Attachment 2
Identified Issues in Draft Audit Report Content

Results in Brief

1. **Page 2: The Office of the President did not disclose to the University of California Board of Regents that it had amassed more than $175M in reserve funds as of fiscal year 2015-16.**

   While UC agrees that all funds should be disclosed in a transparent way, the implication behind the draft audit report's statement, especially the use of the word "amassed," is that the University has done something wrong in using temporary savings for high-priority programs. In some instances, the University maintains a prudent reserve associated with specific programs, which will have the effect of creating an ongoing unexpended balance each year. By way of example, the University's program in Washington, D.C. maintains a prudent reserve on a regular basis to fund unforeseen expenses associated with managing a building and the academic program. In another instance, funds received from a law suit settlement with Enron related to prior energy contracts are held in reserve and used as a revolving fund to support sophisticated studies and complex data retrieval performed in furtherance of the University's climate goals – and these funds are restricted to energy use. In other instances, vacancies and other unexpected events occur in any given budget and create one-time savings. These are not permanent savings and therefore cannot be used to support permanent expenditures; however, they do provide an opportunity each year to redirect some portion of the budget to one-time needs that otherwise would not be funded.

   The $175M in reserve funds (later outlined in Figure 10, pg. 19) should be reflected as $170M (the draft report included $5M that was not UCOP-related fund balance data). The $170M is comprised of $83M in restricted funds (see chart below) and $87M in unrestricted funds.

   FY 15-16 Restricted Fund Year End Balance Summary

Restricted Funds	$M
Lab Research Grant Programs (multi year)	$ 18
Contracts and Grants	13
UC Health (source: UC Medical Centers)	10
UCDC Reserves / PP&E (incl. residence halls)	8
Wholesale Power Program (campus agreement)	7
Building Reserves	7
UC Press	7
Enron Settlement	6
Other Administrative Funds	4
Endowment Cost Recovery	4
Other Program or Academic Funds	3
California Digital Library	2
Specific Academic Program Donations / Income	2
Office of National Laboratories	2
Endowments	1
ANR Federal Funds, State Appropriations	(1)
Internal Loans (UCOP funded)	(9)
Total Restricted Funds	**$ 83**

This document identifies the most apparent and notable issues contained within the draft report, but does not comprehensively address every inaccuracy and mischaracterization. The page numbers and table numbers are references to the draft audit report and may change in the final version of the report.

Restricted funds are provided for specific purposes and generally cannot be used for other purposes. Moreover, maintaining ongoing reserves for restricted funds is prudent management of funds where they are intended to support one designated purpose.

Of the unrestricted fund balance of $87M, $49M was committed as of July 1, 2016 to academic programs, systemwide initiatives, and multi-year campus commitments that the president and chancellors have agreed are high priorities. The largest items in the $49M include: $5.2M for the Global Food Initiative, $4.5M for the Public Service Law Fellowships, $2.5M for Carbon Neutrality, $4.6M for UC Merced Wetlands, $2M for UC Riverside's medical school, and $7.2M for cybersecurity. The Regents are kept apprised of these issues and expenditures throughout the year in their regular, public meetings. The remaining unallocated $38M in the unrestricted fund balance serves as a reserve for unexpected events. Temporary savings that allow for contingencies and some flexibility for unexpected events in large university settings are normal practice and can be referenced via NACUBO using terminology such as "flexible budget." The varying amounts each year underscore the reality that these savings are unpredictable, often one-time in nature and therefore cannot and should not be included in the permanent budget plan. UCOP agrees with CSA that spending from the carry-forward or flexible budget can be more transparent and that appropriate reserve levels should be based on best practices and an agreed-upon methodology to be reviewed and approved by the Regents.

2. **Page 3: The "undisclosed budget" ranged from $77 million up to $114 million in the four years we reviewed.**

The draft report includes new, non-standard budgeting terminology by using "undisclosed budget" to reference UCOP's carry-forward budget. UCOP uses this funding to support programs and initiatives that benefit the University systemwide, as well as individual campuses, faculty, staff and students. The funds were from unexpended budget savings that Regents had approved in prior budgets. Despite these shifts in timing, these initiatives are approved by the president and reviewed by the Regents. Furthermore, applications of temporary savings that allow for contingencies and some flexibility for unexpected events in large university settings are standard practice and can be referenced via NACUBO using terminology such as "flexible budget." The varying amounts each year underscore the reality that these savings are unpredictable and often one-time in nature; they therefore cannot and should not be included in the permanent budget plan.

3. **Page 3: Further, even though the Office of the President stated that expenditures from its undisclosed budget went through a rigorous approval process, it could not demonstrate adequate approval for 82 percent, or $34M, of the expenditures we reviewed from its undisclosed budget in fiscal year 2015-16.**
   &
   Page 34: Consequently, the Office of the President was unable to demonstrate adequate approval for 82 percent, or $34 million, of the five divisions' fiscal year 2015-16 undisclosed budget expenditures that we selected for review.

   CSA did not provide documentation associated with the $34 million identified, so UCOP cannot directly address these claims. Furthermore, it does not identify the methodology of testing the approval, the five divisions in question, or the manner in which the divisions were identified. That said, UCOP provided CSA unfettered access to archives that contain hundreds of decision documents and, when asked, undertook extra efforts to identify others. Because the report does not reveal the expenditures they reviewed, it is impossible for UCOP to respond to this statement.

   Generally, expenditures that are funded from the unrestricted or discretionary carry-forward budget must be approved through UCOP's formal decision-making process. The documents associated with that process outline the purpose, objective and options for the expenditure and must be reviewed and approved by the president. The unrestricted budget for carry-forward funds was $30M for FY 15-16, including $14.8M for the Presidential Initiatives fund.

   Since the start of President Napolitano's tenure, the level of rigor applied to financial decisions made in the Office of the President has increased dramatically. In its report, CSA acknowledges this process improvement.

4. **Page 4: Over the past five years, the Office of the President has underspent the revenue it received from campus assessment by $30M, and as a result, a significant portion of the Office of the President's discretionary reserve consists of funds the campuses could have retained and spent for other purposes.**

   UCOP's governance and charter preserves the authority of the President to, on behalf of the system, make investments that might not otherwise be made at the campus level. Key examples and priorities include UC Riverside's School of Medicine, UC Merced's development, and support services and financial aid for undocumented students. These investments are aligned with the University's mission and more suitably and effectively managed through UC's headquarters, in complete accord with campus priorities, as agreed upon by the president and chancellors.

5. **Page 5: Further, the Office of the President spent at least $21 million between fiscal years 2011-12 and 2015-16 on generous employee benefits...**

   The details of the benefits in the $21 million are provided in Table 9 of the report. Included in draft report's listing are reimbursements for meals, lodging, business meetings and entertainment and cell phones. The University does not consider these employee benefits. All of these are specific business expenses (totaling than $12 million) incurred by employees or on behalf of employees in the normal course of performing their job duties for the University.

6. **Page 6: When we attempted to quantify the costs of its systemwide initiatives, we found that the Office of the President was unable to provide a complete listing of the systemwide initiatives it administers or their cost.**
   &
   Page 72: However, when we requested a list of systemwide initiatives and their associated costs, we found that the Office of the President was unable to provide a complete listing of the systemwide initiatives it administers.

   UCOP provided CSA with a list of systemwide initiatives as requested. UCOP groups these initiatives separately and accounts for them systematically in its budget system.

7. **Page 7: The Office of the President's administrative spending has increased by 28 percent, or $80M, while campus administrative costs have increased by 26 percent over the same time period (from fiscal year 2012-13 through 2015-16).**

   In the aforementioned UCOP numbers, CSA has elected to include costs associated with the UCPath initiative, a new central payroll system that replaces individual campus programs. It is important to note that this vital program increases expenditures centrally, at the immense long-term benefit of eventually replacing current campus-level expenditures. During this period, UCPath costs totaled $15M. Had CSA excluded UCPath from the figures above, UCOP's increase would have been 23%, lower than the 26% increase of campuses. In addition, UCOP's figure includes increasing costs for major initiatives undertaken on behalf of the campuses, such as cybersecurity and large-scale strategic sourcing designed to generate significant systemwide savings.

8. **Page 7: Furthermore, the Office of the President's budget and staffing levels exceed those of the central administration at comparable university systems, such as the University of Texas. The Office of the President explained that this may be because it provides services to its campuses and employees that other universities do not such as the management costs associated with the university's retirement program.**

   There are considerable differences in the structure, scope of services, and level of State-provided direct support between UC and the University of Texas at Austin. That institution serves as both a flagship campus for the system and a major provider of programs and services for its smaller campuses. As a result, the central administration of that system relies heavily on that campus to support several systemwide activities. This is a fundamentally different model than UC and thus makes for an unfair and misrepresentative comparison.

