to provide an opinion regarding the adequacy of procedures and controls of any one individual recharge unit.

Scope of the Audit

The focus of our audit was on the financial and compliance-related aspects of recharge unit management, including rate development, subsidies, and maintenance; periodic billing; and deficit/surplus resolution.

Our audit included an assessment of individual facility, school/college, and central campus procedures and controls. Units and departments that participated in our audit included: CSS, the College of Chemistry (Chemistry Shops), the College of Engineering (Nanofabrication Laboratory), the Division of Biological Sciences (Molecular and Cell Biology Stockroom), and the QB3 Genomic Sequencing Laboratory and the Office of Laboratory Animal Care under the Vice Chancellor for Research.

Our audit procedures included interviews with staff in these units and review of documentation, including management reports and annual recharge rate certifications/proposals and supporting data.

Our audit did not include an assessment of recharge unit external contracts, except to confirm that external users were not charged a lower rate than internal and/or federal users. Pricing of external contracts was evaluated in a separate audit performed in fiscal year 2012 (“Third-Party Relationships -- Revenue Agreements”).

Background Information

Definitions and Relevant Policies

As defined by University policy, service (recharge) centers are “departments which provide a specific type of service to various institutional departments...and which have operating costs supported by recharges to the departments receiving the services.” Policies related to rate setting and billing are based on federal guidance, with additional requirements delineated in University of California (UC) Office of the President and campus policies.

The primary sources of federal guidance are the Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (Uniform Guidance)¹ and the National Institutes of Health (NIH) Notice NOT-OD-13-053 (“FAQs for Costing of NIH-Funded Core Facilities”), both establishing the primary requirements that (i) “the costs of such services must be charged directly to applicable awards

¹ The OMB Uniform Guidance became effective December 26, 2014, replacing OMB Circular A-21.

based on actual usage of the services” and (ii) that rates must be set based on “an established methodology that does not discriminate between activities under Federal awards and other activities of the non-Federal entity” and that is “designed to recover only the aggregate costs of the services”. Further it is established that costs included in the rate must be allowable under OMB cost principles and that “rates must be adjusted at least biennially, and must take into consideration over/under applied costs of the previous period(s)”. The UC Office of the President’s Contracts and Grants Manual formally adopts these federal requirements and further incorporates University Business and Finance Bulletins (BFB) A-47 “University Direct Costing Procedures”, A-56 “Academic Support Unit Costing and Billing Guidelines”, and A-59 “Costing and Working Capital for Auxiliary and Service Enterprises” which establish specific requirements and procedures for recharge costing and billing in addition to the more broadly stated federal parameters. Campus policy, “Campus Recharge Definitions, Background, and Policy”, issued in 2009 incorporates these other policies and further establishes campus-specific processes and accountabilities.

Campus Recharge Activities

As of December 2014, there were approximately 90 recharge centers operating across campus, with approximately \$120 million in recharge income recorded in fiscal year 2014. Campus recharge centers include both technical facilities that provide research-related services (e.g., genomic sequencing) and administrative departments that provide services to other departments (e.g., mail services). Annually, all recharge centers with income greater than \$50,000 are required to submit a rate certification and proposal for central campus review and approval.

Departments are responsible for the overall operation of their recharge centers, with oversight provided by the control unit. Responsibility for ensuring compliance with University recharge policies and procedures resides with both individual departments and central campus (per campus policy, under the Office of the Vice Chancellor–Administration and Finance). Central campus processes are currently coordinated by a designated campus recharge manager who resides in CSS. In addition to performing rate reviews, the recharge manager also provides training and guidance on recharge policies, and coordinates with the Campus Budget Office and the Controller’s Office on recharge-related issues, as needed.

Summary Conclusion

Based on our work performed, it appears that the individual recharge units in our sample were aware of and had procedures in place to support general compliance with relevant policies and regulations. We also noted that the campus provides tools and consultation to assist units in their rate development, and that central campus and department review and monitoring is performed to help identify potential concerns.

However, the campus policy is outdated and we noted that current policy and central campus oversight procedures do not provide adequate assurance that campus priorities and process risks are addressed. Specifically, we noted the following observations:

- Central campus oversight processes and structures are no longer functioning as established by campus recharge policy. Specifically, the establishment of new recharge units and annual recharge rate proposals are not being approved according to the process

and accountabilities outlined in the campus recharge policy. Recharge activities are currently overseen by CSS, which typically provides transactional services to the campus and does not appear positioned to ensure the alignment of recharge processes with campus strategies or to manage the potential campus-wide impacts of recharge activities from a financial, operational, and compliance perspective.

