

Summary

Results in Brief

The University of California (university) is a public, state-supported, higher education institution with 10 campuses throughout the State. The university enrolled the equivalent of 232,613 full-time students and employed the equivalent of 134,410 full-time employees during fiscal year 2009–10. Funding for the university comes from both public and private sources. We defined public funding as those revenues that the university obtained as part of its regular course of business, including government appropriations and contracts, student-paid tuition and fees, and fees generated from auxiliary enterprises. Private funding sources include private sector gifts, research contracts, and grants. For the purposes of this audit, we excluded three areas from our review: private funding, medical centers, and management of U.S. Department of Energy laboratories.

The university's public revenues and expenses gradually increased from fiscal years 2005–06 through 2009–10, with a few exceptions. Revenues increased across several fund categories, with a total increase of 25 percent over the five-year period and an average increase of 5 percent per year despite a decrease in fiscal year 2008–09. Tuition and fees revenue grew the most in dollar amount of any single fund category, because of increased enrollment and higher tuition rates. This increase, as well as funding from the federal American Recovery and Reinvestment Act of 2009, helped to partially offset a decline in general support from the State in fiscal years 2008–09 and 2009–10. During fiscal year 2008–09, expenses outpaced revenues and net transfers in the block of funds known as the general funds fund group, and the ending balance for the fund group at June 30, 2009, decreased significantly to a negative balance of nearly \$120 million. Over the next year, fiscal year 2009–10, the university lowered its expenses in the general funds fund group while revenues increased, allowing the ending balance of the fund group at June 30, 2010, to increase to the level prior to the decline.

During the five-year period we examined, university expenses increased by 15 percent, or \$1.2 billion, excluding certain retirement costs. Annual expenses related to employee retirement benefits increased by \$3 billion due to two changes: the reported expense for providing retiree health benefits increased by \$1.4 billion because of a change in accounting rules and the cost of funding the university pension program increased by \$1.6 billion due to updated actuarial valuations. These changes contributed to a decline in related ending balances of \$4.7 billion from fiscal years 2005–06 through 2009–10. University expenses generally declined during fiscal year 2009–10; however, the greatest proportion of expenses still occurred in the instruction and research categories.

Audit Highlights . . .

Our review of the University of California's (university) public funds, student fees, and auxiliary enterprises, revealed the following:

- » *Public revenues and expenses gradually increased from fiscal years 2005–06 through 2009–10.*
 - *Overall revenues increased by 25 percent primarily from increased enrollment and higher tuition rates.*
 - *University expenses related to employee retirement benefits increased by \$3 billion due to changes in accounting rules and updated actuarial valuations. Other expenses increased by 15 percent, or \$1.2 billion.*
- » *University expenses generally declined during fiscal year 2009–10 but they were still concentrated in the instruction and research categories.*
- » *The university's Office of the President uses an incremental budget process to determine the annual budget amounts for each campus.*
 - *It distributes the State's General Fund appropriation and the majority of tuition revenue to the campuses, but campuses can retain the majority of other revenues.*
 - *The budget process results in varying amounts per student distributed among campuses—in fiscal year 2009–10, amounts per student ranged from \$12,309 to \$55,186 among campuses.*

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- *The four campuses with a higher-than-average percentage of students from underrepresented racial or ethnic groups together received less funding than they would have if campuses received the same amount per student.*
- » *The Office of the President does not make the methodology it uses to determine the amount of funds provided to each campus readily available.*
- » *The Office of the President currently tracks about \$1 billion annually in a Miscellaneous Services accounting code.*
- » *The Los Angeles campus, the Office of the President, and the Regents of the University of California designated the use of \$23 million in revenue for unauthorized purposes.*

The individual campuses receive budget amounts from the University of California Office of the President (Office of the President) but are largely autonomous in their spending. The Office of the President uses an incremental budget process to determine the annual budget amounts for each campus. This process consists of a permanent base amount, which varies by campus, and incremental adjustments made annually to the base amount. Using this incremental process, the Office of the President distributes the State's General Fund appropriation and the majority of tuition revenue to the campuses. Together, these revenues accounted for \$4.4 billion in fiscal year 2009–10. The university allows campuses to retain other types of revenues, such as student services fees, nonresident tuition, and auxiliary enterprises. Although the university generally delegates responsibility to campuses for ensuring that they spend their funding appropriately, the Office of the President provides oversight to verify that financial aid and outreach programs to potential students are appropriately funded.

The university's incremental budget process results in a distribution of the general funds and tuition budget that varies widely per student among the campuses. For fiscal year 2009–10, the amount per student ranged from \$12,309 at the Santa Barbara campus to \$55,186 at the San Francisco campus. Although we understand that differences in funding among the campuses can exist because the Office of the President does not distribute all funding to campuses on a per-student basis (for example, it provides funding to certain campuses for specific research or public service programs), we would expect that the university would be able to identify the reasons for any differences and be able to quantify them. The Office of the President provided four examples of factors that contributed to differences in per-student amounts among the campuses: specific research and public service programs that are budgeted separately from instruction, the size of a campus's health sciences program, historical variations in the amount of support provided for graduate students, and historical variations in the level of state support. However, the university has not quantified any of these factors.

While we found no evidence that the Office of the President considered the racial or ethnic makeup of the student populations at the campuses as part of its budget process, we noted that the four campuses with a higher than average percentage of students from underrepresented racial or ethnic groups all received less funding than they would have received if each campus received the same amount per student. This disparity highlights the importance of being able to quantify and explain the differences in the level of per-student funding at the campuses.

