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November 13, 2018

Paul Alivisatos
Executive Vice Chancellor and Provost

Julie Hooper
Vice Chancellor
University Development and Alumni Relations

Stephen Sutton
Vice Chancellor
Student Affairs

Dear Executive Vice Chancellor and Provost Alivisatos and Vice Chancellors Hooper and Sutton:

We have completed our audit of scholarships and fellowships 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 the Financial Aid and Scholarships Office, the Graduate Division, and Donor and Gift Services 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,

Jaime Jue
Interim Director

cc: Assistant Vice Chancellor and Director Cruz Grimaldo
Vice Provost and Dean Fiona Doyle
Executive Director Nancy McKinney
Executive Director Loraine Binion
Interim Director Solomon Lefler
Assistant Vice Chancellor and Controller Delphine Regalia
Associate Chancellor Khira Griscavage
Senior Vice President and Chief Compliance and Audit Officer Alexander Bustamante



AUDIT AND ADVISORY SERVICES

Scholarships and Fellowships

Audit

Project No. 18-715

November 13, 2018

Reviewed by:

Reviewed and Approved by:

Robert Asato
Auditor-in-Charge

Jaime Jue
Interim Director

University of California, Berkeley
Audit and Advisory Services
Scholarships and Fellowships

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OVERVIEW

Executive Summary

The purpose of the audit was to evaluate the stewardship of scholarship and fellowship funds to ensure that they are effectively managed, gift terms are well understood and adhered to, disbursement opportunities are optimized, accumulations are minimized, and donor reporting is accurate and timely.

Based on the scope of our audit and procedures performed, we observe that central administrative processes and controls appear to be adequate to support

- Awarding of scholarships and fellowships
- Use of funds in accordance with donor terms
- Monitoring fund accumulation
- Donor reporting
- Communication and training on awarding

We note that older scholarships and fellowships with complex restrictions may be increasingly difficult to administer in terms of identifying eligible students as the characteristics of the student population continues to change over time. Although manual identification and matching processes are required to determine eligible students, we conclude that the Financial Aid and Scholarships Office (FASO) and Graduate Division processes are reasonably designed to ensure requirements from donor restrictions are met. Management may wish to establish guidelines that would help determine at what point the annual administrative cost and effort to administer the fund and match eligible students outweighs efforts to work with the donor or the State of California (in cases where donors are deceased) to permanently modify or remove such restrictions so that the available funds can be best used to help students.

For restricted funds with the equivalent of several years of average annual expenditures in accumulated balances, we note that in many cases there are regular patterns of annual expenditures, but not enough to draw down accumulated balances. Upon inquiry with the Graduate Division, we understand that some endowment funds have grown very large over time and it is challenging to identify enough qualified applicants to satisfy fund restrictions. Based upon our discussions with management, they appear to have a reasonable approach to better utilize accumulated scholarship and fellowship funds in the short and medium term. They are also aware that longer-term solutions may involve working with donors or the State of California to broaden or remove restrictions to better utilize available funds.

Source and Purpose of the Audit

The purpose of the audit was to evaluate the stewardship of scholarship and fellowship funds to ensure that they are effectively managed, gift terms are well understood and adhered to, disbursement opportunities are optimized, accumulations are minimized, and donor reporting is accurate and timely.

Scope of the Audit

The scope of our audit included examining current central administrative processes and internal controls related to the activities of

- Awarding of scholarships and fellowships
- Use of funds in accordance with donor terms
- Monitoring fund accumulation
- Donor reporting
- Communication and training on awarding

Our audit fieldwork included interviews and process walkthroughs with staff of FASO, the Graduate Division, and University Development and Alumni Relations (UDAR) Donor and Gift Services and Fund Management units and analyzing Cal Answers and Cal Advancement Data System (CADS) scholarship and fellowship award data, as well as, endowment accumulation data from Fund Management. Our fieldwork was completed in June 2018.

