AUDIT AND ADVISORY SERVICES

Self-Supporting Graduate Degree Programs Audit Project No. 14-627

November 6, 2014

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UNIVERSITY OF CALIFORNIA, BERKELEY

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November 6, 2014

John Wilton
Vice Chancellor
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Vice Chancellor Wilton:

We have completed our audit of Self-Supporting Graduate Degree Programs 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 Campus Budget Office, the Graduate Division, Admissions and Enrollment, Haas School of Business, School of Public Health, and College of Engineering 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: Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae
Executive Vice Chancellor and Provost Claude Steele
Vice Provost Andrew Szeri
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University of California, Berkeley
Audit and Advisory Services
Self-Supporting Graduate Degree Programs

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OVERVIEW

Executive Summary

Audit and Advisory Services (A&AS) completed our audit of self-supporting graduate degree programs (SSGDPs[1]) as part of our annual service plan for fiscal year 2014. The objective of our audit was to assess current business processes and the adequacy of internal controls to ensure compliance with selected financial and reporting requirements outlined in the Presidential "Policy on Self-Supporting Graduate Degree Programs" policy from 2011, specifically those related to the ongoing administration and oversight of programs. Our audit did not seek to evaluate processes related to the evaluation and approval of new program proposals or programmatic considerations governed by the Academic Senate.

Our audit included an assessment of both central campus and individual SSGDP procedures and controls. Units and departments that participated in our audit included: the Campus Budget Office, the Graduate Division, Admissions and Enrollment, the Haas School of Business, the College of Engineering, and the School of Public Health.

Self-supporting programs are those which are primarily funded by revenues from program student tuition and fees, and which are not eligible to receive state funding. The campus has experienced growth in its SSGDP offerings, with four of the eight existing programs launched since 2012. As of fiscal year 2014, revenues associated with student tuition and fees for self-supporting graduate programs were approximately $55 million or 2% of total campus revenues. The majority (95%) of SSGDP revenues derive from the four more established programs. Given the recent and anticipated expansion of SSGDP offerings across a wider range of professional areas, their potential impact to department and campus budgets, finances, and operations will likely continue to grow.

We noted opportunities to strengthen procedures and controls to provide assurance that key financial objectives outlined in the SSGDP policy are achieved. Specifically, based on our work performed:

- It appears that relevant direct and indirect costs are likely not currently being fully included in program cost analyses and fee proposals.
- Procedures and controls are currently not sufficiently robust across programs to provide reasonable assurance of the completeness and accuracy of information included in reports to the University of California (UC) Office of the President and that program revenues and costs are appropriately segregated and identified in the general ledger.

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[1] In the proposed policy revisions under review at the time of the audit, self-supporting graduate degree programs are referred to as "self-supporting graduate professional degree programs" or SSGPDPs versus "self-supporting graduate degree programs" or SSGDPs as is used in the 2011 policy effective at the time of our audit. The 2011 policy also uses the terms "self-supporting programs" and "self-supporting graduate programs". Throughout our report, we use the abbreviations SSGDPs, "self-supporting programs", as well as "self-supporting graduate programs" interchangeably.

- Current campus review procedures related to SSGDPs do not currently entail a detailed assessment of program financial results and on-going financial viability. Further, protocols and accountabilities for determining ongoing financial viability have not been delineated.

Management agrees with our observations and has provided action plans. These actions are expected to be completed within two to three years as part of larger Campus Budget Office process initiatives.

Source and Purpose of the Audit

A&AS completed our audit of SSGDPs as part of our annual service plan for fiscal year 2014. The objective of our audit was to assess current business processes and the adequacy of internal controls to ensure compliance with selected financial and reporting requirements outlined in the SSGDP policy from 2011, specifically those related to the ongoing administration and oversight of programs.

Our audit did not seek to evaluate processes related to evaluation and approval of new program proposals or programmatic considerations governed by the Academic Senate, such as faculty support or degree requirements. In addition, our audit was not designed to provide an opinion on the compliance or adequacy of controls of any individual program, but rather to provide an opinion on the overall design of controls across the campus.

Scope of the Audit

Our audit included an assessment of procedures and controls as of May 2014 related to the following financial and reporting requirements established by the SSGDP policy:

- Self-supporting graduate degree programs do not "strain the resources of the department that sponsors them or have an adverse effect on regular programs on campus."
- "Full program costs, including but not limited to faculty instructional costs, program support costs, student services costs, and overhead, should be covered by student tuition and fees and other non-state funds."
- "Self-supporting program tuition and fees should be based on a full and accurate assessment of all program costs."
- "Self-supporting programs will not be funded from State General Funds."
- "Program deficits including any deficits during the phase-in period, will be covered by the campuses; state funds cannot be used to cover any deficit."
- "State-supported and self-supporting programs must separately account for their use of resources."
- "Reports of state-funded enrollments will exclude students in self-supporting programs."

