

June 1, 2015

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**Subject: *Service Agreements – School of Medicine
Project 2015-39***

The final audit report for *Service Agreements – School of Medicine*, is attached. We would like to thank all members of the department for their cooperation and assistance during the audit.

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.

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Attachment

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AUDIT & MANAGEMENT ADVISORY SERVICES

Service Agreements – School of Medicine
June 2014

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Project Number: 2015-39

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I. Background

Audit & Management Advisory Services (AMAS) has completed a review of Service Agreements – School of Medicine (SOM). 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.

SOM is one of four areas of campus¹ that have the authority to execute certain incoming Service Agreements. The types of services provided by SOM via service agreements are clinical and non-clinical services, laboratory services, consulting, and training. The Health Sciences Business Contracts (Business Contracts) department receives a request from SOM departments interested in providing service to an outside party. Business Contracts negotiates the service contract with the external party and completes a draft agreement. The draft agreement is then sent to the requesting department for approval, and forwarded back to Business Contracts, who then executes the agreement by signing the contract.

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. In most cases, 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.

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

¹ Other areas of campus with authority to execute Service Agreements are the Office of Contract & Grant Administration (OCGA), Scripps Institution of Oceanography (SIO) Contracts & Grants, and University Extension. These areas are addressed in separate AMAS reviews.

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recommendation, with final approval by the Vice Chancellor of Resource Management and Planning.

In 2011, a Service Agreement Oversight Committee was convened to ensure that Service Agreement activity was properly administered across the four areas responsible for Service Agreement activity. 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.

SOM has established the following fund ranges for each Service Agreement classification:

Fund	Agreement Type	Type of Overhead Remittance for Central Administration	Overhead Rate
60107A	Clinical Service Agreements	Administrative Overhead Recovery	4.1%
60108A	Consulting Agreements	Administrative Overhead Recovery	4.1%
60153A	Laboratory Services Agreement On-Campus	Differential Income	16%
60155A	Laboratory Services Agreement Off-Campus	Differential Income	8%
60158A	Other Non-Clinical Service Agreements Off-Campus	Differential Income	8%
60156A	Affiliation Teaching Agreement	Exempt	0%
60990A	Government Service Agreement 0 DI	Exempt	0%

SOM Departments are responsible for properly classifying their Service Agreements during the initial processing. Business Contracts provides an initial review to ensure proper classification. Once an agreement has been executed, it is routed to the Vice Chancellor of Health Sciences (VCHS) Controller’s (Controller) office who provides a secondary classification review, assigns an index to the agreement, and associates the index with a fund based on the classification. Differential income is automatically calculated by the SOM Application system and remitted to central campus, and the Campus Budget Office (CBO) is responsible for monitoring and ensuring that the differential income is remitted properly.

II. Audit Objective, Scope, and Procedures

The objective of our review was to evaluate SOM’s practices for executing Service Agreements with external parties, and assess the direct and indirect cost recovery processes (including billing). In order to achieve our objective, we performed the following:

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- 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 UC BFB G-39 *Conflict of Interest Policy and Compendium of Specialized University Policies, Guidelines and Regulations Related to Conflict of Interest*, UCSD Policy & Procedure Manual (PPM) 200-13 *Conflicts of Interest* and the *Campus Administrative Responsibilities: Principles of Conflict of Interest*;
- Reviewed the Office of Management and Budget (OMB) Circular A-133 (A-133) *Audits of States, Local Governments, and Non-Profit Organizations*;
- Reviewed documentation for Delegations of Authority for Execution of Agreements;
- Reviewed the fiscal closing instructions for Self-Supporting Activities;
- Interviewed the following:
 - Director of Business Contracts;
 - VCHS Controller;
 - Director of the Conflict of Interest office;
 - The CBO Senior Budget Analyst;
 - The Accountant Supervisor for General Accounting
- Evaluated the current processes for negotiating and executing Service Agreements;
- Tested a sample of Service Agreements for Fiscal Year 2013-2014, for compliance with delegation of authority, classification criteria, conflict of interest reporting, and differential income remittance²; and
- Tested a small sample of Service Agreements for Pediatrics and Radiology to assess whether activities were consistent with final contract terms and conditions, and were billed timely.

III. Conclusion

Based on our review, we concluded that the process for executing Service Agreement contracts provided assurance that Service Agreements were correctly classified, and received an appropriate level of review and approval by the individual with delegated authority. The correct administrative overhead (either administrative overhead recovery rate or differential income) for recovery of central administrative support was properly remitted. Billing processes for Pediatrics and Radiology were timely and in accordance with contract terms and conditions.

We noted that internal controls related to State and Local Government Service Agreements could be strengthened to ensure appropriate identification of agreements with federal flow-through funding, and compliance with OMB Circular A-133 reporting requirements. Also, processes related to conflict of interest reporting could be strengthened to ensure compliance with University policy and provide increased institutional oversight of potential conflict situations.

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.

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IV. Observations and Management Corrective Actions

A. Federal Flow Through Funding

We noted that four of the contracts reviewed contained a Catalog of Federal Domestic Assistance³ (CFDA) number, indicating the prime agreement is a federal award, with the UCSD Service Agreement representing a sub-award with federal flow through funding. The contracts were not administered as federal flow through awards. Consequently, the awards were not managed in the federal flow through fund range and required downstream activities were not fulfilled.

