Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF RECHARGE CENTERS AT THE UNIVERSITY OF COLORADO

JUNE GIBBS BROWN
Inspector General

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DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

CIN: A-08-95-00906
November 28, 1995

Jud Hurd, Controller
University of Colorado
Accounting Office
Campus Box 48
Boulder, Colorado 80309

Dear Mr. Hurd:

This report provides you with the results of our *Review* of *Recharge Centers* at the University of Colorado, Boulder, Colorado (University) which covered the period July 1, 1990 through June 30, 1994. The purpose of our review was to determine whether the University had adequate control procedures over the operation of recharge centers.

We found the University did not have adequate control procedures. Specifically, we determined the University had no formal policies and procedures to (1) set and monitor billing rates, (2) adjust billing rates annually to eliminate accumulated surpluses and deficits, and (3) preclude transferring or expending recharge center funds for unrelated purposes.

We are recommending that the University develop and implement procedures and controls over the operation of recharge centers. The University agreed with our report recommendations and suggested that certain clarifying changes be included in the report. A copy of the University's response is included in its entirety in the Appendix.

Background

Office of Management and Budget (OMB) Circular A-21 (the Circular) provides principles for determining the costs applicable to research and development, training, and other sponsored work performed by colleges and universities under grants, contracts, and other agreements with the Federal Government. The Circular requires the institution to apply these cost principles in determining the costs charged to sponsored agreements. Included in the Circular are provisions related to the charging of costs through specialized service facilities known as recharge centers.

In FY 1991, the University of Colorado ranked number 21 in Federal research funding and received Federal funds in excess of $126 million. For the period of our review, the University identified 119 recharge centers.

Scope

This review was made in accordance with generally accepted government auditing standards. The purpose of the review was limited to determining whether the University had adequate internal controls for the operation of recharge centers. Specifically, we determined whether the University had adequate formal policies and procedures for (1) setting and monitoring billing rates, (2) adjusting billing rates to eliminate accumulated surpluses and deficits, and (3) using or transferring recharge center funds for unrelated purposes.

We judgementally selected six recharge centers for review: Chemistry Stores; COGEN; Departmental Precision Shop; Electronic Stores; MCDB Storeroom; and Telecommunication Services. The review was conducted at the University during November and December 1994.

RESULTS OF REVIEW

We found that rates used to bill Federal projects for recharge center services were not based on actual costs as required. Billing rates were not accurate, surpluses and deficits recorded were not reflected in rates, transfers were made to other funds and equipment was expensed rather than capitalized. These problems occurred because the University lacked policies, procedures and related controls over development and adjustment of recharge center rates. Consequently, Federally sponsored research may have been overcharged.

<u>Circular A-2 1</u>

The Circular defines specialized service facilities (recharge centers) as facilities that provide specialized services and charge the users of those services on the basis of actual use. Charges to users should be based on established rates which are reviewed periodically and adjusted as necessary. Specifically, Section J.44.c of the Circular states that:

> *Charges.. .should be designed to recover not more than the aggregate cost of the services over a long-term period agreed to by the institution and the cognizant Federal agency.*
>
> *. . . It is not necessary that the rates charged for services be equal to the cost of providing those services during any one [sic] year as long as rates are reviewed periodically for consistency with the long-term plan and adjusted if necessary.*

Adequate documentation must be retained to support the costs charged to sponsored agreements.

Billing Rates

The University did not determine billing rates for recharge centers based on actual costs of providing services. For example, there were no cost studies to determine the rates for the Chemistry Stores, Electronic Stores and MCDB Storeroom recharge centers. Rates were based on actual cost of materials plus a markup percentage, which was not based on cost.

Although the COGEN, Departmental Precision Shop and Telecommunication Services centers rates were based on cost studies, the studies did not include adjustments for prior balances.