Chapter 1

9. **Figure 3: The University of California Has Multiple Levels of Administration**

   The diagram in Figure 3 shows that the University is governed by the Regents and advised by the Academic Senate on matters of academic policy, admissions and curricula. The diagram that characterizes UCOP's role is misleading, as it excludes integral functions of UC's headquarters: Office of General Counsel, UC Health, systemwide human resources, information technology services and other support for campuses. In addition, UCOP's Operations budget rolls into the Central and Administrative Services budget; it is not a separate item.

10. **Page 16 and Figure 4: The university's campus in Berkeley chose to pay its entire $28 million fiscal year 15-16 assessment with its share of [state general fund appropriations] … In total, the Office of the President collected $288 million in assessments from the campuses, of which 37 percent -- $106 million – was paid using the State's general fund appropriation**.

    The Berkeley campus has confirmed that it did not exclusively use State General Funds to pay the assessment. The fund from which the assessment was paid includes both unrestricted state and non-state funds, including Nonresident Supplemental Tuition, Tuition, and other unrestricted sources. As a result, the figures of $28 million, $106 million, and 37 percent that appear on page 16 are inaccurate, as is the depiction of the Berkeley assessment in Figure 4.

11. **Page 17: Between academic years 2006-07 and 2011-12, the university nearly doubled resident tuition from $6,141 to $12,192 per year.**

    To make this one point, CSA has included selective data that falls outside of the identified and established period of this audit, which is generally 2010-11 to 2015-16. CSA used the latter timeframe for almost all of the other comparisons, data and findings. Furthermore, during the near entirety of the selected audit period, UC maintained tuition at constant levels.

12. **Page 17: The portion of its budget that the Office of the President discloses to the regents for approval increased by more than $100M from fiscal years 2011-12 to 2015-16.**

    The increase of $100 million between 2011-12 and 2015-16 reflects several changes to the programs and initiatives provided by UCOP. The increase is due in large part – 70 percent – to increases in restricted funds that flow through UCOP, mainly the management of the patent portfolio for most of the campuses and the funds for the Education Abroad Program, which is managed at the Santa Barbara campus. The draft audit report fails to clarify this and implies that administrative operations grew dramatically; in reality, the vast majority of this increase was from programs that directly benefit campuses and students. The increase in the unrestricted portion of the budget was due to key systemwide initiatives that include UCPath, investments to address cybersecurity risk, and strategic sourcing, all of which – again – directly benefit the campuses.

13. **Page 19: The budget for the University of California (university) Office of the President has grown without adequate justification.**
    &
    Page 47: The Office of the President acknowledged the need to review staffing in the past: in January 2014, it issued a presidential directive calling for its divisions to create staffing plans in addition to a budget review that was supposed to identify redundancies and determine the appropriate size, shape, and role of the Office of the President. However, it did not document the results of the review. Further, our analysis shows that the review did not decrease staffing levels or costs.

    Growth at UCOP has not been in administrative functions as implied by the draft audit report; rather, by design, it has been entirely in strategic areas that benefit the campuses and allow for long-term savings:

    - Information Technology: Much of the growth here has been movement from external contractors to internal resources, such as Apply UC. Between 2011-12 and 2015-16, growth in this area was 11.1 full-time equivalent staff (FTE).
    - Office of the General Counsel: To reduce overall spending and increase efficiency, UCOP has expanded in-house legal services. Between 2011-12 and 2015-16, there was growth of 14.3 FTE.
    - UCPath: This new initiative replaces eleven separate antiquated systems with one vendor-based product to standardize and streamline human resource and payroll functions across all campuses and to centralize certain services for the system. Between 2011-12 and 2015-16, there was growth of 160 FTE.
    - Chief Investment Officer (CIO): The CIO's office identified opportunities to save money long-term by bringing certain investment management functions in-house instead of using outside consultants and managers. Between 2011-12 and 15-16, there was growth of 6.7 FTE.
    - Risk Services: UCOP created Fiat Lux, a captive insurance company, to allow the University to self-insure and buy re-insurance directly in the market, eliminating the need to purchase coverage through insurance carriers at higher rates. Between 2011-12 and 2015-16, there was growth of 11.9 FTE.
    - Procurement Services: The P200 initiative has saved over $200M thus far. It has expanded its scope and set its next savings goal at $500M (SC500). Between 2011-12 and 2015-16, there was growth of 16.6 FTE.

- ILTI (Innovative Learning Technology Initiative): This program aims to create high-quality online education experiences across all campuses. Between 2011-12 and 2015-16, there was growth of 15.8 FTE.

The remainder of the Office of the President administrative functions have decreased by 40 FTE since President Napolitano assumed leadership in 2013.

14. **Page 19: As a result of these convoluted and misleading budgets, the Office of the President has received little meaningful oversight of its finances.**

This language suggests intent by UCOP to mislead through its reporting of budgets and expenditures. While UCOP acknowledges the importance of continuous improvement, there is no evidence that funds were used for any purpose inconsistent with the missions of the University.

15. **Page 20: Our analysis suggests the Office of the President could currently use from $38 to $175 million from its reserves for other university priorities depending on the results of a review of its funds and commitments.**

The total fund balance as of June 30, 2016 was $170 million. As stated above, portions of the restricted balance are funds provided for a specific purpose and cannot be redirected to other uses. Moreover, another portion of these fund balances will be transferred to campuses in the form of research grant funding or other program services by agreement (i.e. Wholesale Power, UC Health). For more information, see chart in response to issue #1 above. In addition, all of the programs included in the $49 million represent direct alignment with UC's mission; reflect significant stakeholder input from campuses, students, and Regents; and demonstrate shared priorities with the State.

16. **Page 20: The Office of the President maintains two budgets.**

Carry-forward funds are not a separate budget. They generally result from savings from temporary vacancies caused by staff turnover or retirement, as well as other reasons during any given year.

The Office of the President conducts periodic reviews of departments to identify budget trends and to determine if departments annually carry forward an appropriate level of funding. In certain instances, UCOP trims department budgets. However, in most cases, the large variances reflect one-time vacancies or the multi-year nature of projects and are therefore temporary in nature.

17. **Page 21: The combined disclosed and undisclosed budgets for the Office of the President grew faster than inflation; in part because of programs it funded using its undisclosed budget, such as a $1.3 million subsidy program to reduce employee contributions to the university's health insurance program and its $2.2 million**

cybersecurity initiative. The consistent growth in the Office of the President's spending makes the lack of transparency of its budget to its stakeholders particularly troubling.

UCOP lists major areas of growth each year in the Regents item of the UCOP budget submitted for approval. UCOP is fully transparent about such increases. In addition, growth of the University of California systemwide has outpaced that of the Office of the President.

Inflation is only one of the increasing cost pressures on UCOP; rising student enrollment and expanding research and health budgets also impact existing resources. That said, UCOP has grown significantly slower than the University as a whole.

18. **Page 21: Over the past four years for which it has data, the Office of the President has spent an average of $97 million less per year than it planned to spend.**

    UCOP has maintained conservative spending practices through the years. The general management philosophy is to not exceed annual budget targets. The average annual savings amount has varied from year to year and is made up of roughly 60% restricted funds, which are often supporting multi-year awards that are spent in future years. Much of the year-to-year savings can be attributed to temporary vacancies and turnover of staffing at the Office of the President. Consistent with its management practices, UCOP seeks to underspend, as opposed to overspend, in any given year.

19. **Page 22: In fact, as of 2015-16, the Office of the President had $830 million of funds available to spend, but only presented a budget totaling $655 million to the regents.**

    This statement is misleading and inaccurate. The variance between $830M and $655M is the draft report's calculated $175M reserve. The report states that the entire balance is available, neglecting the fact that $83M is restricted (see Figure 6 in the draft report), and $49M was committed in prior years.

20. **Page 23: The remaining undisclosed reserve funds were spent on one-time projects and unanticipated expenses. Thus, most of the spending in this budget was for purposes not approved by the Regents.**

    Funds within the carry-forward budget are spent in accordance with the overall mission and key priorities of the University. Many of the expenditures are for programs that are already established in the permanent budget or are added to the permanent budget in subsequent years, such as the cybersecurity program, the Presidential Postdoctoral Fellows Program or the Sexual Violence/Sexual Harassment office. Moreover, the Regents approve the UCOP budget at the division level, not by program. Some carry-forward funds are spent within the same division they were originally approved, and are thus consistent with the funding levels the Regents originally reviewed and approved. Moreover, these programs are frequently discussed with the Regents in their public meetings.

