

Office of the President

TO THE REGENTS OF THE UNIVERSITY OF CALIFORNIA:

DISCUSSION ITEM

For Meeting of May 18, 2017

STATE AUDIT OF THE ADMINISTRATIVE FUNCTIONS OF THE UNIVERSITY OF CALIFORNIA OFFICE OF THE PRESIDENT

EXECUTIVE SUMMARY

The following is an update on the results of the California State audit of the Office of the President's (UCOP) administrative expenditures. The report included 33 recommendations to UCOP. University leadership believes the recommendations are constructive and will implement all of them. The effort to implement these recommendations is already underway. A number of these recommendations are mentioned in this item and all are included in Attachment 1.

BACKGROUND

The California State audit of UC Office of the President (UCOP) administrative expenditures was requested by Assembly members Phil Ting and Kevin McCarty and approved by the Joint Legislative Audit Committee in August 2016. Fieldwork for the audit began in September 2016 and included multiple site visits by the audit team to UCOP as well as visits to three campuses – UC Berkeley, UC Santa Cruz, and UC San Diego.

The draft audit report was sent to UCOP on March 29, 2017, triggering a five-day agency review period during which UCOP developed its responses to the report. Within that five-day period, as permitted by statute, the Board of Regents Compliance and Audit Committee held a closed meeting to discuss the draft results and obtain input from the Committee to inform the University's response.

Audit Results and Response

The audit report was released to the public on April 25, 2017. The report included 33 recommendations to UCOP. University leadership believes the recommendations are constructive and will implement all of them. The same day that the final audit report was released, President Napolitano created an internal task force to ensure timely and thorough implementation of the 33 recommendations. Executive Vice President and Chief Operating Officer Nava chairs the task force.

The audit report included three sections: one focused on UCOP's staffing, another on UCOP's budget and administrative expenditures, and the third on systemwide and presidential initiatives.

UCOP Staffing

In the area of staffing, the audit report makes recommendations to further refine UCOP's approach on salary levels and ranges. UCOP agrees with these recommendations and will review salary market data to ensure ranges support employee development and pay equity. UCOP also agrees with the recommendation to compare current employee benefit and reimbursement policies to comparable organizations'. It will consider policy changes and incorporate any necessary safeguards to control costs and adjust employee benefits and reimbursement amounts accordingly. Finally, UCOP agrees with the recommendations regarding workforce planning, and will implement a long-range planning framework as part of the development of a strategic plan for UCOP.

In its discussion of salaries, the audit report highlighted examples of UCOP employee salary levels that are higher than positions in the state government. It is important to note, however, that due to UC's complexity, many of the positions that the report identifies are not directly comparable to State government positions. UCOP is committed to adopting best practices for setting employee compensation levels.

The report discusses growth in UCOP staffing during the audit period. UCOP's staff increase of 150 people is due to strategic, cost-efficient decisions to centralize services and bring in-house staff in its legal, technology, and investment offices – as well as others associated with UCPath, the University's ongoing project to streamline and consolidate its antiquated payroll systems. Staff numbers in other areas have declined. Overall, staff at UCOP has dropped by ten percent since 2007-08 while serving a system whose annual budget has increased more than 60 percent during the same period – from \$20.2 billion to \$31.5 billion.

UCOP Budget and Administrative Expenditures

In the section on UCOP's budget and administrative expenditures, the audit report recommends that UCOP modify its budget presentation to the Regents, implement recommended best practices for the UCOP budget process, develop a UCOP reserve policy, and review restrictions on funds to determine if funds can be reallocated to the campuses. UCOP agrees with these recommendations and will implement them.

In its discussion of UCOP's reserves, the report does not accurately characterize the size of the reserves, stating that UCOP held \$175 million in an "undisclosed" reserve fund as of fiscal year 2015-16. UCOP's actual reserves are \$38 million. Of the \$175 million in funds that the report characterizes as UCOP's reserves:

- \$83 million are restricted funds for designated purposes such as research grants, medical centers/schools, and the energy sustainability program.

- \$87 million are unrestricted funds, which include \$49 million in funds committed to academic programs, systemwide initiatives, and multi-year campus commitments. The remaining \$38 million in unrestricted funds is left for reserves.
- \$5 million is not part of UCOP's budget. The State Auditor misinterpreted this as available for UCOP's use.

The \$38 million UCOP maintains in reserves is roughly ten percent of UCOP's operating and administrative budget. The University believes this is a prudent and reasonable amount for unexpected expenses, such as the cybersecurity threat response, or emerging issues like support for undocumented students. To ensure this reflects best practices for reserves, UCOP will develop a reserve policy.

UCOP maintains strong controls over carry-forward and one-time budget items. Expenditures from one-time funds are approved through UCOP's formal decision-making process. President Napolitano personally reviews the vast majority of those documents before approval. The President also instituted a process that requires her explicit approval for use of outside consultants or contractors above \$20,000.