There was no evidence that any of the rates were reviewed or monitored to ensure they reflected the actual costs of operations. The University did not have an adequate accounting system to evaluate costs incurred, records for developing billing rates or the controls to monitor the billing rates and the resultant fund balances. Therefore, billing rates were not accurate.

Surplus and Deficit Fund Balances

Surplus fund balances occur when amounts billed for services exceed the cost of providing such services. Deficit fund balances occur when amounts billed for services are less than the costs for providing such services. Significant, recurring surpluses and deficits indicate a need to adjust the billing rate to reflect actual costs.

We found that all six recharge centers had recurring surplus and deficit balances. The COGEN center had surplus balances of over $1.1 million in fiscal years 1993 and 1994 (its first 2 years of operation). The Telecommunication Services center had surplus balances of over $950,000 for fiscal years 1991, 1992, 1993 and 1994. Surplus balances existed for the Chemistry Stores, Electronic Stores and Departmental Precision Shop centers during each of the 4 years. The MCDB Storeroom center had a recurring deficit for the 4 year period.

Surplus and deficit fund balances occurred because the University did not (1) have written policies and procedures for recharge centers and (2) analyze and adjust billing rates to prevent the accumulation of excess funds. Because surplus and deficit fund balances occurred, Federally sponsored research may have been overcharged.

Transfers

Surplus funds in the recharge centers were transferred to other accounts. Transfers were made to (1) a reserve fund for equipment replacements and additions, (2) retire the principal on bonds used for improving and replacing the telephone and generating systems, and (3) move funds to unrelated accounts. Billing rates should be based on all actual costs of providing services of the recharge centers. By transferring surplus funds out of the recharge centers, actual fund balances are distorted, and rates cannot be properly adjusted to reflect cost.

--Equipment Reserve Accounts

We found three recharge centers transferred funds to equipment reserve accounts. In the COGEN and Telecommunication Services centers transfers were based on amounts budgeted for equipment. In the Electronic Stores center, we could not determine how the amount was computed. Transfers to equipment reserve funds are shown in the following table.

RECHARGE CENTER	FY 92	FY 93	FY 94
COGEN			$300,000
Electronic Stores	$7,000	$5,000	$5,000
Telecommunication Services	$1,785,944	$1,774,513	$2,452,674

--Bond Principal

Section J. 12 of the Circular states that institutions may be compensated for the use of their buildings, capital improvements, and equipment and that such compensation shall be made by computing either depreciation or use allowance. The University transferred funds out of two recharge centers to retire the principal on bonds used for improving and replacing the telephone and generating systems at the University. Recovery of the bond principal should have been made through the University's computed use allowance. However, monthly transfers were based on equal payments to cover the 13 and 15 year bond maturity schedules. These transfers resulted in quicker recovery of building costs than would be allowed by the Circular. Transfers could also result in duplicate recovery of building and equipment costs if depreciation or use allowance were claimed elsewhere. Transfers for the payments of bond principal for the period of our review are shown in the table below.

RECHARGE CENTER	FY 92	FY 93	FY 94
COGEN			$1,865,000
Telecommunication Services	$650,000	$695,000	$745,000

--Unrelated Accounts

The University also transferred funds from recharge centers to unrelated recharge accounts. Transfers were made from three recharge centers (Chemistry Stores, Departmental Precision Shop, MCDB Storeroom) to other recharge accounts to pay for start up costs or for reducing deficits in the accounts. Transfers were also made from the Telecommunication Services recharge center for training and for the salary of the Director of Business Services whose salary should have been charged partially to another account. The following table summarizes the transfers made to unrelated recharge accounts.

RECHARGE CENTER	FY 92	FY 93	FY 94
Chemistry Stores	$1,435	$1,269	
Departmental Precision Shop			$5,094
MCDB Storeroom	$5,062	$6,623	$6,224
Telecommunication Services	$62,435	$373,420	$32,081

Because of the lack of oversight, transfers of funds were made for equipment reserve accounts, payment of bond principal and charges to unrelated accounts. The University did not have written policies and procedures or adequate controls to assure that funds were used only for the operation of recharge centers. As a result, overcharges to the Federally sponsored research may have occurred.