21. **Page 24, Table 4 The Office of the President's Planned Spending From the Undisclosed Budget Includes a Number of Different Types of Expenditures**

    Many of the items in the table (Historically Black Colleges and Universities, Multi-campus Research Programs and Initiatives, President's Postdoctoral Fellowship Program, Sexual Violence, Sexual Assault) are also in the permanent budget. The carry-forward funding in the table represents supplemental funding to advance or commence the program. This table also wrongly categorizes the President's Residence funding; this is not a carry-forward budget item.

22. **Page 25: Furthermore, these documents were included in the materials presented to the regents' committee on finance, rather than as part of the presentation to the entire board.**

    All presentations and documents presented during the Finance Committee meeting are available to the full Board of Regents. During the audit period, the entire board was present for all of the presentations and details.

23. **Page 27: A more transparent budget presentation would separate pass-through funds from the Office of the President's actual operating expenditures.**

    The most recent budget item presented to the Regents clearly distinguished systemwide programs. In previous presentations, systemwide programs were separately identified in an accompanying table.

24. **Page 27: Further, if the Office of the President had provided the prior fiscal year 2014-15 expenditures, the regents would have known that the Office of the President spent more in the prior year than what was approved. We question whether the regents would have approved the Office of the President's fiscal year 2015-16 budget – or the Office of the President's requested $10 million increase to the campus assessment…**

    UCOP rejects the assumption that if the Regents had known about the most recent year's expenditure of carry-forward funds, they would not have approved the budgeted level of funding. Carry-forward funds are temporary, one-time funds and should not be used to support permanently budgeted programs. The budget the Regents approve each year is the permanent budget, which is prudently managed through permanent fund sources. The two are not related and, as such, budget approvals would not have been different.

25. **Page 27: After we asked about its budgeting practices, the Office of the President systemwide controller asserted that it began creating undisclosed budgets as a result of the state budget process and that it had maintained the process because it had always budgeted in that manner.**

    The systemwide controller did not make this statement, and she was not given any documentation to validate this assertion as part of the audit process. This is in violation of CSA's standard auditing practices, which require documented support for all content included in the audit report.

26. **Page 27: When we asked about the Office of the President's failure to base its budgets on the current year's estimated actual expenditures, its management asserted that they would consider using actual expenditures as the basis for future budget planning. However, its management expressed concern that basing budgets on actual expenditures would create incentives for the Office of the President's divisions to spend their full budgeted amounts each year so as not to lose their budget allocations for the following year.**
    &
    Page 28: The Office of the President should base future budget planning on its actual expenditures to improve the accuracy of its estimated budgets, cut unnecessary spending, and reduce the financial burden the campus assessment places on the campuses.

    Most similarly complex entities funded by California's state budget use incremental budgeting – the University of California is no exception. Neither the Governor's Budget nor the final budget adopted each year "is based on the current year's actual expenditures," per CSA's recommendation. UC acknowledges that it is important to review budgets periodically to determine if actual expenditures over several years are in line with permanent budgets. In instances where actual expenditures and planned budgets have been found to be out of alignment over several years, budgets have been reduced. However, it would be imprudent to manage budgets year-by-year on temporary changes that occur in any given year.

27. **Page 28: We do not consider the Office of the President's concerns to be valid because it annually sweeps unused discretionary budget allocations into a discretionary reserve, a practice that already encourages its divisions to spend their entire budget allocations.**

    UCOP considers this an inaccurate statement and the draft report does not provide any evidence to support it. As CSA itself has noted, the vast majority of divisions do not spend their entire budget allocations.

28. **Table 5. The Office of the President's reserve balances indicate that it did not keep the campus assessment as low as possible.**

    This table represents the growth of a reserve balance for a new revenue stream. This balance grew to approximately $30 million. This reserve was then deployed to limit volatility in the campus assessment for the past two years. Based on consultation with the campuses, UCOP chose an approach that led to modest reserves that in turn ensured a predictable assessment.

29. **Page 30: Without adequate opportunity for campuses to provide input on the Office of the President's budget, the Office of the President has less assurance that its budget continues to align with the university's priorities and serve the needs of campuses.**

    The Office of the President develops its priorities with extensive campus consultation. On a monthly basis, the President formally meets with the campus chancellors; the Provost formally meets with campus Provosts; and the Chief Financial Officer formally meets with the Chief Financial Officers of the campuses, among a range of similarly consultative efforts. Ultimately, the Board of Regents and the president establish the priorities of the University, after extensive and purposeful consultation.

30. **Page 31. Although we recognize that the Office of the President needs some flexibility to fund these sorts of programs or projects if they arise during the year, the regents already approve an annual allocation of $10 million for the president to use as she sees fit for the mission of the university. In each of the past four fiscal years, the president did not spend all of this allocation.**

    The unspent expenditure of this allocation represents financial prudence by the University and the current and immediate past presidents. At the time of his departure, President Yudof had not expended the entirety of these budgeted funds. Upon assuming leadership, President Napolitano reviewed University operations and priorities before deciding on the most prudent investments. Since her arrival, the actual expenditures of these funds have effectively come into alignment with the budgeted amount. Again, UCOP's approach is to underspend rather than overspend.

31. **Page 32: Moreover, the director of corporate accounting confirmed that the Office of the President can designate funds as restricted, such as the systemwide administration cost recovery fund which it largely spends on marketing.**

    This is not an accurate statement, and the Director of Corporate Accounting did not make it. No documentation to validate this assertion was provided as part of the audit process. This is in violation of CSA's standard auditing practices, which require documented support for all content included in the audit report.

32. **Page 34: Moreover, after the Office of the President provided this documentation, we found some of the approval documents were incomplete because they did not include the expenditures' justifications or identify the individuals who approved them.**

    CSA did not provide documentation associated with this claim, so UCOP cannot directly address it. Furthermore, it does not elaborate on "some" of the approval documents. Since the start of President Napolitano's tenure, the level of rigor applied to financial decisions made in the Office of the President has increased dramatically. In its report, CSA acknowledges this process improvement.

33. **Page 35: In fact, we found it difficult to determine which decision memos related to the undisclosed budget because the Office of the President does not distinguish between these memos and ones related to its disclosed budget.**

    This statement validates UCOP's stance that it does not, in fact, maintain two budgets.

34. **Page 36: Instead, the Office of the President could only provide annual budget letters that it sent to its divisions that described at a high level specific budget priorities – like reducing meeting costs – and changes to the budget review process.**
    &
    Page 37: However, these letters did not sufficiently explain how the divisions were to implement these guidelines within the framework of an existing budget process.

    As with the development of the budget at the State level, other universities, and countless other complex, multifaceted organizations, UCOP's budget letters describe the priorities and goals the president has established for development of the following year's budget. It is within a UCOP division's purview to determine how to implement these goals.

35. **Table 6. Future budgets are based on current year budget and actual expenditures are not regularly monitored by the budget office.**

    UCOP periodically reviews actual expenditures to determine if departments are over-budgeted. It does so using several years' worth of actual expenditures.

36. **Page 39: The Office of the President's choice to omit information about its other available funding sources is concerning because we determined it could have used these sources to minimize the campus assessment or minimize these funds for other university priorities by returning excess reserves to the campuses in the form of a refund.**

    The Office of the President publicly reports its funding sources by group in the annual presentation to the Regents. Available sources of funding for the ongoing budget were evaluated as part of the preparation of the annual budget, and then included in the high-level funding sources by restriction, as applicable. Providing additional detail around the sources and uses of funds within the UCOP budget is what UCOP has been doing internally for several years, and will provide at the level of detail appropriate and necessary for review by the Regents.

37. **Page 39: The systemwide controller stated that GFOA budget practices do not necessarily apply to the Office of the President because it reports business-type activity whose operations are financed in part by fees charged for its services, making it different from other entities primarily funded through public funds. However, we believe that because the university receives $3 billion in state general funds from taxpayers it should follow GFOA best practices. Moreover, when we contacted the GFOA, a senior manager agreed that these best budget practices are applicable to public sector higher education institutions.**

    This paraphrased misinterpretation of a quote from the Systemwide Controller confuses her comments on Governmental Accounting Standards Board (GASB) requirements with GFOA requirements. The confirmed documented response to CSA from the Systemwide Controller contains the following statement, which is not incorporated in the draft report: "GFOA budget practices are an appropriate overall framework for assessing OP's budgeting process."

