Independent Consultant's Report

Fifth Report: Independent Assessment of CSA Recommendations

Date: July 2, 2018

Period: April 16, 2018 through June 30, 2018 – Year 2 First Quarter

Observations and Findings

Sjoberg Evashenk extended our prior quarter reporting period through April 15, 2018 to allow us to review the majority of information that UCOP would provide to the CSA to meet the April 25, 2018 reporting period. However, that time extension did not extend long enough to include the CSA assessment of the recommendation implementation detailed in UCOP's April 25th submission.

This quarterly report addresses the CSA's response, examines the UCOP's subsequent actions related to the Year One report including budget documents presented to the Regents at the May 24, 2018 meeting, and assesses the UCOP plans and actions to meet the eleven specific recommendations for Year Two – by April 25, 2019.

Our review of actual budget information provided to the Regents in May 2018 reveals that the UCOP fully addressed the form and intent of the CSA's first year recommendations related to the budget. In particular, the UCOP sought to either reduce or keep line budgets flat for the upcoming fiscal year. This entailed absorbing typical operational cost increases from areas such as benefits, salary merits, and contract costs and others. It also redirected approximately $8.5 million for AB 97 enrollment provisions. Through several organizational changes, accounting actions, and budgetary approaches, the FY 2018-19 budget for UCOP is reduced by $33 million (not including programmatic increases to UCPath). With the presentation providing greater insight and transparency, we noted that of the total $876.4 million included in the UCOP budget, approximately $324.1 million passes through to campuses (almost 40 percent) and another nearly $180 million relates to fee-for-service activities provided by the UCOP.

We anticipate that the coming year will bring even more changes and refinements to the budget and its processes and that the FY 2019-20 budget will show that UCOP has not yet hit the final appropriate "baseline" budget. This is due to the many budget-related initiatives in process, including the results of compensation studies for non-SMG employees being completed; required narrowing of salary ranges; on-going evaluations of operations; responses to the State Budget Act; and, other organization changes that could result from the President's efforts to implement Huron recommendations during this fiscal year. These budgetary actions will generate yet another version of a new baseline budget for UCOP.

We heard from both the Regents and the UCOP that all efforts will be made to ensure the university clearly understands the intent and expectations of the CSA relative to the upcoming set of recommendations. UCOP intends to reach out to CSA to obtain feedback on its FY 2018-19 budget presentation and the related recommendations and to conduct meaningful conversations to ensure there is common understanding of upcoming objectives.

WORK UNDERTAKEN DURING THE REPORTING PERIOD

Sjoberg Evashenk has monitored UCOP efforts on an on-going basis and has reviewed not only the data provided to the Regents, but also attended workgroup meetings, reviewed and assessed supporting documents, met with several Regents, reviewed and evaluated benchmarks, and held numerous other conversations to understand UCOP efforts, deliverables, and Year 2 plans. In conducting this work, Sjoberg Evashenk has committed more 100 hours during the 55 day reporting period.

Since our April 15, 2018 quarterly report to the Regents was issued prior to UCOP's submission of its April 25, 2018 report to the CSA; we focused our new quarterly efforts on the UCOP's activities beginning on April 16, 2018. Our evaluations addressed all reports generated from the various workstreams and project management teams, we participated in a number of meetings, reviewed draft documents, provided comments, and reviewed the final submission from the President. This work included the following activities.

- We critically reviewed, provided comments and participated in conversations related to the CSA response to the UCOP's One Year report.
- We met with Regents to discuss the One Year results, the CSA's comments, and clarify our role in the future.
- We participated in numerous conversations and formal meetings related to the processes and presentation of the budget and its various elements.
- In May 2018, we met with staff from the Joint Legislative Audit Committee, Assembly Budget Committee, Assembly Higher Education Committee, and Speaker's office to discuss our efforts and findings.
- We reviewed the CSA 2017 report in detail to identify any specific elements that it may expect to be addressed by UCOP, but not expressly included in each recommendation.
- We reviewed the draft budget item provided to the EBC. We participated in two EBC meetings that addressed where items included in the package were assessed, discussed, questioned,

and advice provided to ensure that the Regents and ultimately the CSA and Legislature would understand and be confident of the data presented and the improvements achieved.

- We conducted an in-depth review of the budget document—comparing the elements to those we found in the audit report; evaluating logic, appropriate detail, and completeness; reviewing for internal consistency; and assessing the overall financial results of the UCOP efforts to reduce costs and redirect funds back to campuses.

- We examined the CSA 2017 report to independently determine the recommendations relevant to Year 2 milestones.

- We met with key UCOP executives regarding plans for addressing the Year 2 recommendations.

- We conducted on-site meetings with two workstream groups—salaries and compensation, and workforce development.

- We reviewed available documents and conducted targeted conversations with UCOP staff related to interim activities and deliverables.

- The EBC was slated to meet June 15, 2018, but the meeting was postponed as the agenda was insufficient to convene the statewide group. The next meeting will be determined by the Chair but likely in August 2019, which we plan to attend.

Year One Recommendations

By April 25, 2018, as stipulated by the CSA, the UCOP submitted its One-Year Report detailing its efforts and results in meeting the CSA's 10 recommendations outlined for completion within the first year period. In its response the CSA found that 6 of the 10 recommendations were fully implemented with 2 partially implemented, one pending, and one not implemented. The CSA's assessment of the first year results differed with our independent interpretation of the requirements embedded within the CSA recommendations and our determination that the University of California substantially met all ten 2018 milestone requirements. We stand behind our independent interpretation and assessment of the UCOP's performance but recognize that the desired outcome for all parties is concurrence of requirements and successful implementation of suggested improvements. Thus, our evaluations will explore requirement expectations and make the Regents aware of any potential issues that may impact the successful achievement of the stipulated recommendations.