- There is a significant administrative and compliance burden associated with recharge rate development and recharge billing. Related to this, we noted an opportunity to evaluate and potentially further clarify policy and criteria for when it is appropriate to recover costs on a recharge basis.
- Current procedures and tools related to rate review could be strengthened to better ensure the consistency of policy interpretation and compliance by units and to facilitate risk-based central monitoring. We noted opportunities to enhance the tracking of recharge activity in the general ledger, as well as rate/process areas where guidance and monitoring could be potentially strengthened.

Management agrees with our observations, and has provided action plans. Plans include the transition of oversight and coordination responsibility for the recharge activity to the Campus Budget Office, and the re-assessment and potential revision of recharge policies and processes.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Policy and Governance

Observation

The campus recharge policy was last updated in early 2009 and does not reflect changes in campus organization, systems, and processes affecting recharge activities that have occurred since then. The policy should be updated given these changes, as well as potential changes in campus financial priorities/strategies and in the external regulatory environment, including the new Office of Management and Budget (OMB) Uniform Guidance. We noted the following areas in particular that management should consider:

- Central campus oversight processes and structures are no longer functioning as established by policy. Specifically, the establishment of new recharge units and annual recharge rate proposals are not being approved according to the process and accountabilities outlined in the campus recharge policy. We acknowledge that there is engagement of department and control unit leadership, as well as CSS, in overseeing recharge unit rates and operations. However, there are certain considerations related to recharge activities that are important for central senior campus management to maintain oversight of because of their campus-wide impact from a financial, operational, and regulatory perspective and/or because of their potential impact on other centrally coordinated activities and decisions. These considerations cross functional lines and include budgetary (use of subsidies, handling of surpluses/deficits) and accounting and billing (OMB and sponsor/award compliance) concerns. To the extent possible, organizing central campus recharge oversight to effectively align with these existing accountabilities and processes is recommended. Further, CSS typically provides transactional services to the campus. Therefore, the recent repositioning of recharge unit management to CSS may need to be reconsidered to ensure the efficient and effective coordination and oversight of policies and processes given the interdependency of recharge activities with other campus activities.
- We noted an opportunity to evaluate and potentially further clarify policy and related criteria for when it is appropriate to recover costs on a recharge basis. There is a significant administrative and compliance burden associated with recharge rate development and recharge billing. Because there are alternative mechanisms that exist for the allocation of costs across internal campus units, it may be appropriate to evaluate these alternatives, particularly for units that are not primarily associated with research and/or are not charged to federal contract and grant funds.

Management Response and Action Plan

Management will transition oversight and coordination responsibility for recharge activities to the Campus Budget Office. As part of this, criteria for recharge unit establishment and processes related to managing the recharge activity will be evaluated, and updated as necessary, given

current campus priorities and external requirements. The campus policy will be revised accordingly. Management expects that these action plans will be completed by March 31, 2016.

Activity Coordination and Support

Observation

The campus offers a number of resources to units to provide support, review, and consultation related to recharge policy and process considerations. However, we noted an opportunity to further develop procedures and tools to better ensure consistent policy interpretation and adherence by units and to facilitate central monitoring.

Recharge rate development is a complex undertaking that requires advanced cost accounting skills and knowledge of various policy and regulatory requirements. We noted various inconsistencies and gaps in unit rate proposals and billing practices. None of these individual findings appear to have significant financial impact at either the campus or unit level, but do serve as examples of areas where additional guidance or review provided by central campus may be warranted. Currently, rate proposals are submitted by all units at the same time, impacting the nature, extent, and timeliness of the central review that can be reasonably performed. Management may also wish to consider clustering rate development support as an alternative to the current decentralized model whereby each individual unit develops rates and performs billing. Specific issues noted include:

- inconsistencies and lack of clarity in the documentation, accounting for, and reporting of unit subsidies, impacting management monitoring of subsidies and results, and potentially understating (or overstating) costs used for purposes of rate development;
- assumptions and costs used in rate proposals that do not have adequate supporting documentation or that are not consistent with campus systems of record (e.g., BETS);
- inconsistencies and inadequate documentation related to decisions regarding the accounting treatment for costs related to equipment and inventory (e.g., capitalization versus depreciation, inventory costing method);
- for one unit, potentially unallowable costs in the recharge fund; and
- lack of unit-level documented procedures related to rate development and billing activities. Recharge rate-related processes and systems are unique to each recharge unit and are generally complex; documented procedures are an important tool to facilitate knowledge transfer and training.

Management Response and Action Plan

Management will evaluate and, as necessary, update review and monitoring procedures. Examples of potential enhancements may include formalizing rate review protocols and templates and developing specific risk-based review criteria. Management will also assess the need to clarify or expand policy guidance/implementing procedures for units. Management expects that these action plans will be completed by March 31, 2016.