

January 18, 2013

ACTING VICE CHANCELLOR FEITELBERG

Subject: Audit Report No. M13A002
 Recharge and Interdepartmental Charges

Attached is the final report for the Recharge and Interdepartmental Charges part of the Departmental Financial Procedures Audit (No. M13A002). Three separate reports will be issued from this audit. The action plans on the report will be entered into the TeamCentral Database and monitored until completion. With the issuance of this final report, please destroy any previous draft versions.

I appreciate the assistance provided to me by the Budget Office and Business and Financial Services staff. If you should have any questions, please feel free to contact me.



Todd Kucker
Internal Audit Director
UC Merced Internal Audit Services

Attachment

cc: SVP Vacca
 Chancellor Leland
 Vice Chancellor Miller
 Assistant Vice Chancellor Ahmed
 Director Jefferds

**UNIVERSITY OF CALIFORNIA, MERCED
INTERNAL AUDIT SERVICES**

**Recharge and Interdepartmental Charges
Report No. M13A002**

January 18, 2013

Work Performed by:
Todd Kucker, Internal Audit Director

Purpose and Scope

Internal audit has completed an audit of UC Merced's processes and procedures related to recharges and interdepartmental cost recovery charges. This review was part of a Departmental Financial Procedures audit which was part of the fiscal year 2013 audit plan. This report is one of three reports issued from the Financial Procedures Audit. The primary objective of the recharge review was to evaluate the adequacy of campus recharge policies and procedures. The audit steps were designed to cover the following:

- To determine whether the current campus policies and procedures related to recharge are adequate to handle defining, establishing, and decommissioning recharge units, and developing, requesting, reviewing, and approving recharge rates; and,
- To evaluate the processes related to recharges and interdepartmental cost recovery.

To evaluate the adequacy of current campus policies and procedures, we reviewed the past procedures of the Campus Recharge Committee and reviewed the current campus recharge policies and procedures by comparing these policies with UC recharge policies and recharge policies on some of the other UC campuses. We discussed the operations of the committee and policies with the Budget Director and with members of the Campus Recharge Committee.

To evaluate the processes of requesting and recording recharges and interdepartmental fees, we reviewed procedures used by various departments to record the information and walked through processes from the point where services are requested through the recording of transactions in the financial system.

Background

Per Business and Finance Bulletin A-47: "University Direct Costing Procedures", a recharge is the cost charged to a University department for specific goods or services provided by another University department. Recharge also relates to the costs charged to self-supporting activities which are primarily funded from external income for identifiable services provided by central campus administrative offices. To oversee campus recharge activities, a Campus Recharge Committee has been set up with members from different areas of the campus.

Per the original charge during Fiscal Year 2010 to the committee: "The Campus Recharge Committee is established as an advisory body to the Vice Chancellor for Administration, and the Chancellor, and is intended to facilitate a more consultative and transparent approach to an important segment of the overall campus economy. The committee reviews and recommends approval or disapproval of: requests to establish new recharge and other income-producing activities, establishment of new recharge rates or revisions to existing recharge rates as submitted by recharge and other income-producing

activities, and proposed corrective action presented by staff in response to an annual review of all existing recharge rates and recharge and income-producing activities. The committee will review University and other policy proposals affecting recharge and other income-producing activities.

The committee includes broad campus representation, so as to provide the Vice Chancellor and the Chancellor with input from representatives of the campus community. In addition to providing recommendations on the establishment of recharge rates, members will review policy and procedures to ensure that UC guidelines are in force and adhered to. Fair and consistent policy and procedure will be enforced.

The Campus Budget Director will serve as chair for the committee. Staff from the Budget Office will support the committee.”

The Campus Recharge Committee has met during the last couple years to establish campus recharge procedures. During Fiscal Year 2012, the former Assistant Budget Director chaired the committee and the following is the breakdown of the seven members of the committee: one faculty member, one administrative employee from the schools (School of Engineering), one employee from student affairs, one employee from the library, and three employees from different administration departments.

Amounts charged for the various goods and services provided by departments have very different cost characteristics. Some interdepartmental charges are more complicated than others. For example, if the bookstore purchases a computer for a department, the cost of the computer is transferred from the bookstore to the respective department. If catering is ordered from Dining Services, the costs include food and staffing costs. If Fleet Services purchases and maintains vehicles for departments, then there are costs such as vehicle depreciation and Fleet department labor. During Fiscal Year 2012, the committee determined that current recharge units should be reviewed and categorized as a “Direct Costing Unit” (where a department charges costs which they incurred to purchase the item without allocating other costs), a “Recharge Unit” (where all costs to provide the good or service are calculated and the unit breaks even), or a “Fee for Service Unit” (where all costs to provide the service are charged and the unit may generate revenue for current and future operational costs) . This proposed categorization is designed to help the recharge committee determine how it should handle each of the different units.

