

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

**UC Davis
Campus Recharge Rates
Audit & Management Advisory Services Project #22-03**

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Campus Recharge Rates

AMAS Project #22-03

MANAGEMENT SUMMARY

Background

As part of the fiscal year (FY) 2022 audit plan, Audit and Management Advisory Services (AMAS) reviewed campus recharge rates.

A recharge is a method of internal cost re-distribution between campus units and departments providing and receiving goods and services. Consistent with UC Davis PPM 340-25 – Rates, Recharges, and Sales Activities, the review & approval process is a shared responsibility between Budget and Institutional Analysis (BIA), Costing Policy & Analysis (CP&A), and the Recharge Activity Unit as illustrated in the table below.

Recharge activity/ Office with Final Approval	High Risk Activities ¹		Low-Risk Activities
	Mandated, Widely Consumed, or >\$250,000 Recharge	>\$50,000 Contract & Grant (C&G) Recharge	Not Mandated and <\$50,000 C&G Recharge
New rate	BIA	CP&A	Unit Leadership
Modifications inconsistent with budget planning guidelines or changes in pricing rationale.	BIA	CP&A	Unit Leadership
Modifications consistent with budget planning guidelines.	Unit Leadership	Unit Leadership	Unit Leadership

In addition, BIA assesses the overall performance of all recharge activities on an annual basis. The recharge rate units must recover any deficit or surplus balance in excess of 15% of the activity's annual expenditures within three years. As of June 30, 2021², there were approximately 175³ funds out of compliance.

Purpose and Scope

The purpose of this audit was to assess the review and approval process for campus recharge rates. However, due to the financial/operational impact of COVID-19, the number of recharge rates reviewed and approved in the recent fiscal years was minimal. As such, based upon our risk assessment, we assessed the processes to monitor recharge activities. To accomplish this objective, we:

- Reviewed relevant UC and UC Davis policies, and interviewed personnel in BIA and CP&A on existing procedures to monitor recharge activities;
- Analyzed financial data used to monitor recharge activities;
- Performed a comparison of UC Davis policies related to managing recharge activities with comparable campuses within and outside the UC System; and
- Surveyed fiscal officers in various recharge units.

¹ High -risk recharge activities are initially reviewed at the unit level.

² Consistent with BIA’s annual compliance assessment methodology, non- compliance was determined based on the fund’s year-end accumulated balance.

³ A detailed table of funds by unit is included in Appendix A.

The scope of the review covered campus recharge activities as of June 30, 2021.

Conclusion

We were able to verify that BIA established adequate procedures to detect non-compliance of recharge activities through its annual compliance assessment. However, this annual compliance assessment was not performed in FY 2019 and FY 2020, as a result of (1) the financial and operational impact of the COVID-19 pandemic, and (2) BIA's efforts to align units with the university's Deficit Management⁴ reporting activities. The annual compliance assessment was resumed in January 2022 for recharge activities as of FY 2021; therefore, no further management corrective actions are required in this area.

We also concluded that there was opportunity to develop guidance that outlines: (1) the requirements for a formal action plan to address non-compliant deficit/surplus balances, and (2) consequences for unresolved non-compliant activity. In addition, BIA has the opportunity to enhance the annual compliance assessment by implementing procedures to review inactive recharge activities. And lastly, our comparative analysis of institutions' policies governing recharge activities showed that the University could benefit from assessing the Non-University Differential rate to recover full indirect cost from non-university customers.

⁴ Implementation of comprehensive guidelines and requirements for deficit management and monitoring in campus units (This guidelines excludes self-supporting activities).