Three recommendations not fully accepted relate to financial and budget data. All parties recognized that the Year One submission would not include actual or preliminary FY 2018-19 financial data; UCOP expressed to us that they explained to the CSA several times over the past year that the University of California Regent's cycle to review and approve the annual budget did not align with the April 25 report issuance/year-one deadline date and that UCOP could not and would not provide "preliminary" budget data. All parties were aware that the detailed budget and financial data would be presented for approval at the May 24, 2018 Regents meeting and be available to the CSA at that time. Sjoberg Evashenk examined the CSA's April 2017 report response, carefully combed through Chapter 1 of the April 2017 CSA report to identify elements of concern to them, and conducted in-depth reviews to follow up on the three Year One recommendations that hinged on budget and financial information, as follows.

> **Recommendation #3**: *Document and review the restrictions on its funds and fund commitments to determine whether it can reallocate any of these funds to its discretionary budget for eventual reallocation to campuses.*

We interpret that this recommendation has four components:

- Document and review restrictions on funds.
- Document and review fund commitments.
- Determine whether any funds reviewed can be reclassified to a discretionary fund.
- Determine whether any fund balances could potentially be reallocated to campuses.

As we stated in our prior April 15, 2018, Fourth Quarterly Report, UCOP provided the auditor with detailed information it would submit to the Regents at its March 2018 meeting addressing its review of funds. That data reflected the results of in-depth research and detailed analyses determining the restricted, unrestricted, designated, and undesignated funds for the FY ending June 30, 2017. This analysis identified funds that were previously restricted that could/should be reclassified under the updated definitions to discretionary spending. Using the FY 2016-17 financial information for these funds, the UCOP estimated amounts potentially available for reallocation to campuses. The CSA accepted the deliverables UCOP provided for the review of funds, fund classification, and reclassification of funds to discretionary; however, it determined UCOP had only partially addressed the **fund commitment** aspect saying that the April 2018 information did clearly identify the amount of undesignated/unrestricted funds actually committed and how much would be available for other uses.

While the UCOP believes, and we concur, that it provided such information (as demonstrated in the March 2018 Regents meeting materials) and fulfilled the recommendation in April 2018, the FY 2018-19 budget submission which included the data that the CSA viewed as needing to be included to fulfill the requirement.

Part 2 of the Board of Regents Item B1[1] offers a detailed discussion of *fund balances* and *fund reserves.* In regard to the aspects of the recommendation that the CSA found insufficient, the budget document provides the details and specific amounts for the FY 2018-19 budget related to forecasted fund balances (restricted fund balances, fund reserves and/or designations), fund commitments, and amounts "available for systemwide purposes." The budget reflected:

- Restricted fund balances $ 6.0 million
- Designated fund balances $91.7 million

[1] Meeting of May 24, 2018, Fiscal Year 2018-19 Budget for the University of California Office of the President, item B1

- Undesignated forecasted fund balances—historically used by UCOP $30.3 million
- Undesignated unrestricted systemwide forecasted fund balances $25.8 million

UCOP went out ahead of future CSA recommended actions and proposed reallocating to campuses or systemwide programs as follows:

- $10 million from the investment income balance (a component of the undesignated forecasted fund balance historically used by UCOP) to the UC Riverside School of Medicine.

- $30 million ($3 million per campus) to address housing strategies. $14.5 million would be redirected from the Housing Loan Program (Regents designated program within the $91 million of designated fund balances) and $15.5 million from GO Bond investment income, part of the undesignated unrestricted systemwide forecasted fund balance.

- Another $34.7 million from General Funds to eliminate historical UCOP department deficits and to replace the previous temporary budget and establish the Strategic Priorities Fund (which is set at an amount that is half of the prior temporary budget managed by the President).

There are still remaining undesignated and uncommitted balances; before committing any of these remaining balances the UCOP will close the FY 2017-18 books and determine the actual amounts remaining. UCOP proposes to work in consultation with the campuses to develop a plan for these balances for consideration no later than the March 2019 Regents Meeting.

We find that with the submission and approval of the FY 2018-19 budget package that UCOP has addressed and met both aspects of CSA Recommendation 3.

> **Recommendation #4:** *Develop a reserve policy that governs how large its reserves should be and the purposes for which they can be used.*

The UCOP conducted research and benchmarked against a broad group of entities assessing all the major areas of funds held by UCOP including building and equipment reserves, program reserves, strategic priorities reserves, and operating reserves. As a result, two reserve pools – central operating reserve and strategic priorities reserve – were determined to need parameters. After developing and vetting the recommended reserve policies with the Regents, UCOP recommended and the Regents adopted the proposed Policy on the Central Operating Reserve for the University of California Office of the President on January 25, 2018. The Operating Reserve would be funded through the restricted pool of the President's Endowment Fund (designating $15 million or at least three and a half percent of covered funds and expenses, whichever is greater). This endowment fund is not on UCOP's ledger but held at the system level; the new policy allows UCOP to borrow from the corpus in said emergency. While the UCOP's budget does include an allocation from the President's Endowment fund – approximately $8.4 million at 6/30/17 (and the balance is included in the unrestricted undesignated funds), the reserve would be funded from the systemwide endowment and, therefore, no such reserve is reflected on the UCOP budget or in its reserves.

To respond to the CSA's recommendation to "combine both the disclosed and undisclosed budget into one budget presentation" UCOP created the Strategic Priorities Fund with explicit purposes to fund "term-limited priorities and initiatives."[2] The first step in the process to establish this fund involved committing $2 million from the existing President's Initiative Fund to the AB 97 redirection, eliminating that fund and the incorporating the remaining $7.8 million into the new Strategic Priorities Fund (SPF). The President approved the policy guidelines and the Regents reviewed these provisions in January 2018. The FY 2018-19 budget reflects the initial funding of the SPF at about $30 million and expects that fund to be replenished annually. Schedule E in the FY 2018-19 budget details the projected commitments and fund balance for the SPF.