38. **Page 41: Specifically, although the university receives an annual financial audit by an independent external auditor, this audit is conducted at a systemwide level, which obscures the Office of the President's financial activities and does not specifically valuate the Office of the President processes.**

    UCOP rejects the assertion that this process obscures financial activities – deliberately or otherwise. There is no intent to "obscure" information, and the draft report includes no corroboration for that characterization. The purpose of the annual financial audit is to carefully assess the entire University, which it does comprehensively according to accepted audit standards.

39. **Page 42: For example, the university's most recent annual financial report indicated that the university as a whole maintained a deficit unrestricted fund balance of $11 billion, a significant portion of which is attributable to pensions and retiree health benefit obligations. However, as we demonstrated earlier in this chapter, the Office of the President itself maintains a significant surplus reserve balance – $92 million of discretionary reserves at the end of the fiscal year 2015-16.**

    The $92 million of discretionary reserves referenced above should be corrected to reflect $87M after the $5M adjustment ($175M vs. $170M, see issue #1 above). Furthermore, as clarified earlier, the $87M has commitments of $49M against it yielding an unallocated carry-forward balance of $38M. With regard to the pension and retiree health benefits, any comparison of either the purported $11 billion deficit or UC's reserve to UCOP's carry-forward balance is comparing apples to oranges. The $11 billion deficit is related to the requirement by GASB rules that the current value of retirement health benefits be reflected on balance sheets. The $11 billion is associated with the entire University system and includes the Office of the President's proportionate share of these costs. The $87M million in carry-forward funds is an entirely separate matter. Lastly, with regard to the pension issue, UC has taken steps in recent years to restructure and address financial issues associated with pension and retirement benefits in order to correct the $11 billion issue.

40. **Page 43: ...the Office of the President was unable to provide us with information regarding the actual restricted revenue it received.**

    This statement neglects to mention the lack of time provided by CSA for UCOP to meet this request. CSA made the request to UCOP on March 22, one week before the release of their draft report. The Budget and Finance office responded that it would require an extensive manual effort to compile this data for the entire audit period, which could not be completed in such a short time. The CSA statement implies that UC is "unable" to provide it at all, which is not a correct representation of UC's response.

Chapter 2

41. **Page 48: Although the Office of the President has consistently stated publically (sic) that it is doing all it can to keep its operating costs low, its staffing levels have grown by 11 percent since fiscal year 2010-11. As Table 7 shows, this rate of growth outpaced the rate of staffing growth for the university by 1 percent.**

    As draft report itself points out, many of the projects and programs managed by UCOP are systemwide. The increase in UCOP staff has been necessitated by additional systemwide projects that reduce redundancy on the campus level. In addition, the 11% growth for the 6-year period equates to annualized growth of less than 2% per year.

42. **Page 48/49: From fiscal years 2010-11 through 2016-17, the Office of The President increased the number of staff at its Oakland location by 153 employees, while it employed only 17 additional staff at the campuses. Employees at the Office of the President's headquarters generally perform administrative functions, such as human resource administration, accounting, and information technology (IT) support.**

    The draft report is dramatically understating the scope and scale of functions provided by UCOP. The office manages programs that serve the entire system, allowing campuses to capture the savings and efficiencies of centralized operations, while coordinating activities that allow them to operate as one university – all this, with its core operations and staff comprising just 1 percent of UC's overall budget.

Among UCOP's most critical functions:

- Serving students: Maintain UC's admissions process and centralized application portal; administer over $5 billion financial aid annually; provide academic support for underrepresented K-12 students; partner with community colleges and education groups for enrollment outreach
- Serving the public: Oversee five medical centers that provide critical care, serving 1 million patients each year; administer $220 million in grants that support campus research and innovation; overseeing State-funded research programs combatting cancer, HIV/AIDS and tobacco
- Serving UC's mission: Provide funding for and, in many cases, manage a wide array of programs, including: improving K-12 education through programs focused on low-income, underserved or underrepresented student groups as well as teacher training and support; an extensive network of researchers and educators reaching out to every CA county to solve local economic, agricultural and natural resource problems; leading efforts in areas of societal and global impact such as climate change and sustainability, food security, and innovation and entrepreneurship
- Serving UC: Manage fiscal operations of UC's $30B budget and UC's $100B investment portfolio; negotiate systemwide collective bargaining agreements; oversee legal and ethical compliance; promote UC's interests in Sacramento and Washington, D.C.; administer plans for 200,000 current and retired faculty and staff

UCOP's identified growth of 153 employees supports additional systemwide initiatives. The limited campus growth proves the fact that UCOP's systemwide initiatives indeed benefit the campuses by diminishing redundancies.

43. **Page 49: Although the Office of the President has maintained relatively steady staffing and salary levels for its senior management group, it has increased both staffing and salary levels for its managers and senior professionals and for its professional and support staff. In fact, it increased its managers and senior professionals' staffing levels by 32 percent from fiscal years 2010-11 through 2015-16, from 519 employees to 685 employees. Further, the total salaries it paid its managers and senior professionals increased by $38 million, a 59 percent increase, and their average salaries increased by 22 percent, or nearly $27,000, over this same time period.**

UC has transitioned to a new system called Career Tracks, which has enabled UCOP to standardize job classifications, and review and update job descriptions to better reflect employees' day-to-day responsibilities. In addition, UCOP Human Resources conducted reviews to ensure the management structure was consistent with the Career Tracks system, i.e., that managers must supervise two or more full-time career staff. This analysis, the transition to Career Tracks, as well as the restructuring of UCOP that began in 2008-09, reduced the number of UCOP employees designated as managers. Furthermore, UCOP staff are now in job classifications that more closely reflect their actual duties. Thus, when Career Tracks was implemented in 2014, of the 91 employees classified as managers under the old system, 41 were moved to non-manager classifications.

A broader review of data between 2007-08 and 2015-16 (which includes pre-recession years) actually shows a 29% drop in UCOP managers working in largely administrative functions.

44. **Page 50: For instance, an associate director in the public affairs division with an annual salary of $160,632 does not directly manage any employees. Likewise, a manager in the academic affairs division with an annual salary of $120,200 manages only one employee. In fact, we identified 10 managers who appeared to oversee only one employee and 6 managers who did not oversee anyone at all. When we shared this analysis with the Office of the President it stated that the guidance was not a strict rule. However, we question whether the number of managers and their corresponding pay is justified given the Office of the President's perspective that its managers do not necessarily need to oversee at least two staff.**

    Since many UCOP managers oversee systemwide projects and programs, a manager of a systemwide program leverages existing staff in the same programmatic function at the campuses rather than adding staff under the manager at UCOP. Because UCOP managers are accountable for systemwide programs, their job duties, their title, classification and pay reflect the scope of their responsibilities accordingly.

45. **Page 50: The Office of the President could save millions of dollars in salary costs by paying its executive management and administrative staff salaries that more closely align with those offered by state agencies and the California State University (CSU). The Office of the President's higher salaries are largely the result of its decision to use mostly private sector data when determining appropriate salaries for its positions.**

    The University's salary ranges and pay practices are aligned with the marketplace in which it competes for talent. Its medical enterprise is aligned with other public and not-for-profit teaching hospitals' pay practices; its academic positions are aligned with public and private higher education institutions; and its administrative and operational positions are aligned with public and private employers in the geographies that it targets for recruitment. In the last category, higher education pay data accounts for at least 50% of the data UCOP uses to create the pay structures for executives. In addition, where there were reasonable matches at CSU, the State, counties and municipalities, UCOP included that data in the creation of the market reference zones (MRZs). For example, the Chief Investment Officer position is matched to CalPERS and CalSTRS, in addition to a host of other public higher education institutions.

46. **Page 50: Further, the Office of the President has established wider salary ranges than comparable state employees that may not allow it to effectively control costs or provide incentives for employee development because employees do not necessarily have to take on additional responsibilities to earn more money.**

    The State is heavily unionized and its ranges reflect that reality and are influenced by the bargaining process. For UC, MRZs reflect actual pay ranging from the 25^{th} to the 90^{th} percentile of our market comparators. Our salary ranges are similarly situated with the median market pay reflected by our salary range midpoints. Those ranges are indicative of pay for seasoned professionals at the higher end and those with little or no job-related experience at the lower end. This encourages employee development, allowing them to migrate through a given salary band by increasing their skills and abilities. This is a much more fiscally prudent way of managing staff and compensation, as it helps control grade inflation and better manage salary compression.

