



AUDIT AND ADVISORY SERVICES

Endowed Chairs and Professorships Audit Project No. 14-628

June 24, 2014

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June 24, 2014

Nicholas Dirks
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Scott Bidy
Vice Chancellor
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Chancellor Dirks, Executive Vice Chancellor and Provost Steele and Vice Chancellor Bidy:

We have completed our audit of endowed chairs and professorships 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. Please destroy all copies of draft reports and related documents. Thank you to the staff of Donor and Gift Services—University Relations, Gift Planning—University Relations, the Chancellor's Immediate Office, the Academic Personnel Office, the Office of the Vice Provost for the Faculty, and the Campus Budget 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,

Wanda Lynn Riley
Chief Audit Executive

cc: Vice Provost Janet Broughton
Assistant Vice Provost Heather Archer
Assistant Vice Chancellor Irene Kim
Executive Director Nancy McKinney
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**University of California, Berkeley
Audit and Advisory Services
Endowed Chairs and Professorships**

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OVERVIEW

Executive Summary

The purpose of the audit was to assess compliance with University policies governing the establishment and administration of endowed chairs and professorships. Their market value as of June 30, 2013 was approximately \$652 million across 466 chairs.

Endowed chairs are reserved for distinguished scholars and teachers and may be used to honor a colleague or to attract new faculty to the campus. An endowed chair provides funds to a chair holder in support of his or her teaching, research, and service, and is supported by payout from an endowment fund, a fund functioning as an endowment, or from an annual allocation. Unless expressly prohibited by the gift instrument, an endowed chair or professorship may provide payout to support the base salary and/or other salary components of a chair holder, consistent with University policy and campus procedures. Certain chair types, such as administrative or presidential, are expected to be used by the chair holder to support other faculty in their department or center. Hewlett-matched chairs and chairs under the Common Good payout model have specified categories of distribution and use of payout, such as for chair holder allowance, graduate student support, infrastructure and faculty salary pool.

During our review, we noted that campus processes appear strong regarding the setup of new endowment terms, approvals and collaboration across central units that have a role in administration of endowed chairs and professorships. However, there were opportunities to develop and strengthen other processes related to monitoring performance in administration of the endowed chairs throughout the lifecycle.

We observed that there were several revisions of campus policies and guidelines related to endowed chairs that need to be updated and formally approved. Some units have been given exemption from adopting the prevailing payout model but we were unable to identify formal approval and documentation for these exemptions. The majority was concentrated in three units and included almost all of their chairs. While the campus guidelines on distribution and yield indicated that exemptions will be considered on a chair by chair basis, these three units appear to have received blanket exemptions. The campus has begun analyzing performance regarding long accumulated payout, expiring and expired chairs, long vacant chairs and other aspects of endowed chair management; however, processes have not yet been formalized, fully documented or implemented.

There are chair types, such as administrative, presidential and other non-Hewlett-matched, where support of multiple faculty members are explicitly allowed per payout policy. However, we observed some instances where there appeared to be disbursements from non-administrative, presidential or other non-Hewlett and non-Common Good chair funds for faculty members other than the chair holder and one chair where similar distributions were made throughout the year though it was listed as vacant.

Management agrees with the audit observations and has proposed action plans that, if implemented timely, should address the risks associated with the observations noted.

Source and Purpose of the Audit

The purpose of the audit was to assess compliance with University policies governing the establishment and administration of endowed chairs and professorships. The market value of all endowed chairs and professorships as of June 30, 2013 was approximately \$652 million across 466 chairs.

Scope of the Audit

We reviewed samples of endowed chairs and professorships and conducted audit testing to assess the following:

- 1) Adequacy of and compliance with policies and guidance governing the endowed chairs and professorship life cycle;
- 2) Approval process and the quality and completeness of chair terms to ensure compliance with applicable policies, laws and best practices;
- 3) Chair selection processes;
- 4) Timing of full funding versus appointment of chairs and the impact on endowment and donor management;
- 5) Design and application of and campus compliance with payout models;
- 6) Analysis of trends and monitoring of accumulated payout;
- 7) Exemptions/exceptions to payout models;
- 8) Tracking and reappointment of expiring chairs; and
- 9) Long vacant chairs and related accumulation and management.