To charge other departments for goods or services, departments complete “Interdepartmental Recharge Request Forms”. For Accounting Services to post the recharge information in the University’s financial system, both the department that requested the goods or services and the departments that provided them are required to approve these paper forms.

While most recharges related to direct, identifiable costs, another type of interdepartmental charge relates to indirect administrative costs which are charged to departments with “income producing activities”. The quarterly “Administrative Cost Recovery charges” are calculated by Business and Financial Services based upon the

departments' number of purchase orders, payroll checks, invoices processed through accounts payable, and the number of general ledger transactions. The Administrative Cost Recovery is designed to be a direct offset of general fund allocation to campus units. The amount that Administration benefits from the allocation reduces the amount of general fund allocation by the same amount during the annual budget process.

Conclusion

Based upon the review, we concluded that current recharge policies and procedures are not adequate for the campus. Campus recharge activities would benefit from a more representative and active Campus Recharge Committee which verifies that amounts charged between departments are equitable and that recharge policies and procedures are properly adhered to. We noted the following areas for improvement:

Areas for improvement:

- Campus Recharge policies and procedures should be established and approved by campus leadership
- Additional campus representation should be added to the Campus Recharge Committee
- Processes for approving and recording recharges and interdepartmental charges should be streamlined
- Interdepartmental charges should be reviewed by an independent group

Observations

1. Campus recharge policies should be established and approved by campus leadership

During the review of the Campus Recharge Policies and Procedures, we noted that the policies are still in draft form and have not yet been approved by the campus leadership. The Budget Office has been working to put together recharge policies that will provide guidance and necessary authority for the Campus Recharge Committee.

The lack of approved recharge policies and the lack of an active Campus Recharge Committee has caused some issues for different recharge units. For example, Fleet Services had a recharge rate that should have been reevaluated by the Campus Recharge Committee. Over the years, the rate was not updated and Fleet Services generated a large operating deficit. The Campus Recharge Committee should have been annually reviewing deficits and surpluses resulting from incorrectly set recharge rates.

During the audit, the recharge policies and procedures in effect at other UC campuses were reviewed to determine where UC Merced campus recharge policies and processes might be improved. The following policy requirements and practices should be established and communicated to the campus:

- The recharge committee should have sufficient representation from the different Vice Chancellor areas;
- The recharge committee should meet at scheduled times throughout the year to review recharge rates;
- Approval of new recharge units should come from the committee and a department cannot charge other departments without having the rates properly reviewed and approved by the Campus Recharge Committee; and,
- Policy should explain which changes to recharge rates should be approved by the recharge committee and which changes can be approved by a Vice Chancellor.

To communicate the policies and procedures, other campus budget offices offered recharge training courses so employees had a better understanding of how to handle recharges.

Recharge committee procedures should communicate to the campus units when the committee will meet and the timeframe required for the committee to review and approve new rates after the necessary information has been provided.

Management Action Plan:

The Budget Office has drafted a new set of materials to well-define the role of the Recharge Committee. This will also be a framework for campus-wide training. A campus calendar will be constructed to ensure that the review process is formal and adequate in order to support campus consultation about proposed new rates.

A new slate of Committee members has been constructed and will be presented in January 2013 to the Acting Vice Chancellor for Planning and Budget and ultimately the Chancellor for final approval.

The first goal of a newly convened Committee will be to formally adopt the new package (documents) for campus submittal of proposed new recharges. The documents will include drafts of the charter, campus policies and recharge rate request forms. This will be communicated and available broadly for campus personnel. A series of training sessions will be conducted jointly for campus personnel by the Budget Office and Business and Financial Services.

Any rates reviewed by the Committee and approved by campus executives will be posted on the Budget Office Web site.

The charging of new members of the Campus Recharge Committee, convening of the first meeting of the new committee, and adoption of new materials will be completed during January through March 2013. The recharge training courses will begin by May 31, 2013 and will continue to be offered on a periodic basis.