The report also suggests that UCOP has not been adequately transparent with its budget information, particularly as it relates to activities supported by one-time funds. UCOP is implementing the recommendations that will further enhance the visibility and transparency of these programs. This will build on efforts already underway. UCOP has made wide-ranging and extensive information about its budget and financials publicly available through a variety of methods. Since 2007, the UCOP budget has been presented to the Regents annually for approval. In addition, the Chair and Vice Chair of the Finance and Capital Strategies Committee receive a more detailed briefing, including information at the divisional and department level. UCOP's systemwide programs and administration, including expenditures, are included in the campus financial schedules that the University posts online. Further, annual financial statements for UC, including UCOP, are prepared and audited by an outside auditor and also available online.

Systemwide and Presidential Initiatives

In the final section on systemwide and presidential initiatives, the audit report recommends that UCOP improve guidance and tracking of systemwide and presidential initiatives, review, with stakeholder input, the prioritization and budget of these initiatives, and establish targets for UCOP systemwide initiatives and administrative costs, reallocating any resulting savings to the campuses. UCOP agrees with these recommendations and will implement all of them.

As it relates to systemwide and presidential initiatives, the report suggests that UCOP is not adequately engaging the Regents and the campuses on expenditure of funds supporting these initiatives, and states that the projects and initiatives are of "questionable benefit." Systemwide and presidential initiatives reflect the core values of the Regents and the University as a whole and address some of the most pressing issues facing California. They reflect the University's fundamental missions and substantially benefit the campuses and their students, faculty, and

staff. The initiatives advance several of the State's highest priorities: support for undocumented students, developing climate solutions and mitigating the University's carbon footprint, advancing health-related research, and strengthening our relationship with Mexico. The initiatives also address the Regents' most pressing priorities: enhancing the diversity of the UC community, improving the transfer process for community college students, and broadening outreach to high schools and community colleges. All of these initiatives receive substantial promotion and public attention through public events, press releases, media interviews, websites, and social media channels, and UCOP confers frequently with the Regents about them. In total, President Napolitano and UCOP officials spoke about one or more presidential initiatives before at least 16 separate Board of Regents meetings.

Other Recommendations

All three sections of the report include recommendations that UCOP reallocate to campuses savings that result from the audit recommendations and periodically report to the Regents on the amounts of these reallocations. UCOP agrees with these recommendations and will utilize savings either by reducing the total amount of the assessment or by directing them to initiatives and programs that benefit the campuses and the system. UCOP's primary goal is to effectively limit assessment growth, aiming to incorporate areas of savings where available. UCOP will periodically report to the Regents on the financial impact of implementing the audit recommendations.

On the topic of the campus assessment, the report states that UCOP has overcharged the campuses and that there should be additional consultations about the creation of systemwide programs and initiatives. UCOP manages programs that serve the entire UC system, allowing campuses to benefit from the savings and efficiencies of centralized operations, while coordinating activities that allow UC to operate as one university. UCOP relies on campus assessment funds to provide these services. UCOP is committed to building on its efforts to keep the assessment as low as possible. From fiscal year 2011-12 to fiscal year 2015-16, the assessment grew at a compounded rate of only 2.3 percent (from \$278 million to \$304 million). Meanwhile, the systemwide revenue increased by a compounded annual rate of 6.8 percent (from \$24 billion to \$31 billion), and the number of students grew nearly seven percent (from 237,000 to 253,000). Since President Napolitano joined the University in 2013, the assessment share of systemwide revenue has dropped from 1.08 percent to 0.98 percent. UCOP develops priorities with extensive campus consultation. On a monthly basis, the President formally meets with campus Chancellors; the Provost formally meets with campus provosts; and the Chief Financial Officer (CFO) meets with campus CFOs. These are among a range of campus consultative efforts. Further, Regents and the President extensively consult with one another before establishing University priorities.

The report also included recommendations to both the Regents and the Legislature. The recommendations to the Regents included requiring the Office of the President to implement California State Auditor's (CSA) recommendations and report periodically on its progress, holding a public meeting to discuss systemwide and presidential initiatives, holding a public meeting to discuss the results of the Office of the President's review of its fund restrictions and funding commitments, requiring the Office of the President to engage in a financial audit of only

the Office of the President's operations, and contracting with an independent third party to assist the Regents in monitoring implementation of a three-year corrective action plan for the Office of the President.

The recommendations to the Legislature included directly appropriating the Office of the President budget to eliminate the need for a campus assessment and requiring the Regents to contract with an independent third party to assist the Regents in monitoring the three-year corrective action plan for the Office of the President.

Key to Acronyms

CFO	Chief Financial Officer
CSA	California State Auditor
UCOP	UC Office of the President

Attachments:

[Attachment 1: CSA Recommendation List](#)

[Attachment 2: California State Auditor Report – Office of the President Administrative Expenditures](#)