



# AUDIT AND ADVISORY SERVICES

## Budget Monitoring Deficit Spending Audit

Project No. 11-569

March 18, 2011

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March 18, 2011

Erin Gore  
Associate Vice Chancellor  
Budget and Resource Planning

Associate Vice Chancellor Gore:

Audit and Advisory Services (A&AS) completed an audit of Budget Monitoring Deficit Spending as per our annual audit 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.

The audit objective was to evaluate the controls related to identifying departmental deficits, administering mitigation plans, and monitoring progress toward eliminating deficits. Our evaluation included, but was not limited to, an assessment of the adequacy of internal controls, compliance with University and external policies and procedures, prudent business practices, and the economy and efficiency of operations. The audit scope included review of budget deficit management procedures during FY2010 and current monitoring and deficit resolution progress in the current FY 2011. Audit techniques included in-depth discussions with departmental personnel, review of policies and procedures, review of exception reports and detailed testing of selected budgets that were in deficit during the audit period.

We observed that, overall, the design of control activities governing the Deficit Resolution Policy appear to provide reasonable assurance that budget deficits are detected and mitigated timely. However, we noted that certain inconsistencies in the administration of, adherence to, and monitoring of the policy potentially increases the risk of continued deficit spending. Management has provided a response including a description of how the new Operational Excellence Budget Tool, due April 30, 2012 for the FY 2013 budget planning process, is expected to reduce these risks.

The aforementioned and other observations with management corrective actions are expounded in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the campus Budget Office staff 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,

Wanda Lynn Riley  
Chief Audit Executive

cc: Assistant Vice Chancellor Teresa Costantinidis  
Vice Chancellor John Wilton  
Senior Vice President Sheryl Vacca  
Associate Chancellor Linda Morris Williams  
Interim Associate Vice Chancellor and Controller Delphine Regalia

**University of California, Berkeley  
Audit and Advisory Services  
Budget Monitoring Deficit Spending**

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# OVERVIEW

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## Executive Summary

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## Purpose of the Audit

The purpose of this audit was to evaluate controls related to identifying departmental deficits, administering mitigation plans, and monitoring progress toward eliminating deficits. The campus Deficit Resolution Policy requires elimination of departmental deficits by each fiscal year close unless the unit in deficit has a written deficit reduction plan approved by the Vice Chancellor--Administration and Finance and the Chancellor. Given the current and increasing University budget crisis, departments are more susceptible to deficits with limited options for viable plans to eliminate them in the near term.

## Scope of the Audit

The audit scope was to evaluate controls related to identifying departmental deficits, administering mitigation plans, and monitoring progress toward eliminating deficits for current funds during the period July 1, 2009 through June 30, 2010. The scope did not extend to recharge, contract, or grant funds as they have been addressed in other recent audits.

Our audit procedures focused on the administration of Deficit Resolution Policy as it pertains to detection, mitigation and resolution practices at different levels of the campus organization, including at the level of the department, control unit, central budget office, the Vice Chancellor--Administration and Finance and the Chancellor.

Each campus department with deficit balances on or after June 30, 2010 was potentially in scope. However, for the purposes of selecting a sample, we selected departments or units with deficits

that exceeded \$400,000 that had been incurred within FY 2010 or having a carryover deficit balance from a prior period.

Our audit procedures, included but were not limited to, review of applicable policies and internal budget office monitoring documents as well as interviews with Budget Office, control unit and departmental staff responsible for implementing and administering the Deficit Resolution Policy.

## **Background Information**

### *Forecast of Campus Funding*

The statewide economic crisis has caused an ongoing decline of anticipated state funding to the University and has resulted in campus budget cuts that are expected to be permanent. As the campus looks for ways to cut costs and increase revenues, the risk of deficit spending and intentional misrepresentation of budget position by departments increases. The dramatic cutbacks proposed for higher education in FY 2012 come on the heels of three years of severe state cuts and a 20-year decline in California's per-student UC funding, which has dropped 57 percent since 1990.

### *Budget Process*

As part of our procedures, we obtained an understanding of the current campus budget process. We understand that the mission of the campus central Budget Office is to manage the budgetary resources of the Berkeley campus in support of the University's mission of instruction, research, and public service. As described on its campus website, the Budget Office provides executive management with information and analyses to inform central decision-making and strategic planning processes, including guiding the annual budgetary process, assessing ongoing budget and planning issues, and establishing and monitoring controls over fund allocations. It provides decision support through cost benefit analysis, institutional research, and data reporting, analyzing, and forecasting. In addition, the Budget Office is responsible for ensuring that campus budgetary policy and practice conform to federal, state, and University regulations.

The campus Deficit Resolution Policy, which was created in July 2005 and revised in April 2010, states that all deficits in current, loan and plant funds should be cleared throughout the year and must be cleared by the close of the fiscal year. The policy requires ongoing monitoring and elimination of departmental deficits by the fiscal year-end close. If departments are unable to resolve their deficit they may obtain a waiver to the deficit policy, if approved by their control unit, the campus Budget Office, the Vice Chancellor-Administration and Finance and the Chancellor, for a specified timeframe with a payment plan created to resolve the deficit within that period. Under special circumstances approved by the Chancellor, deficits may be carried forward if an authorized deficit resolution plan is in place and the unit is in compliance with plan or if the unit is in compliance with the campus recharge policy. Subsequent to the start of this audit, the Budget Office modified the policy in November 2010 reducing their deficit review responsibility from quarterly to semi-annually during the budget process and during the fiscal year end close.

