



Internal Audit Report

SILICON VALLEY INITIATIVES

Report No. SC-11-06

August 2011

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August 15, 2011

GORDON RINGOLD
Director, Silicon Valley Initiatives

Re: Internal Audit Report No. SC-11-06 - Silicon Valley Initiatives

Dear Gordon,

Internal Audit & Advisory Services (IAS) has completed a review of the Silicon Valley Initiatives office (SVI) to evaluate the adequacy of controls over selected financial management activities, and related business functions under the SVI and to assess the status of the University Associates LLC and its efforts to develop a multi-institution campus within the NASA Research Park at Moffett Field.

In general, controls over SVI financial financial management activities, and related business functions were found to be well managed and in compliance with applicable policies and regulations. However, SVI is facing a projected budget deficit in 2015. While selected planning documents have identified top level goals for UCSC presence in Silicon Valley, there is a need to implement a comprehensive campus planning process to ensure SVI's short term and mid-term accomplishments are leveraged to meet the university's longer term goals.

We would like to express our appreciation to your office for the cooperation and assistance provided throughout this engagement and in the identification and development of corrective actions contained in this report.

Sincerely,

A handwritten signature in blue ink that reads "Barry Long".

Barry Long, Director
Internal Audit & Advisory Services

Attachment

Gordon Ringold
August 15, 2011
Page 2

Distribution:

Senior Auditor Beahan
Assistant Vice Provost Siegel

UCSC Audit Committee:

Special Assistant Beaston
Vice Chancellor Delaney
Vice Chancellor Doyle
Assistant Vice Chancellor Lew
Vice Chancellor Margon
Assistant Vice Chancellor Moreno
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Associate Chancellor Sahni
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SILICON VALLEY INITIATIVES

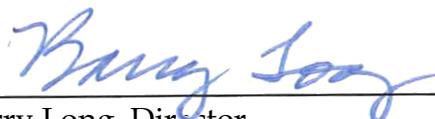
Report No. SC-11-06

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Frank Beahan
Senior Auditor

Approved:



Barry Long, Director
Internal Audit & Advisory Services

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I. EXECUTIVE SUMMARY

Internal Audit & Advisory Services (IAS) has completed a review of the Silicon Valley Initiatives Office (SVI) to evaluate the adequacy of controls over financial processing, management, payroll, reporting, and related business functions under SVI and to assess the status of the University Associates LLC and its efforts to develop a multi-institution campus within the NASA Research Park at Moffett Field.

In general, SVI controls and related business functions were found to be well managed and in compliance with applicable policies and regulations.

However, SVI is facing a projected budget deficit in 2015, and while top level goals exist for UCSC presence in Silicon Valley in the current version of the Academic Plan, The Two Year Action, and the SVI draft report, *Toward a UCSC Strategic Plan for Silicon Valley*, there is need to address the long term goals into Silicon Valley.

In the near term, the SVI office has been engaged in reinvigorating the working relationship with NASA; establishing new UCSC faculty research centers; working with campus divisions and UNEX to expand graduate studies in Silicon Valley; reaching out to Silicon Valley companies and investing in relationships between UC and NASA researchers with the objective of materializing research opportunities; and physically relocating to the UNEX building. These activities have consumed considerable SVI resources given their small size. In 2010, due to the depressed real estate market and the absence of financing opportunities, UCSC and its UA-SV LLC partners put the NASA Research Park development in "sleep mode".

The following issue requiring management corrective action was identified during the review:

- A. *Silicon Valley Initiatives' ongoing short to mid-term planning, management of operations, and regular reporting has yet to be coupled with an effective, long-term comprehensive campus planning process. As a result the university is subject to increased risks associated with failure to achieve its stated goals.*

Observations and related management corrective actions are described in greater detail in Section III of this report. A summary of relevant and/or recent Silicon Valley planning outcomes are identified in Appendix A; an abbreviated summary of UCSC's involvement in Silicon Valley prior to 2007 is listed in Appendix B; and a summary of SVI's fiscal history is presented in Appendix C.