Our audit included an assessment of both central campus and individual SSGDP procedures and controls. Units and departments that participated in our audit included: the Campus Budget Office, the Graduate Division, Admissions and Enrollment, the Haas School of Business (Evening and Weekend Master of Business Administration program), the College of Engineering (Professional Master of Engineering and Master of Advanced Study in Integrated Circuits programs), and the School of Public Health (On-Campus/Online Professional Master of Public Health program).

Our audit procedures included interviews with staff in these units and programs, and reviews of related data and documents, including process documentation, annual cost analysis and fee proposals submitted to the UC Office of the President, and general ledger detail.

Background Information

Definitions and Relevant Policies

Self-supporting programs are those which are primarily funded by revenues from program student tuition and fees. These programs are not eligible to receive state funding; however, if campuses determine that programs meet a strategic need, they may elect to provide additional assistance to programs using non-state discretionary funding sources (e.g., unrestricted gifts).

As outlined in the SSGDP policy from 2011, the University has recognized self-supporting programs as an important option to meet "demonstrated higher education and workforce needs" by serving additional students "above and beyond the resources provided by the state". Accordingly, self-supporting programs should primarily serve a non-traditional population (e.g., working adults), be offered through an alternative mode of delivery (e.g., online), and/or be offered at alternative timeframes (e.g., evenings) or locations. In addition, self-supporting programs are also recognized to provide potential opportunities to enhance existing programs through the generation of additional revenues, the cultivation of broader industry partnerships, and the development of the campus' online education capacity.

Current policy and procedure related to the approval and administration of SSGDPs is established through the SSGDP policy from 2011. The policy outlines program proposal and approval protocols, appropriate rationales for offering self-supporting programs, the types of programs that can be established as self-supporting programs, and general principles and rules for program funding, pricing, revenue/expense accounting, and reporting. The specific areas of policy in scope of this audit are outlined above in the "Scope of the Audit" report section. As of the writing of this report, a revised SSGDP policy has been proposed by the UC Office of the President and is in the comment period. The proposed policy seeks to further clarify which program types are eligible to be self-supporting, protocols for converting existing programs to self-supporting status, and certain funding and accounting rules, such as the handling of funding and reimbursements for faculty member participation in SSGDPs.

Other campus administrative procedures that do not pertain directly to the scope of our audit, but which govern certain aspects of campus processes related to SSGDP program approval and on-going review include the "Berkeley Campus Review Process Guide for Academic Programs and Units" and the "Guide for the Review of Existing Instructional Programs".

Campus Programs and Processes

As of June 2014, there were eight self-supporting graduate degree programs being operated on campus across five schools and colleges: the Haas School of Business, the College of Engineering, the School of Public Health, the Berkeley Law School, and the School of Information. Programs offered include both on-campus and online programs.

The campus has experienced growth in its SSGDP offerings, with four of the eight existing programs launched since 2012; additional programs are currently being proposed for approval.

As of fiscal year 2014, revenues associated with student tuition and fees for self-supporting graduate programs were approximately $55 million or 2% of total campus revenues. The majority (95%) of SSGDP revenues derive from the four more established programs.

As is required by the SSGDP policy, each program prepares and submits cost analyses and fee proposals to the UC Office of the President on an annual basis. As is established by University and campus procedures, the Campus Budget Office is designated as the primary financial partner to self-supporting programs and is responsible for providing assistance with program financial administration and oversight, including the annual UC Office of the President reporting process.

Summary Conclusion

Until recently, SSGDPs on campus included only a few that could readily maintain their self-supporting status, and there has not been a significant impetus to evaluate campus processes related to the financial administration of these programs. However, given the recent and anticipated expansion of SSGDP offerings across a wider range of professional areas, the potential impact of self-supporting programs to department and campus budgets, finances and operations will likely grow.

We noted opportunities to strengthen procedures and controls to provide assurance that key financial objectives outlined in the SSGDP policy are achieved. Specifically, based on our work performed:

- There are certain program delivery costs that are not currently included in direct costing analyses or that may not be fully reflected in cost estimates. In addition, it is not clear that sufficient analysis has been performed to assure that school and campuswide indirect costs associated with SSGDPs are fully recovered.
- Procedures and controls are currently not sufficiently robust across programs to provide reasonable assurance of the completeness and accuracy of information included in annual cost analysis and fee proposal reports to the UC Office of the President and that program revenues and costs are appropriately segregated and identified in the general ledger. Examples of issues noted include errors in the information included in such reports and individual unit accounting practices that potentially complicate the monitoring of actual program expenses and income/deficits.
- Current campus review procedures related to SSGDPs do not currently entail a detailed assessment of program financial results and on-going financial viability. Further, protocols and accountabilities for determining ongoing financial viability have not been delineated.

