

**UNIVERSITY OF CALIFORNIA, DAVIS  
AUDIT & MANAGEMENT ADVISORY SERVICES**

**Office of Research  
Indirect Cost Recoveries  
Audit & Management Advisory Services Project #15-02**

**May 2015**

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**MANAGEMENT SUMMARY**

**Background**

University of California Office of the President (UCOP) Contracts & Grants (C&G) manual establishes the principle of full cost recovery for work or services performed for non-University entities. However, the policy requires approved exception (waiver) from UCOP's Office of Research and Graduate Studies (ORGS) for rates below the University of California Davis (UCD) negotiated indirect cost rates as identified in the Colleges and Universities Rate Agreement. Exception requests are considered according to one of two criteria: 1) Sponsor Policy or 2) Campus Vital Interest. Each exception request may be either for an individual award or a class of awards (applicable only for Sponsor Policy rationale).

Sponsors may restrict reimbursement of indirect cost recoveries (ICR) to less than the full rate due to statute, codified agency regulations, or program terms published in a sponsor's solicitation or announcement. If a sponsor's policy restricting indirect cost recovery is imposed individually by program managers, an individual exception may be approved. A class exception due to sponsor policy may be requested for non-profit sponsors, including domestic governmental agencies, international organizations, and foreign charitable foundations. Additionally, when the development of campus research, training, or public service programs or infrastructure may be best served by accepting a sponsored award at less than the indirect cost rate normally paid by the sponsor, a campus vital interest waiver may be allowed for individual awards only. These exceptions must be approved by the Vice Chancellor for Research, who has been delegated the authority by the Chancellor.

At UC Davis, there are five functional units that process extramural agreements or awards which include activities involving indirect cost recoveries: Sponsored Programs, Health System Contracts, Graduate Studies, University Extension and Extramural Accounting. Sponsored Programs is the sole unit at UCD responsible for reviewing ICR waiver documentation for appropriateness prior to submission to UCOP for approval according to UC Davis policy 230-03.

During FY14 (July 1, 2013 thru June 30, 2014) there were 5,774 active<sup>1</sup> awards with 2,274 awards that had indirect cost waivers<sup>2</sup> for part or all of the award. Of the awards with indirect cost waivers, 2,093 awards were due to sponsor policy limitations while 182<sup>3</sup> were due to vital interest. In addition, 1,684 had class waivers while only 590 had individual awards.

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<sup>1</sup> Active awards are defined as all awards that were outstanding, started, and ended during FY14.

<sup>2</sup> For award with ICR waivers, Audit and Management Advisory Services (AMAS) has not verified if the indirect cost rate within KFS agrees to the approved UCOP rate. AMAS has also relied upon the information within KFS's ICR waiver number field to determine if an award has an ICR waiver. Therefore, any situations where an ICR waiver number may have been placed but the indirect cost rate agrees to F&A rates would not be identified.

<sup>3</sup> One award had indirect cost waivers due to both sponsor policy and vital interest since the waivers were for different award accounts/award supplements.

## **Purpose and Scope**

The objective of our review was to assess the UC Davis policies, procedures, and processes related to the approval, application and monitoring of indirect cost rate waivers.

Our review included an assessment of the current process for obtaining indirect cost waivers, interviews with personnel from the Office of Research, Extramural Accounting, Budget and Institutional Analysis (BIA), and limited testing of extramurally funded contracts, grants, and awards. The scope of our review covered all extramurally funded contracts, grants, and awards that were active during/part of FY14. In addition, extramurally funded projects associated with the Agriculture and Natural Resources were excluded.

## **Conclusion**

Based on the audit performed, Sponsored Programs has adequate controls to ensure appropriate ICR waiver documentation and UCOP approval has been obtained for extramural awards originating from their office. There is also a strong communication between Sponsored Programs and Accounting and Financial Services regarding extramural awards, indirect cost rates, and ICR waivers. As UCD transitions onto a new research administration system, controls to ensure data integrity will be strengthened and will allow the sharing and integration of award data with associated financial information.

In evaluating the impact of ICR waivers on the UCD campus at large, the audit did identify shortfalls in the current ICR waiver approval process and lack of reporting information related to ICR waivers as this hinders UCD management's ability to provide timely input on decisions impacting the campus financial resources. For FY14 active awards with indirect cost waivers, approximately 52% of awards with ICR waivers have indirect cost rates between 0% and 5% (*Refer to Appendix A for additional information*). The loss of ICR associated with ICR waivers has a greater impact to the overall UCD campus compared to the respective Schools/Colleges or Office of Research since the Provost withholds ICR funds to provide research infrastructure, capital, and other initiatives such as faculty start-ups and graduate student support. In FY14 the Provost withheld approximately 63% of FY13 ICR generated net of categorical set-asides<sup>4</sup> by UCD (*Refer to I. ICR Distribution Methodology and Appendix B.2 for additional information*).

Our observations and recommendations are presented in the body of this report along with corresponding management corrective actions.

