



# AUDIT AND ADVISORY SERVICES

Chancellor's Expenses  
(BFB-G-45) – Birgeneau  
Audit  
Project No. 14-638B

December 15, 2014

Prepared by:

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December 15, 2014

Chancellor Nicholas Dirks:

We have completed our audit of annual reporting on Chancellor's expenses as required by university policy Business and Finance Bulletin (BFB) G-45 and as per our annual service plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Our observations with management action plans are expounded upon in the accompanying report. During the reporting period, the campus had a change in leadership. This report (14-638B) covers audit observations specifically related to former Chancellor Robert Birgeneau's expenses who stepped down as chancellor on May 31, 2013.

Audit observations specifically related to Chancellor Nicholas Dirks' expenses are covered in a separate audit report (14-638C). Audit observations related to the general process of preparing, reviewing, and approving the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses by the Office of the Chancellor are covered in a companion audit report (14-638A). All three audit reports should be considered together for our collective observations related to the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses for the 2012-2013 reporting period.

Please destroy all copies of draft reports and related documents. Thank you to the staff of the Office of the Chancellor and the Controller's Office for their cooperative efforts throughout the audit process. Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

A large, stylized handwritten signature in black ink, appearing to read "Wanda Lynn Riley".

Wanda Lynn Riley  
Chief Audit Executive

cc: Chancellor Emeritus Robert Birgeneau  
Associate Chancellor Linda Morris Williams  
Associate Chancellor and Chief of Staff Nils Gilman  
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca  
Assistant Vice Chancellor and Controller Delphine Regalia  
Deputy Associate Chancellor and Chief Operations Officer Wanda Ellison Crockett  
Principal Financial Analyst Karen Moses  
Deputy Chief Ethics, Risk and Compliance Officer Barbara VanCleave Smith

**University of California, Berkeley**  
**Audit and Advisory Services**  
**Chancellor's Expenses (BFB-G-45)**  
**(Chancellor Birgeneau)**

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## OVERVIEW

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### Executive Summary

The purpose of our audit was to complete a review of the campus's *Annual Report of Fiscal Year Expenses for the President/Chancellor* (Annual Report of Fiscal Year Expenses) for the fiscal year July 1, 2012 through June 30, 2013 as well as the *Annual Report of Taxable Expenses of the President/Chancellor* (Annual Report of Taxable Expenses) for the reporting period November 1, 2012 through October 31, 2013 (collectively, the 2013 reports). Both reports are required under university policy, Business and Finance Bulletin G-45: Implementing Requirements on Expenses Incurred in Support of Official Responsibilities of the President and Chancellors (BFB-G-45), for completeness and accuracy relative to amounts recorded in the campus general ledger and other supporting books and records.

During the reporting period, the campus had a change in leadership. This report (14-638B) covers audit observations specifically related to former Chancellor Robert Birgeneau's expenses who stepped down as chancellor on May 31, 2013.

Audit observations specifically related to Chancellor Nicholas Dirks' expenses are covered in a separate audit report (14-638C). Audit observations related to the general process of preparing, reviewing, and approving the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses by the Office of the Chancellor are covered in a companion audit report (14-638A). All three audit reports should be considered together for our collective observations related to the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses for the 2012-2013 reporting period.

Based upon our audit procedures, we observe that the process of preparing, reviewing, and approving the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses was not operating effectively for the 2012-2013 reporting period to ensure completeness and accuracy of reporting.

Specifically, with respect to former Chancellor Birgeneau's expenses, we observed the following:

- The University of California Police Department coordinated with the campus and system offices of risk management to install security measures including a monitored alarm system, custom blinds, secure mailbox, locks, and door re-enforcements at the personal residence of the former chancellor. Funding for the project was approved in April 2013 by risk management at the University of California Office of the President. The enhancements cost approximately \$36,000. Such expenses required approval of the University President which was not obtained.
- The campus paid approximately \$3,365 for the use of a cellular phone and a tablet for the associate of the former chancellor through June 2014 (the close of our fieldwork period) after her associate appointment ended when the former chancellor stepped down on May 31, 2013. Per consultation with the tax services coordinator at the UC Office of the President, absent a documented business purpose, these payments should be reported as miscellaneous income for 2013. These amounts would be taxable income to the associate

of the chancellor to the extent the phone was used after May 31, 2013 without a demonstrated and documented business purpose.

Management agrees with the observations and has proposed action plans that, if implemented, should reasonably address the observations noted above.

### **Source and Purpose of the Audit**

The purpose of our audit was to complete a review of the campus's *Annual Report of Fiscal Year Expenses for the President/Chancellor* (Annual Report of Fiscal Year Expenses) for the fiscal year July 1, 2012 through June 30, 2013 as well as the *Annual Report of Taxable Expenses of the President/Chancellor* (Annual Report of Taxable Expenses) for the reporting period November 1, 2012 through October 31, 2013 (collectively, the 2013 reports). Both reports are required under university policy, BFB-G-45: Implementing Requirements on Expenses Incurred in Support of Official Responsibilities of the President and Chancellors, for completeness and accuracy relative to amounts recorded in the campus general ledger and other supporting books and records.