Charging Expense for Purchase of Capital Equipment

Section J. 12 of the Circular states that institutions may be compensated for the use of their buildings, capital improvements, and equipment and that such compensation shall be made by computing either depreciation or use allowance. Five of the six recharge centers expensed the cost of some capital equipment the year of purchase. Expenditures charged under the Capital equipment account were as follows:

RECHARGE CENTER	FY 91	FY 92	FY 93	FY 94
Chemistry Stores	$3,573	$2,459		
COGEN			$7,583	$4,791
Departmental Precision Shop	$9,851	$20,650		
Electronic Stores	$1,169			
Telecommunication Services	$5,371	$4,445		

The University had procedures requiring equipment purchases over $500 to be capitalized. However, because of the lack of University oversight on recharge centers, these costs were expensed instead of being capitalized, resulting in quicker recovery of Federal funds, as well as noncompliance with the Circular.

Recommendations

We recommend that the University:

❶ Develop and implement policies and procedures to assure that recharge centers are managed in accordance with the Circular and which provide for:

a. performing rate studies supported by current cost data,

b. monitoring fund balances and billing rates,

c. adjusting of the billing rates to eliminate the surplus or deficit fund balances,

d. ensuring that funds are used only for the operation of the recharge centers;

e. identifying and excluding unallowable costs from the recharge center accounts;

❷ For amounts identified in examples, replace the amounts in the recharge centers fund balance or refund the Federal share.

❸ Review the other recharge accounts to determine whether recharge centers used funds for unrelated or unallowable purposes and make adjustments as necessary.

Other Matters - Interest Earned

While reviewing recharge centers, we noted an issue not strictly related to our initial scope. The University had a pooled investment account for idle funds. Net interest earnings on the pooled investment balances were not credited back to the Department or fund that earned the interest. Interest earnings were generally credited to accounts under the President and the Chancellor to be used for University-wide and campus-wide initiatives.

Section J.44.b of the Circular specifies that the cost of each service shall consist of direct and related indirect costs with deductions for appropriate income. Any credits, such as interest, resulting from surpluses should be made to the original users to offset costs. We believe that interest earned on pooled investment funds should be credited back to the fund which earned the interest.

Auditee Comments

The University agreed with the report recommendations and suggested certain clarifying changes to the report. In addition, the University requested that the (i) Surplus and Deficit Fund Balances section of the report be deleted or clarifying information be added concerning the need for working capital, (ii) Transfers section of the report discuss GAAP requirements on transfers of funds to renewal and replacement accounts and retirement of indebtedness accounts, and (iii) recent OMB authorization permitting changes to the definition of equipment from a cost of $500 to a cost of $5,000 be added to the report.

OIG Response

We have incorporated certain suggested clarifying changes which we considered appropriate. Regarding working capital reserves, we have not changed the final report but believe if it is reasonably defined in the University policies and procedures and adhered to, surplus and deficit balances should not be a problem.

Regarding GAAP, we also have not changed the report. Unless the University elects an alternative method, we believe that funds for renewal and replacement accounts and retirement of indebtedness accounts should be based on the current use allowance policy.

Until the University actually changes their definition of equipment, we believe equipment costing between $500 and $5,000 should be capitalized and not expensed.

* * * * *

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determination as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See **45** CFR Part 5.)

Sincerely,

Barbara A. Bennett

Barbara A. Bennett
Regional Inspector General
for Audit Services

Enclosure

HHS Action Official
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October 20, 1995

Ms. Barbara A. Bennett
Regional Inspector General for Audit Services
Department of Health and Human Services
Region VII
601 East 12th Street
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Kansas City, Missouri 64 106

Dear Ms. Bennett

The following are our comments on the draft report on the results of your *Review of Recharge Centers* at the University of Colorado at Boulder (UCB) which covered the period July 1, 1990 through June 30, 1994.