Although the Office of the President has taken steps to make its budget more transparent in recent years, it could do more to improve the transparency of the processes it uses to determine annual budget amounts for the campuses. The Office of the President does not make the methodology it uses to determine the amount of funds provided to each campus readily available to university stakeholders. This reduces stakeholders' ability to understand how funding is budgeted to campuses and to hold the university accountable for its method of budgeting funds.

The university maintains detailed records of revenues, expenses, and beginning and ending balances of funds for its operations. Its corporate financial system contains revenue and expenditure records for more than 32,000 funds with revenues from public sources. These records provide sufficient information to determine the types of revenues and expenses for each fund, and to report on the impact transactions within a fund have on their respective ending balances from year to year. The university's financial records also identify whether funds have restrictions placed on them. These records show that each year from 36 percent to 38 percent of public revenues were restricted for specific uses by sources such as federal contracts and grant agreements during fiscal years 2005–06 through 2009–10. The university can use the rest of its public revenues at its discretion. The university also maintains records of overhead cost reimbursement for contracts and grants. By examining these records, we were able to determine the amount of funds the university received and how most of the funds were spent.

Further, we found that the university pledged tuition revenue to obtain debt financing at lower interest rates. However, the Office of the President took steps to ensure that external debt financing proposals identified specific repayment sources that it deemed were appropriate for this purpose. We examined financial records to determine whether the university had made any debt payments for principal or interest out of tuition revenue and identified no such payments. We also identified another university system, the University of Texas, that pledges tuition revenue in this way.

The university publishes annually a report of campus financial schedules that provides useful information about its operations. However, access to additional information, such as beginning and ending balances and information related to specific funds, would be beneficial. Fund-specific information, including balances, would allow users to review the financial performance of specific organizational units from year to year, as well as identify funds with poor financial performance or negative balances. Without fund information, stakeholders do not have complete information to help them hold the Office of the President accountable for the

university's financial performance. In the supplemental information to this report located on our Web site (www.bsa.ca.gov/reports/2010-105/), we present data from the financial records maintained by the Office of the President.

In our review of university accounting records, we found that the Office of the President uses a single accounting code, Miscellaneous Services, to account for more than \$6 billion for the five years we reviewed, or about 25 percent, of the annual public noncompensation expenses for the university. This lack of specificity prohibits meaningful analysis of a significant portion of the university's expenses at a systemwide level, and limits the ability of stakeholders to understand how the university uses these funds.

We examined the university's policies regarding auxiliary enterprises—revenue-generating programs or activities that are operated like businesses, such as housing, dining, and parking. The Office of the President delegates responsibility to the campuses to account for and provide oversight of their auxiliary enterprises. Further, as of December 2010, auxiliary enterprises are no longer required to be entirely self-supporting. The university revised its definition of an auxiliary enterprise at that time to allow campuses to subsidize these enterprises with available funding from appropriate sources. Even so, it is important that the university disclose any subsidization that occurs so that stakeholders can hold campuses accountable for this new use of funding.

Finally, in reviewing capital financing of auxiliary enterprises, we found that the Los Angeles campus, the Office of the President, and the Regents of the University of California (regents) designated the use of \$23 million in revenue from a student referendum for unauthorized purposes. Although the university believes it has the authority to use these revenues for the two capital projects we examined, our legal counsel stated that neither the policies in place when students approved the referendum nor the regents' approval of the referendum's results provide a sufficient basis for expanding the uses of the revenue beyond the purposes stated in the original referendum. Despite designating a total of \$23 million in referendum funds for these two projects, the university has spent only \$5.2 million to date on one of the projects and has dropped its intention to spend \$15 million on the other project.

Recommendations

To address the variations in per-student funding of its campuses, the university should complete its reexamination of the base budget to the campuses and implement appropriate changes to its budget process. As part of its reexamination of the base budget, it should:

- Identify the amount of revenues from the general funds and tuition budget that each campus receives for specific types of students (such as undergraduate, graduate, and health sciences) and explain any differences in the amount provided per student among the campuses.
- Consider factors such as specific research and public service programs at each campus, the higher level of funding provided to health sciences students, historical funding methods that favored graduate students, historical and anticipated future variations in enrollment growth funding, and any other factors applied consistently across campuses.
- After accounting for the factors mentioned earlier, address any remaining variations in campus funding over a specified period of time.
- Make the results of its reexamination and any related implementation plan available to stakeholders, including the general public.

To help improve accountability in the university's budget process, and to help minimize the risk of unfair damage to its reputation, the university should take additional steps to increase the transparency of its budget process. Specifically, the Office of the President should:

- Continue to implement the proposed revisions to its budget process.
- Update its budget manual to reflect current practices.
- Make its revised budget manual, including relevant formulas and other methodologies for determining budget amounts, available on its Web site.
- Continue its efforts to increase the transparency of its budget process beyond campus administrators to all stakeholders, including students, faculty, and the general public. For example, the Office of the President could make information related to its annual campus budget amounts, such as annual campus budget letters and related attachments, available on its Web site.

Agency Comments

The university states that it agrees with the importance of transparency and accountability. However, it adamantly disagrees with our analysis and comments in Chapter 2 regarding variations in per-student funding among the campuses. Despite objecting strongly to the way we arrive at our conclusions, the university agrees that these variations should be examined. Finally, although it disputes certain language in our report regarding other issues, it stated that it concurs with the general intent behind the recommendations.