SUMMARY OF OBSERVATIONS

Obs. No	Brief Observation		Owner	Management Corrective Action	Completion Date
22-03.A	There is an absence of formal action plan to address deficit/surplus balances in self-supporting funds.	1	BIA	BIA will develop guidance for units to submit a formal action plan for non-compliant funds including, but not limited to: <ul style="list-style-type: none"> Information on what is required in the action plan How the action plan will be evaluated by BIA Template to develop an action plan to address a non-compliant deficit/surplus balance 	11/15/22
	There is an absence of consequences for unresolved non-compliant activity.	2	BIA	Within the guidance developed in MCA A.1, BIA will develop consequences for unresolved non-compliant activity.	11/15/22
22-03.B	BIA does not have a process to assess inactive funds.	1	BIA	BIA will implement a process to assess inactive accounts, including considerations for (a) a minimum annual income/recharge threshold to approve recharge rates; and (b) closing out recharge facilities/activities.	11/15/22
22-03.C	There is an opportunity cost associated with the university's practice of charging a reduced indirect cost rate to non-university customers.	1	CP&A	CP&A will define the full cost recovery for recharge activities and determine implementation procedures needed.	12/15/22

Observations, Recommendations, and Management Corrective Actions

A. Guidance

There is an absence of a formal action plan to address deficit/surplus balances in self-supporting funds.

The Detailed Guidelines for Recharge Activities and Rates⁵ require units to recover any deficit or surplus balance in excess of 15% of the activity's annual expenditures within three years. BIA annually monitors the year-end accumulated balances of self-supporting funds to identify deficit/surplus balances out of compliance. BIA produces a Compliance Report for each unit based on the "Self-Supporting Compliance Report" in the KFS financial system. This report lists all self-supporting funds and the number of years the fund was out of compliance. The report is distributed to unit leadership and requires units to indicate whether the fund is, in fact, non-compliant, or if the fund was closed or not a rate-based activity. For non-compliant funds, units are required to provide comments on their plans to resolve the existing surplus/deficit balance. However, aside from collecting unit responses, BIA does not have a standardized process for units to submit plans to address deficit/surplus balances.

The annual compliance assessment ensures that unit leadership is aware of non-compliant funds. The implementation of a formal action plan by units with non-compliant funds would further assist BIA in accurately assessing if units will be able to successfully address deficit/surplus balances or determine if further action is needed.

Recommendation

We recommend BIA standardize a process requiring units to submit action plans to address non-compliant deficit/surplus balances.

Management Corrective Action

- 1) By November 15, 2022, BIA will develop guidance for units to submit a formal action plan for non-compliant funds including, but not limited to:
 - Information on what is required in the action plan;
 - How the action plan will be evaluated by BIA; and
 - Template to develop an action plan to address a non-compliant deficit/surplus balance.

There is an absence of consequences for unresolved non-compliant activity.

Based on our comparative analysis of policies with comparable campuses within and outside the UC System, we found that most institutions outline consequences for units that have not resolved non-compliant activity as agreed upon. Most notable among the consequences were:

⁵ This document is a supplemental component to PPM 340-25 and provides detailed guidance for developing and managing recharge activities and rates.

- Central reallocation of a unit's unrestricted funds to cover the deficit balance;
- Inability to increase rates when there is a surplus balance;
- Temporary suspension until corrective actions were implemented; and
- Shut down of the recharge facility/activity.

Lack of consequences permits the ability of units to carry forward deficit/surplus balances and prevents BIA from enforcing established action plans.

Recommendation

We recommend BIA develop consequences for unresolved non-compliant activity.

Management Corrective Action

- 2) By November 15, 2022, within the guidance developed in MCA A.1, BIA will develop consequences for unresolved non-compliant activity.

B. Annual Compliance Assessment

BIA does not have a process to assess inactive funds.

Per review of the FY 2019 to FY 2021 Self Supporting Compliance Report, out of 295 funds, 50 (17%) were inactive (did not have any activity in all three years) or had income/recharge activity only. Approximately 44 of these 50 inactive funds were low-risk (as defined per the matrix included previously in the Background section of the report).

Without a process to address inactive funds, deficit/surplus balances in these accounts carry forward from fiscal year to fiscal year. As such, there are seldom consequences associated with leaving inactivity unaddressed, which may contribute to a culture of units believing it is acceptable to have recharge facilities open without activity. Additionally, because the majority of the inactive funds are low-risk, consideration should be given to establishing a minimum annual income/recharge threshold which activities must meet in order to have a recharge rate approved. This may benefit the university by reducing administrative costs associated with the establishment and management of recharge activities.

