August 26, 2014

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Subject: ***Service Agreements, Phase I***
Audit & Management Advisory Services Project 2014-02

The final audit report for Service Agreements, Phase I, Audit Report 2014-02, is attached. We would like to thank all members of the department for their cooperation and assistance during the audit.

Because we were able to reach agreement regarding corrective actions to be taken in response to the audit recommendations, a formal response to the report is not requested. The findings included in this report will be added to our follow-up system. While management corrective actions have been included in the audit report, we may determine that additional audit procedures to validate the actions agreed to or implemented are warranted. We will contact you to schedule a review of the corrective actions, and will advise you when the findings are closed.

UC wide policy requires that all draft audit reports, both printed (copied on tan paper for ease of identification) and electronic, be destroyed after the final report is issued. Because draft reports can contain sensitive information, please either return these documents to AMAS personnel or destroy them at the conclusion of the audit. We also request that draft reports not be photocopied or otherwise redistributed.

David Meier
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Attachment

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AUDIT & MANAGEMENT ADVISORY SERVICES

Service Agreements, Phase I
August 2014

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Project Number: 2014-02

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I. Background

Audit & Management Advisory Services (AMAS) has completed a review of Service Agreements as part of the approved audit plan for fiscal year 2013-14. This report summarizes the results of our review.

A Service Agreement is a written legal agreement between the University and an external entity containing terms and conditions under which goods and/or services are provided by the University. Service Agreements may be issued for approved recharge activities for ongoing or continuous sales of goods and/or services at rates approved by the UCSD Recharge Rate Review Committee, or for services provided for non-recharge activities. A Service Agreement must be signed by persons having University of California San Diego (UCSD) contracting authority.

Four areas of campus have the authority to execute certain incoming Service Agreements; University Extension (Extension), Scripps Institution of Oceanography (SIO), School of Medicine (SOM), and the Subawards Team within the Office of Contracts and Grants (OCGA). To initiate a new Service Agreement, a proposal must be submitted and approved at the proper department levels prior to the start of a new rate or activity and should include a business plan and the funding sources for anticipated or unanticipated operating deficits. Central offices with authority for review of Service Agreements review information submitted by departments, and authorize the activity through signing a contract to provide the services. The use of a Service Agreement checklist aids in the classification of services, establishment of the proper accounting information and facilitates an appropriate departmental approval sequence. A Service Agreement template facilitates an efficient process for implementing services and standardizes the contract requirements eliminating the need to negotiate routine agreements.

University of California (UC) Business and Financial Bulletin (BFB) A-59, *Costing and Working Capital for Auxiliary and Service Enterprises*, requires that recharge and other self-supporting activities charge the full cost of conducting business when selling to external non-University customers. These activities are supported by campus administrative offices and are generally conducted in campus funded and maintained space, so they do not pay directly for their own facility costs such as debt service, building maintenance, and utilities. As a result, the policy requires an appropriate level of campus overhead be included with the total price charged to external customers. This is accomplished by adding a differential income overhead rate to the direct cost of the service provided, with some portion remitted back to the campus and contracting department.

Differential income rates for Academic Support and Service Enterprise Activities are:

Full Differential Income Distribution

Activity location	Central Administration		Departmental Support		Full Differential Income Rate
On campus	16%	+	29%	=	45%
Off campus	8%	+	14%	=	22%
Ship Use	6%	+	12%	=	18%

A Vice Chancellor responsible for the service activity may choose not to retain a distribution for departmental support. In these cases, the activity is still required to remit the minimum distribution for central administration. These minimum rates are reflected below.

Minimum Income Distribution

Activity location	Central Administration		Departmental Support		Full Differential Income Rate
On campus	16%	+	0%	=	16%
Off campus	8%	+	0%	=	8%
Ship Use	6%	+	0%	=	6%

In some cases, an activity may have an approved exemption from remitting the differential income, because they pay for their own facility costs and many of their own administrative needs. These activities are assessed an administrative overhead recovery recharge of 4.1% for recovery of costs for central administrative support, instead of the differential income overhead assessment. Administrative overhead recovery recharge exemption requests must be submitted to the Financial Analysis Office for review and recommendation, with final approval by the Vice Chancellor of Resource Management and Planning.

Historically, the campus has experienced issues surrounding the application of appropriate overhead rates to recover campus administrative costs associated with the service activity. In May 2010, the Auxiliary and Self-Supporting Activities (ASSA) Task Group[1] provided a list of recommendations for addressing the issue of appropriate overhead cost recovery. One of the recommendations was to standardize and automate the overhead recovery process. Until that automation could be implemented, the recommendation was to calculate each activity's overhead and monitor the remittance transactions, using a batch process. Departments are responsible for establishing the appropriate accounting structure and for recording the proper entries in the financial ledger. In addition, departments are responsible for remitting differential income as part of their fiscal year end closing activities, and the Campus Budget Office (CBO) is responsible for monitoring and ensuring that the differential income is remitted properly.

In 2011, a Service Agreement Oversight Committee was convened to ensure that Service Agreement activity was properly administered across the General campus, at SIO and in

[1] The ASSA Task Group was appointed in November of 2009 at the request of the Chancellor to review the process for administrative overhead cost recovery.

the Health Sciences. The committee charge was to pursue delegations of authority related to Service Agreement contracting; provide policy interpretation and guidance for processing service agreements; and serve as a resource to resolve issues related to Service Agreement classification and responsibility.