### **Scope of the Audit**

The scope of our review included reportable expenses and the housing provision associated with the official duties of the Chancellor that are required to be tracked and reported according to BFB-G-45. The reporting period for the Annual Report of Fiscal Year Expenses is the university fiscal year; whereas the reporting period for the Annual Report of Taxable Expenses covers the twelve months from November to October.

The campus reporting period for both 2013 reports covered two chancellors as Chancellor Birgeneau stepped down on May 31, 2013 and Chancellor Dirks assumed the position on June 1, 2013. Expenses associated with their official duties were reported separately by the campus, resulting in two Annual Reports of Fiscal Year Expenses and two Annual Reports of Taxable Expenses for the 2012-2013 reporting periods.

Our audit procedures included, but were not necessarily limited to, the following:

- obtaining copies of the 2013 reports, with attachments, for Chancellors Birgeneau and Dirks as signed by each;
- obtaining an understanding of management's process to collect and record amounts reported on the 2013 reports;
- independently extracting expense information from the general ledger related to reportable categories;
- comparing expense information from the general ledger with that reported on the 2013 reports and inquiring with management on any differences including the root cause;
- assessing the overall accuracy and completeness of the amounts reported on the 2013 reports; and
- assessing whether reportable deficiencies or significant deficiencies existed in management's process and internal controls related to the preparation, review, approval, and submission of the 2013 reports.

### **Background Information**

University policy BFB-G-45 states that the university intends "to comply with Internal Revenue Service regulations concerning the provision of housing and payment of expenses associated with the official duties of the President and Chancellors." The policy requires each campus to use standardized expense categories in their general ledger to track expenses related to these

reportable categories. The campus has a range of Chartfield 1 and Chartfield 2 values in the campus general ledger system to track reportable expenses by category. Each campus must prepare an Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses using templates provided in the policy.

### **Summary Conclusion**

Based upon our audit procedures, we observe that the process of preparing, reviewing, and approving the Annual Report of Fiscal Year Expenses and Annual Report of Taxable Expenses was not operating effectively for the 2012-2013 reporting period to ensure completeness and accuracy of reporting.

Specifically, with respect to former Chancellor Birgeneau's expenses, we observed the following:

- The University of California Police Department coordinated with the campus and system offices of Risk Services to install security measures including a monitored alarm system, custom blinds, secure mailbox, locks, and door re-enforcements at the personal residence of the former chancellor. Funding for the project was approved in April 2013 by risk services at the University of California Office of the President. The enhancements cost approximately \$36,000. Such expenses required approval of the University President which was not obtained.
- The campus paid approximately \$3,365 for the use of a cellular phone and a tablet for the associate of the former chancellor through June 2014 (the close of our fieldwork period) after her associate appointment ended when the former chancellor stepped down on May 31, 2013. Per consultation with the tax services coordinator at the UC Office of the President, absent a documented business purpose, these payments should be reported as miscellaneous income for 2013. These amounts would be taxable income to the associate of the chancellor to the extent the phone was used after May 31, 2013 without a demonstrated and documented business purpose.

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## SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

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### Non-University House Security Measures

#### Observation

The process for assessing the need for and then implementing security enhancements at the personal residence of university employees is limited to a very small circle of employees. In the course of their work ancillary implications or requirements may not be apparent, and thus overlooked. We observed a lack of appropriate approval and consideration of tax implications.

Regents Policy 7708, *University-Provided Housing*, states the following in relation to an executive officer's residence: "Capital improvement projects of a Chancellor's residence or office under \$25,000 require the prior approval of the Executive Vice President – Business Operations. Capital improvement projects between \$25,000 and \$5,000,000 require the prior approval of the University President."

The University of California Police Department coordinated with the campus and system offices of risk services to install security measures including a monitored alarm system, custom blinds, secure mailbox, locks, and door re-enforcements at the personal residence of the former chancellor. Funding for the project was approved in April 2013 by the UC chief risk officer. The enhancements cost approximately \$36,000. Such expenses required approval of the University President which was not obtained.