Recommendations

1. Develop and implement policies and procedures to assure that recharge centers are managed in accordance with the Circular and which provide for:

   a. performing rate studies supported by current cost data,

   b. monitoring fund balances and billing rates,

   c. adjusting of the billing rates to eliminate the surplus or deficit fund balances,

   d. ensuring that funds are used only for the operation of the recharge centers,

   e. identifying and excluding unallowable costs from the recharge center accounts.

   UCB Response
   We concur. Policies and procedures have been drafted which cover the concerns in your recommendations. The policies have undergone one review and will be finalized by June 30, 1996.

2. For amounts identified in examples, replace the amounts in the recharge centers fund balance or refund the Federal share.

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CCB Response
We concur for unallowable amounts. UCB will review all amounts in the examples. Those which are unallowable will be returned to the recharge centers' fund balance.

3. Review the other recharge accounts to determine whether recharge centers used funds for unrelated or unallowable purposes and make adjustments as necessary.

UCB Response
We concur. Based upon the new policies and procedures, UCB will review the other recharge centers and make appropriate adjustments.

We offer the following comments on selected items in the **RESULTS OF REVIEW** section.

The correct title is Telecommunication Services rather that Telephone Operations.

Page 3 - Surplus and Deficit Fund Balances -- It is our understanding that surplus or deficit fund balances in and of themselves are not a violation of the Circular. Section J.44.c of the Circular states . . *It is not necessary that the rates chargedfor services be equal to the cost ofproviding those during any one year as long as rates are reviewed periodically for consistency with the long-term plan and adjusted if necessary.* Also, it is our understanding that Circular A-87 revisions permit a reasonable working capital reserve to cover 60 days of cash expenditures. While A-87 is not applicable to institutions of higher education, it is our understanding this has been applied as a reasonable basis for institutions of higher education internal service units. We believe our recharge centers fund balance surpluses are within this 60 day rule with few exceptions. Our draft recharge center policies and procedures enforces the 60 day rule and requires periodic review for consistency with the long-term plan and adjustments if necessary. We request this section of the report be deleted or that the above clarifying information be included.

Page 3 - Transfers -- The introduction to this section comments on the transfer of funds from the operating accounts in the current fund group to renewal and replacement accounts and retirement of indebtedness accounts in the plant fund group. These transfers are required by Generally Accepted Accounting Principles (GAAP) by which we are audited. Our draft recharge center policies and procedures address this issue to keep us in compliance with GAAP while ensuring that billing rates are based on all actual costs. We request that the GAAP requirement be included in this section of the report.

We would also like to note that GAAP prohibits us from booking and reporting depreciation. While we cannot book and report depreciation, we can base our transfers to renewal and replacement plant funds on a depreciation calculation. Our draft recharge center policies and procedures recognize that these transfers shall be based on a depreciation calculation.

Page 4 -- Unrelated Accounts -- We are not aware of any transfers from the Telecommunication Services for the salary of one professor. Transfers are made to partially fund the salary of the Director of Business Services who is responsible for the Telecommunication Services operations. This practice will be reviewed to consider charging Telecommunication Services directly for an appropriate portion of the Director's salary.

Page 5 -- Charging Expense for Purchase of Capital Equipment -- We would like to note that OMB has recently authorized cognizant agencies to change the definition of equipment from a cost of $500 to a cost of $5,000. Under this provision, 5 of the 9 items listed would be considered operating costs and not equipment purchases. The University is evaluating the adoption of the $5,000 threshold. If adopted, these would not be violations. We do agree the expenditures were violations based on the criteria in force at the time. We feel it would be helpful to include this clarification in the report to help readers understand the perspective of this issue.

Sincerely,

Jud Hurd
Controller