UNIVERSITY OF CALIFORNIA, DAVIS
INTERNAL AUDIT SERVICES

Administrative and Resource Management
Budget and Institutional Analysis
Recharge Rates
Internal Audit Services Project #13-06

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MANAGEMENT SUMMARY

As part of the Internal Audit Services (IAS) audit plan for fiscal year (FY) 2012-2013, IAS conducted a review of recharge rates at UC Davis. A recharge activity is defined in Policy and Procedure Manual (PPM) section 340-25, *Rates, Recharges, and Sales Activities – Recharge Activities*, as an activity that provides specific, ongoing, repetitive goods or services to campus units on a fee basis. Budget and Institutional Analysis (BIA) is the campus entity responsible for establishing policies and procedures surrounding recharge activities and recharge rates.

The purpose of the review was to assess the review and approval process to ensure that recharge rates are reasonable and that costs are adequately comprehended and supported.

The specific objectives of the review were to:

- Assess the review and approval process for recharge rates on campus;
- Evaluate the process for monitoring the accumulated balances and cost recovery status of recharge activities;
- Assess the process and procedures in conducting mid-year financial reviews, as required by policy in PPM 340-25;
- Determine whether the campus' 3% assessment on recharges/income of self-supporting activities (including recharge activities) is compliant with federal costing standards;
- Assess the adequacy of training provided by BIA to recharge units and campus personnel in offices of deans, vice chancellors, and vice provosts, who have oversight responsibilities for recharge activities within their units;
- Determine whether procedures governing the dissolution of inactive recharge activities are adequate to ensure that finances of inactive units are appropriately resolved in a timely manner;
- Evaluate the procedures by which activities are categorized as auxiliary enterprises or otherwise deemed to be exempt from campus recharge rate policies because their rates are subject to a review and approval process external to the University.

Our audit work included reviewing and analyzing all campus, University of California, and federal costing policies, procedures, and processes governing recharge activities, including the rate submission, review, and approval process. We also interviewed personnel from BIA. We obtained and reviewed BIA's recharge activity training materials. We also reviewed financial data for campus recharge activities available through Davis Financial Information System (DaFIS) Decision Support reports.

In late 2010 and early 2011, BIA extensively revamped the recharge activity and rate submission, review, and approval process based on the establishment of risk categories, with high risk activities being categorized as: (a) those involving a mandated good/service or where the unit is the sole provider, e.g., Fleet Services; or (b) those with annual billings to federal project accounts in excess of $200,000, e.g., Genome Center. High risk activities in category (a) are reviewed by the Services Activities Recharge Advisory Group (Recharge Group) while those in category (b) are reviewed by the Federal Costing Advisory Group (Federal Recharge Group)[1]. Medium risk activities are those that involve a non-mandated good/service and have annual billings to federal project accounts of between $50,000 and $200,000.These are submitted to BIA, and for new activities, reviewed and approved internally within BIA by the Associate Vice Chancellor. All other recharge activities are considered low risk and are reviewed at the dean/vice chancellor/vice provost level. IAS reviewed this risk structure and the processes of review by the two Recharge Groups and considers them to be sound and effective.

BIA and Accounting and Financial Services (A&FS) are now redesigning the recharge unit billing, financial reporting, and monitoring procedures, to enhance the effectiveness and efficiency of all recharge processes on campus. Legacy billing and reporting processes and tools have been replaced by new processes and more robust financial reporting tools in Decision Support. These new reporting tools will assist with the mid-year and annual financial reviews by management within the recharge units themselves, as well as the campus' oversight of recharge units' financial performance. A component of the revised financial monitoring structure will be the establishment by BIA of a risk-based model (similar to the one described above for the rate submission, review, and approval process) that relies on delegation of responsibility and accountability to the offices of deans, vice chancellors, and vice provosts, based on risk profiles of the recharge units. Because of the new financial reports and the delegation of responsibility for financial monitoring, BIA will be updating its training initiatives and materials, with a focus on personnel within the offices of deans, vice chancellors, and vice provosts.