II. INTRODUCTION

A. Purpose

The purpose of the audit was to evaluate the adequacy of controls over financial processing, management, payroll, reporting, and related business functions under Silicon Valley Initiatives; and assess the status of the University Associates LLC and its efforts to develop a multi-institution campus within the NASA Research Park at Moffett Field

B. Background

The UCSC Silicon Valley Initiatives Office (SVI) was initiated in 2000 and subsequently located in Building 19 in the historic district of Moffett Field at the NASA Research Park (NRP). SVI is the organization tasked with oversight of UCSC's research work with NASA at Moffett Field and the development of UCSC's research and graduate studies programs in Silicon Valley. At the beginning of FY 2012, SVI had a permanent annual budget of \$911,000 with a permanent staff of 2.8 FTE. Initially SVI focused on development of research collaboration with NASA. Currently, SVI's strategic and programmatic activities are focused on further development of the relationship with NASA and expanding UCSC graduate research presence in Silicon Valley. See Appendix B for a summary chronological listing of UCSC's history of involvement in Silicon Valley prior to 2007.

Currently, SVI oversees the University Affiliated Research Center (UARC), a 10-year (2003 to 2013), \$300 million dollar research contract between UC and NASA Ames Research Center (ARC), located at Moffett Field in Mountain View. SVI also oversees various programs and grants, consisting of the Advanced Studies Laboratory (ASL), a partnership with NASA creating shared research space at NASA Ames Research Center, operated by UCSC. SVI also administers NASA-related grants such as the Bio | Info | Nano R&D Institute. Funding for this grant has recently ended but for 5 years this was an effort to bring together NASA, UC and industrial affiliates in collaborative research in the ASL. In addition SVI provides office, classroom, and meeting spaces for the Jack Baskin School of Engineering's presence in Silicon Valley, including graduate programs such as the Technology and Information Management program (TIM), the masters degree in Network Engineering (MSNE), and the certificate in Knowledge Services (KSEM).

In 2008, the scope of SVI responsibility expanded as UCSC, working with the UC Office of the President, formed a limited liability corporation, University Associates – Silicon Valley LLC (UA-SV LLC), in order to join together regional higher education partners to explore the possibility of joint participation in the planning for, and evaluation of proposals for, a 77-acre portion of the NRP called the University Development Area, pursuant to a long term lease of land from NASA. SVI was identified as the unit having

administrative responsibility for UCSC facilities and graduate/research activities arising from UCSC participation in the activities of UA-SV LLC.

Also, in 2008 UA-SV LLC signed a lease for the University Development Area of the NRP. The initial term of the lease is 60 years, with three, 10-year extended term periods. Execution of the lease agreement began an exploratory “pre-development period”, during which time the LLC will move through a series of milestones to determine both the economic feasibility and desirability prior to the last chance to exit the lease in December 2013. From the UCSC perspective, the pre-development period ends in September 2013, with a Regents vote on the project prior to the final exit opportunity.

UA-SV LLC has received \$3.5M in academic member contributions to cover both startup and operating costs since 2008. UC sources (SVI discretionary funds and central campus allocations) have provided \$2.7M to date, with the remaining balance covered by its LLC partner institution. A real estate developer was selected to develop a feasibility assessment and proposal for the development of a large mixed-use campus. UA-SV LLC hired attorneys and consultants to assist in their due diligence review of the real estate developers assessment and proposal.

In 2010, it was decided by UCSC and its UA-SV LLC partners to put the development of the University Development Area in “sleep mode” due to the depressed real estate market and absence of financing opportunities. While in sleep mode, UA-SV LLC has minimal staffing and is obliged to pay a renegotiated and reduced lease cost with NASA. It is anticipated that UA-SV LLC will continue to explore options with NASA and its partners.

A summary of SVI’s current agenda includes the continued oversight of:

- current Silicon Valley Initiatives.
- the UARC contract. Of critical importance is high level involvement with NASA to develop further collaboration and enhance the likelihood of renewal of the UARC contract in 2013.
- the SV-UA LLC management of the NRP land lease opportunity, along with EVC and Chancellor relocation of SVI in August 2011 to the UNEX building on Augustine Drive in Santa Clara. SVI is leasing the 3rd floor of the building. SVI has entered into an MOU with UNEX to exchange 3rd floor classroom space for building and information system maintenance responsibilities.
- in the development of research linkages between UC and NASA with the appointment of an SVI Director, UC Office of NASA Partnerships. This position will focus full time on coordinating the advancement of research collaborations (grants, cooperative agreements, UARC task orders, etc.) between UC researchers (all campuses) and NASA researchers (all centers).