Background Information

Endowed chairs are reserved for distinguished scholars and teachers and may be used to honor a colleague or to attract new faculty to the campus. An endowed chair provides funds to a chair holder in support of his or her teaching, research, and service, and is supported by a payout from an endowment fund, a fund functioning as an endowment, or from an annual allocation. In addition, unless expressly prohibited by the gift instrument, an endowed chair or professorship may provide payout to support the base salary and/or other salary components of a chair holder, consistent with the campus policy on non-19900 (state) funds. An administrative endowed chair provides funds in support of teaching, research, and service activities of the department, research unit, school, or college.

Academic Personnel Manual (APM) 191 is the systemwide policy for the overall administration of endowed chairs and professorships, but allows for additional campus guidance. In addition,

donor terms prescribed in endowed chair acceptance documentation must not contradict systemwide and campus policies and should include minimum language, such as, mention of the mandatory 2.5% gift fee assessed for administrative costs for all gifts.

Guidelines for the implementation of APM 191

According to APM 191, each campus shall have written procedures for endowed chairs. The campus has created local guidelines; however, there have been several revisions since the initial version to reflect changes in campus practices, such as the minimum amount required to create an endowed chair. Based upon discussions with management, it is unclear if any of them were formally approved. Since the initial version, the authority to approve the creation of new endowed chairs has been delegated by the Chancellor to the Executive Vice Chancellor and Provost.

Guidelines for distribution of yield from endowed chairs

Prior to 2006, acceptable usage of endowed chair payout terms was broadly described in APM 191, campus guidelines and the individual gift terms. However, in 2007 the campus received a pledge of over \$100 million in funding from the Hewlett Foundation to establish 100 endowed chairs and subsequently created funding models for Hewlett and non-Hewlett chairs specifying use of payout for chair holder allowance, graduate student support, infrastructure support, and the faculty salary pool. The campus has also created an additional payout model, the Common Good model, which is structured similarly to the Hewlett model. The campus has attempted to convert the pre-Hewlett endowed chairs and professorships to the Common Good model where legally possible.

Summary Conclusion

During our review, we noted that:

- 1) There have been a few revisions of the campus guidelines dated as recently as 2011, though it is unclear whether these revisions were formally approved. Since then, there have been practical changes to how the campus implements the policy that are not reflected in the most recent guidelines. The campus should evaluate and update the guidelines to reflect actual practice and process as well as to identify any gaps that may exist, including documenting administrative responsibilities over portions of the end-to-end process.
- 2) We observed that 185 of the pre-Hewlett endowed chairs have been designated as “exempt from payout models”, with nearly 100 of them concentrated across three departments and units. All of the non-Hewlett endowed chairs and professorships in those three areas were exempted from the prevailing payout model. However, we were not able to determine the terms of those exemptions or formal approval by the Chancellor and/or EVCP.
- 3) Through random sampling and review of financial detail for eleven chairs, we observed that for some it appeared that the payouts were being used in ways potentially inconsistent with the payout distribution specified in the applicable

funding model or policy regarding vacant chairs. While certain types of allocations to faculty members may be appropriate when those allocations benefit the area of scholarship that the chair supports, some payouts appeared to be used to support faculty other than the named chair holder. This support included funding summer salary, travel, lump sum disbursements and equipment purchases. There were also instances where expenditures were made from the payout of a vacant chair.

In addition, although the campus has begun analyzing accumulated payout to identify years of accumulation, a process has not yet been developed and implemented to work with departments to actively manage fund accumulation before it exceeds the equivalent of five years of payout as required in APM 191.

- 4) Although the campus has begun analyzing long vacant chairs, a process has not yet been fully developed to work with departments to actively manage vacant chairs.

In addition, the campus has not yet implemented a formal process to proactively track and follow-up with deans/departments on reappointments or new appointments for chairs that are expired or close to expiration.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Adequacy of Campus Policies and Guidance Governing Endowed Chairs and Professorships

Observation

APM 191, F. *Campus Procedures*, states that “Each campus shall have written procedures on the establishment and naming of endowed chairs, the disestablishment of endowed chairs, the filling of chairs, and the use of endowment payout for faculty salaries. These procedures shall incorporate and be consistent with the Policy on Endowed Chairs and Professorships and with these Administrative Guidelines and Procedures.”