IAS also noted that some recharge activities do not publish a schedule of their rates and prices, as is required by University of California Business and Finance Bulletin A-47, *University Direct Costing Procedures*. In the absence of published rates, campus units that are being billed by recharge activities cannot verify that the rates being billed are accurate. This requirement will be added to campus policy PPM 340-25 and communicated to units and to the offices of deans, vice chancellors, and vice provosts as part of the training program described above.

Policies and procedures surrounding the campus' 3% assessment on self-supporting activities and the dissolution of inactive recharge activities are considered to be reasonable, while a minor observation was noted regarding exemptions for rates of auxiliary enterprises, as described in the body of this report.

[1] The Federal Recharge Group is a subset of the Recharge Group, consisting primarily of individuals from BIA and Accounting and Financial Services.

I. OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT CORRECTIVE ACTIONS

A. The campus is in the midst of redesigning the recharge unit billing, reporting, and financial monitoring procedures, to enhance the effectiveness and efficiency of all processes.

Background – Financial Monitoring by BIA and Recharge Rate Groups

Per Policy and Procedure Manual (PPM) 340-25, *Rates, Recharges, and Sales Activities – Recharge Activities,* approved in January 2011, BIA has responsibility for reviewing the financial performance of all recharge activities on an annual basis. Per BIA's published procedures in "Detailed Guidelines for Recharge Activities and Rates," the purpose of the review is two-fold: (a) to identify recharge activities that demonstrate signs of non-compliance;[2] and (b) to evaluate recharge activities whose risk profiles may have changed (i.e., significant increases/decreases in total or federal recharge revenue). BIA's procedures state that: "BIA will focus on activities that have significant year-end surplus or deficit balances and those with significant increases or decreases in total or federal recharge revenue."

BIA Annual Reviews

In the Recharge Group and Federal Recharge Group meetings, which are managed by BIA and generally occur monthly, the respective Recharge Groups review campus recharge units. Included within the scope of these reviews, in addition to a review of units' rates, is a financial evaluation of units' revenues, expenses, and accumulated balances, which fulfills the annual financial review requirement of PPM 340-25. Some of the large recharge units on campus that have been reviewed recently by the Recharge Group are Fleet Services, Utilities, and Custodial Services, while some of the large units that have reviewed by the Federal Recharge Group are the Genome Center and the Mouse Biology Program.

For a number of reasons primarily related to limitations of financial reporting tools (as discussed in the following section) and personnel resources, with the exception of the high-risk units reviewed by the two Recharge Groups and a limited number of medium risk activities, BIA has not been reviewing the finances of other campus recharge activities in a systematic, comprehensive manner since BIA took over this responsibility from A&FS in 2010 and revised PPM 340-25 in January 2011.

To gauge the potential campus-wide risk of deficits and surpluses for recharge activities, IAS conducted a rudimentary desk review of all UC Funds containing recharge activity.[3] For comparative purposes, we considered recharge/income activity for fiscal year (FY) 2012 through 6/30/12 and FY 2013 through 4/30/13, and accumulated balances as of those dates. IAS used the following three risk factors to

[2] Non-compliance relates to the requirement in section E of University of California Business and Finance Bulletin (BFB) A-56, "*Academic Support Unit Costing and Billing Guidelines*, that states: "Every effort should be made to ensure that year-end surpluses or deficits do not exceed one month of the recharging unit's activity."

[3] There are approximately 600 UC Funds classified as "service enterprises," "self-supporting activities," or "sales and service – educational activities," most of which include recharge activity.

conduct our desk review: (a) funds with deficits or surpluses in excess of $25,000 at both 6/30/12 and 4/30/13; (b) that also had recharges/income in excess of $25,000 in both FY 2012 and FY 2013 through 4/30/13; and, (c) whose deficit or surplus at each measurement date also exceeded the allowable threshold of 8.33% (one month's activity) by greater than $25,000. For deficits, IAS identified 17 activities that met these three criteria.[4] At 4/30/13, these deficits ranged from $44,000 to $1.5 million, and averaged $400,000 with a median of approximately $275,000. For surpluses, IAS identified 15 recharge activities that met these three criteria.[5] At 4/30/13, these surpluses ranged from $33,000 to $1 million, and averaged $250,000 with a median of approximately $165,000.