47. **Page 51: The Office of the President could save at least $700,000 annually by aligning its executive salaries to those of comparable public sector executives**

    While salary levels paid in the public sector should be an important component in the University's market comparisons, they should not be the only component. The University largely recruits from a very different market than state government. Moreover, the State has historically recognized the importance of the University's need to be competitive with both public and private institutions. Its State-approved faculty salary comparison institutions are half public and half private for this reason, acknowledging that the University must compete with both kinds of institutions for its faculty. The same is true for staff. As a result of the last audit, the Legislature inserted language into the 2015-16 budget requesting the University include more public-employee comparisons in its market zones analysis, and UC has complied where applicable.

48. **Page 51/52: The 10 Office of the President executives we analyzed had combined salaries of $3.7 million-over $700,000 more than their combined highest paid state employee counterparts. Furthermore, in many instances, the state employee executives had roughly the same levels of responsibility compared to Office of the President executives. For example, the director for the California Department of Human Resources (CalHR) earns about $100,000**

less than the vice president of human resources at the Office of the President. Both positions are responsible for labor relations, collective bargaining, employee salaries and benefits, job classifications, recruitment, and retention; however, CalHR is responsible for over 225,000 employees compared to 190,000 at the university.

In this example, CSA is overlooking the additional scope of UCOP's Vice President of Human Resources role, including the complexity of the strategic programs focusing on talent and retention, and the oversight and creation of compensation and benefits programs, including pension and retiree benefits. It should be noted that retirement programs for CalHR are administered by CalPERS, and having the vast majority of State staff unionized further simplifies the CalHR position. In addition, the complexity of the research and health services organizations, which does not exist at CalHR, expands the scope of the UC job.

49. **Page 52: Nonetheless, CSU executives have more responsibility than their Office of the President counterparts in some instances. For example, the CSU's chief financial officer-whose annual salary was $70,000 less than the university's chief financial officer in fiscal year 2014-15-is in charge of the business and finance division, the mission of which includes management of information technology services.**

    The draft audit report highlights information technology services that are not in the portfolio of the UC CFO, while it ignores all the other critical aspects of the UC CFO portfolio that are not in the CSU CFO's scope of job responsibilities. These include the roles the UC CFO plays with respect to asset management, financial investments, and capital finance, among others.

    The UC CIO also has significantly greater levels of complexity than CSU or the State, since the role includes supporting UC's expansive research and health enterprise, including the strategic initiative supporting the use of big data in the enhancement of clinical delivery.

50. **Page 53: The Office of the President has asserted that the higher education environment necessitates higher pay for its staff. Although that assertion may have merit for certain executive employees, it has much less merit for administrative staff who perform similar duties no matter where they work. Nonetheless, Table 8 shows that the Office of the President paid the administrative staff we reviewed over $2.5 million more in annual salaries than the maximum salaries for comparable state employees, even after including a cost of living adjustment. We analyzed the job duties, responsibilities, and qualifications of the Office of the President**

administrative classifications to identify similar state positions. We found that the *average* Office of the President salary was higher than the *maximum* amount the State could pay an employee to perform the same administrative duties for eight of the 10 positions we reviewed.

UC does not believe that CSA chose truly comparable jobs in its analysis. First, job comparisons to CSU and the State may not be appropriate given potentially vast differences in the scope of responsibilities. For instance, when UCOP reviewed the job description that CSA selected from the State for an Executive Assistant 3 (EA3), it found that the State job was much lower level with fewer responsibilities. In addition, the CSU range was much closer to the range for the UC EA3 position and their duties are more aligned.

Additionally, the draft audit report indicates that CSA, "…added a 4 percent cost-of-living adjustment for comparing the salaries of State employees to OP employees." Best practices for compensation would not apply cost-of-living differentials, but rather cost-of-labor differentials. UC uses data from the Economic Research Institute, which includes thousands of employers, and indicates that the cost of labor in Sacramento is approximately 6% greater than the national average while Oakland is 17% greater than the national labor average.

The draft audit report compares represented IT positions at the State to a non-represented position at UC. Market demand for qualified IT employees is extremely high in the Bay Area. UC must pay the Bay Area's competitive wages in order to attract and retain qualified employees and prevent costly turnover.

51. **Table 8. Office of the President Administrative Staff Salaries Generally Exceeded Salaries of Comparable State Employees.**

While salary levels in the public sector should be an important component in the University's market comparisons, they should not be the only one. The University largely recruits from a different market than state government. Moreover, the State has historically recognized the importance of the University's need to be competitive with both public and private institutions.

52. **Page 55: When we suggested that the Office of the President give greater weight to public sector pay when setting its salaries, it claimed lowering salaries would make it less competitive in the Bay Area job market and therefore affect its ability to attract talent. It especially emphasized this point for the technology positions we selected. Nonetheless, we disagree with the implication that pay alone attracts talent. The Office of the President offers stability and generous benefits including a retirement plan that are not always provided in the private sector. Moreover, the Office of the President**

can attract individuals for whom working for the public sector to advance the university's prestigious reputation has an intangible benefit. These factors help to offset the pay differential between the Office of the President and the private sector.

UCOP never asserted that pay alone is the single factor attracting talent and agrees that many other factors may attract employees to UC, one of which is UC's prestigious reputation. However, without competitive pay, prospective employees may not even consider UC as a viable employer.

The University's retirement plan is a consideration for employees who plan to spend a large portion of their career at UC. However, for prospective employees who for various reasons anticipate a shorter tenure with the University, cash compensation is more critical than long-term benefits that will not impact them.

53. **Page 55: The Office of the President's salary ranges are too wide to effectively control payroll costs or ensure internal equity within job classifications. The maximum of every salary range the Office of the President uses for its non-represented employees is at least double the minimum salary for the same range. For example, the Office of the President's highest salary range that was effective from July 2014 through June 2016 spans from $124,600 to $344,600-a difference of $220,000.**

    The spread of the State's salary range for the IT position, a minimum (~$65,000) and maximum (~$86,000), is approximately 35%. This narrow band would not allow much latitude to attract new hires with differing skills or abilities, nor would it allow for encouraging employee development without costly promotions to the next level. This type of structure causes grade inflation and lessens the institution's ability to provide meaningful opportunity for employee growth and development.

    UCOP regularly assesses internal equity within job classifications, and when promotions are requested, human resources conducts additional reviews to assess skills and abilities against pay.

54. **Page 56: Further, the use of such wide salary ranges can create situations in which two employees perform similar duties and have similar responsibilities but earn vastly different amounts. In fact, we noted 51 instances of employees in the Office of the President who had pay rates that were more than 50 percent higher than those of peers in the same classifications. In these instances, the salary differences could not be attributed to the employees' responsibilities or skill levels because-according to the university's policy manual-the purpose of the classification process is to ensure that the university correctly identifies**

positions' required skill levels and assigned responsibilities. If an employee operates at a higher skill level or performs more difficult work than others in his or her classification, that employee should have been placed in a higher classification.
&
Page 58: However, we disagree that the wide salary ranges are necessary because the Office of the President's classification system already ensures salary accommodation for junior-level staff at lower tiers within a series and more experienced staff at higher tiers. In fact, the large salary ranges paired with the classification system creates an environment in which staff do not need to perform additional responsibilities to earn higher salaries.

UCOP is uncertain how CSA was able to reach the conclusion that "the salary differences could not be attributed to the employees' responsibilities or skill levels" without the underlying data required.

In addition, the notion that "if an employee operates at a higher skill level or performs more difficult work than others in his or her classification, that employee should have been placed in a higher classification" is not true since the overall responsibilities, as well as the higher level of skill and ability requirements, dictate the classification for a job. The draft audit report seems to suggest that UCOP should be promoting more people, rather than managing their career development within a classification system more defined than the State's, which could actually lead to higher salaries and less savings.

55. **Page 60: Specifically, while State policy only permits the reimbursement of meals for employees on travel and prohibits reimbursement for business meetings with agency employees, the university's policy allows for up to $174 per person per day in reimbursements for business meetings, entertainment, and other occasions. As a result, the Office of the President has reimbursed its staff more than $2 million for meals since fiscal year 2011-12.**

It is very rare that a UC employee would have a daily expense total of $174. This is covered in policy BUS-79 and there are caps for each type of meal (http://policy.ucop.edu/doc/3420364/BFB-BUS-79). In most instances there would be one or two meals catered (for example a light breakfast and a lunch for a conference or all day meeting). Another example would be a lunch meeting with a donor, which has a cap of $47 per person including tax, tip, etc. The policy requires that the event or meeting support University business.

