

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
RECHARGE CENTER CONTROLS
AT THE
UNIVERSITY OF CALIFORNIA,
SAN FRANCISCO**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG Office of Audit Services. Final determination on these matters will be made by authorized officials of the HHS operating divisions.



JUNE GIBBS BROWN
Inspector General

NOVEMBER 1995
A-09-95-04002



Region IX
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

CIN: A-09-95-04002
November 27, 1995

Steve Barclay
Vice Chancellor - Administration
University of California, San Francisco
San Francisco, CA 94143-0402

Dear Mr. Barclay:

The purpose of this letter is to provide you with the results of our REVIEW OF RECHARGE CENTER CONTROLS AT THE UNIVERSITY OF CALIFORNIA, SAN FRANCISCO (UCSF).

OBJECTIVES

The overall objective of the review, conducted as part of a nationwide effort, was to determine whether adequate policies and internal control procedures existed for the operation of recharge centers in compliance with the Office of Management and Budget (OMB) Circular A-2 1.

The specific sub-objectives were to determine whether:

- recharge centers are adjusting billing rates to eliminate accumulated surpluses and deficits over a specified operating cycle;
- recharge centers are generally excluding duplicate or unallowable costs in calculating the billing rates;
- recharge center costs are generally excluded from the calculation of the indirect cost rates;
- recharge center funds are not being used for unrelated purposes; and
- recharge centers are charging all users equitably.

SUMMARY OF FINDINGS

The UCSF's policies were generally consistent with OMB Circular A-2 1. Specifically, UCSF had policies which required staff to: (i) review recharge center billing rates annually, (ii) base billing rates on costs, and (iii) bill all-users equitably. In addition, UCSF requires its large recharge centers to establish advisory or user committees to review and comment on billing rates and services.

Although UCSF's policies were generally consistent with OMB Circular A-21, UCSF did not adequately control and monitor recharge center operations to ensure compliance. Specifically, the Budget and Financial Analysis Office (**Budget Office**) [page 7] did not provide adequate oversight. As a result, of the eight centers selected for review:

- eight used **unapproved billing rates** [page 8];
- six did not submit appropriate **rate proposals** [page 8]; and
- one charged **differential rates** to users [page 9].

We also found that one recharge center accumulated funds for the final disposal of low-level radioactive waste. Although this practice is reasonable, the center did not restrict the appropriate portion of the surplus fund balance **as a reserve for waste disposal** [page 10] or establish a business plan for use of the funds.

During the exit conference, UCSF personnel informed us that they plan to implement **new policies** [page 10] for the operation of recharge centers.

PRINCIPAL RECOMMENDATIONS

To ensure compliance with the provisions of OMB Circular A-21, we recommend that UCSF:

- ▶ require the Budget Office to provide oversight as directed by the UCSF's Policy and Procedure Manual (PPM),
- ▶ establish controls and monitor recharge center operations,
- ▶ reach an agreement with DCA regarding the reserve for waste disposal, and
- ▶ request its independent auditors to evaluate the implementation of the new recharge center policies as part of the OMB Circular A-133 audit.

UCSF'S COMMENTS

In written comments dated November 22, 1995, UCSF concurred with all of the recommendations presented in the report.

INTRODUCTION

BACKGROUND

The University of California (UC) educational system consists of the Office of the President and nine campuses statewide, including UCSF. The Office of the President performs administrative functions for the system as a whole and supports all campus operations. At UCSF, educational and research activities are conducted both on-campus and at various off-campus locations. For the Fiscal Year (FY) ended June 30, 1994, UCSF received over \$219 million in Federal research grants and contracts. For the same fiscal year, financial statements show revenues in excess of \$1.19 billion and expenditures of \$1.12 billion.

Recharge centers at universities, also known as specialized service facilities, operate as in-house enterprises and are used to finance, account for, and report upon the provision of goods and services to individual users or other operating units. These centers function as nonprofit businesses, funding operations through fees from users. Recharge centers typically include motor pools, telecommunications, computer centers, supply stores, animal care facilities and other specialized services. As of June 30, 1993, UCSF had identified 21 recharge centers each with revenues in excess of \$200,000. Total FY 1993 revenue for these operating units was \$78.7 million.

The UCSF's policy requires that all recharge rates be reviewed and approved annually. Each winter the Chancellor requests the departments to submit recharge rate proposals. The recharge center updates and proposes rates. If a center has over \$500,000 in annual billings, the center is required to establish an advisory or user committee to review and comment on the rates. The Dean, Vice Chancellor, or Director reviews, approves, and submits the rate proposal to the Budget Office. The Budget Office reviews proposed rates and approves rates as delegated by the Chancellor. While it is the responsibility of each recharge center manager to publish and distribute current rate schedules, the Budget Office is responsible for annually distributing a consolidated list of approved recharge activities and their principal rates.