The campus' operating budget for FY 2010 was approximately \$1.8B. When the 2009-2010 fiscal year-end close process was initiated in July 2010, the associated deficit to be resolved was approximately \$81M, which represented 4.5% of the campus budget. There may be several

internal and external factors that have contributed to the decreasing trend of deficit waiver balances on campus since the implementation of the policy. We observed that, since the inception of the Deficit Resolution Policy, deficit waiver requests have appeared to decrease from \$113.6M in FY 2006 to \$64M at FY 2010.

### **Summary Conclusion**

As the campus continues to face a steady decline in funding, the need for improvements in deficit prevention and resolution is crucial to fiscal stability. We observed that overall the Deficit Resolution Policy appears to have had a positive impact on campus accountability for deficit spending in the five years of its existence. However, our audit identified areas of potential improvement that may assist the campus with navigating the challenge of resolving current deficits while proactively managing the campus' vulnerability to deficit increases resulting from further declines in state funding. Our specific observations include the following:

- Manual allocation transfers to departments were not always done within the current fiscal year, which could negatively impact the budget position of the recipient department and potentially create a year-end deficit.
- In one of two detailed evaluations of departmental monthly budget reviews, we observed that the quality of budget reviews appeared to lack reviews of substantive fund overdrafts for the purpose of timely detection and mitigation.

We also observed other risks that could potentially impact budget deficits if not mitigated by the responsible parties. The potential for inappropriate use of restricted funds to resolve deficit via departmental correcting entries is not currently addressed in the Budget Office process. We have examined this risk in our recent audits related to cost transfers, project closeouts and other controls implemented by the Controller's Office related to preventing inappropriate use of restricted funds.

Furthermore, the risk of potentially fraudulent activity to hide deficit positions was not specifically incorporated into the design and implementation of the Deficit Resolution Policy. However, we note that the newly formed Office of Ethics, Risk, and Compliance Services (OERCS) has been tasked with creating a campus fraud risk management program with planning and implementation due to be complete by FY 2013.

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## **SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN**

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### **Management Oversight of Timing of Allocation Transfers**

#### ***Observation***

Budget Office analysts transfer allocations to departments manually. Failure to do this timely and/or before the fiscal year end could result in the appearance of a deficit or to increase the amount a department might already be in deficit. In one case, a transfer was made over a year late without the Budget Office or the department timely identifying the omission. The failure to transfer the funds was caused in part by the analyst acquiring responsibility for a division that had a different process of transferring allocations than was the process for her primary caseload so she waited until the allocation was requested by the department. The department had also undergone transition in their leadership and had not detected that they did not automatically receive the allocation as they had been accustomed. Timing and management oversight over allocations could be standardized to ensure that analyst error is not a factor in the department's ability to operate and/or manage their budget balance.

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

In year allocations of funds to central campus departments happen through many mechanisms, including automated transfers, block grants, and manual transactions. Specific commitments vary in their complexity and expected timing, from those that are a function of actual appointments or expenditures to others that are more generic in nature. The Budget Office is in the process of implementing a new budget tool as part of Operational Excellence that we hope will include functionality to make allocations easier and more consistent. In the meantime, the analyst whose allocation methodology differed from the others' standard has been instructed to make manual allocation in a manner consistent with the rest. The action plan is anticipated to be completed with the implementation of the budget tool by April 30, 2012 for the FY 2013 budget planning cycle. The tool will allow for anticipated allocations due to departments to be viewable on a monthly, quarterly or annual basis. Receipt of the allocation will make the field balance; otherwise, it would be obvious that the allocation was not received. The Budget Office would also like to completely automate the allocation transfer process to eliminate the manual process.

## **Departmental Monthly Reviews**

### ***Observation***

To help departments document the fact that they performed the key controls, the Controller's Office developed a Key Controls Checklist which includes management sign-off that the department monitors funds in overdraft status (expense exceeds authorized budget) via BAIRS summary reports and takes follow-up action.

In one of two detailed evaluations of departmental monthly budget reviews, we observed that the quality of budget reviews appeared to lack substantive reviews of fund overdrafts for the purpose of timely detection and mitigation of deficits.

The College of Letters and Science Dean's Office had a cumulative deficit to be swept of approximately \$1.169 million as of July 23, 2010. This amount represents nearly 12% of the total population that was initially to be swept, 1.4% of the total cumulative deficit population (waiver and amount swept), and 2% of the sample total deficit amount.

Failure to perform key controls to identify and mitigate deficits increases the risk that deficits are not detected and mitigated in a timely manner.

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

The reason that the deficit process is only run once a year at fiscal close is because it is only at that time of the year that the current process and technology produce financial information in a format to effectively predict potential deficits. Units currently budget for a full year of revenue and expenditures at fluctuating rates throughout the year; rendering quarterly assessments ineffective. The new budget tool is expected to be implemented by April 30, 2012 for the FY 2013 budget planning cycle and should provide units with the ability to more effectively monitor budget-to-actuals over the course of the year. With that system, the campus will be able to more accurately predict potential year end deficits over the course of the entire fiscal year.