In addition, while the accumulated amount referenced is technically correct, the amount of $2 million is for 5 years, which amounts to $400K per year.

56. **Page 60: …we identified an instance in which the Office of the president paid for all three meals for attendees when it hosted a conference. For example, for a one-day compliance symposium it hosted in 2015, the Office of President spent $153 in meals per person for about 280 university attendees. The total cost of catering for the symposium was $74,000, most of which the Office of the President paid for out of campus assessment fund.**

    While it is accurate that the Office of the President spent $74,000 on meals for about 280 attendees at a sponsored compliance symposium, it is factually incorrect to describe the event as a one-day compliance symposium. This was a three-day compliance symposium to provide professional development training for the University's compliance and audit personnel as well as many other employees. The training was provided in multiple simultaneous instruction tracks with all participants attending common general session lunches. Many of the University attendees received continuing education hours required for their respective professional associations or certifications (legal, CPA, internal audit, compliance and healthcare) in a cost-effective manner.

57. **Page 60: The Office of the President reclassified the Searles Fund as a discretionary funding source in 2011-12 as discussed in Chapter 1**

    UCOP undertakes periodic reviews of fund restrictions, and the release of the Searles Fund was one result of that action. UCOP believes this a prudent financial action that is consistent with appropriate budgeting practices.

58. **Page 61: Specifically, an employee spent more than $350 per night on a hotel room, even though this cost exceeded the federal and state allowable limits by $140 per night.**

    Since CSA did not provide any data or context for this expenditure, UCOP is unable to verify it, or provide evidence showing the reservation was necessary due to geographic or other factors.

59. **Page 62: For example, although the Office of the President spent at least $2 million on cell phones and other electronic devices for its employees, it has no formal process for tracking the number of devices it issues.**

    UCOP does not agree with this statement. It provided CSA extensive detail regarding the electronic devices issued to employees. During the audited period prior to President Napolitano's arrival, fewer controls were in place for electronic device issuance. She has since undertaken proactive efforts to enhance practices and controls in this area.

60. **Page 63: We identified several instances in which employees received both stipends and bonuses in addition to their regular pay. For example, since**

fiscal year 2011-12, the current director of the operating budget (university budget director) has collected more than $47,000 in bonuses and stipends. In fiscal year 2012-13 alone, this individual received more than $18,000 in stipends and a $5,000 bonus in addition to his $122,000 salary.

Beginning in 2015, UCOP instituted new procedures to review and approve stipends to ensure that the amount of the requested stipend align with increased responsibilities.

The $18,321 in stipend pay that the individual in question received in 2012-13 was entirely due to his appointment as interim Director of Student Financial Support from July 2012 to June 2013 following the retirement of an individual from that position in June 2012. During that time, he was performing two jobs – his official position (deputy director) and that of the director – at great savings to the department.

Similarly, in 2011-12, he received stipends totaling $11,307 because his manager had taken on the role of Interim Executive Director of Admissions following a retirement in June 2011, also resulting in great savings to the department.

Those two temporary appointments accounted for $29,628 of the $47,000 figure cited. The remaining $17,500 was attributable to four bonuses that he received during the five-year period from 2011-12 to 2015-16, which represented about 2.6% of the total base salary that he received during that period.

61. **Page 66: However the fiscal year 2015-16 budget the Office of the President presented to the regents included $36 million more in spending than the fiscal year 2014-16 budget. Furthermore, despite the directive the Office of the President's staff in Oakland and at the campuses grew from 1,577 full-time staff in 2012-13 – the fiscal year before the budget review announcement to 1,667 full-time staff in 2015-16.**
    &
    Page 71: Further, even though it has publicly stated that it has consolidated its own and the campuses' operations, both the Office of the President and campus administrative costs have increased.

Since the Great Recession of 2008, the number of UCOP staff performing administrative functions has grown in primarily strategic areas. UCOP made deliberate investments to expand its legal, investment, and technology management services to attain large savings for the entire UC system. In addition, in the effort to be more cost-effective (especially long-term), UC brought many core services in house, rather than extending contracts with outside service providers.

Areas of strategic growth include:

- Information Technology: Much of the growth here has been movement from external contractors to internal resources such as Apply UC.
- Office of the General Counsel: UCOP has expanded in-house legal services that were formerly performed by outside counsel as part of the effort to reduce overall spending and increase efficiency.
- UCPath: This new initiative replaces eleven separate antiquated systems with one platform. It allows UC to standardize and streamline human resource and payroll functions across all campuses while centralize other services.
- Chief Investment Officer (CIO): The CIO's office identified and acted on money-saving opportunities by bringing certain investment management functions in-house rather than continuing to rely on outside consultants and managers.
- Business Resources Center: Created to standardize business practices, this office provides support for UCOP. Since President Napolitano assumed leadership, increased automation has led to improvements in efficiency and, therefore, lower staffing levels.
- Risk Services: UCOP created Fiat Lux, a captive insurance company, to allow the University to self-insure and buy re-insurance directly in the market, eliminating the need to purchase coverage through insurance carriers at higher rates.
- Procurement Services: The P200 initiative has saved over $200M and has expanded in scope, with the next savings target set at $500M (SC500).
- ILTI Online Education: This program creates high quality online education across all campuses, in line with the State goal to expand digital instruction.

Together, these areas of strategic growth have grown 113% (+317.9 FTE) while the remaining administrative areas of UCOP fell by 8% (-68.9 FTE) between 2007-08 and 2015-16.

Since President Napolitano began leading the University in mid-2013, staff working in other administrative functions at UCOP have been cut by 5% (-39.2 FTE between 2013-14 and 2015-16).

The areas of strategic growth have relied predominantly on increasing technical and professional staff at UCOP.

Chapter 3

62. **Page 71: In particular, we found that the Office of the President budgeted $210 million in discretionary money on system wide initiatives in fiscal year 2015-16, using funds that the campuses could have otherwise spent to support the university's core missions. Although many of these initiatives provide academic or public benefits, we question the Office of the President's decision to prioritize them over campus spending on students.**
&
Page 72: The Office of the President has not prioritized its spending decisions to ensure that the university system is able to dedicate the maximum amount of funding possible to support its goals of access and affordability for California residents.
&
Page 74: We acknowledge many of these initiatives have value. However we question the Office of the President's decision to prioritize them over campus spending on students

UC operates in a dynamic environment where funds are expended in response to internal and external needs and demands. This is true for UCOP, which not only provides critical management of functions on behalf of the campuses, but also increasingly coordinates and funds key systemwide activities. UC has three primary missions: teaching, research, and public service. Funds are allocated in a manner consistent with those missions.

These one-time expenditures go towards some of the most important and topical initiatives undertaken by the University. In recent years, UCOP has funded activities that include:

- Support for undocumented students, including expanded financial, legal and student services
- Systemwide initiatives that diversify UC's undergraduate, graduate and faculty populations and provide them continual support, i.e. partnerships with Historically Black Colleges and Universities
- Programs that enhance student opportunity and experience, including the President's Postdoctoral Fellowship Program as well as the Public Service Fellowships for law students and other students taking advantage of UC's Sacramento and Washington, DC centers
- Investments in UC's transfer infrastructure, further simplifying and streamlining the transfer process to UC for California Community College students
- The Carbon Neutrality Initiative and associated investments in climate science research systemwide
- Campus-driven programs such as start-up funds for UC Merced to recruit top-notch academic staff, support for UC Riverside's medical school expansion, and establishment of Blum centers for Developing Economies on several campuses

- The Global Food Initiative and funding vital resources that address food security issues on the campuses
- Innovation and entrepreneurship activities, including a centralized investment fund to catalyze innovation and award programs to stimulate research in strategic areas

Furthermore, CSA's perspective fails to acknowledge that UC is a system of individual campuses that benefit from accomplishing shared objectives.

63. Table 11. The Office of the President does not Consistently Track Spending on Systemwide Initiatives

UCOP rejects this assertion. This table includes a significant amount of restricted funding that is either multi-year, or carried over from year to year in order to satisfy multi-year commitments to campuses and third parties. This is true for Breast Cancer Research Program funds, HIV/AIDS research funds and the Los Alamos National Laboratory/Lawrence Livermore National Laboratory Research funds. The table also represents a mix of programs that are housed and overseen directly by UCOP (including the President's Postdoctoral Fellows or the Historically Black Colleges and Universities Initiative), and those that are housed outside of UCOP but are included in UCOP's budget, such as the Education Abroad Program.