Background Information

University Development and Alumni Relations–Donor and Gift Services

Our review of scholarship and fellowship data provided by UDAR found approximately 2,800 scholarships and fellowships whose primary purpose is undergraduate and graduate support (excluding travel- and research-specific awards or stipends). The fund balance of these scholarships and fellowships as of June 30, 2017 totaled approximately \$35.6 million. These funds are administered by FASO, the Graduate Division, and by campus departments.

Fund Management offers stewardship reporting on scholarships and fellowships. The reports contain a brochure illustrating the impact of the scholarship or fellowship support and correspondence from the campus unit and the student recipient. The timeline of the reporting is agreed upon between the campus unit and Fund Management.

Financial Aid and Scholarships Office (FASO)

According to FASO, there are approximately 900 scholarship funds that they administer. There exists a computerized matching program for approximately two-thirds of the funds but approximately one-third are manually awarded since the terms may be such that the matching program may not be effective and, therefore, a manual matching process may better ensure the accuracy of the match and that the terms are fulfilled.

The matching program consists of built queries of student recipient data to confirm the match with fund terms. A pool of 6,000 students are matched to scholarships through the program and nearly all scholarships are awarded between June and September.

Students are automatically considered for and awarded a scholarship if they have financial need and a grade point average of 3.5 or better for continuing, 4.1 or better for entering from high school, or 3.5 or better for a transfer student.

Graduate Division

The Graduate Division administers approximately 70 different fellowship programs totaling approximately \$94 million. As part of the fellowship application process, students can view and identify the fellowship criteria that applies to them. This criteria will provide additional information for matching the student with fellowships for which they may be eligible and best fits the student's profile. The Graduate Division also offers training to the campus for using Campus Solutions in areas related to awarding fellowships.

Summary Conclusion

Based on the scope of our audit and procedures performed, we observe that central administrative processes and controls appear to be adequate to support

- Awarding of scholarships and fellowships
- Use of funds in accordance with donor terms
- Monitoring fund accumulation
- Donor reporting
- Communication and training on awarding

In our interviews with FASO and the Graduate Division, we understand that many scholarships and fellowships with complex restrictions are older and current campus practices for donor engagement discourage incorporating complex donor restrictions that would be difficult to administer in the long run. Also, these older funds with complex restrictions may be increasingly difficult to administer in terms of identifying eligible students as the characteristics of the student population continues to change over time. Management may wish to establish guidelines that would help determine at what point the annual administrative cost and effort to administer the fund and match eligible students outweighs efforts to work with the donor or the State of California (in cases where donors are deceased) to permanently modify or remove such restrictions so that the available funds can be best used to help students.

For restricted funds with the equivalent of several years of average annual expenditures in accumulated balances, we note that in many cases there are regular patterns of annual expenditures, but not enough to draw down accumulated balances. Upon inquiry with the Graduate Division, we understand that some endowment funds have grown very large over time and it is challenging to identify enough qualified applicants to satisfy fund restrictions.

Based upon our discussions with management, they appear to have a reasonable approach to better utilize accumulated scholarship and fellowship funds in the short and medium term. They are also aware that longer-term solutions may involve working with donors or the State of California to broaden or remove restrictions to better utilize available funds.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Administration of Scholarship and Fellowships with Complex Restrictions

Observation

Our audit was designed to assess the current risk associated with potential non-compliance with gift terms for scholarship and fellowship funds administered by the Financial Aid and Scholarships Office (FASO), the Graduate Division, or individual schools, colleges, or departments. To identify the potential population of funds with complex restrictions, we performed an analysis of those funds which recorded expenses in the 574XX (Payments to Students and Student Aid) expense category of the general ledger in fiscal year 2017.

Out of approximately \$47 million in expenses in this category across over 2,300 funds, we note that approximately 98% of expenses were associated with funds which we judgmentally deemed, based upon the fund description, that the campus would not have difficulty identifying eligible students consistent with donor preferences or restrictions.