- UCSC faculty members to establish research centers in material sciences, computer network sciences or astrobiology. SVI may provide seed funding and space for the centers at its new location, at the ASL, or elsewhere
- UNEX and the Divisions of Engineering and Social Sciences to further develop graduate coursework offered in Silicon Valley.

With the number of items on its current agenda SVI's small management office has been primarily focused on managing the challenges at hand. Near term, the focus is on managing the relationship with NASA, relocating to the UNEX building, and administering to Silicon Valley Initiatives and UA-SV LLC activities. Intermediate term, SVI is focused on the success of the research centers and graduate programs at its new location. SVI management asserts that success with the research centers and graduate studies will lead to further opportunities and resources.

C. Scope

The preliminary survey phase of the engagement included interviews with Silicon Valley Center and Financial Affairs management. In those discussions, UA-SV LLC operations were characterized as being currently inactive; as a result we restricted our review to the UCSC expenditures in support of the real estate development activity and the status of SVI and campus planning toward a Silicon Valley campus.

We reviewed the summary financial activity of SVI since its inception in 2000 through FY 2011. Refer to the summary fiscal history presented in Appendix C. Based on our analysis we focused on the expenditures in support of UA-SV LLC (2008-2011) and the SVI expenditures under current management in fiscal years 2010 and 2011. We conducted testing on a sampling of transactions.

We reviewed UCSC planning documents that support efforts to expand graduate studies, collaborative research and partnership building in Silicon Valley.

We did not review the historical costs of SVI or the financial activity of UA - SV LLC.

D. Positives

In our testing of transactions we selected samples of expenditures of all types and did not find any material reportable conditions. The transactions appear to be appropriately authorized and recorded.

III. OBSERVATIONS REQUIRING MANAGEMENT CORRECTIVE ACTION

A. Lack of Formal Comprehensive Planning Process

Silicon Valley Initiatives' ongoing short to mid-term planning, management of operations, and regular reporting has yet to be coupled with an effective, long-term comprehensive campus planning process. As a result the university is subject to increased risks associated with failure to achieve its stated goals.

Silicon Valley Initiatives management should work with central campus leadership to initiate a summary planning process to ensure SVI's short term and mid-term accomplishments can be leveraged to meet the university's longer term goals in Silicon Valley.

Comments:

SVI is positioned to play a critical role in the expansion of UCSC's presence in Silicon Valley. This is a complex endeavor, requiring considerable commitment and resources, involving multiple goals/objectives, participants, organizations, and it will continue to evolve over years. This complex undertaking would benefit from a formal comprehensive planning process.

However, SVI management is not currently involved in formal long-term planning. Current and past management have engaged in planning activities. Thus, we did not identify an absence of planning, rather we identified a need for consistency and formality of a high level summary planning process.

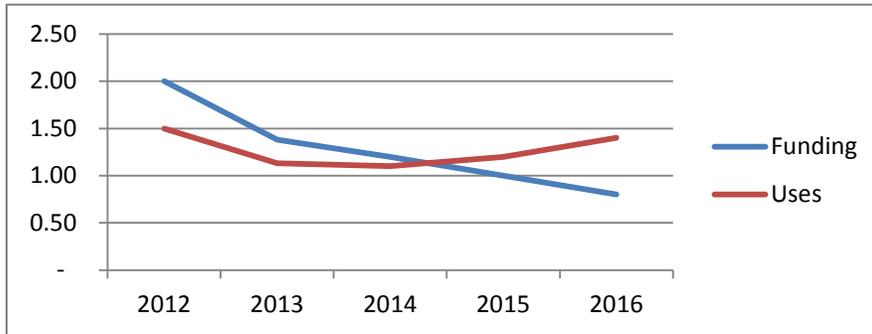
Given its staff size and resources, SVI management has focused on existing activities and those near-term projects that serve as building blocks for UCSC's long-term goals in Silicon Valley.

In the near term, SVI needs to engage in a planning process to ensure its efforts to develop research centers, graduate coursework with UNEX and relations with corporate partners are appropriately supported and funded. In the long-term, there is a need to set the entire planning process within a project management context. A strategic summary of planning needs and status of such efforts would assist decision makers in periodically addressing two of the core questions concerning the planning process: where are we now and what do we do next?