2. Additional representation should be added to the Campus Recharge Committee

During the audit, we compared UC Merced's recharge policies and the responsibilities of the Campus Recharge Committee with recharge policies and procedures at other UC Campuses. It was noted that the UC Merced Campus Recharge Committee had less campus representation than other campuses. The breakdown of members on the UC Merced Recharge Committee shows the minimal representation from research areas

- Three members of the UC Merced Campus Recharge Committee are from different departments within Administration;
- Only one member is a faculty member conducting research;
- Only one member is from the schools (an MSO);
- One member is from the Library; and,
- One member is from Student Affairs (Vice Chancellor).

In contrast, UC Davis has twenty members on their recharge committee with much more representation from groups that are more involved with research areas and with broad representation from employees whose areas are impacted by the recharge processes.

We recommend that the makeup of the Campus Recharge Committee be changed to include more representation from faculty, research, and campus units that report to the Provost and other Vice Chancellors.

Management Action Plan:

A new committee will be put together which includes more representation from the campus. The new committee will be set up by January 31, 2013.

3. Processes for approving and recording recharges and interdepartmental fees should be streamlined

During the review of approvals of recharges and interdepartmental charges, some inefficient processes were noted.

- A paper approval form is manually filled out by the departments providing the goods or services. The paper form is routed back and forth between the providing and receiving departments and then routed to Accounting Services.
- For many recharge activities, the cost information is completed on the forms and sent to the department who ordered the services after the services have been completed. As the service has already been provided, there is little incentive for the receiving department to quickly approve the form.
- The information on the approval forms is reviewed multiple times. Employees in the departments providing and receiving the goods or services review the

amounts. Then the forms are sent to Accounting Services where the information is reviewed again for accuracy and compliance with University policies. If issues are noted by Accounting Services, the form is sent back to the department that provided the goods or services for correction.

It was noted that it often takes four to six weeks from the time the goods or services were requested to the time when the charges are recorded in the financial system.

Processes related to obtaining approvals and recording the information in the financial system should be improved. One way to speed up the process would be to obtain approval at the point when the goods or services are ordered. During the review, it was noted that recharges for departments that required approval of the charges up front resulted in quicker processing of the recharges. The approved goods or services could be recorded in the financial system and then it would be the responsibility of the departments that received the goods or services to follow up if the resulting charges in the financial system appear unreasonable.

During the audit, we noted that Administrative Computing and Systems (ACS) has been working to implement a system which automated the recharge approval process. We recommend that ACS obtain user feedback from the departments that will utilize the systems. By obtaining feedback from these various groups, the overall approval process might be improved.

Management Action Plan:

An online recharge processing tool has been finalized and is ready for deployment. Accounting Services staff will be coordinating with Parking Services to have their departmental parking recharge go live by February 4, 2013. Bookstore will be the next major recharge unit, followed by dining services. Both the units are targeted to go live with the on-line process by June 1, 2013. The rest of the campus approved recharge units will be worked on to complete the campus rollout by June 30, 2014.

4. Interdepartmental charges should be reviewed by an independent group

During our review of the quarterly administrative cost recovery charges, we noted that the charges are not reviewed by an independent group. Business and Financial Services calculates and applies the charges to departments which have “income producing activities”. While the charges are allocated to Business and Financial Services and Human Resources, the charges are not designed to ultimately benefit these areas as the charges merely offset other general fund allocations. Amounts allocated to the administrative units result in a dollar for dollar reduction in their budget.

The fees are unpopular with the affected departments as they only see the reduction of their available budget dollars being transferred to administrative departments without understanding the purpose for the charges. Also, it is difficult for the affected

departments to research the charges as the amounts are calculated based upon a complicated methodology related to the number of payroll checks, purchase orders, vendor invoices, and general ledger transactions.

To minimize the perceived conflicts, the methodology for calculating these charges should be reviewed and approved by campus leadership or by another group to which this review is delegated.

Management Action Plan:

Business and Financial Services will prepare information to be presented to the campus leadership. Internal Audit will arrange for a suitable time to present the current process jointly with Business and Financial Services. Any recommendation for changes to the methodology received from the leadership will be implemented during Fiscal Year 2015-2016, the first year of the campus Facilities and Administration rate (F&A) renewal, or the first year following submission of campus disclosure statement, whichever occurs first. This time constraint is to remain consistent (compliant) with UC Merced Indirect Cost Recovery Contract submitted and approved by Federal Health and Human Services Department to remain in effect through Fiscal Year 2014-2015.

The presentation to campus leadership will be completed by March 31, 2013.