We observed that there were several revisions of the campus implementation guidelines of APM 191 and we could not confirm which of the revisions had been formally approved. There have been recent changes, such as delegation of approval of new chairs to the Executive Vice Chancellor and Provost and changes to the administration of endowed chairs and professorships, that warrant the updating and approval of the formal campus guidelines.

Formal guidelines that do not reflect actual current practices increase the risk that endowed chairs and professorship management may be administered inconsistently or may not address current delegations of authority or executive decisions. It is also important that campus practices are periodically reviewed to ensure that they do not contradict APM 191 and other related policies.

Management Response and Action Plan

The Vice Provost for the Faculty (VPF) will coordinate the following steps in order to update, clarify, and disseminate portions of the campus’s “Administrative Guidelines for Endowed Chairs and Professorships”: work with the [Academic] Senate’s Budget Committee on proposed revisions to the guidelines pertaining to faculty and academic-personnel processes; circulate proposed revisions to University Relations (UREL) and to the Academic Personnel Office (APO) for comment; issue a final policy via a CalMessage to all faculty; ensure that the policy document is posted on the APO web site; and request that earlier versions be deleted from other sites where they reside. VPF and APO will “own” this document and have primary responsibility for revising and implementing its provisions. University Relations will be consulted on all proposed revisions. APO will cross-link to the University Relations document discussed below. This effort will be completed by December 31, 2014.

University Relations will coordinate the following complementary steps: draft revisions to the guidelines that pertain to administrative aspects of chairs and professorships; circulate proposed revisions to the Vice Provost for the Faculty, who will prepare a response in consultation with the Budget Committee and APO; issue a final policy and disseminate it to development staff; and ensure that the document is posted on the University Relations web site. University Relations

will “own” this document and have primary responsibility for revision and implementing its provisions. VPF and APO will be consulted on all proposed revisions. University Relations will cross-link to the VPF/APO document described above. This effort will be completed by December 31, 2014.

Exemptions from Application of Payout Models

Observation

The *New Campus Guidelines on Distribution of Yield from Endowed Chairs* issued by the Chancellor and Executive Vice Chancellor and Provost on October, 31, 2008 established a “yield distribution model that applies to all endowed chairs on campus.” The guideline further indicated that the terms in each of the payout models listed, including the model that would come to be known as the Common Good Model, would apply unless they contradicted donor terms and exceptions would be considered on a case-by-case basis.

We observed that nearly 100 of the 185 endowed chairs that are listed in the Cal Advancement Data System (CADS) as being “exempt from payout models” are primarily from one department and two schools on campus, regardless of chair type and funding amount. The exempt chairs represent the entire population of non-Hewlett chairs in those units. Although University Relations is tracking the endowed chairs and professorships as exempt, we were not able to confirm the existence of terms for the exemptions and whether or not the exemptions were formally granted and documented.

The absence of documented terms identifying whether or not the exemption will apply to future endowed chairs increases the risk that the campus is not able to assess current or future need for the exemptions or compliance with the terms.

Management Response and Action Plan

Understanding the nearly 100 exemptions granted to the one department and two schools is important to the campus’s ability to manage these gift funds and comply with donor gift instruments. University Relations will convene a workgroup to determine the scope and history of the exemptions and will produce recommendations by June 30, 2015. The recommendations will at a minimum address whether or not the exemptions will apply to post-Hewlett chairs.

University Relations will also undertake a project to document the other approximately 85 exemptions. This will be completed by June 30, 2015.

Use of Payout

Observation

Use of Payout for Other than the Chair Holder

According to the *Policy on Endowed Chairs in the Development Policy Manual* (1992), “Income from an endowed chair is to be made available to the faculty member appointed to the chair in support of teaching and research.”

The Implementation Guidelines for Payout from Endowed Chairs and Professorships (February 2013 version) specifically allows for some discretion in the administration of “all non-Hewlett chairs, \$2 million and \$3 million Chancellor’s Distinguished Multidisciplinary Chairs”. The Development Policy Manual, Section D.3 *Policy on Presidential Chairs*, states that “the income allocated for the Presidential Chairs may be subdivided to support more than one chair...”

However, the payout models for the various Hewlett and the Common Good chairs specifically identify payout amounts and percentages for distribution categories, such as scholarly allowance for the chair holder, graduate student support in the unit of the chair holder, and faculty salary pool to help pay the academic-year professional salary of the chair holder.