Part 2 of the FY 2018-19 budget package details fund balances and reserves as required by the CSA. UCOP further breaks down fund balances by fund definition—restricted, unrestricted designated, and unrestricted—and provides tables to reflect the fund balances by main category at 6/30/17 and forecasted for 6/30/18, and show amounts reserved and remaining. We reviewed these tables and traced the amounts back to spreadsheets that reconcile to the financial system for agreement. We found that the classifications were reasonable and amounts appropriately traced to the worksheets. The worksheets include categories that UCOP and the Regents agreed to exclude from the fund balance budgets: accruals (comprised primarily of pension, leave, and insurance accruals), self-insurance reserves (USHIP, UC Health Care insurance, Be Smart About Safety, property, casualty, auto/fleet), Fiat Lux program, and unexpended capital outlay related amounts. The majority of these categories are unrestricted and designated with the exception of Fiat Lux which are restricted. Our analysis confirms that these amounts comply with the provisions set forth in the reserve plans and policy.

Figure 14 of the Budget package addresses UCOP restricted funds in categories for contracts and grants, gifts and endowments, and federal and state appropriations. By nature, all these funds are unavailable for uses other than the intended purpose—approximately $6 million is forecasted for these funds at 6/30/2018.

Part 2 also provides data relative to unrestricted designated funds primarily composed of specific funds intended to support particular programs—Regents designated funds include Housing Loan Program and DOE laboratories; programs and initiatives such as UC Press, UCDC, and Writing Placement Exams; and designated central services that include endowment cost recovery, energy and sustainability, UCPath, and others. We individually assessed each line item within these categories to determine if and how much of the balance should be reserved, verses how much should just remain in the fund balance. Within the Regent's designated category, approximately half of the DOE balance was reserved. However, the UCOP determined that the fund balance in the Housing Loan Program should be reduced—it reserved $39.4 million of the expected $54 million 6/30/18 balance and reallocated (with Regent approval) $14.5 million back to the campuses to be used for

[2] January 24, 2018, presentation to University of California Regents, Finance and Capital Strategies Committee

"campus housing strategies." With the exception of UC Press and UCDC where the majority if not all of the fund balances were reserved, the remaining balances in most all the other line items in both the programs and initiatives, and central services were designated unreserved, leaving the entire designated category to be approximately $77.2 million in the various fund balances.

Unrestricted amounts in the UCOP budget are separated into "unrestricted UCOP" and "unrestricted systemwide" to highlight the manner in which these funds are historically used. Two line items comprise the majority of UCOP unrestricted funds—general funds (primarily its central operating funds from various sources) and investment income fund (which includes the Presidents Endowment Fund, Searles, TRIP and STIP)—together comprising nearly $63 million. Of the $34.7 million[3] in projected general fund balance, all is committed—including redirecting about $23 million to the Strategic Priorities Fund (see above). Separately budgeted but also a use of general funds will be the elimination of fund balance deficits in departments within UCOP. Investment funds are expected to have a $33.4 million fund balance at 6/30/18 and about $10 million is committed for supporting the UC Riverside School of Medicine with the remainder available at year end. UCOP Building and Parking is in this category and the projected fund balance is reserved to support these facilities. Overall, of the UCOP portion of the unrestricted fund balance, nearly 49 percent is available for the future.

The unrestricted systemwide balances and reserves are reflected in two line items. One is General Obligation Bond Income which is fully committed when the $15.5 million is redirected to campuses for housing needs. The second is benefits reserves—UCOP has reserved approximately 47 percent of the projected year-end balance for systemwide employee benefits programs and considers that, while technically not designated for those purposes, the remaining funds should be directed at those programs.

We view that the UCOP has provided adequate detail and delineation of fund balances and reserves and find Recommendation #4 fully implemented.

> **Recommendation #5:** *Implement our recommended budget presentation shown in Figure 11 on page 40. Specifically, the Office of the President's budget presentation to the regents should include a comparison of its proposed budget to its actual expenditures for the previous year. It should also include all its expenditures and identify changes to the discretionary and restricted reserves. The Office of the President should combine both the disclosed and undisclosed budgets into one budget presentation.*

Recommendation #5 also infers several components within the text of that item. The presentation shown in the CSA's single graphic "Figure 11" stipulates:

- **a.** Inclusion of all budgetary allocations, both those previously termed as temporary and not reflected in prior UCOP budgets (disclosed and undisclosed);

[3] In Table 16a, there is an addition error in footing the columns. The amounts in the line items are correct but the totals at the bottom are off by $500,000. The 6/30/15 balance should be $61.1 million, forecast column should read $66.3 million and the remaining balance column $29.8 million.

b. Separate display of expenditures, particularly those relating to pass-through funds and fee-for-service funds received and expended for campuses;

c. Budget to actual results;

d. Budget based on actual expenditures projected and adjusted for program changes; and,

e. Reserve balances, particularly changes to both the “disclosed and undisclosed budgets”.

The UCOP has interpreted Recommendation #5 to encompass a broad range of matters including researching best practices for budget development and presentation; upgrading its BDS budget system to provide the system-generated data for budget preparation; reengineering its processes to adopt a more uniform and documented approach; developing a budget manual that documents the process for building the annual budget; and reforming its budget package to include the components required by the CSA.

Sjoberg Evashenk reviewed the budget manual, financial detail, and the budget package delivered to the Regents for its deliberation and approval at the May 24, 2018 meeting. Overall, we found that UCOP met and exceeded the requirements set forth by the CSA.

As we discussed in our April 15, 2018 report, we reviewed the data gathered by the budget processes workgroup related to best practices of “traditional GASB institution budget treatment” and “emerging industry best practices”.[4] The workgroup’s analysis of Government Finance Officers (GFOA) and National Association of College and University Business Officers (NACUBO), GASB, and statewide budget presentations notes a shift from public research institution sources and uses approach to those reflecting “statement of revenue, expenses, and changes in net assets” financial statements—we noted these are commonly referred to as Business Type Activities reporting. Our review of the budget manual and the presentation shows that the UCOP has implemented many of the elements shown as best and leading practices and provides a robust and detailed budget. We expect that over the coming months as the processes evolve and the systems supporting the budgetary and financial records of UCOP improve or are replaced, the data and the presentation will continue to be refined. This year UCOP instituted zero-based budgeting for certain aspects of expenditure budgeting and we expect that the workforce planning tool that is currently under pilot will become an additional resource for budgeting personal service expenses. We anticipate and will monitor these on-going efforts.