We identified a small sub-population of student aid expenses of approximately \$1 million (2%) across 52 funds (2%) which we judged had complex restrictions that may be difficult to satisfy in terms of identifying eligible students and for which there may pressure to utilize these funds for student aid in a manner not in accordance with donor's gift restrictions.¹

We conducted interviews and process walkthroughs with FASO and the Graduate Division which together administer approximately 70% of the dollar amount of expenses and number of funds with complex restrictions. Although manual identification and matching processes are required to determine eligible students, we conclude that FASO and Graduate Division processes are reasonably designed to ensure requirements from donor restrictions are met. The remaining 30% represent fifteen funds spread out across the campus that total approximately \$250,000, or an average of \$16,000 per fund in student aid expenditures. Although we did not conduct audit testwork on the administration of this last group of funds by individual schools, colleges, or departments, we observe that this last group represents collectively small but concentrated risk of non-compliance with donor restrictions.

In our interviews with FASO and the Graduate Division, we understand that many of these funds with complex restrictions are older and that current campus practices for donor engagement discourage incorporating complex donor restrictions that would be difficult to administer in the long run. We note that these older funds with complex restrictions may be increasingly difficult to administer in terms of identifying eligible students as the characteristics of the student

¹ We identified an additional approximately \$1 million in student aid expenditures in fiscal year 2017 against scholarship and fellowship funds for which the donor had indicated a preference for eligibility that may be potentially complex and difficult to determine eligible students. However, in these cases, the donor intent is noted in the fund description as a preference rather than a restriction. In our judgmental review and categorization, if the fund description indicated a donor preference but otherwise stated that the fund could be used more broadly if an eligible student could not be identified satisfying those preferences, we did not consider the fund to have a complex restriction.

population continues to change over time. Management may wish to establish guidelines that would help determine at what point the annual administrative cost and effort to administer the fund and match eligible students outweighs efforts to work with the donor or the State of California (in cases where donors are deceased) to permanently modify or remove such restrictions so that the available funds can be best used to help students.

Management Response and Action Plan

Graduate Division

While the list of funds with complex restrictions is modest, the Graduate Division still sees potential benefit in reviewing the awarding processes for such funds, with a goal of reevaluating whether current structures are best-suited for ensuring compliance with fund terms while minimizing administrative burden. Our plan is three-pronged:

Reevaluate administration of complex Graduate Division-controlled funds (November 2018)

For those funds controlled centrally by the Graduate Division, we will review fund terms to assess which of three existing administrative structures best ensures proper fund expenditure in each case:

- (1) The matching process, whereby a fund is used to pay for part or all of a pre-existing award/commitment.
- (2) A standalone competition, through which students apply for the funds and receive them on top of their existing/other funding. (Permitting eligible students to self-identify can, in some cases, both increase the size of the pool and add essential data points to ensure compliance with donor intent.)
- (3) Transfer administrative control from the Graduate Division to an academic department, perhaps substituting for other allocations being provided. (In some cases, departments may be better positioned to identify eligible recipients.)

In undertaking this review, we will adopt a comprehensive outlook that seeks to maximize awarding opportunities and minimize administrative burdens campus-wide.

Consider administrative cost in deciding whether to pursue changes to fund terms (December 2018)

While the potential changes outlined above are likely to reduce administrative burdens to a reasonable level, the administrative cost of identifying appropriate recipients may remain high in some cases. While the Graduate Division generally pursues fund term changes in response to accumulations, as part of the 2018-19 fund matching process, we will explore the possibility of using administrative burden, potentially including cost-benefit ratios, as an additional consideration when deciding whether it's worth reaching out to a donor or otherwise pursuing term changes.

Consult with departments regarding their complex funds (May 2019)

Using the list of 52 funds as a guide, we will consult with departments on the funds that they control and consider whether changing the administrative structure might work better. (For

example, bringing a fund into the Graduate Division's matching process may increase the pool of potential recipients).