CRITERIA

The costs incurred by specialized service facilities for providing goods and services should be recharged to users based on established billing rates and actual services provided. Costs charged to Federal grants and contracts by UCSF specialized service facilities must meet requirements set forth in OMB Circular A-71. Section J.44 of the Circular specifies that charges to users should be designed to recover not more than the aggregate cost of the services over a long-term period.

OBJECTIVES , SCOPE AND METHODOLOGY

Objectives

The overall objective of the review was to determine whether adequate policies and internal control procedures existed for the operation of recharge centers in compliance with OMB Circular A-2 1.

The specific sub-objectives were to determine whether:

- recharge centers are adjusting billing rates to eliminate accumulated surpluses and deficits over a specified operating cycle;
- recharge centers are generally excluding duplicate or unallowable costs in calculating the billing rates;
- recharge center costs are generally excluded from the calculation of the indirect cost rates;
- recharge center funds are not being used for unrelated purposes; and
- recharge centers are charging all users equitably.

Scope

Our review consisted of evaluating controls at the university-wide level and analyzing the fund balances of UCSF's 21 recharge centers with revenues in excess of \$200,000. We limited our review of UCSF's internal control structure to reviewing controls over:

- the establishing, monitoring and periodic adjusting of billing rates;
- preventing unallowable costs from being included in recharge rates;
- preventing the use of recharge funds for unrelated purposes; and
- the billing of recharge users.

We limited our detailed review to eight recharge centers.

EIGHT CENTERS SELECTED FOR REVIEW

- Animal Care Facility
- Biomolecular Resource Center
- Radiation Waste Disposal and Safety
- Lab Medicine - Clinical Support Unit
- Information Technology Services
- Campus Storehouse
- Radiology - Bone Densitometry
- Radiology - Imaging Lab

Methodology

Our review was conducted in accordance with generally accepted government auditing standards.

The UCSF identified 21 recharge centers each with annual revenues in excess of \$200,000. From our analysis of these 21 recharge centers, we judgmentally selected eight centers for detailed review based on several factors. The primary factors were total charges to Federal grants and contracts, unusual variations in fund balance, and size of the fund balance in relation to annual revenues.

We interviewed UCSF personnel and reviewed records. To determine whether controls were in place to exclude recharge center costs from the computation of the indirect cost rate, we interviewed the UCSF official who prepared the proposal and a negotiator with the Department of Health and Human Services, Division of Cost Allocation (DCA). For the eight centers selected, we reviewed the rate proposals and supporting documentation for FY 1993-1994, or an earlier proposal if the 1994 proposals were not available. We also reviewed UC's OMB Circular A-133 audit reports for Fiscal Years ended (FYE) June 30, 1991, 1992 and 1993, and UCSF Internal Audit reports covering the Budget Office and recharge center operations issued within the last 3 years. In addition, we reviewed a report issued by the National Institutes of Health (NIH), Office of Management Assessment, Division of Program Integrity, dated January 31, 1995, on two Federal grants which used the Bone Densitometry recharge center in the Department of Radiology.

We relied on the fund balances provided by UCSF's internal accounting records to compute the amount of charges to Federal grants and contracts. We used the fund balances as of June 30, 1994, as the base amount for each selected center. The Federal billing percentage for each recharge center was based on an analysis of billings for FY 1993. For each recharge center, we multiplied the fund balance by the Federal billing percentage to determine the amount of direct Federal charges in each fund balance.

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Additionally, since charges to Federal grants and contracts were subject to an on-campus indirect cost recovery rate of 43 percent for FY 1994, we added the amount of indirect costs applicable to direct Federal charges to determine the total Federal charges.

Our field work was conducted at UCSF during November 1994 through September 1995. We discussed our findings with UCSF personnel at an exit conference held on October 17, 1995.

FINDINGS AND RECOMMENDATIONS

The UCSF's policies were generally consistent with OMB Circular A-21. Specifically, UCSF had policies which required staff to: (i) review recharge center billing rates annually, (ii) base billing rates-on costs, and (iii) bill all users equitably. In addition, UCSF requires its large recharge centers to establish advisory or user committees to review and comment on billing rates and services.