Of important note, the upgrades to the BDS system allowed UCOP to generate the needed budget data from the system—CSA was concerned that data were not verifiable as data were previously not system-generated. The upgrades undertaken by IBM now allows UCOP to generate fund source and use data by program and department and also provides budget to actual information that is now “system-generated”.

Also noteworthy, while the CSA did not require that UCOP detail all fund sources, its budget provided this information and related this data to the expenditures. The sources of funds are provided within the three defined fund categories—unrestricted and undesignated, unrestricted but designated, and

[4] March 14, 2018, University of California Regents, Finance and Capital Strategies Committee materials, Attachment 3

restricted. As the FY 2018-19 budget is the first time that UCOP included sources, this year will become the baseline for trending and comparing this data.

a. To address the first bullet above requiring the inclusion of all expenditures into a single budget, UCOP merged all aspects of what was previously termed as temporary funding into the full budget. This involved capturing all one-time and some on-going programs and initiatives that are determined by the President and requested through decision memos and improving the related processes to capture these expenses and formalize them into the budget. A primary tool for this is the Strategic Priorities Fund and the related procedures (updated and reissued) for requesting and using such funding. The UCOP merged the FY 2017-18 Regents budget and temporary funds into a complete full budget as reflected in Schedule G in the budget package. We found that the FY 2018-19 budget follows this new inclusionary format. Additionally, the programs and initiatives that were previously primarily funded using temporary funds are now funded through the Strategic Priorities Fund which is included in the total budget and also detailed in Schedule E, and details on the Presidential initiatives are narratively discussed and budgets reflected in Attachment 3.

b. The second bullet above relates to separating expenditures. The UCOP budget is categorized into programs and initiatives, which incorporates state and federal programs, systemwide programs, and campus programs; central and administrative services which are presented by UCOP department; UCPath Center; and, Strategic Priorities Fund which supports Presidential Initiatives and other emerging or nonrecurring/short term/one-time projects or needs. The budget is presented in a number of views following these functional areas with Schedule A providing the detail suggested by the CSA. Other figures and schedules such as *Figure 7—FY 18-19 Uses of Funds by Functional Area* provide data at different levels and descriptions. Figure 7 offers a big picture of the entire budget – summary of each major component of Programs and Initiatives totaling $395.7 million, Central and Administrative Services broken down by department totaling $379.5 million, Strategic Priorities Fund equaling $30.0 million, and UCPath operations at $71.2 million.

   Two aspects of the UCOP budget are clearly conveyed in this new budget format—the portions of the UCOP budget that relate to pass-through funding and fee-for-services. In *Figure 9 – Pass-Through Funds Programs*, UCOP details the 10 major programs housed at campuses but the funding flows-through UCOP and range from Agriculture & Natural Resources (ANR) totaling $158.5 million, to UC Observatories receiving $22.2 million, to Diversity Initiatives receiving $3.0 million. Pass-through funding comprises $324.1 million of the UCOP budget with 96% of those funds relating to the $395.7 million Programs and Initiatives portion of the budget. *Figure 12—UCOP Fee for Service Activities* shows detail of the department budgets providing fee-for-services activities including such key services as General Counsel[5] of $44.5 million, Investments and Asset management $39.1 million, and UC Retirement System of $29.5 million. The vast majority of fee-for-service activities are provided

[5] General Counsel has a significant increase in its budget resulting from the change in accounting method from reflecting the net of revenues and expenses and the treatment of outside counsel costs. We expect this budget to normalize in the future. This is one example of the several significant accounting and reporting changes instituted by UCOP for this budget year.

by departments within the Central and Administrative Services budget category; the fee-for-service total of $179.7 million is a significant portion of the $379.5 million budget supporting the UCOP Central and Administrative services.

c. The CSA required that UCOP provide budget to actual amounts in its budget presentations. Budget to actual figures are typically a management tool utilized during the year to monitor actual costs against budgeted amounts. In management reports, year-to-date and or monthly amounts are compared on a like-kind basis periodically through the year. As an example, UCOP provided 6 month year-to-date actuals compared to budgeted amounts to the Regents at the February 2018 meeting. Annual budgets must be developed well prior to the end of the current fiscal or calendar year in order to be adopted before the beginning of the new fiscal year – thus year-end results must be forecasted to provide a comparison for budget purposes since final year end numbers will not be available until long after the budget must be in place. UCOP provided FY 2017-18 forecasted amounts throughout the budget packet—comparing budget to forecasted actual for FY 2017-18 and FY 2018-19 (Figure 10 and Figure 13 and Schedules C and D). UCOP also used projections to forecast fund balances and reserves (Figures 14 through 16b).

   It is reasonable for UCOP to use forecasted actual amounts for its current year budgeting purposes and this is best practice. In future budgets, budget to actual figures for the most recent complete year could be included, showing prior year actual, current year projected, and budget year amounts. The accuracy of these projections can be determined after year-end closing of the accounting records. We expect that budget staff will review actual results against their projections and make any adjustments to the system or assumptions to improve accuracy and reliability.

d. The CSA's 2017 report states that the UCOP's budget presentation should be based on actual expenditures projected and adjusted for program changes. The UCOP budget system, BDS, did not previously have the functionality to generate budget information without significant manual manipulation of the numbers. With the recent upgrades to the BDS system, most of the budget data is generated based upon the financial information obtained from the UCLA general ledger system that supports UCOP accounting. With this financial data, UCOP was able to forecast FY 2017-18 year-end balances and provide within the budget package comparisons of forecasted actual to budget amounts for the current and the budget year and also a reconciliation of the FY 2017-18 budget to the FY 2018-19 budget showing variances and providing explanations on material changes. These *Cause of Change* documents are in Schedule F (1) and F (2).