Financial Aid and Scholarships Office

Once a year, the Financial Aid and Scholarships Office will review the utilization of scholarship funds with complex restrictions, and will determine based on the year to date awarding and disbursement if a strategy needs to be activated to work with University Development and Alumni Relations to loosen the restrictions. The office plans to begin this review by December 31, 2018.

Managing Accumulation of Payouts for Scholarship and Fellowship Funds

Observation

A secondary purpose of our audit was to consider the risk that the campus was not able to optimally utilize available balances of scholarship and fellowship funds. University Development and Alumni Relations (UDAR) shared their analysis indicating approximately \$20 million in accumulated balances in funds with greater than two years of average expenditures designated for graduate or undergraduate student support. They represented that they have been working with campus units to discuss opportunities to better utilize these accumulated balances.

Upon examining their data, we note that approximately 71% of these balances are for funds designated for graduate student support (over 95% of which are identified with the College of Letters and Science or the Executive Vice Chancellor and Provost organization). The remaining 17% and 11% are designated for undergraduate support or a combination of undergraduate and graduate support, respectively.

We note that in many cases there are regular patterns of annual expenditures from these funds, but not enough to draw down accumulated balances. Upon inquiry with the Graduate Division, we understand that some endowment funds have grown very large over time and it is challenging to identify enough qualified applicants to satisfy fund restrictions.

Based upon our discussions with management, they appear to have a reasonable approach to better utilize accumulated scholarship and fellowship funds in the short and medium term. They are also aware that longer-term solutions may involve working with donors or the State of California to broaden or remove restrictions to better utilize available funds. We note that, to the extent that these balances are drawn down, the draw down may temporarily contribute to the campus budget deficit; as payouts from the endowment and quasi-endowment funds, they would have been recognized as revenue in those prior years.

Management Response and Action Plan

Graduate Division

The Graduate Division views the accumulation of gift and endowment funds in relation to two factors:

- (1) The site of fund administration (i.e., the Graduate Division vs. departments), with the potential impact on both the ability to spend fund income and the administrative burden of such spending.
- (2) The role of gift and endowment income within a unit's total pool of graduate funding resources and overall graduate funding plan.

While our ability to address accumulations in departmentally-controlled funds is limited, two of our existing initiatives hold promise for bringing about improvements in this area:

Review of departmentally restricted fund terms/history to reconsider site of administrative control (April 2019)

For those funds held by the Graduate Division but controlled by departments, we will review the fund terms and administrative history to revisit the question of how each fund should be administered. We anticipate three options for each fund:

- (1) Transfer administrative control to the awarding department (i.e., move the funds from the Graduate Division's ledger to the department's).
- (2) Absorb the fund into the Graduate Division matching process (providing departments with alternative funds where appropriate).
- (3) Maintain the status quo (i.e., fund held by Graduate Division, but awarding controlled by a department).

In considering possible changes in this area, we will focus on how best to guarantee compliance with donor terms, maximize opportunities to utilize fund income, increase visibility of the fund in relevant budgeting processes, and ensure necessary and appropriate reporting to donors.

Incorporation of all funds (Graduate Division and departmental) into a comprehensive graduate funding/planning system (Fall 2020)

The Division's principal SIS-related initiative is development of a new graduate funding system that incorporates all funds (Graduate Division and departmental) into a single fund management and planning tool. By displaying disparate funding streams together, and tying them to long-term funding commitments, the graduate funding community should be better able to identify both the existence of unspent balances and opportunities to utilize those accumulations to better fund graduate students.

Financial Aid and Scholarships Office

Once a year, the Financial Aid and Scholarships Office, in collaboration with Student Affairs Finance, will review the accumulated scholarship funds and determine why funds have accumulated (complex restrictions, timing, evolving campus programs, etc.) and will determine based on the year to date awarding and disbursement if a strategy needs to be activated to impact additional awarding and disbursement. The office plans to begin this review by December 31, 2018.