In addition, developing a resource or funding plan for SVI is a critical need, as SVI is projecting a budget shortfall in FY 2015. At that time its costs are projected to exceed funding and its carry forward balance will be exhausted. As a result, SVI will need to identify funding sources to continue investing in the development of graduate

programs and research in Silicon Valley. Refer to the *SVI Project Budget Shortfall* chart below.

SVI Project Budget Shortfall



(amounts in millions – carry forward balances are included in funding amount)

If and when the SV-UA LLC real estate development project comes back online, the complexity of planning efforts and schedules will grow exponentially. Meanwhile, there are summary planning efforts that could be undertaken to identify and summarize the status of planning needs and their corresponding efforts to date.

The current status of long-term planning is probably best described in the conclusion of *Toward a UCSC Strategic Plan for Silicon Valley*, the draft 2010 staff report of the chancellor’s Silicon Valley Taskforce:

To summarize, in order to realize the vision of UCSC as the UC for Silicon Valley, UCSC must commit to the following planning goals/objectives in relation to the establishment of a new Graduate Research Center:

- Goal 1: Establish an Economically Viable Plan to Develop a Graduate Research Campus in Silicon Valley*
- Goal 2: Identify Leading Research Areas and Programs for Phase 1*
- Goal 3: Identify Specific Degree Programs, Curricula, Phasing*
- Goal 4: Articulate the Needed Administrative Frameworks*
- Goal 5: Identify Development Targets and Approaches for Academic Programming*
- Goal 6: Define basic Partner Interfaces (programmatic and administrative) in relation to all other Goals*

Each of these goals represents a specific planning process that is needed to complete the strategic plan in order to realize the enlarged vision of UCSC as the UC for Silicon Valley.

The above conclusion recognizes the multi-faceted planning processes required for the complexities underlying UCSC expansion in Silicon Valley.

A summary of the planning process would facilitate decision-makers in coordinating planning activities. It may well be determined that there are short, intermediate and long term issues requiring separate yet simultaneous planning functions. It may be determined that one group should focus on the immediate operational requirements and accomplishments, while another group of campus leaders focus on involving constituencies in the long-term development of consensus supporting UCSC expansion of graduate research in Silicon Valley.

Agreements:

1. SVI management will complete and submit an interim planning status report to the EVC by 1/30/2012, which will include a proposal for how to develop and implement the comprehensive planning process going forward.
2. Pursuant to whatever process is agreed upon in agreement 1, SVI management will develop a formal summary planning process, composed of a high-level running summary of planning activities, as a way of managing and monitoring the accomplishment of UCSC goals in Silicon Valley by 3/30/2012.

Appendix A: Summary of UCSC – Silicon Valley planning documents

Current UCSC Mission Statement:

Consistent with our deepest values, independent, critical thinking, active understanding, creativity, diversity, and social responsibility, the mission of UCSC is to realize the dynamic interplay amongst research, education, and public service in order to produce active and engaged citizens well prepared to meet the world's most profound challenges.

2005 – Update of the 1988 UCSC Long Range Development Plan.

In order to accommodate projected statewide student demand, and to provide graduate and professional degrees important to the continued prosperity of the state of California, UCSC must plan for its growth.

2008 – UCSC Strategic Academic Plan contains Guiding Principles, and Goals & Strategies.

Under principles, it lists four rubrics for campus-wide planners:

- We increasingly view UCSC as a single unit;
- UCSC must invest differentially, rather than incrementally and homogeneously (in order to target areas where we will have the greatest impact);
- We should think of disciplines and fields of study as evolving rather than simply growing;
- We must align academic and budgetary processes and priorities.

2008 – UCSC Action Plan – Near-Term Investments with a Long-Term Perspective.

Under the leadership of the Campus Provost/Executive Vice Chancellor and the Vice Provost for Academic Affairs, the campus will:

- Determine which of the proposed professional schools and/or graduate programs to pursue.

Under the leadership of the Vice Provost for Silicon Valley Initiatives and the Vice Provost for Academic Affairs, the campus will:

- Develop details of education and research programs to be located in Silicon Valley, including the feasibility of a graduate school of management;

2009 – Chancellor George Blumenthal - An Enlarged Sense of Vision: UCSC as the UC for Silicon Valley:

Our vision is to seed innovation, entrepreneurship, and sustainability through the creative reuse of an important public asset, for regional benefit. We aim to establish world-class programs and facilities dedicated to preparing the workforce of the future and to conducting research at the forefront of science and technology.