As a desk review, the IAS analysis does not take into account factors that would not be known without detailed discussion with each recharge unit. These factors include the following: (a) potential monitoring performed at the dean/vice chancellor/vice provost level; (b) rate adjustments that may have been made by the units during FY 12 or FY 13 to reduce/eliminate deficits/surpluses over the three-year period allowable by policy; (c) other operational actions that may have been taken by management in FY 12 or FY 13 to reduce deficits/surpluses; (d) seasonality of operations in FY 2013 (since the analysis optimally should be performed at year-end close rather than a month-end close); (e) the financial impact of other accounts outside of the recharge activity UC Fund that may be subsidizing/contributing to the activity as allowable by policy; and (f) surpluses permitted by policy to be retained by the activity under certain circumstances.

<u>Redesigned Billing, Reporting and Monitoring Processes</u>
Throughout fiscal year 2013, BIA and A&FS have begun implementing strategies for improving the recharge unit billing, reporting, and monitoring processes. Following is a summary of the actions that have already been implemented or are underway:

- The accounting procedures for the campus' recharge billing process have been changed. Whereas previously all recharge units billed their charges under a single Kuali object code (7200 – "Service"), as of May 2013, use of this object code is no longer permissible, i.e., all billing documents with object code 7200 are being automatically rejected by Kuali. Instead, each recharge unit has been assigned its own unique object code. This transition will improve the recharge unit reporting and monitoring processes. For instance, to assess recharge unit billings to federal project accounts, units and BIA will now be able to run the existing DS report #199, "Object Code Summary by SFGT (Sub Fund Group Type)," which will allow BIA to quickly/efficiently identify each recharge unit's billings to federal accounts, which is an element of each activity's risk profile.

- The redesigned DS report #193, "Statement of Operations – Self-Supporting Compliance," summarizes the financial operations of recharge units, including

[4] 14 of the 17 units had deficits at both measurement dates in excess of 16.67% (two months of activity.)
[5] 13 of the 15 units had surpluses at both measurement dates in excess of 16.67%.

revenues, expenses, and accumulation/calculation of surpluses/deficits for analysis of compliance with the requirements of BFB A-56 as detailed above.

Previously, DS report #263, "Statement of Cost Recoveries," had been the tool for calculating surpluses/deficits of recharge activities for review of compliance with BFB A-56. However, this report has been defective throughout FY 2013, as the report included erroneous data and miscalculated surplus/deficit percentages. A service request to fix the defective report was processed by Accounting and Financial Services (A&FS) in September 2012; nevertheless, A&FS allowed the defective report to remain available to users throughout FY 2013, which potentially could have led units to make misguided operational decisions based on inaccurate financial information.[6]

- The redesigned DS report #193 has a feature added to enhance efficiency of recharge activity monitoring process. Historically, the DS report #193 has been available only by single recharge unit. However, the redesigned report includes a feature allowing the report to be produced by organization, such that BIA (or a school/college/division) will be able to produce a single report for all recharge units within a school/college/division. This feature will support and enable a new, risk-based monitoring process under development by BIA, through which financial monitoring of recharge activities will be delegated to schools/colleges/divisions based on established risk levels.

The development of the new Decision Support reports, in combination with the establishment of a risk-based approach to the annual financial monitoring of recharge activities, should allow campus units and BIA to conduct effective reviews of the accumulated balances and cost recovery status of campus recharge units.

<u>Management Corrective Actions</u>

1. By January 15, 2014, BIA will establish risk-based policies and procedures for the annual recharge activity financial review process. The policies and procedures will outline responsibilities of BIA, offices of deans, vice chancellors, and vice provosts, and those of recharge units.

2. By February 15, 2014, the accumulated balances and cost recovery status of recharge activities will be reviewed in accordance with the risk-based policies and procedures established by BIA per the corrective action in #1 above.