   The CSA's recommendation was a catalyst for UCOP to go ahead and upgrade its BDS system while it prepares to replace both its budget and accounting systems with more modern, functional, and integrated tools. The FY 2018-19 budget was system-generated and each program and department data were evaluated and adjusted to incorporate stated goals and objectives including vacancies, zero-based budgeting for a number of non-personnel costs, absorbing salary, benefit, and other contract increases, and management program or administrative decisions. While it is expected that each year a similar process of program and operational examinations and reconsideration will occur, having a system that will generate budget data based upon actual costs will be beneficial and allow for year-over-year trending and evaluation.

e. Issues relating to reserves and fund balances were primary concerns of the CSA. Sjoberg Evashenk's reading of the CSA's concerns were two-fold and interrelated. Specifically, the CSA took issue with the portion of the President's budget that was not conveyed to the Regents and used for temporary and/or one-time funding of programs and initiatives. In addition, they noted that the fund balance or the reserves that remained unspent at year end were considerable, suggesting that the campus assessments could be lower and such balances would not build. To address these concerns the UCOP has taken several steps. As previously discussed, there is no longer a temporary budget or spending that is outside of the Regents approved budget. Additionally, the UCOP has identified the sources of its funding, evaluated every fund and classified each as restricted, unrestricted designated, and unrestricted. In considering fund balances and fund reserves UCOP went even further in detail to classify and to project reserves and fund balances. It reviewed March 31, 2018 fund balance and developed forecasted balances at June 30, 2018.

   As a part of its fund definitions, it was determined that fund balances relating to restricted funds and designated funds were to be considered committed to the intended purpose of those funds. Fund Balances for restricted funds (primarily contracts and grants, gifts and endowments, and federal and particular state appropriations) were reflected in Figure 14.

   Unrestricted designated funds include programs that are self-funded and funds generated are intended to maintain the program operations—UC Press, UCDC, Digital library are some of those programs. Similarly, UCOP categorized certain central services that generate revenue as programs that should retain balances to support operations; primarily endowment cost recovery, and energy and sustainability (UCPath and others are included but have immaterial balances). In total, Central Services Designated funds are projected to amount to about $21.3 million with over 93 percent of those funds attributable to endowments and energy.

   The Regents have designated that certain housing programs funds be used only for those programs and has designated DOE laboratory funding within the same category. When reviewing the balances in the Regents designated housing program the UCOP noted that even setting aside a prudent reserve, excess funds remained. Recognizing the housing needs at the campuses, the President recommended a one-time expenditure of $14.5 million from that fund balance for "campus housing strategies." We see this as one example of early implementation of the CSA's recommendation for reallocating balances back to the campuses.

   UCOP further defined fund balances attributable to unrestricted and undesignated funds into those relating to UCOP operations and those relating to systemwide purposes. Like the other fund balances, we understand that UCOP will evaluate, report, and make recommendations each year related to these funds. We anticipate that as budgeting is refined and existing balances are either used or reallocated out to the campuses that fund balances, after setting aside appropriate reserves, will dwindle and remain at a very modest level. Therefore, reallocation of these funds will be one-time or time specific activities and are unlikely to be available to support any on-going activity or program. That said, as shown in Figures 16a and 16b, UCOP identified amounts from both the UCOP operations pool and the systemwide pool for reallocation to campuses in FY 2018-19. In total approximately $25.5 million was recommended for allocation to campuses for UC Riverside School of Medicine and campus housing strategies. Another $20.3 million was redirected to the Strategic Priorities Fund which will provide support to Presidential Initiatives and other requested or identified needs both as the campuses and within the UCOP. Another $14.4 million will eliminate historical UCOP departmental deficits to put all operations on a firm foundation going forward. These one-time funding decisions do not eliminate all available fund balances; the projected $56.1 million remaining in the funds should be actively reviewed in the coming budget for potential use. We view these actions to redistribute a good portion of these funds out to the campuses as early adoption of CSA recommendations projected for the future.

We find that UCOP has demonstrated full compliance with Recommendation #5.

Recommendation #11: *Determine how to restructure salary ranges to make certain the ranges encourage employee development and ensure pay equity.*

Recommendation 11 asks UCOP to assess ways it should or could restructure its salary ranges to make certain the ranges encourage employee development and ensure pay equity. Sjoberg Evashenk's interpretation of this recommendation aligned more with that of the UCOP, neither of which aligned with the CSA. For reasons we will highlight, we viewed the recommendation was focused more on a position and salary structure and schema that would provide a clear path and required information for employees to plan the progression of their careers and to ensure fair and equitable pay throughout the system. That is why our analysis of the issue focused on the information and tools within Career Tracks.

The divergence between CSA and UCOP (as reviewed by Sjoberg Evashenk) on this issue resulted when year one and year two recommendations were considered in concert by the CSA. First, Recommendation #10 required the UC to develop a method for weighing comparable public and private sector pay data when establishing salaries for positions—this was to be accomplished by April 2018 and adopted. The next step would be to complete the related compensation surveys for the jobs in Career Tracks.

UCOP viewed that having the salary information was essential to developing a plan to narrow the ranges. This view was further enforced when considering Recommendation #24 that states: "*To ensure that its staffing costs align with the needs of the campuses and other stakeholders, the Office of the President should do the following by April 2019: Narrow its salary ranges."* Decisions made relative to the narrowing of the salary ranges, both the plan and the execution of the plan, have potential far reaching and significant impacts and must be made with complete information and stakeholder input. The CSA disagreed with these notions and found UCOP non-compliant.

Position matching for non-represented Career Tracks employees to the State and California State University system is on-going. UCOP expects essential data from CalHR and CSU by the end of June 2018; this data will allow UCOP to analyze positions and apply the weighting methodology adopted by the Regents to positions in Career Tracks to complete the compensation studies. Concurrently, UCOP has engaged Sullivan Cotter to assist in developing the plan for narrowing salary ranges. UCOP intends to present the plan to the Regents late in the summer and to the CSA in October 2018.

This recommendation is not yet complete and we will continue to monitor progress over the summer.