The goal of the [University Associates-Silicon Valley, LLC] partnership is to create a prototype for an environmentally sustainable community and contribute to the economic vitality of the

region, while providing a unique collaborative environment in which to deliver innovative education and research.

-UCSC Chancellor George Blumenthal, March 2009

2009 – UCSC Two-Year Goals Statement - Two-Year Priorities: This two-year goals statement identifies and contextualizes UC Santa Cruz priorities for President Yudof and The Regents, updating and extending the campus’s October 2009 statement.

1. Strengthen and maintain excellent and emerging core academic programs; develop new academic and professional programs in targeted areas.
2. Identify success factors for and barriers to substantially grow research over the next five years.
3. Enhance UC Santa Cruz's distinction and achievements in undergraduate education.
4. Develop focused plans for the campus's presence and partnerships in Silicon Valley.
5. Prepare for UC Santa Cruz's first comprehensive fund-raising campaign.

2010 – Excerpt from *Toward a UCSC Strategic Plan for Silicon Valley*, the report of the Chancellor’s Silicon Valley Taskforce.

The Present Strategic Context - Santa Cruz hosts the University of California campus closest to the heart of Silicon Valley. UC Santa Cruz educators are already deeply involved with the Silicon Valley through teaching, research, and public service. UCSC’s Silicon Valley Initiatives serves as an umbrella organization to provide a framework for creating and supporting intellectually worthy and financially sound graduate research partnerships between UCSC and the three axes of Silicon Valley: private industry, government organizations, and educational institutions.

Building on our interdisciplinary foundations, our existing collaborations with regional higher education partners, and our leadership in diverse areas of research, UCSC is poised to expand upon our existing partnerships to create larger and more ambitious economies of scale.

The Silicon Valley partnership between UCSC and the NASA Ames Research Center offers a multi-faceted consortium through which to interact with regional players at multiple levels. Ames investigators and their resources can provide opportunities for UCSC faculty and students across fields as varied as Biology, Earth Sciences, Information Sciences, Materials Science, and Astrophysics. Ames is a natural point of collaboration for both interdisciplinary and inter-institutional endeavors, allowing UCSC researchers to work in partnership with Ames and industry alongside our counterparts from other premier universities such as UC Berkeley, Stanford, and Carnegie Mellon.

