



# AUDIT AND ADVISORY SERVICES

Composite Benefit Rates

Audit

Project No. 14-635

December 15, 2014

Prepared by:

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Dorothy Lipari  
Auditor-in-Charge

Reviewed by:

Approved by:

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Jaime Jue  
Associate Director

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Wanda Lynn Riley  
Chief Audit Executive



AUDIT AND ADVISORY SERVICES  
Tel: (510) 642-8292

611 UNIVERSITY HALL #1170  
BERKELEY, CALIFORNIA 94720-1170

December 15, 2014

John Wilton  
Vice Chancellor  
Administration and Finance

Vice Chancellor Wilton:

We have completed our audit of Composite Benefit Rates 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 the Office of the Chief Financial Officer 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: Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae  
Executive Director Paula Milano  
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca  
Associate Chancellor Linda Morris Williams  
Assistant Vice Chancellor and Controller Delphine Regalia

**University of California, Berkeley**  
**Audit and Advisory Services**  
**Composite Benefit Rate Audit**

**Table of Contents**

OVERVIEW .....	2
Executive Summary .....	2
Source and Purpose of the Audit .....	4
Scope of the Audit .....	4
Background Information .....	4
Summary Conclusion.....	5
SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN .....	7
Structure of Administrative Support and Control Activities .....	7
Adequacy of Process Documentation .....	8
General Ledger Adjustments .....	9

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## OVERVIEW

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### Executive Summary

The purpose of the audit was to assess management's current process and related internal controls associated with the preparation, review, approval, recording, monitoring, reconciliation, and reporting of composite benefit rates for internal and external stakeholders. Our assessment covered the implementation of composite benefit rates (CBRs) for the 2012-2013 fiscal year (FY 2013), the first year of implementation for the campus. Actual costs for those fringe benefits included in the composite benefit rate calculations were approximately \$290 million.

As of the close of our fieldwork in June 2014, the campus had nearly two years' experience with the implementation of CBRs. In addition, discussions regarding the first year of implementation were still being conducted with the campus's cognizant agency for federal awards. We observe that the design of internal controls associated with the preparation, review, approval, recording, monitoring, reconciliation, and reporting of CBRs and actual fringe benefit costs are currently not sufficiently mature to ensure accuracy and consistency from year to year. As part of our audit testwork, we replicated management's overall approach to implementation of CBRs for FY 2013 using transactions recorded in the campus general ledger. Overall, our replication calculations were generally consistent with management's and any differences, which we deem not material, are likely attributed to: (1) relatively small manual adjustments made by individual campus units with a small net collective effect that are not reflective of the campus process or (2) to differences in the timing of our data extracts.

We believe management's process and control activities should be strengthened in the following areas:

- *Structure of Administrative Support and Control Activities.* The functions associated with CBRs currently reside with one individual. Those tasks include preparation, review, submission, and negotiation of CBR proposals; preparation, review and submission of actual benefit costs and average rate calculations to our cognizant agency; preparation, review, and reporting of any variances; and coordination of potential reimbursement discussions (where applicable). This consolidation of functions and responsibilities without adequate back up or management review places the campus in a position of increased risk of business disruption, errors, or omissions.
- *Adequacy of Process Documentation.* There is currently insufficient documentation to evidence appropriate levels of control regarding the preparation, review, and approval of CBR rates. In the absence of documented processes with embedded internal control points, the reliability, consistency, and accuracy of the annual process related to the preparation, review, approval, recording, monitoring, reconciliation, and reporting of composite benefit rates for internal and external stakeholders is at risk. In the absence of such process documentation, only a single contributor, currently without supporting institutional staff or material assistance, has thorough and detailed knowledge of the CBR calculation methodology, the CBR process, and the full institutional history of CBR rate development and implementation for the campus. Should this individual vacate her position (1) there is likely no one who understands composite benefit rates to the extent

required to produce new calculations and to recreate past calculations as may be required by internal and external stakeholders and (2) key correspondence and agreements with our cognizant agency regarding CBR development and implementation may not be preserved properly as business records in the event they are needed.

- *General Ledger Adjustments.* The new CBR model was designed to eliminate the need for individual units to make adjustments to actual benefit expense accounts; rather adjustments should be made to CBR assessment accounts since they are being assessed at the composite rate. The campus practice of allowing broad access to general ledger accounts by individual units raises the risk that erroneous or inappropriate transactions are recorded in the actual benefit accounts. We believe the risk of error or potential manipulation is non-trivial, particularly since we understand that these benefit expense accounts are not reviewed on a routine basis (only the liability accounts associated with them are reconciled) and any errors likely would be undetected.