> **Recommendation #9 to the Regents:** *To ensure that the Office of the President's financial safeguards are adequate, the regents should require the Office of the President to engage in a financial audit of the Office of the President.*

In November 2017, PricewaterhouseCoopers (PwC) presented audited financial statements for the UCOP. As we noted in our January 2018 report, PwC conducted this audit as one of UCOP operations as a department of the University of California—revenues and expenditures. UC departments, including the campuses, do not prepare full financial statements for their entities as they are considered a "department" not a separate business entity of the university. Full business type activity reporting would include Statement of Net Position and Statements of Cash Flow; these statements are prepared for the university systemwide and not at the department level. Therefore, the scope of the audit recommended by the CSA was understood by UC and PwC to be an audit of the UCOP operations which would include the revenues and expenses of the department. This audit missed the mark with CSA and as a result, UCOP and CSA met on a number of occasions subsequent to the November 2017, 6 Month Report to agree on additional UCOP specific financial information to be provided to the CSA. The agreement included:

- *Present to the Regents a schedule of UCOP funds, fund balances, and fund restrictions including reserve balances*.
- *Present to the Chair of the Regents and Chair of the Compliance and Audit Committee a schedule of revenue and expenses for UCOP showing significant departments within UCOP in separate columns*.
- *Engage a third party firm to conduct a review of the UCOP reserve and budgeting internal controls after the FY 2018-19 budgeting process is complete, to allow for new controls over reserves and budgeting to be implemented (by September 2018).*

CSA has accepted the schedule of UCOP funds that was submitted in March 2018. However, the determination by CSA on full compliance with the matters related to fund balances, fund restrictions, and reserves is contingent on the fulfillment of Recommendation #3. As previously stated, we view that Recommendation #3 is complete.

During mid-June 2018, UCOP provided us with draft documents of the "Consolidated Schedule of Statement of Revenues and Expenses" at June 30, 2017 as agreed to under the second bullet above. We reviewed the schedule and traced data back to the audited financials prepared by PwC and to relevant amounts presented in the budget documents—we found all in agreement. There are a number of footnotes and associated information that accompany the schedule and that data aligned with information we gathered though our processes. We understand that the selected systemwide programs detailed in the statements were to include those programs of at least 10 percent of the budget; the schedule goes beyond 10 percent and includes the top 6 programs, the smallest of which is 2 percent of the UCOP expenditures. We found the report complete and detail appropriate and reasonable. The draft was slated for submission to the designated Regents and Regents committee by the end of June 2018.

The final bullet above stipulates that UCOP will engage a third party auditor to conduct the internal controls reviews over financial and budget information, as expected by the CSA. We conducted conversations with the UC internal auditor who indicated that the third party auditor had been selected and the contract negotiation nearly complete. The scope will follow that agreed to between UCOP and CSA and the project is scheduled to commence the first part of July and be complete in September 2018. UCOP management asserts that with new budget process tools and procedures are in place and inherent in these are appropriate controls. We understand the audit will apply the policies, procedures, and guidance relating to the new processes to its audit.

We will continue to monitor the progress on each outstanding requirement and include the progress and result in our next report.

YEAR TWO CSA RECOMMENDATIONS

In addition to those recommendations outstanding from Year 1, we identified 11 recommendations that UCOP will address during Year 2 with deliverables expected by April 25, 2019. As mentioned, Sjoberg Evashenk's current reporting period includes the submission of the UCOP's One Year report, the CSA's response to that report, submission and approval of the FY 2018-19 budget, and UCOP's Year 2 efforts. Much of our work during this quarter relates to Year 1 issues, as detailed in the prior sections. Similarly, in order to meet the two significant deadlines in April and May, in addition to assisting with end of the year State budget matters, UCOP leaders and staff directed much of their effort and attention on these matters and as the month of June comes to a close, UCOP is focusing on ramping up to meet the April 2019 goals.

Over the past few weeks, key UCOP managers are reviewing the workstream plans, evaluating the membership and goals of workstream groups (a few have been disbanded while others are being refocused), and some will have new leadership. Since the commencement of the efforts to address the CSA recommendations in its 2017 report, milestones for all 33 recommendations were considered by the UCOP's audit implementation leadership and the individual workstream groups and incorporated into plans, with the pacing and tasks designed to, at a minimum, meet those timeframes.

Our review of the recommendations targeted for April 2019 finds all but one are in progress[6].

Fund Restrictions, Fund Reserves, Budget Development, and Budget Presentation

We identified three April 2019 recommendations that relate to areas involving fund restrictions and fund balance, budget development, and budget presentation.

> **Recommendation #20**: *Publish the results of its review of fund restrictions and fund commitments and any funds it anticipates reallocating to campuses.*

The UCOP has already accomplished this April 2019 recommendation. As detailed in prior sections, it completed a review of all of its more than 500 funds, created definitions, and classified the funds into these groupings. Within the May 2018 budget package, the UCOP published details of the projected FY 2017-18 balances within those fund categories, amounts that were deemed committed, and amounts available for reallocation or potential reallocation to the campuses or for other purposes. We anticipate that the UCOP will continue to review fund balances and reserves on a periodic basis during the year and will report on the balances in its budget presentations.

Further, UCOP remains actively pursuing a new financial reporting system for its "department." During the month of June it met with representatives of certain campuses to continue to do its due diligence in evaluating the suitability of using one of these systems for UCOP needs. Primarily considerations in UCOP's determination of a new system are cost, adaptability to UCOPs program and fund needs, and functionality of reporting to meet the budget and CSA requirements. UCOP also continues to explore obtaining a new budget system to integrate with a new general ledger and reporting system.

> **Recommendation #21:** *Implement the best practices for budgeting identified by GFOA and NACUBO, including developing budget policies and procedures and formally documenting, approving, and justifying all one-time and unexpended expenditure requests.*

As previously stated in this report, the UCOP has researched and adopted many best and leading practices from NACUBO, GFOA, and others for policies, procedures, and presentations of its budget. UCOP managers convey that they are committed to continual improvement and evolution of these policies, procedures, and practices and will plan to research and consider best practices, and update as needed.