Recommendation

We recommend BIA implement a process to assess inactive funds.

Management Corrective Action

- 1) By November 15, 2022, BIA will implement a process to assess inactive funds, including considerations for (a) a minimum annual income/recharge threshold to approve recharge rates; and (b) closing out recharge facilities/activities.

C. Indirect Cost Rate

There is an opportunity cost associated with the university's practice of charging a reduced indirect cost rate to non-university customers.

Based on Business and Finance Bulletin (BFB) A-47: *Direct Costing Procedures*, "Recharges shall be related to the cost of goods or services furnished and must provide for the recovery of actual costs." UC Davis uses a Non-University Differential (NUD) rate for indirect costs associated with providing goods and services (such as those performed by the recharge units) to non-university customers. The NUD rate is based on the Facilities & Administrative (F&A) rate⁶ and it does not cover components that are not typically utilized by outside clients such as the Library, Sponsored Project Administration, and Equipment.

Based on our comparative analysis of policies with 9 comparable campuses within and outside the UC System, we found that 8 institutions used the F&A rate as the indirect cost rate for external customers. While both methods are appropriate, because of the potential financial impact, consideration should be given to recovering the full indirect cost from non-university customers. In FY 2021, \$5.7M was recovered using the NUD rate. In comparison, \$9.6M could have been recovered using the full F&A Rate. As such, the opportunity loss of charging full cost recovery is approximately \$3.9M.

FY 2021 NUD Assessment	5,653,000
FY 2021 NUD Rate	33.7%
Derived Base Recharge Cost	16,774,481
FY 2021 Full F&A Rate	57.0%
NUD at full cost recovery	9,561,454
Opportunity loss of charging full cost recovery	3,908,454

Recommendation

We recommend CP&A evaluate the indirect rate for non-university customers and determine if a change is needed.

Management Corrective Action

- 1) By December 15, 2022, CP&A will define the full cost recovery for recharge activities and determine implementation procedures needed.

⁶ The NUD Rate is based on the Sponsored Program F&A Rate (Other Sponsored Activities on Campus - 39%).

Appendix A

Funds⁷ with rate-based recharge activities as of June 30, 2021:

Responsible Unit	Compliant ⁸	Inactive ⁹	Number of consecutive years out of compliance ¹⁰				Total funds	Total NC funds
			1st Year NC ¹¹ Deficit	1st Year NC Surplus	3rd Year NC Deficit	3rd Year NC Surplus		
College of Agricultural and Environmental Sciences	21	12	4	12	10	18	77	44
School of Veterinary Medicine	4	13	-	7	6	16	46	29
School of Medicine	13	6	-	6	4	12	41	22
Office of Research	3	10	2	5	7	7	34	21
College of Letters and Science	4	-	2	2	3	10	21	17
Finance, Operations, and Administration	13	-	3	6	1	3	26	13
College of Biological Sciences	4	1	1	-	8	3	17	12
College of Engineering	3	6	2	3	2	1	17	8
Office of the Provost	3	1	-	-	1	2	7	3
School of Law	-	1	-	-	-	2	3	2
School of Education	-	-	-	1	-	1	2	2
Student Affairs	2	-	-	1	1	-	4	2
Total	70	50	14	43	43	75	295	175

⁷ Per FIS 193 Self-Supporting Compliance Report (Funds in Sub fund group type Other Services-Other Rate Based Activities [OSSSO] and Sales and Service Ed Activities [SSEDAC]).

⁸ Compliance was based on funds that had a year-end accumulated surplus/deficit balance within 15% of FY 2021 expenditures.

⁹ Inactivity was based on funds that were inactive (no income/recharge or expenditures) and/or had income/recharge activity only from FY 2019 to FY 2021.

¹⁰ Non-compliant (NC) funds were categorized based on number of consecutive years out of compliance from FY 2019 to FY 2021.

¹¹ Non-Compliance was based on funds that had a year-end accumulated surplus/deficit balance in excess of 15% of FY 2021 expenditures.