Although UCSF's policies were generally consistent with OMB Circular A-2 1, UCSF did not adequately control and monitor recharge center operations to ensure compliance. Specifically, the **Budget Office** did not provide adequate oversight as required by UCSF's policies. As a result, of the eight centers selected for review:

- eight used **unapproved billing rates**;
- six did not submit appropriate **rate proposals**; and
- one charged **differential rates** to users.

We also found that one recharge center accumulated funds for the final disposal of low-level radioactive waste. Although this practice is reasonable, the center did not restrict the appropriate portion of the surplus fund balance as a **reserve for waste disposal** or establish a business plan for use of the funds.

During our exit conference, UCSF officials informed us that they have drafted **new policies** for recharge centers. The new policies will continue to require the Budget Office to review all rate proposals annually. The UCSF also plans to establish a centralized review committee. This committee is required to review proposals from new recharge centers and centers with annual billings in excess of \$500,000.

BUDGET OFFICE

The Budget Office did not provide adequate oversight of recharge centers as required by UCSF's policies. The UCSF's internal auditors, in their Recharge Core Audit Report dated August 1993, found that the Budget Office (i) could not identify all existing recharge centers, (ii) did not monitor the receipt of rate proposals, and (iii) did not review rate proposals on a timely basis. Although the Budget Office concurred with these findings, we found that the Budget Office had not taken corrective action.

The Budget Office was not able to provide us with a complete list of existing recharge centers for FY 1994. This occurred because some departments were inappropriately using the recharge accounting code for non-recharge activities. As a result, the Budget Office

had difficulty identifying which activities related to recharge centers. Thus the Budget Office was not able to provide adequate oversight of recharge operations.

We also found that the Budget Office did not have procedures in place to monitor the receipt of rate proposals. In addition, the Budget Office had not reviewed rate proposals for FY 1994. If rate proposals are not reviewed, there is no assurance that recharge centers are using acceptable billing rates or that UCSF's policy is being followed on a consistent basis.

UNAPPROVED BILLING RATES

Although UCSF policy required all recharge centers to have approved billing rates in order to engage in recharge activities, UCSF did not implement adequate controls to ensure compliance. The UC Business and Finance Bulletin A-47, effective July 1, 1984, states that "*All recharge activities shall publish a schedule of rates and prices which shall be reviewed and approved by the Chancellor or his/her delegate.*" However, all eight of the recharge centers reviewed billed for services using rates which were not currently approved by the Budget Office.

By permitting a recharge center to bill for services using unapproved billing rates, there is no assurance that the rates were consistently applied in accordance with appropriate Federal cost principles and University policies.

RATE PROPOSALS

Six of the eight centers reviewed did not submit appropriate rate proposals. Three centers (Carnpus Storehouse, Clinical Support Unit (CSU), and Radiology - Imaging Lab) did not submit rate proposals for FY 1994; the Biomolecular Resource Center (BRC) submitted an incomplete rate proposal for FY 1994. In addition, two recharge centers included improper costs.

Not Submitted

For the three centers that did not submit rate proposals, the Budget Office was not able to demonstrate that these centers reviewed their previous year's rates, current balances, and expected volume of services to determine whether rates needed to be adjusted. The UCSF PPM Section 460 states, "*Rates must be reviewed annually.... The Budget Office should be notified even if the recharge activity requests no rate changes after its internal analysis.*"

Incomplete

The BRC submitted a rate proposal for FY 1994, but it was incomplete. The proposal did not contain developed rates for all services provided by the center. We found that the

price list contained more services and rates than were developed in the proposal. Although the UCSF PPM Section 460 requires recharge centers to develop a rate schedule for each item or service provided, the BRC's rate proposal contained only rates for major services.

Improper Costs

The Information Technology Services recharge center included an unallowable charge of \$1,057 for a holiday party in its rate proposal. Although this did not have a material impact on the rate development, it demonstrates a control weakness. The UCSF established object codes to capture unallowable costs; however, neither the center nor the Budget Office used these codes to exclude unallowable costs from the proposal.

As another example, the Bone Densitometry center in the Department of Radiology was the subject of a NIH investigation which disclosed that the center's recharge rates were unacceptable for billing purposes. The NIH disallowed costs of \$83,781 (\$61,669 of direct costs and \$22,112 of indirect costs) on a Federal grant because the Bone Densitometry rates utilized were not calculated in accordance with Federal cost principles or University recharge policy. In addition, NIH found that radiology scans were not adequately supported with subject lists or other documentation. The UCSF submitted to NIH the final Financial Status Report for the grant which excluded the \$83,781 of disallowed costs.