The CSA recognized that the UCOP has developed and uploaded its Budget Manual. This manual is considered a "living document" as it will be updated and revised as processes evolve and improve over the coming months and years. Additionally, during the budget preparation efforts, the UCOP made deliberate efforts to formally document its iterations and decisions, and with the upgrades to the BDS system, has retained a detailed audit trail of these processes.

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[6] See Recommendation #26

During the past year, the UCOP has updated and improved its policies and procedures for formally requesting, justifying, and approving one-time and other expenditure requests. The policies and related procedures continue to evolve and pertain primarily to the Strategic Priorities Fund which is intended to form the pool of funds available to meet one-time or emerging issue requests. In addition to providing formal direction and processes for requesting and justifying SPF funds (written documentation), the policy will set forth decision-making processes and will require reporting on the use of the funds. We will monitor the development of the related policies and guidance.

> **Recommendation #22**: *Continue to present a comprehensive budget based on the presentation in Figure 11 to the regents, the Legislature, and the public.*

The UCOP provided its budget that fully incorporates the components that CSA recommended. Nonetheless, as noted above, UCOP plans to continue to refine its budget development practices as well as its presentation with a goal of continual improvement. This recommendation is "continuing" but should be considered complete.

SALARY LEVELS AND RANGES

The CSA also made three recommendations relative to employee wages and salary ranges.

> **Recommendation 23:** *Set targets for any needed reductions to salary amounts using the results from its public and private sector comparison and adjust its salaries accordingly.*

The UCOP is still in the process of matching State and CSU positions and has not yet conducted the compensation study and weighting efforts to calculate the results. Leadership is in the process of interpreting and defining "target" in this context. Our reading suggests that such a target might be "to align compensation for each classification with the median of the range that is determined after matching and weighting processes are complete." The results of the compensation matching and weighting work would be compared against existing salary schedules—where the results reveal that UC positions are too high (or too low), then adopting the needed changes would comply with the target definition.

The UCOP's workstream groups charged with matching SMG positions and salaries has completed its work and presented the recommendations for weighting salaries for SMG employees – Regents adopted those recommendations in March 2018 and also agreed with the recommendation to apply the same weighting methodology to non-represented employees. UCOP is in the process of matching the positions and duties of non-represented UC employees to positions within State service, California State University system, and industry. The UCOP has matched approximately 60 percent of non-medical Career Tracks jobs to industry and was successful in potentially matching about 45 percent to CSU positions. It has been less successful in identifying potential matches for State jobs that resulted in only approximately 17 percent of career track positions. CSU and CalHR are gathering the data for these potential matches and UCOP expects those results by the end of June 2018. With that data, UCOP will apply the approved weighting methodology to the Career Tracks positions.

This workstream's plan includes requesting that the Regents convene a committee similar to the one it formed to examine the MRZ issue relating to the SMG positions so that UCOP can actively involve the Regents and take advantage of their talent and expertise. With the input of the Regents, the results from the studies would be vetted and evaluated, likely in terms of comparing existing pay scales for these classifications but also for equity with represented employees, where appropriate. The results of these efforts would then be provided to the President and to the Regents.

We will conduct follow-up reviews of progress related to this recommendation in the next quarterly report.

> **Recommendation #24**: *Narrow its salary ranges.*

The UCOP is actively working with Sullivan Cotter to develop its plan for narrowing salary ranges. Such a plan is expected by September 2018. Concurrent with these efforts, as noted in Recommendation #23, the UCOP is in process of analyzing the compensation of its non-represented, non-SMG employee classifications and those efforts will ultimately result in recommendations for resetting existing salary scales. We anticipate that once the plan is done and the compensation studies complete, that UCOP will apply the plan to the recommended pay scales to narrow the ranges.

We will continue to monitor the progress of achieving the recommendation in the coming weeks and will provide a progress report in the next quarterly report.

> **Recommendation #26:** *Create a plan for reallocating funds to campuses that it saves as it reduces its staffing costs.*

This recommendation will not be addressed by the salaries and range workstream group, but rather by the President. This is pending since any plans for reallocating UCOP funds can only be determined as part of the President's budget setting process next fiscal year once any potential savings have been identified. We have not yet heard the President's plans for reallocating to campuses any funds derived from salary or other economizing strategies undertaken by the UCOP for the upcoming or future years.

Employee Benefits

The CSA directed only one recommendation for Year 2 relating to employee benefits and reimbursements.

> **Recommendation #25**: *Set targets for appropriate employee benefits and implement new processes that ensure employees adhere to the revised policies regarding employee benefits.*

During the course of Year 1, the UCOP and the Regents took a number of actions and changed several policies involving employee benefits and reimbursements. As a result, car allowances and employer contributions to retirement savings plans are phasing out; new limits were placed on travel costs, meeting and entertainment allowances, and relocation and moving reimbursements; and additional controls on stipends, cell phones, and performance bonuses. CSA agreed that each of these targets were met and achieved the intent of the auditor's first year recommendation.

Policies, procedures and guidance were adopted to formalize these changes and managers and staff notified of these new provisions. A review of internal controls over fiscal activities and budget processes is being procured by UCOP (as noted earlier in this report). Inherent to such audits, auditors will identify controls and test transactions and practices against the established criteria; through this process adherence to these policies should be demonstrated. The internal control reviews should be complete in the fall. We will review those reports at that time.