64. Page 74: According to the *Budget for Current Operations*, the costs related to the central and administrative services represent about 2.3% of the university's overall budget.

This statement is not accurate. The summary of the UCOP budget within the report (page 150) states that "the total central budget represents 2.3% of the overall University of California budget." This refers to the entire UCOP budget, both the Central and Administrative Services portion and the Systemwide Academic and Public Service Programs. The entire budget represents 2.3% of the University's overall budget. The costs related to the central and administrative services at UCOP represent only about 1% of the University's overall budget.

65. Page 74: However, our analysis demonstrates that the Office of the President's claim that it spent only about $314 million in fiscal year 2015-16 to administer the university is inaccurate because its administrative budget did not always account for administrative activities connected to systemwide initiatives.

CSA has not provided any evidence to support this assertion.

66. Page 77: Considering that the Office of the President acknowledged the building had been underutilized since 2003, the decision to continue to invest campus funds on Casa de California is questionable.

UC takes enormous pride in its longstanding relationship and work with Mexico. Casa de California (Casa) serves as a tangible representation of that relationship. UCOP does not contest that Casa was underutilized in the past, but rejects the idea that the solution would be to disinvest. Instead, catalyzed by the President's UC Mexico Initiative, UC advanced its efforts to collaborate with Mexico and better utilize Casa de California. UCOP also recognizes the significant support it has received from key State legislators and the Latino Caucus in its engagement of Mexico at large and for Casa de California specifically.

67. **Page 81: Our analysis found that over four years, the Office of the President spent an average of 69 percent of its total expenditures on administrative costs while campuses consistently spent 14 percent of their expenditures on administrative functions.**
    &
    Page 81: The expenditure data also show that although campus administrative costs have increased at the same rate as their nonadministrative costs, the Office of the President's administrative costs have escalated, while nonadministrative expenditures have dropped.

    This statement does not account for the different functions of the Office of the President and the campuses. By design, UCOP seeks to alleviate administrative burdens and responsibilities on the campuses. As such, a higher average rate of administrative costs and expenditures are expected at UCOP, with non-administrative priorities residing with the campuses.

68. **Page 82: Our review of budget and staffing data for these institutions indicates that for fiscal year 2015-16 the Office of the President's $655 million disclosed budget and 1,670 staff exceeded the cost of central administration for these institutions. The Office of the President stated that it may spend more on administration than other institutions in part because it provides services to its campuses and employees that other universities do not provide, such as retirement management.**

    This statement does not provide a sufficiently robust picture of UCOP's programs and services. It is an indisputable fact that UCOP manages many more programs than other institutions: centralized admissions, procurement, medical center procurement, tuition and financial aid policy, faculty salary policies, as well as the largest retirement plan in the State other than CalPERS – and, of course, the systemwide initiatives identified in this report. The draft audit report implies that because other institutions' central offices do so with less funding, UC's should be able to as well – while failing to acknowledge the greatly expanded scope of services UCOP provides and the subsequent benefits to the campuses and to the entire system as a whole.

69. Table 14

Reference: Fiscal Year 2012-13 Office of the President Budget

Statement: The Office of the President has developed a rigorous and transparent budget that fully reflects the complexities of the central administration's structure and funding mechanisms.

CSA Assessment: This budget does not present all the Office of the President's revenue sources, show spending from its undisclosed budget, or describe the purpose of its units.

UCOP Response: UCOP presents the UCOP budgeted revenues to the Regents by fund source (restricted and unrestricted), including the amounts and calculation of the campus assessment. All total budgeted revenues are summarized at the level of detail appropriate for the Regent's review.

As part of the continuing improvement to the budget process, in subsequent budget years, the "Background" section of the UCOP Regent's budget presentation was expanded to include discussion and details key programs and their related funding/revenue (see FY15/16 items F5 and F6).

All UCOP actual expenditures are made from approved and budgeted funds. A small percentage of actual unrestricted expenditures (3% of total budget in FY12/13) were made through the carry-forward budget (referred to in the draft report as the "undisclosed budget"). The carry-forward budget's funding results from prior-year savings from Regents' approved budgets. Carry-forward budget funding is used for programs with systemwide benefits such as academic programs, student support and UCOP-sponsored technology improvements, which are reported to the Regents.

The purpose of the units or divisions at UCOP is to improve organizational management, accountability and efficiency across the UC system. The structure and purpose of UCOP was presented to the Regents when UCOP began bringing its budget for Regents approval, in May 2007. *Reference item F3 in the Committee on Finance meeting of May 17, 2007.*

Statement: Comprehensive: The Office of the President budget has reconciled funding into one consolidated budget… including ongoing funding previously in the undisclosed budget.

CSA Assessment: The Office of the President did not present $80 million dollars in expenditures from its undisclosed budget to the regents.

UCOP Response: The carry-forward budget total of $80M was comprised of $62M in restricted funds and $18M in unrestricted funds. The carry-forward budget's funding results from prior-year savings from Regents' approved budgets. Carry-forward budget funding is used for programs with systemwide benefits, such as academic programs, student support and UCOP-sponsored technology improvements, which are discussed with the Regents.

Items that were deemed annual recurring expenses were reclassified as permanent and were consolidated into the permanent budget for consistency.

Statement: Rigor: New reporting and budget development systems at the Office of the President provide comprehensive oversight over department budgets.

CSA Assessment: We determined during this fiscal year the Office of the President could only demonstrate approval for 2 percent of the $37 million in undisclosed budget expenditures that we tested.

UCOP Response: The Budget Development System, in its first year of use, introduced significant improvements to controls, reporting, budget management and approval workflows. The implementation of the system and associated process changes have increased reporting and tracking mechanisms on a trajectory towards continual improvements in these areas. Without additional information that supports CSA's assessment, UC is unable to provide additional detail on our system's efficacy.

Reference: Regents Minutes from 2012-13 Office of the President Budget Presentation

Statement: The Chief Financial Officer stated that the Office of the President is no longer funded using state money.

CSA Assessment: Although the Office of the President no longer directly levies the State General Fund, the campuses used $79 million in fiscal year 2012-13 from their State General Fund appropriations to pay for the Office of the President's campus assessment. State General Funds constituted almost one-third of the total campus assessment amount.

UCOP Response: Prior to the institution of funding streams, UCOP was funded in part directly from State General Funds. The Office of the President does not direct the campuses on which sources of funding to use to pay the assessment. The Systemwide Budget Manual states: "Campuses are permitted to use any fund source or combination of fund sources not otherwise legally restricted to cover their share of the annual assessment." Furthermore, the report does not acknowledge the possibility that the Chief Financial Officer was conveying that UCOP was not receiving a direct State allocation. On numerous occasions, the CFO confirmed to CSA this was the intent of his statement; the report fails to acknowledge this.

Reference: Regents Minutes from 2013-14 Office of the President Budget Presentation

Statement: The Office of the President plans to engage in multi-year budgeting so that campuses can be advised of the possible impact on their budgets.

CSA Assessment: The Office of the President has yet to develop multi-year budgets.

UCOP Response: In past years, the Office of the President has, at times, asked divisions to prepare multi-year projections. However, because of the considerable fiscal uncertainty in recent years, developing multi-year budgets has been difficult. However, the development of this process remains a key priority.

Reference: Fiscal Year 2014-15 Office of the President Budget

Statement: The President directed her staff to reduce travel costs by 10 percent.

CSA Assessment: The Office of the President's budget data shows that its disclosed budget included an estimated 21 percent increase for meetings, travel, and other related costs.

UCOP Response: Overall, actual spending outside of UCPath project-related travel decreased over 9% between FY13-14 and FY15-16.

Statement: A new process for approving the use of consultants was expected to lower the amount of funding spent for this purpose.

CSA Assessment: The Office of the President's budget data shows that its disclosed budget included an estimated 2.5 percent increase for consultant costs.

UCOP Response: The new process for evaluating and approving any consultant spend over $20K was implemented starting 2014. There was not an expectation that the spending in this category would be reduced right away; rather, UCOP anticipated that these new procedures would reduce the spending over time, ensure it was directly in line with its critical initiatives, and validate the work done by consultants that could not otherwise be performed by existing UCOP staff. The increase noted in that year was mainly due to the consultants hired to work on the UCPath project, while other areas held flat or decreased in consultant spending.

Reference: Regents Minutes from 2014-15 Office of the President Budget Presentation

Statement: The Office of the President considered which functions should be centralized and which should remain at the campuses.

CSA Assessment: The Office of the President is unable to demonstrate that any services were centralized as result of this process.