## **Source and Purpose of the Audit**

The purpose of the audit was to assess management's current process and related internal controls associated with the preparation, review, approval, recording, monitoring, reconciliation, and reporting of CBRs for internal and external stakeholders.

## **Scope of the Audit**

Our assessment covered the campus's implementation of CBRs for FY 2013, the first year of implementation for the campus. Our audit procedures included interviews and walkthroughs with appropriate composite benefits personnel and others. Our scope included review of available information relating to the CBR proposal and submission of actual FY 2013 results to the campus's cognizant agency. To evaluate the implementation, we extracted and analyzed general ledger detail related to the FY 2013 assessments of CBRs to campus units as well as actual benefit costs recorded in the campus Payroll/Personnel System (PPS) and general ledger (via the Berkeley Financial System). We compared our analysis to information prepared and submitted by the Office of the Chief Financial Officer (CFO) to the campus's cognizant agency for federal contract and grants. Our fieldwork was principally conducted between April and June 2014.

## **Background Information**

Responsibility for administering CBRs currently resides with the Office of the CFO, and specifically with the Executive Director, Space and Capital Resources.

CBRs are standard benefit rates developed by the campus for each fiscal year and are used for business transactions containing a fringe benefit component. The campus was approved to use CBRs in federal contracts and grants proposals and billings effective FY 2013. CBRs are applied to employee salaries, by employee category, to arrive at fringe benefit costs. The rates are used for internal reporting purposes to charge (and budget) campus divisions and units for their share of fringe benefit costs. Not all fringe benefits are included in the CBR rate calculations, notably vacation and sick leave are excluded.

Management represents that the primary objective for implementing CBRs was to increase the predictability and decrease the variability of one of the largest areas of costs for the campus. Additional objectives included aligning hiring incentives and reducing unnecessary work.

CBRs, whether provisional for the first year of implementation or estimated in subsequent years, that are billed to the campus's federal contract and grant awards are approved by the Department of Health and Human Services (DHHS). The National Institutes of Health (NIH) reviews the rate calculations on behalf of DHHS. Proposed rates are estimated by the Office of the CFO and reported to DHHS. The campus begins using the approved rates at the beginning of the appropriate fiscal year. At the end of the fiscal year, the Office of the CFO calculates the actual average fringe benefit rates based on actual employee group mix, salaries, benefit usage, etc., compares actual average fringe benefit rates by employee category to the approved rates, and reports these actual results to DHHS. Any differences between fringe benefit assessments using CBRs and actual benefit costs incurred are carried as cost variances forward into the CBR calculations for the next available fiscal year. Since the campus implemented CBRs for the first time in FY 2013, as of the end of our fieldwork, the campus had not yet completed discussions with DHHS regarding cost variances. In the meantime, the campus's FY 2014 rate was

approved prior to the beginning of the fiscal year. Discussions with DHHS regarding the campus FY 2014 experience with CBRs will take place in spring and summer of 2015.

For the initial year of CBR implementation (FY 2013), the rates approved by DHHS were provisional, meaning that any variation between actual benefit costs by employee category and benefit amounts charged and billed to federal contract and grants are financially settled and differences are not carried forward into the calculation of future rates. In those employee categories where actual rates were higher than the approved rates (i.e., the campus's actual average rate for fringe benefits for a particular employee category was greater than the composite rate used), no amounts are due to federal sponsors. In those instances where the actual average rate for fringe benefits was lower than the composite rate used, the campus negotiates with DHHS as to whether a reimbursement is due and how much it should be. In the latter case, the potential reimbursement is only due on the difference between the rates as applied and fringe benefits billed to the federal sponsor.

The CBR cycle covers an 18-month period; 12 months of usage and 6 months to report on actual fringe benefit costs and average rates, compare the actual rates with the approved rates, and report the results of the analysis to the NIH. For the first year only, the campus requested, and was granted, a reporting extension.