DIFFERENTIAL RATES

The Clinical Support Unit (CSU) billed users at differential rates which may have discriminated between federally and nonfederally supported activities. The CSU provided immunology laboratory services and established a price list which included each type of test. For customers who ordered a large number of tests: the CSU could provide tests at a lower unit cost. The CSU was willing to pass on these savings to users by negotiating quantity discounts on a case by case basis. Although the CSU was generally able to compute discounts without accumulating significant surpluses or deficits, UCSF did not have sufficient controls to assure that Federal and nonfederal users were treated consistently. The UCSF did not perform a review of the rate proposal which may have identified the potential for price discrimination between federally and nonfederally sponsored projects.

The auditors who performed the A-1 33 audit for FY 1993 reported this finding and recommended that the center specify quantity discounts in the rate schedules to avoid any potential discrimination between federally and nonfederally supported activities. During our review, we found that UCSF had not yet implemented appropriate corrective action, but was working with DCA to resolve the finding.

The UCSF agreed to develop future rates based on separate components, such as labor and materials, rather than a cost per test basis. In this way, if a large user has lower labor

costs per test, the savings will be reflected on the invoice with a relatively lower number of labor hours billed.

RESERVE FOR WASTE DISPOSAL

One recharge center, Radioactive Waste Disposal and Safety, had built a reserve to cover the future cost of waste disposal. As of FYE June 30, 1994, the center had accumulated \$5 11,340 in surplus funds of which 55 percent, or \$28 1,237, was attributable to federally sponsored projects. The actual charges to Federal projects included \$120,932 of indirect costs for a total of \$402,169. The reserve, which is maintained in the operating fund as a surplus balance, has not yet been used because the construction of the Ward Valley site was delayed.

At present, UCSF's low-level radioactive waste is collected and stored in local facilities, but eventually UCSF will be required to transfer the waste to a regional facility. currently planned for construction in Ward Valley, California under the Low-Level Radioactive Waste Act. The billing rate per cubic foot of waste is based on actual costs to accumulate and store the waste locally plus an estimate for the cost of disposal at Ward Valley. In this way, the research projects which generate waste are charged for the cost of final disposal.

Although OMB Circular A-21 states that specialized facilities should not recover more than the aggregate cost of the services, the reserve built up by the recharge center effectively associates the cost of final waste disposal with the projects which generate the waste.

Since the reserve is reasonably estimated and the waste disposal is probable, UCSF and DCA should reach an agreement regarding the reserve. The agreement should require UCSF to (i) restrict the appropriate portion of the surplus fund balance as a reserve account, (ii) establish a business plan for use of the funds, and (iii) refund any portion of the reserve not used as intended or adjust future billing rates.

NEW POLICIES

The UCSF officials informed us that they have drafted new policies for recharge centers. The new policies will continue to require the Budget Office to review all rate proposals annually. The UCSF also plans to establish a centralized review committee. This committee is required to review proposals from new recharge centers and centers with annual billings in excess of \$500,000.

RECOMMENDATIONS

To ensure compliance with the provisions of the OMB Circular A-21, we recommend that UCSF:

- ▶ require that the Budget Office provide oversight as directed by the UCSF Policy and Procedure Manual.
- ▶ establish controls and monitor recharge operations to ensure that all centers:
 - 0 use currently approved rates to bill for services;
 - 0 submit rate proposals in accordance with Federal cost principles and University recharge policy;
 - 0 include only allowable costs in their rate proposals; and
 - 0 bill users equitably.
- ▶ reach an agreement with DCA regarding the reserve for waste disposal which provides that UCSF:
 - 0 restricts the appropriate portion of the surplus fund balance as a reserve account;
 - 0 establishes a business plan for use of the funds; and
 - 0 refunds any portion of the reserve not used as intended or adjusts future billing rates.
- ▶ request its independent auditors to evaluate the implementation of the new recharge center policies as part of the OMB Circular A-133 audit.

UCSF'S COMMENTS

In written comments dated November 22, 1995, UCSF fully concurred with our recommendations. The complete text of UCSF's response is included as an appendix to this report.

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We request that you respond to the HHS action official named below within 30 days from the date of this letter. Your response should present 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), HHS/OIG Office of Audit Services 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)

To facilitate identification, please refer to the Common Identification No. A-09-95-04002 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lawrence Frelot". The signature is written in a cursive, flowing style.