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<sup>4</sup> Categorical set-asides are ARRA funding, Garamendi-financed buildings, and specialized F&A rates.

## I. ICR DISTRIBUTION METHODOLOGY

Beginning in 2011-12, UCOP through the UC Funding Streams Initiative changed its methodology for allocating funds generated by indirect cost recoveries. All funds generated by a campus are now retained by/returned to that campus and in exchange, UCOP charges an assessment of 1.6% on the total net expenditures of each campus from two years prior (e.g., FY09-10 expenditures will drive the FY11-12 assessment). The proceeds from the assessment support UCOP operations and other system-wide programs.

In addition, as part of the incentive-based budget approach, the campus allocation of ICR funds are distributed to the applicable deans (for organized research units, funds are allocated to the Vice Chancellor for Research) based on the unit responsible for generating the funds<sup>5</sup> instead of directly allocating to the departments. The purpose of this policy change was to enable deans to manage a broader spectrum of resources for their unit and transparently manage and allocate the funds to each department. The new process takes the net ICR generated by each unit (after categorical set-asides) and distributes a fixed percentage back to the unit. In FY13, approximately \$123.6 million in ICR was generated with Federal contracts and grants providing approximately 70% of the ICR (*Refer to Appendix B.1*). Approximately 37% of net ICR generated by the unit (after categorical set-asides) was distributed (*Refer to Appendix B.2*) back to the unit in FY14. The remaining amount was allocated to the Provost to provide research infrastructure, capital, and other initiatives such as faculty start-ups and graduate student support<sup>6</sup>.

## II. UPCOMING CHANGES

As a result of the Indirect Cost Waiver Policies and Practices Workgroup (ICWPPW) recommendations report issued on July 2, 2012, UCOP is currently evaluating the decision to delegate the authority to approve exceptions to indirect cost rates to each campus Chancellor, with the opportunity to re-delegate the authority to the appropriate level at each campus. Currently, there are two campuses (UC Irvine and Los Angeles) that are participating in a pilot program, where the campus Chancellors have been delegated the authority to approve exceptions as of March 2014 to indirect cost rates related to all active sponsor categories except for federal sponsors.<sup>7</sup> Furthermore, the program has allowed campuses to provide feedback to UCOP regarding the implementation of technical changes to the Research Enterprise Management System (REMS), which is an application used system-wide to track indirect cost exceptions, UCOP approval for exceptions, maintain sponsor codes, and publish sponsor guidance.

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<sup>5</sup> Responsible unit is defined as the administrative home of the award. An award can be divided into smaller portions and have more than one administrative home.

<sup>6</sup> In FY12-13, one time funding was provided to the School of Medicine (SOM) and the School of Veterinary Medicine (SVM) since the implementation of the UC Funding Streams Initiative will make these two units responsible for significantly higher assessments.

<sup>7</sup> Under federal guidelines, campuses cannot volunteer to reduce indirect cost recovery unless there is a sponsor policy. To ensure compliance, UCOP at this point in time believes it should retain such approvals.

Furthermore, in July 2014 UC Davis Office of Research began their transition toward a comprehensive and campus-wide software solution for research administration called Sponsored Programs Administration and Research Kiosk (SPARK). SPARK will be the system of record for maintaining proposals, awards and research compliance data. The new system will allow UC Davis to submit and view proposal and award data in real time and will fully integrate with Quali Financial System (KFS) to facilitate the exchange of data related to Contracts and Grants Accounting records.

### III. **OBSERVATIONS**

#### A. **Review and Approval of Waivers**

**There should be greater transparency over the impact of indirect cost waivers.**

As part of the new incentive-based budget approach, the ICR associated with an award has a significant impact on the UCD campus since approximately 63% of net ICR generated in FY13 was withheld for campus-wide purposes by the Provost in FY14 (*Refer to I. ICR Distribution Methodology*). The initial decision to apply for awards with a lower ICR due to sponsor policy limitations resides with the principal investigator, and is reviewed by the department chair. Awards requesting ICR waivers due to sponsor policy limitations are also reviewed by the UC Davis Office of Research and approved by UCOP ORGS. The focus of the Office of Research review is generally upon the adequacy of the documentation supporting the waiver request rather than evaluation of whether the loss of ICR associated with the award is reasonable and/or acceptable for the campus. There is no periodic reporting of active indirect cost waivers, estimated ICR loss, exception type, and type of sponsor (federal, state, local or private agreement) at the local level, though UCOP does prepare an annual report which provides limited information. As a result of the current process, UCD management is unable to assess or project the financial impact of indirect cost waivers.

#### **Recommendation**

1. The approval process for indirect cost waivers should take into consideration the overall impact of the waiver decision on UCD's financial position and research enterprise. The principles and guidelines for approval of indirect cost waivers at the local level should be developed by the Vice Chancellor-Chief Financial Officer (VC-CFO) along with the Vice Chancellor for Research, with discussion and input from the appropriate stakeholders such as the deans and the Academic Senate.
2. Contracts and Grants Accounting should provide periodic reporting on indirect cost waiver activity to ensure adequate and timely information is available for oversight, along with short and long term strategic decision making for the campus.