### **Summary Conclusion**

We conclude that the design of internal controls associated with the preparation, review, approval, recording, monitoring, reconciliation, and reporting of CBRs and actual fringe benefit costs are currently not sufficiently mature to ensure accuracy and consistency from year to year. As part of our audit testwork, we replicated management's overall approach to implementing CBRs for FY 2013 using transactions recorded in the campus general ledger. Overall, our replication calculations were generally consistent with management's and any differences, which we deem not material, are likely attributed to (1) relatively small manual adjustments made by individual campus units with a small net collective effect that are not reflective of the campus process or (2) to differences in the timing of our data extracts.

We believe management's process and control activities should be strengthened in the following areas:

- *Structure of Administrative Support.* The functions associated with CBRs currently reside with one individual. Those tasks include preparation, review, submission, and negotiation of CBR proposals; preparation, review and submission of actual benefit costs and average rate calculations to our cognizant agency; preparation, review, and reporting of any variances; and coordination of potential reimbursement discussions (where applicable). This consolidation of functions and responsibilities without adequate back up places the campus in a position of increased risk of business disruption, errors, or omissions.
- *Adequacy of Process Documentation.* There is currently insufficient documentation to evidence appropriate levels of control regarding the preparation, review, and approval of CBR rates. In the absence of documented processes with embedded internal control points, the reliability, consistency, and accuracy of the annual process related to the

preparation, review, approval, recording, monitoring, reconciliation, and reporting of CBRs for internal and external stakeholders is at risk. In the absence of such process documentation, only a single contributor, currently without supporting institutional staff or material assistance, has thorough and detailed knowledge of the CBR calculation methodology, the CBR process, and the full institutional history of CBR rate development and implementation for the campus. Should this individual vacate her position (1) there is likely no one who understands composite benefit rates to the extent required to produce new calculations and to recreate past calculations as may be required by internal and external stakeholders and (2) key correspondence and agreements with our cognizant agency regarding CBR development and implementation may not be preserved properly as business records in the event they are needed.

- *General Ledger Adjustments.* The new CBR model was designed to eliminate the need for individual units to make adjustments to actual benefit expense accounts; rather adjustments should be made to CBR assessment accounts since units are being assessed at the composite rate. The campus practice of allowing broad access to general ledger accounts by individual units raises the risk that erroneous or inappropriate transactions are recorded in these accounts. We believe the risk of error or potential manipulation is non-trivial, particularly since we understand that these benefit expense accounts are not reviewed on a routine basis (only the liability accounts associated with them are reconciled) and any errors likely would be undetected.

These observations are discussed more fully in the Summary of Observations section below.



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## SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

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### Structure of Administrative Support and Control Activities

#### Observation

Many key functions associated the campus's implementation of CBRs reside with one individual in the CFO's office. This individual is currently responsible for the preparation, review, submission, and negotiation of CBR proposals; preparation, review and submission of actual benefit costs and average rate calculations to our cognizant agency; preparation, review, and reporting of any variances; and coordination of potential reimbursement discussions (where applicable). She is also responsible for communicating CBR information to a wide variety of campus personnel, including those working with sponsored agreements or CBR assessments. She represents the campus to external parties and maintains working relations with those associated with CBRs, including DHHS, NIH, the University of California Office of the President, external and internal auditors, etc. Finally, she coordinates and directs third-party consultants and vendors, as necessary.

This individual performs these functions as a single contributor, without supporting institutional staff or material assistance. She is the only person who has thorough and detailed knowledge of the CBR calculation methodology, process, discussions and agreements with our cognizant agency, and complete history of composite benefits at the campus. In addition, she alone maintains the full supporting documentation for all calculations, submissions, and correspondence. Should this individual vacate her position, there is likely no one who understands CBRs to the extent required to produce new calculations and recreate past calculations as may be required by internal and external stakeholders. The recreation of past calculations is needed to address and support potential future external regulatory audits or inquiries. We requested, but were not provided, examples of relevant supporting documentation, such as correspondence and agreements related to discussions with our cognizant agency regarding negotiations and approvals for the use of CBRs by the campus.

During the initial CBR implementation, an analyst and a small implementation team supported this individual; however, these resources have not existed for some time due to staff turnover and discontinuation of the use of external consultants.

Occasionally, a new function may become concentrated to an individual as the process is developed and during the initialization period. Once the initialization has been completed, knowledge of the function is normally transferred (backed up) so that more than one person is familiar with the function and sufficient internal control, including appropriate segregation of duties, is provided.

Composite benefits is an important function that affects many campus operations. The consolidation of key CBR functions into one position, without backup, places the campus in a position of increased risk of business disruptions, errors, or omissions.