SYSTEMWIDE INITIATIVES

The CSA set three recommendations for the UCOP relating to systemwide initiatives and administrative programs for year one. These recommendations have been accomplished through the extensive work done on the budget described earlier. The Year 2 recommendation is:

> **Recommendation #28:** *Establish spending targets for systemwide initiatives and administrative costs.*

The FY 2018-19 UCOP budget adopted by the Regents includes spending targets and descriptions of the five categories included in "Programs and Initiatives." The budget details that this grouping comprises 45 percent of the UCOP budget, or $395.7 million. Within this budget, nearly 30 percent is targeted for functions benefitting the State, multiple campuses, or the entire system; 68 percent is directed to activities that are either required by current legislation or programs that UC operates on behalf of the State or federal government; and, two smaller components—Systemwide Initiatives (about 2 percent) is focused to fund time-bound or single occasion commitments such as the UC Health CHQI initiative; and the remaining less than $1 million supports campus specific programs.[7] Additionally, the budget document's Figure 10 illustrates budget variances within each category and explanations for those changes and Schedule C of the FY 2018-19 budget reflects detail at the program and initiative levels with forecasted expenses through FY 2017-18 and year-over-year variances.

The UCOP separately provides targets and spending related to the President's Initiatives, which going forward will be funded through the newly established Strategic Priorities Fund. The total target for this fund is $30 million, which is 38 percent lower than prior years. For the budget year, the President set a goal of committing no more than half the SPF funds at the beginning of the fiscal year to "accommodate other projects or emerging issues that will arise during the year."[8] The budget also reveals details pertinent to all activities funded from the SPF in Schedule E, showing the targeted commitments for each Presidential Initiative as well as UCOP Central and Administrative initiatives to be supported in the coming year.

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[7] May 24, 2018, Board of Regents Budget item, Page 10 narrative and Figure 8.

[8] May 24, 2018, Board of Regents Budget item, Page 14 narrative.

Similarly, the FY 2018-19 budget document details budget targets for Central and Administrative Services, totaling 43 percent of the UCOP budget.[9] The budget separates the $379.5 million spending plan into the 12 divisions supporting the UCOP and the UC System. Five divisions comprise approximately 85 percent of the budgeted spending—Operations, General Counsel, Academic Affairs, Finance, and Investments. Figure 13 reflects the budget targets for these divisions and provides explanations for projected variances between the current and budget year. Further, Schedule D provides budget target and year-over-year variances for each division at the functional level.

As the UCOP and the President is committed to continual improvement, for each budget year going forward, the budget process should incorporate assessing and evaluating the upcoming needs of the UCOP, campuses and the system. We view that with the demonstrated detail provided and format established, the Regents, Legislature, and the public will have the information to view UCOP's budget targets and related cost of operations. We consider this recommendation is in full compliance and complete.

> **Recommendation #29:** *Publish the results of the review of systemwide and Presidential Initiatives, including any funds the Office of the President anticipates reallocating to the campuses.*

The UCOP budget is a public document and conveys the results of the UCOP's efforts to fully review, classify, set targets, and explain its systemwide programs[10] and particularly the Presidential Initiatives—which are described in detail in Attachment 3 of the FY 2018-19 budget document. As discussed earlier in this report under Recommendation #3 and #4, the President reallocated funds within the FY 2018-19 budget back to the campuses. Additionally, reductions in the UCOP operating budget, program budgets, and the former Presidential Initiatives Funds provided $8.5 million for meeting the provisions of AB 97.

As the UCOP has successfully published the results of its review of systemwide and Presidential Initiatives and reallocated funds to campuses in the coming year, we believe it has successfully completed this recommendation.

> **Recommendation #30:** *Restructure budget and accounting systems to ensure the costs of the Office of the President can be clearly tracked and reported annually. Specifically, the budget and accounting systems should be able to distinguish between systemwide initiatives, presidential initiatives, and administrative costs.*

As previously mentioned, the UCOP engaged IBM to execute numerous upgrades to the BDS (budget system). These upgrades added several areas of functionality to the system; in regards to this recommendation, the BDS can now allow for distinguishing data in sufficient detail to allow UCOP to pull reports by program and fund, thus identifying budget amounts by Presidential Initiative, systemwide initiative and program, and administrative division costs. This functionality is reflected in

[9] May 24, 2018, Board of Regents Budget item, Page 14 narrative.

[10] The UCOP also provided detailed descriptions and classifications of all systemwide programs and initiatives to the Regents at the March 2018 meeting.

State of California Workforce Planning Model

- Phase 1 - Set The Strategic Direction for the Workforce Plan
- Phase 2 - Gather and Analyze Departmental Data for the Workforce Plan
- Phase 3 - Develop the Workforce Strategies and Plan
- Phase 4 - Implement Strategies
- Phase 5 - Evaluate the Workforce Plan

the many tables and graphics in the FY 2018-19 budget package, particularly Schedules A, B, C and E.

Our assessment is that the delivery of this budget information is demonstrative of completing this recommendation.

WORKFORCE PLANNING

Recommendation #27: *Implement phase two of CalHR's best practice workforce planning model by determining its current and future staffing and competency gaps. As part of this phase, the Office of the President should consider the input of stakeholders including campuses and students, regarding which elements of its organization are of critical importance and which elements it could potentially eliminate or downsize.*

UCOP's workforce planning workstream group has taken a full-scope approach to fulfilling all the related requirements presented for the three-year period by the CSA. There are many dependencies as well as complementary activities required to complete the entire workforce plan. The UCOP delivered and the CSA accepted Phase I of the Workforce Planning model. During the past year and continuing into this year, UCOP not only has commenced tasks related to Phase 2 of CalHR's best practice plan, but also has begun tasks relative to Phase 3.

A key component of Phase 2 that UCOP adopted in addition to the elements in the CalHR model was to test a pilot program "to socialize with leadership the process to assess current staff and future needs." The pilot commenced in late October 2017 and the results are expected by the end of July 2018. Additionally, several of the first tasks of Phase 2 have and are reaching completion—e.g. gathering and analyzing three years of staffing data from the payroll and HR system to analyze elements and trend. This data will be used to project future workforce, forecast the impact of demographics on each classification, and evaluate the impact of separations on each classification. The workgroup is also assessing staff competencies and together with the prior steps will determine current needs and begin projecting future needs. Also, staff are in the process of conducting a demand analysis, supply analysis, and a gap analysis which should be completed in the next quarter.

We will assess the progress and success of achieving the many interim tasks in during the coming quarter.