II. Audit Objective, Scope, and Procedures

The objective of our review was to evaluate campus practices for executing Service Agreements with external parties and assess the overhead cost recovery process. In order to achieve our objective, we performed the following:

- Reviewed UC BFB A-59 and Blink Guidance pertaining to Service Agreements and income-producing activities;
- Reviewed relevant campus-wide reports addressing or referencing Service Agreement issues, such as the ASSA Task Group (May 2010), and the Service Agreement Oversight Group (2011);
- Reviewed documentation for Delegations of Authority for Execution of Agreements;
- Reviewed the fiscal closing instructions for Self-Supporting Activities;
- Reviewed the Administrative Computing and Telecommunications (ACT) Project Proposal Charters for Differential Income (2010) and Administrative Overhead (2013) Automation;
- Interviewed the OCGA and SIO staff responsible for Service Agreement administration;
- Evaluated the current processes for negotiating and executing Service Agreements in OCGA and SIO;
- Interviewed the CBO Senior Budget Analyst regarding the monitoring and collection of differential income for contracted services;
- Interviewed the Accountant Supervisor for General Accounting regarding the accounting processes for Self Supporting activities; and
- Tested a sample of service agreements from SIO and OCGA for compliance with delegation of authority, classification criteria, and differential income remittance[2].

The School of Medicine and Extension processes will be evaluated in detail during later phases of this review.

III. Conclusion

Based on our review, we concluded that the process for executing Service Agreement contracts provided reasonable assurance that Service Agreements were appropriately classified, and that Service Agreements for non-recharge activities received an appropriate level of review. It also appeared that processes for remitting the differential income to central campus units was generally effective, although manual and labor intensive. Automation of the administrative overhead recovery is currently planned for

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[2] Our evaluation of service agreements was limited to documentation initially submitted as part of the requisition and did not assess whether activities were consistent with final contract terms and conditions.

September 2014, and will be used for the Fiscal Year End Closing process of 2014-2015. Future plans for the automated recovery of differential income will be reviewed after the administrative overhead recovery implementation.

We did note that internal controls related to establishing the appropriate accounting structure and delegations of authority for signing Service Agreements could be strengthened to ensure compliance with University policy and ensure that agreements are appropriately executed, and the campus receives the appropriate overhead revenue to support operating expenses.

IV. Observations and Management Corrective Actions

A. Differential Income Remittance

A secondary review for Service Agreement requests was not in place to ensure the activity was established in an appropriate fund prior to approval.

A Service Enterprise activity will have a specific fund number assigned in the appropriate Chart of Accounts[3]. Accounting for activity in the proper fund range assists in ensuring that indirect costs are properly charged and allows for central monitoring and collection of that income. Departments are responsible for accounting for the activity in an appropriate fund, collection of revenue from outside sources, and transfer of differential income as part of the fiscal year end closing process. Using the correct fund range allows the CBO to monitor for differential income remittance and to ensure that the proper amount is transferred. The fund ranges are assigned by General Accounting.

Initially, the departments would submit the checklist to the Service Agreement Officer, who would forward the checklist to General Accounting for review. General Accounting was assigned to review the Service Agreement Checklist and ensure that the proper accounting information, such as Index and Fund, was documented and constructed in IFIS prior to the Service Agreement being signed. This was to ensure that the activity was established in a fund range that was captured in the CBO's oversight processes.

During detailed testing we noted that two agreements processed by OCGA did not contain proper accounting information on the Service Agreement Checklist. The fund number was not included and the indexes used could not be validated within the Integrated Financial Information System (IFIS). AMAS validated the proper index and fund information for the two agreements with the departments, and confirmed that the agreements were set up within the proper fund range to ensure differential income remittance. However, during interviews, we noted that the process to review Service Agreement requests for proper accounting information

[3] The elements of the Chart of Accounts (COA) are the basis for the recording, organization, and reporting of financial information in IFIS.

had been modified. Instead of requiring General Accounting approval before the Service Agreement being signed, the agreements were signed, and information submitted to General Accounting. However, General Accounting was not validating the activity was recorded in an appropriate fund.

This control weakness could possibly allow departments to bypass the overhead remittance to central campus. If the correct fund is not used to track revenue, the CBO's report will not identify the service activity and subsequent income because the report is based on revenues recorded in the fund numbers that are assessed differential income.

Management Corrective Action:

General Accounting, OCGA, and SIO, in consultation with the CBO, will collaborate to develop a monitoring process to validate the accounting information for Service Agreement requests to ensure the proper fund information is used.

B. Delegation of Authority

Service Agreement contracts were executed without proper University contracting authority.

A delegation of authority specifies the scope of authority being delegated to an individual in the organization. The delegation for contracting authority is granted by the Chancellor through an official letter and is written to the title of the position to which the authority has been delegated. The authority is reassigned automatically when someone leaves the position. Letters may contain individual names, but authority always remains with the position title. A UCSD delegation of authority letter generally includes a reference to any applicable Presidential letter and any specific terms, restrictions, or requirements.

Historically, the responsibility for reviewing and approving Campus Service Agreements was located in Procurement and Contracts, under the Business Contracts unit. The initial authority for the execution of Service Agreements was granted to the Assistant Director of Business Contracts, Procurement and Contracts in January 2009 and to the Interim Director, Procurement and Contracts in May 2010. In May 2014 the service agreement function was transferred to the Sub-award team from Procurement and Contracts to OCGA. Delegations of authority had not been updated to reflect this organizational change.

In addition, Business Contracts employed a Service Agreement Officer (SAO) position reporting to the Assistant Director of Business Contracts with responsibility for reviewing and signing Service Agreements. This position was held by a Temporary Services employee. During detailed testing, we reviewed six service agreements and noted that all six were executed by the SAO.

However, the SAO did not have a delegation of authority on file for the execution of agreements.

Management Corrective Actions:

OCGA is currently working with Policy and Records Administration to establish a new delegation of authority for Service Agreements.

Going forward, OCGA will ensure that only individuals with properly delegated authority sign Service Agreements.