## **Management Response and Action Plan**

The production of CBRs at UC Berkeley has been a team effort. While a single person has been on point for the entire project, consultation with key members of the campus community including IT, the Controller's Office, UC Office of the President, the federal government and outside consultants. However, change in organizational structure and responsibility with the Office of the CFO recently have made the redundancy of positions challenging. With the arrival of a new CFO, a process to plan for organizational transition is underway. It is expected that by February 2015 a plan to create a more robust position control will be completed and implementation begun.

## **Adequacy of Process Documentation**

### **Observation**

As part of our audit, we requested key documents associated with the process of preparation, review, approval, and subsequent monitoring and analysis of the campus's first-year implementation of CBRs. Our primary requests included the following:

- Initial CBR proposed rate document (FY 2013) and agency approval; the Year 2 (FY 2014) proposed rate document and agency approval; and the methodology and supporting work papers for each document, including supporting calculations.
- Documents provided to the DHHS and the NIH that contains information regarding the actual fringe benefit costs incurred and average actual benefit rates as a percentage of compensation by employee class and the comparison of those rates with the initial proposed and approved rates as well as the methodology and supporting work papers for the document.
- Adjustments made as a result of the agency review of the submissions.
- Correspondence with the DHHS and the NIH regarding adjustments required by them or questions raised by them.
- Correspondence with UC Office of the President.

As detailed in the prior observation, the process of preparation, review, approval, and subsequent monitoring and analysis of CBRs is currently concentrated in a sole contributor. While this individual participated in general discussions of the above items with us and contended that the information requested existed, with the exception of the initial CBR proposal, she did not provide sufficient information for us to adequately assess or reperform her work.

As part of our audit testwork, we replicated management's overall approach to implementing CBRs for FY 2013 using transactions recorded in the campus general ledger. We understand that the campus had several complex adjustments to actual benefit and compensation totals that we could not fully replicate based upon the information we were provided as of the close of our fieldwork in June 2014. Overall, our replication calculations were generally consistent with management's and any differences, which we deemed immaterial, are likely attributed to (1) manual adjustments made by individual campus units with a small net collective effect that are not reflective of the campus process (see discussion in the following observation) or (2) to differences in the timing of our data extracts.

However we observe there is not sufficient documentation to evidence appropriate levels of control regarding the preparation, independent review, and approval of these rates. In the absence of documented processes with embedded internal control points, the reliability, consistency, and accuracy of the annual process related to the preparation, review, approval, recording, monitoring, reconciliation, and reporting of CBRs for internal and external stakeholders is at risk of business disruption, errors, or omissions.

### **Management Response and Action Plan**

Production of CBRs require multiple data sets from multiple systems of thousands of data points and requiring modelling several scenarios. Inputs from the vast numbers of stakeholders and reviewers also create a large quantity of documentation. We agree that more rigorous management of CBR documentation could assist with responding more quickly and easily to inquiries. Within the transition plan mentioned above, a framework for data management will also be developed.

## **General Ledger Adjustments**

### **Observation**

We observed that the bulk of actual benefit costs are recorded in conjunction with payroll compensation transactions recorded in PPS that are subsequently recorded in the campus general ledger. Based on discussions with the Controller's Office, we also observed other financial journal entries related to benefit costs and compensation being made directly into the general ledger by the central payroll and general accounting groups.

Although having a collectively small net total dollar amount, we noted a non-trivial number of journal entries to actual benefits and compensation expense accounts. These entries did not come from PPS, but were made directly by units into the general ledger.

We understand that the new CBR model was designed to eliminate the need for individual units to make any adjustments to actual benefit expense accounts; rather adjustments should be made to CBR assessment accounts since they are being assessed at the composite rate.

Given the scope of our audit and the small net total dollar amount of unit adjustments, we did not conduct further work into these journal entries. It is possible that they relate to correcting entries that may be appropriate. However, we observe that the campus practice of allowing broad access to general ledger accounts by individual units raises the risk that erroneous or inappropriate transactions are recorded in these actual benefits accounts. We believe the risk of error or potential manipulation is non-trivial, particularly since we understand that these benefit expense accounts are not reviewed on a routine basis (only the liability accounts associated with them are reconciled) and any errors likely would remain undetected.

### **Management Response and Action Plan**

The observation provided for general ledger adjustments is not unique to CBRs and will be addressed in the budget process audit response.