Lawrence Frelot
Regional Inspector General
for Audit Services

Attachment:

APPENDIX UCSF's response, dated November 22, 1995

Direct reply to:

David S. Low
Division of Cost Allocation
Regional Administrative Support Center
Room 304, Federal Building
50 United Nations Plaza
San Francisco, California 94102

APPENDIX



Steve Barclay
Vice Chancellor - Administration
513 Parnassus Avenue, S-126
San Francisco, CA 94143-0402
Tel: (415) 476-4148
Fax (415) 476-9634

Office of the Vice Chancellor - Administration
San Francisco, California 94143-0818

November 22, 1995

Lawrence Frelot
Regional Inspector General of Audit Services
Office of the Inspector General, Region IX
Department of Health & Human Services
50 United Nations Plaza
San Francisco, California 94102

Dear Mr. Frelot:

Subject: Resocnse to DHHS OIG Review of Recharge Center Controls at UCSF

UCSF acknowledges the findings and the recommendations contained in your October 24, 1995 draft report, which reviews recharge center controls at UCSF. We concur with the recommendations and provide below statements describing the corrective actions planned (and in many cases already implemented).

General Findina 1:

"...The Budget Office did nut provide adequate oversight as required by UCSF's policies."

Response:

Tine campus acknowledges that there was ncr adequate oversight of the recharge center process during 1992-93, the year that the audit reviewed. Recent senior management changes had just occurred in the Budget Office before that fiscal year began.

In 1994-95, the year in which the audit was taking place, the Budget Office directed a revamping of campus recharge policy and the recharge review process. An extensive campuswide training program ensued, with the purpose of identifying all campus recharge activities and reviewing them to insure that their charge basis and methodologies were property constituted and adequately supported. A copy of the new campus recharge policy is attached for review.

All 1995-96 recharges have been reviewed and approved in accordance with the new policy.

November 22, 1995

General Finding 2:

"...could not identify all existing recharge centers, did not monitor the receipt of rate proposals and did not review rate proposals on a timely basis."

Response:

The campus acknowledges this finding. In addition to the actions mentioned above, the Budget Office has made a further organizational change, placing management and oversight of the recharge center review and approval process under the Associate Director of the Department, instead of continuing it as a separately managed unit. Beyond this, KPMG Peat Marwick was engaged to assist in the identification and review of rate proposals. An internal tracking system was established to monitor both receipt of proposals and timeliness of the review process. Review-time objectives have been established, and a complete review of all recharge centers has been engaged for the 1995-96 fiscal year. The Budget Office and the campus Accounting Office have taken steps to eliminate improper use of the recharge accounting code for non-recharge activities. Recharge control codes were implemented, without which a recharge cannot be transacted in the campus General Ledger.

General Finding 3:

"...Recharge centers billed for services using rates that had not been approved: centers did not submit appropriate rate proposals or, in some cases, any rate proposal for review at all: centers included improper costs in rate proposals or had developed rates which were unacceptable for billing purposes."

Response:

The campus acknowledges that there were control weaknesses in the review of billing rate proposals. As mentioned above, in addition to a management change, the campus has engaged KPMG Peat Marwick to assist in the rate proposal review to insure that incomplete proposals are not approved, that improper costs or charge rates are not allowed, and that all rate proposals are reviewed annually.

General Finding 4:

"...billed users at differential rates which may have discriminated between federally and non-federally supported activities."

November 22, 1995

Response:

The campus acknowledges this finding and has taken steps in its review process to identify any rate proposal that may have potential for price discrimination between federal and non-federal sponsored projects.

General Finding 5:

Reserve for waste disposal - need for agreement regarding reserve.

Response:

The campus will meet and discuss the issue of the radioactive waste disposal reserve to insure that, as is currently the case, the reserve is restricted appropriately for the intended use and that either refund or future billing rate adjustment occurs for any part of the reserve not used.

General Finding 6:

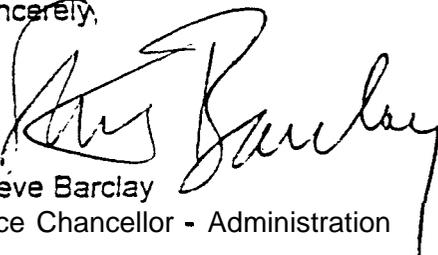
Evaluation of implementation of new recharge center policies.

Response:

The campus will request that its independent auditors evaluate the implementation of the new recharge center policies as pan of the CM6 Circular A-133 audit.

If you require additional information or have any questions, please contact Director Cordon at (415)476-385 1

Sincerely,



Steve Barclay
Vice Chancellor - Administration

cc (w/o encl.): Chancellor J. B. Martin
Vice Chancellor D. Bainton
Director R. E. Obana
Director H. C. Cordon
Manager J. Ohy