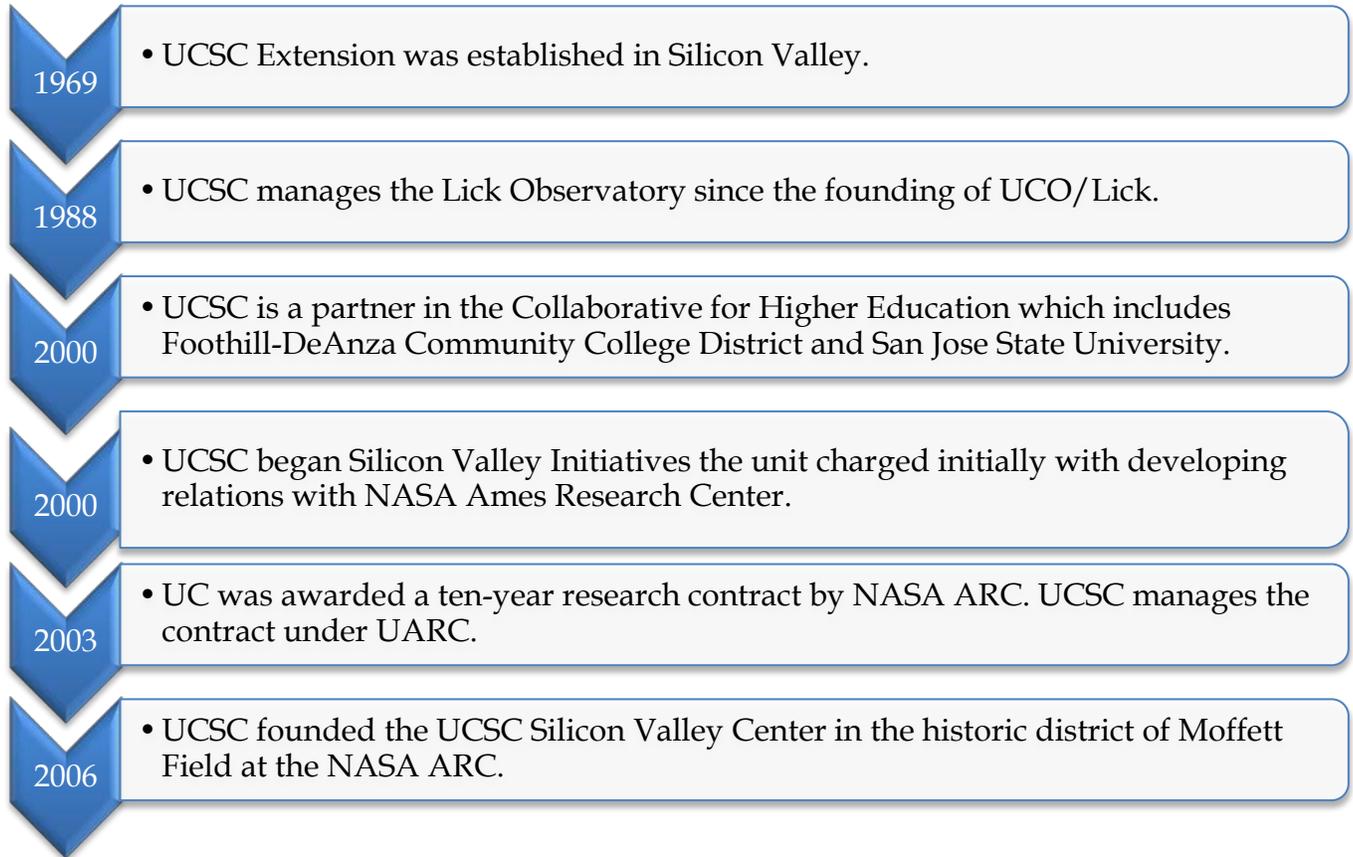
Leaders at Ames want to expand the connections between UCSC and NASA, and they wish to foster stronger relationships between NASA, industry, and academia. UCSC researchers located in labs and offices inside Ames and in offices in the NASA Research Park at Moffett Field are

working on projects of interest to Silicon Valley Industry. Presently, we are exploring the opportunity to establish a branch of our campus at Moffett Field, co-located with Ames. At a minimum, this UCSC graduate center in the NASA Research Park could provide an urban foothold for every division on campus, and it can also provide an opportunity for a limited number of world-class centers of study. Strategic planning and differential investment can continue UCSC's tradition of diverse excellence in fields that directly relate to available Silicon Valley collaborations.

-Martin Chemers and Tracy Larrabee, Vice Provoosts for Silicon Valley

Appendix B: Summary of UCSC presence in Silicon Valley

The following is an abbreviated history adapted from the Chancellors Silicon Valley Taskforce as reported February 2010:



Appendix C: Summary of Silicon Valley Center Fiscal History

SILICON VALLEY CENTER - SUMMARY OF EXPENDITURES PER FUND PER FISCAL YEAR												
TD Fund Title	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Campus U/R Funds Interest						18,750	6,250					
Chancellor U/R Funds Interest	450	1,516										
Gen Fund/Fed Overhead (Unexpen Bal)										1,267,976	67,466	1,843,014
General State Appropriations	237,626	726,839	856,753	719,493	315,131	594,188	859,840	912,587	2,155,848	1,114,067	1,489,026	868,990
Federal C&G Overhead												22,102
Insurance Claim Funds											(10,168)	10,168
Educational Fund												12,735
NASA UARC Award Fee										184,264	125,855	396,650
Equipment					900							2,478
UOF-Regents Research Program								48,307	47,888	28,005	126,114	230,254
	238,076	728,354	856,753	719,493	316,031	612,938	866,090	960,894	2,203,736	2,594,313	1,798,294	3,386,392
								5,298,630				9,982,734
								years	8		years	4
								average	662,329		average	2,495,684
								(1)				(2)
(1) Fiscal Years 2000 through 2007 average annual expenditures of \$662,329												
(2) Fiscal Year 2008 through 2011 average annual expenditures \$ 2,495,684 due to investment in SV-UAC LLC start up and related pre-development costs.												
Source: Planning and Budget Financial Management Workbench data												