OMB Circular A-133⁴ establishes uniform audit requirements for non-Federal entities that administer Federal awards. A Federal award is any federal financial assistance and federal cost-reimbursement contract that non-federal entities receive directly from federal awarding agencies or indirectly from pass-through entities. Federal agencies are responsible for applying the provisions of OMB Circular A-133 to non-Federal entities if they are recipients expending Federal awards received directly from Federal awarding agencies, or are sub recipients expending Federal awards received from a pass-through entity (a recipient or another sub recipient).

Each agency that expends federal awards is required to document the expenditures in the form of the Schedule of Expenditure on Federal Awards (SEFA). The SEFA should include federal awards received directly from a federal agency and indirectly from pass-through entities. In addition, OMB Circular A-21, and new Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (effective for new awards after December 26, 2014) require that employee salaries charged directly to federal and federal flow-through funds must be certified. In order to meet the compliance requirements of these federal regulations, incoming agreements with federal or federal flow-through funds must be properly identified and established in the appropriate UCSD federal or federal flow-through fund range.

OMB Circular A-133 states that Federal awarding agency should identify Federal awards by informing the recipient of the Federal terms. UCSD has observed in contracting with the County of San Diego that this sometimes occurs via a formal notice, but may also occur through the inclusion of a CFDA number on a contract, or in some instances, notification may not occur at all.

OCGA has identified guidelines for considering when UCSD becomes a sub recipient, and the agreement should be handled as a subaward, versus a vendor

³ The Catalog of Federal Domestic Assistance is a government-wide listing of Federal programs, projects, services, and activities that contains financial and nonfinancial assistance programs administered by departments and establishments of the Federal government.

⁴ Existing guidance currently addressed in Circular A-133 is migrating to the Uniform Guidance A-81.

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providing services, where a service agreement would be used. A contract is considered a subaward or subcontract when the prime sponsor is federal, and the award is from a flow-through entity as a grant (financial assistance); when the contract contains a CFDA number; the activities assigned PI effort; or the contract contains flow through terms. A contract is considered a service agreement using federal funding when the department is only delivering a service; when the UCSD standard Service Agreement Template is signed; and UCSD's participation is not novel or requiring Principal Investigator participation. The type of funding is usually a direct budget line-item for a federal agency. The UCOP Office of Costing Policy and Analysis also supports this distinction.

Four of 20 County contracts we evaluated contained a CFDA number, but were not properly identified as federal flow through funds at the time of contracting. Departments were responsible for reviewing the statement of work (SOW) and budget schedules where federal funding appeared to be indicated, however, it appeared that the departments were not aware of specific indicators to identify these types of contracts. Business Contracts indicated that it did not review the SOW or budget schedules as part of its review process. As a result, the contracts were not established in a campus federal flow-through fund range and therefore not listed on the Campus SEFA. For these contracts, Federal requirements for administering the funds may not be met, placing the campus at risk for non compliance with Federal regulations.

Management Corrective Action:

SOM Business Contracts will assess all County contracts for Federal terms and conditions and the presence of a CFDA number, and for all others will request confirmation from the County that Federal funds are or are not being passed through the contract. If Federal flow through funding is identified by the CFDA number or County confirmation, the VCHS Controller will work with the Campus Office of Post Award Financial Services and OCGA to ensure the contracts are properly administered in a federal flow-through fund range in order to meet all downstream reporting requirements.

B. Conflict of Interest Disclosure

Business Contracts did not have a process to assess Conflict of Interest disclosure for all Service Agreements as part of the review process.

A conflict of interest refers to situations in which employees may have the opportunity to influence a University's business decision in ways that could lead to personal gain or give advantage to firms in which employees have an interest. All University employees are expected to separate their University and private interests in accordance with existing University policies and State law.

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PPM 200-13 states that “The University's overall policy on conflict of interest is that none of its faculty, staff, managers or officials shall engage in any activities which place them in a conflict of interest between their official activities and any other interest or obligation.” The Administrative Responsibilities for the Principles of Conflict of Interest are guidelines to ensure a working atmosphere free of any conflicts of interest and that Employees participating in outside activities on behalf of the university must perform their functions ethically and objectively.

As it relates to Service Agreements, a systematic review of financial disclosures from key personnel should identify any financial interests prior to the acceptance of contracts from governmental and non-governmental sponsors. Both SIO Contracts and Grants and the Office of Contract and Grant Administration require a financial disclosure via the 700-U form for all Service Agreement requests during their initial requisition process. UCSD Extension conducts a preliminary inquiry with all service agreement requests, and any indication of a financial interest then triggers submittal of the 700-U.

During our review, we noted that SOM only required disclosures for agreements with for-profit entities and lab service agreements that provide results to for-profit entities as part of the Service Agreement requisition process. Disclosures for Clinical Service Agreements, Consulting, Laboratory Service Agreements and Non-Clinical Service agreements with non-profit entities were not required.

University officials cannot appropriately evaluate the potential for conflict situations if a disclosure is not requested of personnel involved in the negotiation process. Also, although there may not be a financial conflict within the Service Agreement process, there could still be a perception of a conflict, which should be addressed in the interest of transparency.

Management Corrective Action:

Business Contracts will conduct a preliminary inquiry of financial interests for all service requests. In the event of a positive disclosure, a 700-U will then be required and sent to the COI office for review.