Through random sampling and review of expenditures for eleven endowed chairs, we observed that for some chairs under the Hewlett and Common Good payout model, it appeared that the payouts were being used for expenses for faculty other than the named chair holder. There is currently not a formal process in place to monitor and confirm compliance of use of payout with payout model and/or chair terms.

In addition, although the campus has begun analyzing accumulated payout, a process has not yet been developed and implemented to work with departments to actively manage fund accumulation (either due to vacancy or chair non-use of payout) before it exceeds the equivalent of five years of payout as required in APM 191.

We also noted that language in systemwide policies was interpreted differently amongst stakeholders in terms of whether or not chair payouts could be used to support other faculty who were not the chair holder. Varied interpretation regarding of payout use increases the risk that donor intent and accepted terms are not being followed.

Vacant Chairs

According to APM 191, Section D.6. *Use of Fund Payout*, “In the event an established, fully-funded chair has remained vacant for a period of three years or more, or in the event that the chair’s accumulated income exceeds five years of payout, the campus shall review the fund’s terms and administrative history to ascertain the reason for the accumulation and take appropriate corrective action *consistent with the terms of the gift instrument or consistent with the terms of the administrative allocation*. Such action may include:

- a. Implementing a new expenditure plan designed to fill the chair and/or to utilize the payout fully;
- b. Seeking a reallocation of the fund by the Chancellor providing for an alternative purpose for utilization of the fund payout consistent with the terms of the gift instrument;
- c. Seeking re-designation of the chair and/or fund purpose by the Chancellor, following consultation with and approval of the donor....”

We observed one instance where expenditures were made from the payout of a vacant chair.

During this review, we were unable to identify instances where approvals were obtained for fund transfers from vacant chairs or to sustain multiple faculty members from one chair.

Management Response and Action Plan

Proper stewardship of donor intent will benefit from the development of a structured analytical approach to assessing payout accumulation and use, and a process for actively monitoring same in order to assess compliance. While University Relations has made good progress on analyzing accumulated payout, the campus has yet to adopt the expenditure practices that will enable us to significantly impact the level of payout accumulation. Monitoring use of payout to ensure compliance with donor intent and University and campus policies and guidelines requires an unprecedented level of scrutiny, and doing so effectively will require both systematic and accessible reporting tools as well a method of enforcement. Successfully shifting the campus’s practices will require the sponsorship of the highest levels of campus administration. University Relations will provide the Chancellor and Executive Vice Chancellor and Provost with a report of accumulated payout as of June 30, 2014 by December 31, 2014. It will develop an analytical framework for assessing use of payout by June 30, 2015, and report its findings for fiscal year 2014-15 to the Chancellor and Executive Vice Chancellor and Provost by December 31, 2015.

In addition to these specific steps, a workgroup with appropriate representation from the Executive Vice Chancellor and Provost, the Vice Chancellor for Administration and Finance, and the Vice Chancellor for University Relations will be convened by University Relations by June 30, 2015. The purpose of the workgroup will be to develop a framework for setting campuswide expectations for use of payout, including limits of accumulation and appropriateness of use. The products of this workgroup might include policies, guidelines, and reporting tools.

Monitoring of Expiring, Expired and Long Vacant Chairs

Observation

Although there have been discussions and analysis to date amongst stakeholders, a process for centrally monitoring expired or expiring chairs and other risk areas, such as long vacant chairs, has not yet been developed and implemented.

The failure to centrally track expired or expiring chairs and to ensure that chairs are either reappointed or newly selected on a timely basis restricts the campus from being able to accurately assess whether a chair is actually vacant or if the department failed to provide updated documentation. In addition, leaving chairs vacant beyond three years and without an action plan

to fill it puts the campus at risk of not being able to apply the gift in a way that is beneficial to the unit and campus and in good stewardship of the gift.

Management Response and Action Plan

Proper stewardship of donor intent will also benefit from the development of a formal process to track and take action regarding expiring and expired appointments and vacancies. While there is a centralized repository of appointment data maintained by University Relations in CADS, the use of this data to manage such appointments and vacancies is not well-developed. University Relations and the VPF will, along with the APO, develop processes for tracking and taking action on such appointments and chairs. Doing so will require the involvement of the schools and colleges, and they will invite the deans to participate in the process by providing input and/or representation to any workgroups or meetings that may be convened. The schools and colleges will be notified of this effort by December 31, 2014 and the process will be implemented by June 30, 2015.