**Management Corrective Actions**

- a. The VC-CFO will be the final campus approval authority for a new campus policy or process to be developed in consultation with the Academic Senate and Vice Chancellor for Research that provides principles and guidelines to guide approval of ICR waivers. The campus policy or process should reflect a new system-wide policy that is anticipated to be released that will identify the circumstances and types of “automatic” versus “voluntary vital interest” waivers. A draft policy will be circulated for review and approval within six months after the new OP policy is released.
- b. The VC-CFO will lead a post-implementation review of the indirect cost budget model that incorporates principles and metrics related to local decisions to accept awards from sponsors with reduced indirect cost rates. The review will be ready for evaluation by the Provost by January 15, 2016. Consultation with the Academic Senate will occur by July 15, 2016.
- c. Contracts and Grants Accounting will work with the VC-CFO to determine what information regarding indirect cost waivers can be provided to make adequate and timely decisions regarding campus financial resources by January 15, 2016. The first report(s) will be produced by March 31, 2016.

**Appendix A- Statistical Data on Awards with Indirect Cost Waivers**

*Appendix A.1- ICR Rates for Awards with Indirect Cost Waivers*

<b>ICR Rates</b>	<b>Number of Awards<sup>8</sup></b>
0% - 5%	1202
5% - 10%	231
10% - 15%	345
15% - 20%	261
20% - 25%	50
25% - 30%	153
30% - 35%	28
35% - 40%	9
40% - 45%	25
45% - 50%	12
50% - 55%	4
55% - 60%	2
<b>Grand Total</b>	<b>2322</b>

*Appendix A.2- Sub-Fund Group Type for Awards with Indirect Cost Waivers*

<b>Sub-Fund Group Type</b>	<b>Number of Awards</b>
Private Contracts & Grants (w/FFT)	1337
Federal Contracts & Grants <sup>9</sup>	578
State Contracts & Grants (w/FFT)	314
Local Contracts & Grants (w/FFT)	45
<b>Grand Total</b>	<b>2274</b>

**Appendix B- FY13-14 ICR Data**

*Appendix B.1- ICR Generated by Source*

<b>Source</b>	<b>ICR Generated</b>	<b>% of Total</b>
Federal Contracts & Grants	\$86,318,350	70%
Private Contracts & Grants (w/FFT)	\$22,797,667	18%
State Contracts & Grants (w/FFT)	\$13,719,688	11%
Local Contracts & Grants (w/FFT)	\$731,588	1%

*Appendix B.2- ICR Distributed per Unit*

<sup>8</sup> 48 awards have more than one ICR Rate and therefore are listed twice.

<sup>9</sup> The following Federal Agencies have the largest number of contracts/grants at UC Davis: US Dept. of Agriculture (296 awards), National Science Foundation (87 awards), National Institute of Health (60 awards), and Dept. of Interior (58 awards)

Unit	ICR generated <sup>10</sup>	Set-aside Total	ICR generated net of set-asides	ICR due to unit <sup>11</sup>
CA&ES	\$16,295,005	(\$84,391)	\$16,210,614	\$5,998,000
CBS	\$14,377,926	(\$3,097,813)	\$11,280,113	\$4,174,000
COE	\$12,501,546	(\$3,914,850)	\$8,586,697	\$3,177,000
HArCS	\$877,217	\$0	\$877,217	\$325,000
MPS	\$8,389,171	(\$262,776)	\$8,126,395	\$3,007,000
DSS	\$2,992,702	(\$77,788)	\$2,914,914	\$1,079,000
SOE	\$944,733	(\$2,276)	\$942,458	\$349,000
GSM	\$90,387	\$0	\$90,387	\$33,000
LAW	\$5,081	\$0	\$5,081	\$2,000
SOM	\$41,877,743	(\$12,464,040)	\$29,413,703	\$10,883,000
SON	\$157,675	\$0	\$157,675	\$58,000
SVM	\$11,274,400	(\$2,732,212)	\$8,542,189	\$3,161,000
RESH (ORUs)	\$13,244,353	(\$2,382,167)	\$10,862,186	\$4,019,000
GRAD	\$13,640	\$0	\$13,640	\$5,000
VFRM	\$18,547	\$0	\$18,547	\$7,000
VPFS	\$70,636	\$0	\$70,636	\$26,000
PROV	\$10,559	\$0	\$10,559	\$4,000
VCSA	\$414,340	\$0	\$414,340	\$153,000
CHAN	\$5,401	\$0	\$5,401	\$2,000
GENL	\$6,287	(\$1,065)	\$5,222	\$2,000
Grand Total	\$123,567,350	(\$25,019,377)	\$98,547,973	\$36,462,000

<sup>10</sup> Based on the administrative home of the award

<sup>11</sup> For FY13-14, approximately 37% was distributed to units per information from Budget and Institutional Analysis