The full nature of the expenses were not communicated to the Controller's Office when incurred, thus not allowing that office to determine whether the costs were reportable as taxable income warranting a potential adjustment to the former chancellor's 2013 W-2 form. Campus management treated this capital improvement to his personal residence as a working condition fringe benefit and excluded the expense amount from reportable 2013 taxable income. Per our review of the Internal Revenue Service guidance on working condition fringe benefits<sup>1</sup>, income for this capital improvement is excludable from taxable income only if the following criteria are met:

- 1) *A security study is conducted by a person who has the authority and responsibility to determine both (i) the need for the employer-provided security, and (ii) the appropriate protective services to respond to the threat that exists.*
- 2) *The study is conducted in accordance with the internal written procedures that require an independent and objective assessment of (i) the nature of the threat, (ii) the appropriate response to the threat, and (iii) the length of time necessary to respond to the threat.*
- 3) *The study includes an evaluation of any employer-provided transportation that may be required.*
- 4) *The employer applies the security recommendations contained in the study to the employee on a consistent basis.*

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<sup>1</sup> Internal Revenue Service Treasury Regulation 1.132-5(m)(2)(v)



At the request of the Chancellor's Office, Audit and Advisory Services sought a tax opinion from internal and external legal counsel. External counsel opined, based on the information provided, that conditions 1, 3 and 4 to exclude expenses from taxable income were met but expressed no opinion regarding condition 2. With the assistance of campus counsel, additional documentation was provided. The following opinion was rendered by campus counsel.

"You have asked my opinion whether the second condition under Treas. Reg. 1.132-5(m)(2)(v) identified by outside tax counsel for excluding the value security improvements at Chancellor Birgeneau's private residence from his gross income was met... I've contacted Cheryl Lloyd and Gary Leonard at OPRM, and Andy Goldblatt and Margo Bennett to determine whether there were any 'written policies' that might fulfill this requirement. Margo informs me that she and prior chiefs were requested by OPRM 'to submit an email . . . with the facts and justification for the proposed [security] work.'

This process apparently grew out of responses to threats against animal researchers and was applied subsequently to other types of threats. In January 2008, Grace Crickette issued a memorandum to Vice Chancellors that set out the parameters for this form of coverage and the circumstances under which it would be provided. That memo (attached) provided that certain expenses 'including costs incurred from additional personal security measures' could be reimbursed to employees in response to threats arising from their university employment. Sedgwick CMS, the university's claims administrator, subsequently published a policy (attached) establishing procedures for making claims, including those involving security enhancements. That policy specifies that the campus police chief is to make security decisions, including the need for security enhancements at the employee's home.

While I do not have sufficient expertise to independently determine whether these policy documents meet the requirements of Treas. Reg. 1.132-5(m)(2)(v), a review of old email correspondence (attached) indicates that in 2008 OP tax specialists determined that 'so long as security measures were appropriate as determined by the chief, the cost of the security would not be taxable to the employees,' and that OP has been operating pursuant to that understanding since. This suggests that OP considered all of the requirements of the regulation to have been fulfilled."

### **Management Response and Action Plan**

Recognizing that the office of Risk Services at UC Berkeley acts as a conduit to the chief risk officer at UC Office of the President for threat and security issues, the gap identified in this review, provides an opportunity to evaluate internal procedures in collaboration with appropriate offices at UC Office of the President.

To ensure compliance with policy, Risk Services will strengthen the "threat assessment" process by documenting its procedures that reflect data collection and decision points up to submitting a formal request for approval to the UC chief risk officer. Risk Services will consult with UC Office of the President in the development of the form that will provide critical information in the assessment and decision-making process. The written procedures and the form for documenting funding requests will be in place by January 1, 2015.

In consultation with both external and internal counsel, it was determined that there exist no taxable liability for the installation of the security measures at the former chancellor's primary residence. However, in accordance with policy, retroactive approval of the security measures taken for former Chancellor Birgeneau have been submitted to UC Office of the President for Presidential approval.

### **University Payment for Non-University Officer Use of Cellular Phone and Tablet**

#### **Observation**

BFB-G-45 states that "the President may approve the appointment of the Chancellor's spouse or domestic partner as Associate of the Chancellor or Acting Chancellor..." Appointment as the associate of the chancellor reflects the contributions and services that individual performs as an ambassador for the university. Such an appointment allows for reimbursement of or payment for expenses including business related travel, entertainment, university equipment, and cellular phone usage. Such expenses are generally not taxable to the Chancellor or their associate.

During our review, we noted that the campus paid approximately \$3,365 for the use of a cellular phone and a tablet for the associate of the former chancellor through June 2014 (the close of our fieldwork period) after her associate appointment ended when the former chancellor stepped down on May 31, 2013. Per consultation with the tax services coordinator at the UC Office of the President, absent a documented business purpose, these payments should be reported as miscellaneous income for 2013. These amounts would be taxable income to the associate of the chancellor to the extent the phone was used after May 31, 2013 without a demonstrated and documented business purpose.

#### **Management Response and Action Plan**

The associate of the chancellor continued the use of a cell phone and iPad based on her volunteer ambassador role in representing the University of California, Berkeley.

Management is in agreement with the audit findings and has advised former chancellor Birgeneau of the tax liability. Whereby the former chancellor acknowledges the issue and has agreed to cover the taxable obligation based on final review of the cellular bill expenses that seem high in comparison to previous usage.