UCOP Response: The aforementioned statement was part of a larger statement from the 2014-2015 Office of the President Budget Presentation. The full statement from the minutes is as follows: "Mr. Brostrom noted that the effort this year to maintain the UCOP unrestricted fund budget at a flat level was a springboard for a broader assessment of UCOP, for considering which functions should be centralized and which left on the campuses. Following the departure of former Chief Financial Officer Taylor, UCOP is considering realignment and possible consolidation of certain offices." In that full context, it is clear that UCOP has demonstrated both centralization of key services, and realignment and consolidation of certain offices. Since that time, UCOP has increased centralization of HR and Payroll functions through the roll-out of our UCPath system. Additionally, UC has seen increased centralization in our Procurement department as evidenced by the creation of strategic sourcing centers of excellence in Life Sciences, IT, Professional Services, and MRO commodities. UCOP has also followed through on realignment and centralization of certain offices. UCOP undertook an elaborate "assessment" of both the CFO/COO structure and systemwide vs. campus activities, which many campuses participated in. The result was that the CFO and COO divisions went through a significant reorganization that eliminated multiple SMG positions. Additionally, multiple groups were consolidated into one OP Operations Department; capital markets finance and capital programs were consolidated into capital asset strategies and finance; and banking and treasury were consolidated into the OCIO division. It is clear that the CFO's statement was factually correct.

Statement: In response to Governor Brown's request for a document analyzing all elements of the Office of the President, both historically and at present, the Chief Financial Officer stated that many documents were available.

CSA Assessment: The Office of the President never provided the office of the Governor with such a document, but stated that it had many communications with the Governor's Office.

UCOP Response: The Chief Financial Officer stated that many documents were available and this remains true to this day. Our website provides a multitude of reports including our budget plan, organizational structures for the divisions and departments at UCOP, and others. Any member of the Governor's Office, as well as the general public, can access these documents at any time. The CFO's comment was not a commitment to send documents, but rather a statement about the availability of such documents online. Furthermore, the Office of the President has had many communications with the Governor's Office, and the CFO meets frequently with Director of Finance Michael Cohen in addition to other individuals from the Department of Finance. Additionally, after the Regents meeting, UCOP entered into a months-long work effort with the President, Director of Finance, and many members of his team looking at the cost structure of the University (Committee of Two process). This involved several meetings, which lasted several hours each, as well as extensive review of documents, both for UCOP and for campuses.

Statement: In response to a question from Governor Brown, the Chief Financial Officer stated that a great deal of the Office of the President's budget flows through to the campuses, and that its actual administrative functions account for $90 million of the budget.

CSA Assessment: After subtracting all of the funds that flowed through to campuses, the Office of the President's central and administrative budget was $279 million.

UCOP Response: The UCOP budget can be divided into three large buckets: one representing traditionally administrative functions; one related to central services provided for all campuses such as benefits, retirement plan management, legal services, etc.; and one for systemwide academic and public service programs and initiatives. The CFO's statement was related to just that portion of the budget that is primarily administrative in nature.

Statement: A regent-designate asked about funding for UCPath and why it was not listed on the budget shown to the regents. The Chief Financial Officer responded by saying that all of UCPath's costs to date were being capitalized and that once UCPath was operational, its costs would appear on the Office of the President's budget in the next fiscal year.

CSA Assessment: Budget data for fiscal years 2013-14 and 2014-15 show that the Office of the President spent $14.9 million and $13.7 million respectively for UCPath's operational costs.

UCOP Response: The expenses associated with the UCPath project design and build-out have been and will be capitalized until the system is implemented and operational. Outside of those expenses, funds have been budgeted in the operating budget for the UCPath Center operations since fiscal year 2013-14.

<u>Reference: Fiscal Year 2015-16 Office of the President Budget</u>

Statement: The Office of the President characterized a $13.4 million budget increase as a cost of living adjustment for its employees and stated that it was only the fourth increase in the last eight years.

CSA Assessment: The budget increase for staff salaries was actually a three percent across-the-board increase. The Office of the President leadership determined the amount rather than using a cost of living metric. The Office of the President also gave 3 percent salary increases in fiscal years 2011-12, 2013-14, and 2014-15 that were not tied to a cost-of-living adjustment.

UCOP Response: This has been clarified in CSA discussions with the Chief Operating Officer and the Deputy Chief of Staff. Response from the COO: *"The description of that increase as a COLA is an error. Both by design and in its implementation, it was an across-the-board increase. You will note that a COLA is tied to a certain metric, but this was a level determined by leadership and as such was an across the board increase."*

<u>Reference: Regents Minutes from 2015-16 Office of the President Budget Presentation</u>

Statement: Monies received from campus assessments would not affect enrollment.

CSA Assessment: Since campuses can choose to pay the campus assessment using State General Funds, tuition and fees, it is possible that the amount of the campus assessment affects enrollment.

UCOP Response: The aforementioned statement was part of a larger statement from the 2015-16 Office of the President Budget Presentation. The full statement from the minutes is as follows: "Regent Ortiz Oakley asked about the relationship of this increase to the budget agreement with the Governor, and what impact it might have on funds received from the State for enrollment growth at UC. Ms. Nava recalled that the budget agreement with the State was a four-year agreement, which afforded the University the opportunity to evaluate its salary programs. Monies received from campus assessments would not affect enrollment." The 2015-16 assessment increase was 3.5% for a total of $10M systemwide. When reviewed at the campus level, it is clear that such a miniscule change in the budget would not impact enrollment levels. The auditor's reference to Santa Cruz, whose assessment increased by just under $87K, demonstrates this fact as the $87K increase represents only 0.01% of their total 2015-16 operating budget. Between 2014-15 and 2015-16, UCSC revenues increased by $40 million and expenditures increased by just under $25 million, with the assessment representing only .3% of this increase; within this context, it is improbable that the campus assessment affected enrollment decisions. As stated in public documents frequently throughout the year, the University's goal is to enroll as many eligible California residents as the State is able to fund – and there is no connection between enrollment and the assessment.

70. **Page 84: When we asked the Office of the President how it determined which changes to share with the regents, the chief operating officer stated that the Office of the President only shares what it considers to be strategic budget changes and that it does not have a dollar threshold for when it must share information with the regents.**

This is not an accurate reflection of the discussion as it occurred, nor did the individual in question, the Chief Operating Officer, receive documentation to validate this assertion as part of the audit process. This is in violation of CSA's standard auditing practices, which require documented support for all content included in the audit report. What the report neglected to include was her statement that UCOP shares material changes as well as those things that are matters of strategic importance. UCOP also has concerns about the use of the word "only," which is untrue, as UCOP shares additional information when helpful and productive.

71. Page 85: The Office of the President Inappropriately Interfered With Our Audit and Limited Our Ability to Provide Complete Information to the Legislature and Public

During the course of the audit, members of the CSA audit team submitted two surveys to each of the campuses. One survey was 52 pages and the other was 6 pages. These surveys were sent to various individuals at the campuses, without CSA soliciting any guidance about who on the campuses was knowledgeable about a particular issue or best-positioned to respond on behalf of the respective campus. The coordinating processes facilitated by UCOP that followed were designed to get the auditors accurate information and ensure that the information they received was from the individual best-positioned to respond to a particular issue on behalf of the given campus.

72. Page 89: The Office of the President Delayed Our Access to Expenditure Approval Documents Related to Its Undisclosed Budget and Failed to Provide Us All of the Information We Requested

Over the course of this audit, UCOP staff expended more than 3,600 hours meeting with CSA representatives or preparing responses to their requests and questions. This included at least 250 information requests made over a 7 month period, with many of these involving a significant number of sub-requests. One such request contained 225 sub-requests or requests for additional information. It should also be noted that most of these requests were addressed to a small number of staff members. The volume and process by which the requests were made severely impacted UCOP staff's ability to perform their University work and had an adverse impact on UCOP's operations.

With specific regard to the approval documents referenced, the draft report fails to identify that the delays associated with their request to have unfettered access to an archive of material outside the scope of CSA's audit included 1) all archived documentation from the past four UC presidents, 2) privileged legal advice memos and documentation, 3) confidential and sensitive personnel information, and 4) correspondence with a range of elected officials. Any delay associated with UCOP's response was related to efforts to coordinate with CSA's legal counsel to identify the material within this broader archive that was needed for the audit, while limiting unnecessary risks associated with providing unfettered access to a massive set of confidential, sensitive, and privileged materials, the vast majority of which were well outside of the scope of CSA's audit.