3. By February 15, 2014, BIA will update all of its training programs and materials. With the expectation that under the new risk-based review process, personnel in the offices of deans, vice chancellors, and vice

[6] Before the reprogramming asked for in the service request could be fully implemented, the decision was made to replace the DS #263 report with the redesigned DS #193 report. The DS #263 report was taken off-line in June 2013 when the redesigned #199 report became available.

provosts will assume more responsibility in annual financial monitoring process, BIA will need to increase its efforts in training these personnel about the nature and purpose of the annual review and the financial reporting tools available to conduct the review. BIA training materials will need be revised to reflect these changes, and references to outdated Decision Support reports will need to be deleted.

B. Some recharge activities do not publish a schedule of their rates and prices, as is required by BFB A-47, "University Direct Costing Procedures." In the absence of published rates, campus units being billed by recharge activities cannot verify that the rates they are being billed are accurate.

BFB A-47, "University Direct Costing Procedures," states in section D.4: "All recharge activities shall publish a schedule of rates and prices." Based upon discussion with BIA management and a search for published rates for limited sample of recharge units, we found that some campus units are not publishing their rates as required by policy. Without published rates, campus units being billed by recharge centers on Internal Billing documents cannot be certain that the rates being billed are accurate.

<u>Recommendation</u>

BIA does not have the resources available to maintain a centralized database or website of the approved rates of all recharge units on campus, and, given the overall risks involved, these measures are not considered necessary. Therefore, responsibility and accountability for compliance with BFB A-47 must reside with the recharge units. Therefore, IAS recommends that units be notified of the policy requirement to publish their rates through the following means:

1. The training materials and programs being revised by BIA in conjunction with MCA I.A.3 above should include an element notifying units that rates must be published.

2. BIA should update the recharge unit responsibilities section of PPM 340-25 to include the requirement for units to publish their rates.

3. The form letter on the BIA website for offices of deans, vice chancellors, and vice provosts to notify a unit that a new activity, or modification to an existing activity, has been approved should be revised to include a statement notifying units of the requirement to publish a schedule of rates. Additionally, the form letters from BIA and the Recharge Groups notifying units that recharge activities have been approved should also be modified to include a notification to units that policy requires that rates must be published.

Management Corrective Actions

1. By February 15, 2014, in conjunction with the revisions to the BIA training programs and materials addressed in MCA I.A.3 above, units will be advised of the policy requirement that a schedule of rates be published.

2. By February 15, 2014, BIA will update the responsibilities section of PPM 340-25 to add the requirement that recharge units must publish and maintain a schedule of their current rates.

3. By February 15, 2014, BIA will update all form letters sent to recharge units by BIA or the offices of deans, vice chancellors, or vice provosts, as appropriate, to include a disclosure that the unit is responsible for publishing and maintaining a schedule of its current rates.

C. BIA does not substantiate that units have accurately self-identified that they are exempt from PPM 340-25 either because they are auxiliaries or are subject to a review and approval process external to the University.

PPM 340-25 states in section I.B.1: “The following activities are not considered recharge activities and are not subject to this policy: auxiliaries and activities that rely on rates subject to a review and approval process external to the University.” Auxiliary enterprises provide non-instructional support to students, faculty, and staff. Examples of auxiliary enterprises on campus include the bookstore and the student residence halls.

When an activity is established, units self-identify within Kuali the level of review to which the activity’s rates and finances are subject, i.e., (i) Recharge Group; (ii) office of dean, vice chancellor, vice provost; or (iii) exempt. No communication of these exemptions is made to BIA, so BIA cannot follow-up with units to validate that the exempt designations are accurate. (Note that in the past, completion of this designation within the accounting system has not been a required field, and as a result, comprehensive analysis of these types of activities is not straightforward.) There has been at least one incidence recently of a large unit incorrectly operating under the assumption that it was exempt from PPM 340-25 when in fact it was not.

Management Corrective Action

BIA has been working with A&FS over the past few months on a solution to this internal control issue. Potential process changes include having completion of the “exemption” field within Kuali be mandatory, and having the associated account document route to BIA for approval prior to the account being established. By January 15, 2014, BIA will come to a decision as to specific action to be taken.

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