



AUDIT AND ADVISORY SERVICES

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

December 15, 2014

Prepared by:

Desmond Hamilton
Auditor-in-Charge

Reviewed by:

Jaime Jue
Associate Director

Approved by:

Wanda Lynn Riley
Chief Audit Executive



AUDIT AND ADVISORY SERVICES
Tel: (510) 642-8292

611 UNIVERSITY HALL #1170
BERKELEY, CALIFORNIA 94720-1170

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 (14-638C) covers audit observations specifically related to Chancellor Nicholas Dirks' expenses.

Audit observations specifically related to former Chancellor Robert Birgeneau's expenses, who stepped down as chancellor on May 31, 2013, are covered in a separate audit report (14-638B). Audit observations related to the general process of preparing, reviewing, and approving the *Annual Report of Fiscal Year Expenses for the Chancellor* and the *Annual Report of Taxable Expenses for the Chancellor* 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 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: 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 Dirks)

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OVERVIEW

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 of which 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 (14-638C) covers audit observations specifically related to Chancellor Nicholas Dirks' expenses.

Audit observations specifically related to former Chancellor Robert Birgeneau's expenses, who stepped down as chancellor on May 31, 2013, are covered in a separate audit report (14-638B). 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 Chancellor Dirks' expenses, we observed the following:

In order to prepare the Annual Report of Taxable Expenses, University House employees must report the proportion of their work effort for personal service to the Chancellor and his family, which is considered a taxable expense and treated as additional compensation. University policy limits this effort to 25% as an allowable personal use of university resources. As filed, the Annual Report of Taxable Expenses for the 2012-2013 reporting period for Chancellor Dirks reports no personal services provided. However, supporting documentation we reviewed that was completed by the University House manager and housekeeper indicated that they did provide personal services for the Chancellor during the reporting period.

As a result, based upon the reported approximate percentage of time spent providing personal services, we estimate that the value of personal services provided by University House employees to the Chancellor was understated by approximately \$9,600 in wages and benefits (calculated using the campus's composite fringe benefit rate) for the 2012-2013 reporting period. Therefore, the Annual Report of Taxable Expenses should be amended to reflect this additional compensation. In addition, the amended report should be forwarded to the Controller's Office

and Payroll Office to determine the appropriate reporting of compensation for the entire 2013 calendar year to relevant parties.

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 of which 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 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 Chancellor Dirks' expenses, we observed the following.

In order to prepare the Annual Report of Taxable Expenses, University House employees must report the proportion of their work effort for personal service to the Chancellor and his family, which is considered a taxable expense and treated as additional compensation. University policy limits this effort to 25% as an allowable personal use of university resources. As filed, the Annual Report of Taxable Expenses for the 2012-2013 reporting period for Chancellor Dirks reports no personal services provided. However, supporting documentation we reviewed that was completed by the University House manager and housekeeper indicated that they did provide personal services for the Chancellor during the reporting period.

As a result, based upon the reported approximate percentage of time spent providing personal services, we estimate that the value of personal services provided by University House employees to the Chancellor was understated by approximately \$9,600 in wages and benefits (calculated using the campus's composite fringe benefit rate) for the 2012-2013 reporting period. Therefore, the Annual Report of Taxable Expenses should be amended to reflect this additional compensation. In addition, the amended report should be forwarded to the Controller's Office and Payroll Office to determine the appropriate reporting of compensation for the entire 2013 calendar year to relevant parties.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Presentation and Disclosure of BFB-G-45 Annual Report of Taxable Expenses

Observation

In order to prepare the Annual Report of Taxable Expenses, University House employees must report the proportion of their work effort for personal service to the Chancellor and his family, which is considered a taxable expense and treated as additional compensation.¹ Per BFB-G-45, “Support staff effort that represent a personal benefit to the President or Chancellor (or family) is taxable to the Officer. Personal services performed by support staff should be limited to no more than 25%, on an annualized basis, of the total duties assigned to such staff.”

In addition to the 25% annual limitation, the policy also specifically states that; “The value of **all** support staff time, regardless of the percentage of such time, incurred in performing personal errands or other personal duties for the President/Chancellor is taxable to the Officer.”²

BFB-G-45 provides the following specific examples of these “personal-benefit expenses”:

- “Running personal errands such as shopping or picking up dry-cleaning, laundry, prescriptions, etc.;
- Transportation services, including driving an Officer or family member to the airport for a personal trip or vacation;
- Wardrobe-related laundry/dry cleaning/ironing services;
- Caring for pets, including the cost of pet food and supplies; and
- Handling private mail and telephone calls.”

The Office of the Chancellor uses the standard template from the policy (Exhibit 1 to BFB-G-45) to collect information on personal services in these categories provided by support staff.

As filed, the Annual Report of Taxable Expenses for the 2012-2013 reporting period for Chancellor Dirks reports no personal services provided. However, supporting documentation (completed templates) we reviewed that were completed by the University House manager and housekeeper indicated that they did provide personal services in these categories for the Chancellor during the reporting period.

As a result, based upon the reported approximate percentage of time spent providing personal services, we estimate that the value of personal services provided by University House employees to Chancellor was understated by approximately \$9,600 in wages and benefits

¹ According to BFB-G-45: “All support staff assigned to the residence are required to report the percentage of their time devoted to performing taxable personal services for the Officer using the report provided in Exhibit 1. Total support staff expenses, including the personal amount of such expenses, must be reported on the Annual Report of Taxable Expenses of the President/Chancellor (Appendix B) in order to calculate the amount taxable to the Officer.”

² BFB-G-45 states that: “Services provided by the cook in preparing meals for the Officer and his or her family are not taxable.”

(calculated using the campus's composite fringe benefit rate) for 2012-2013 reporting period.³ Therefore, the 2012-2013 Annual Report of Taxable Expenses should be amended to reflect this additional compensation. In addition, the amended report should be forwarded to the Controller's Office and Payroll Office to determine the appropriate reporting of compensation for the entire 2013 calendar year to relevant parties.

Management Response and Action Plan

The audit finding outlined in the report illuminates there was confusion about the interpretation of the BFB-G-45 policy with respect to reporting personal service during the transition period of onboarding a new Chancellor. Management is cognizant and takes seriously the responsibility to ensure staff understand the policy requirements regarding reporting personal service when on behalf of the Chancellor or his family. With the appointment of the newly appointed chief of staff/associate chancellor, the incumbent has actively participated in the identification of the gap in application of the policy by staff. Moreover, he has collaboratively worked with the internal auditors to address issues raised during this audit engagement. The staff at University House have been further trained on the reporting and certification process.

Management will work with the Controller's Office and Payroll Office to determine the appropriate reporting of compensation for the Chancellor that is directly attributed to receiving personal service for the 2013 calendar year.

³ In addition to the reportable and taxable categories of personal-benefit expenses listed above and reported by support staff on the standard templates, we also included amounts for housekeeping services of the personal areas of the residence that exceeded eight hours per week. Regarding housekeeping services, BFB-G-45 states that "the personal areas of the residence should not be cleaned more than once per week." (BFB- G-45 page 2)