Management agrees with our observations and action plans are included in the observation section below. These actions are expected to be completed within two to three years as part of larger Campus Budget Office process initiatives.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Overall Management Response

It is important to note that the roles and responsibilities of the Campus Budget Office or execution thereupon are changing. Historically the Campus Budget Office has served as more of a go-between with the UC Office of the President and the schools and colleges on the SSGDP call. In the past the role was limited and perfunctory in nature. Management now sees its role as more proactive in establishing greater oversight of procedures and controls, comprehensive understanding of program business practices and improved protocols to better ensure financial viability of programs. This is a large and noble agenda and will take two to three years to effectively implement. Management believes this timeline is reasonable and necessary given the relative priority and potential impact of the noted audit observations as compared to other Campus Budget Office priorities and concerns, and does not believe that the timeline represents undue risk to the campus. In addition, we expect incremental progress in the strengthening of Campus Budget Office involvement in program financial oversight, which will help to mitigate risk in the interim, and management acknowledges assumption of any residual risks. If the pace of growth in self-supporting graduate degree programs accelerates, management will re-evaluate the timeline for actions. Specific comments are listed below each observation.

Cost Analysis and Recovery

Observation

As outlined in policy, self-supporting is defined to mean "that full program costs, including but not limited to faculty instructional costs, program support costs, student services costs, and overhead, should be covered by [SSGDP] student tuition and fees or other non-state funds…". Based on our work performed, it appears that relevant direct and indirect costs are likely not currently being fully quantified and/or covered accordingly. Our conclusion is based on the following observations:

- There are certain program delivery costs that are not currently included in direct costing analyses or that may not be fully reflected in cost estimates. In some instances, staff assert that the related time and effort is not thought to be significant or that it is difficult to anticipate and estimate related costs. Examples include some program staff support. Further, for those costs in their costing analyses, estimates are used that are largely judgmental rather than based on a detailed analysis of costs and cost drivers.
- Schools and colleges also incur indirect costs in connection with the delivery of SSGDPs. There is no standard rate established to guide programs in determining indirect cost amounts, and it is not clear that schools and colleges are being reimbursed for these costs.
- The campus assesses a 15% charge on SSGDP revenues associated with central campus program support. The 15% rate was established in fiscal year 2011, with a

stated plan to re-evaluate rate reasonableness in fiscal year 2013. As of the time of the audit, the rate does not appear to have been re-evaluated. Further, at the time of our audit, programs were not uniformly being assessed the 15% charge.

- In fiscal year 2013, the Graduate Division and Admissions and Enrollment proposed and were allotted an increase in annual central funding related to their support of SSGDPs commensurate with their estimates of current costs. However, the current allocations are not structured to vary with enrollment levels, and therefore may not fully cover per student costs as enrollment levels increase. In addition, the current funding structure did not provide for a reimbursement of unfunded costs already incurred, and does not account for costs that may be incurred in connection with the launch of new programs.

Management Response and Action Plan

Management acknowledges the cost piece should be revisited, specifically relating to existing and future processes. Additionally, management agrees there should be a better understanding of associated costs related to indirect costs, particularly as they pertain to the college/school or the department. Management does not necessarily agree the current Graduate Division and Admissions and Enrollment funding structure needs to be reviewed. However, it will take this comment under advisement should it decide to review this at a later date. Management plans on addressing the cost piece and the associated indirect costs in the next few years with each program so the campus has greater visibility into existing and new programs' costs.

Accounting and Reporting Procedures

Observation

Based on our review of a sample of SSGDP accounting and reporting documents and our walkthrough of current processes, we noted that procedures and controls are currently not sufficiently robust across programs to provide reasonable assurance of the completeness and accuracy of information included in reports to the UC Office of the President and that program revenues and costs are appropriately segregated and identified in the general ledger.

Our specific findings include:

- For at least two programs, there were discrepancies between the information reported by units in the UC Office of the President cost analysis and fee proposal and actual costs and revenues recorded in the general ledger. In one instance, it appears there was an error in report preparation; in the second instance, estimates were used where actuals were requested in the template. The noted discrepancies were not significant from the perspective of overall program financial results, but highlight the opportunity for additional controls related to report preparation and review.
- Practices for tracking program revenues and expenses in the general ledger vary across programs. In all cases, programs use some combination of designated organization codes, funds, or other unique identifiers. In some instances, in particular those where multiple organization codes and funds were used, practices appeared to

potentially complicate the monitoring of actual program expenses and income/deficits. It may be appropriate for approaches to vary across programs; however, the establishment of guidelines by the Campus Budget Office in consultation with the Controller's Office to ensure their transparency and appropriateness is warranted.

- Methodologies and criteria for determining allocations of costs for the purchase and/or use of shared resources are not explicitly described and justified by all programs, creating a risk that full costing cannot be demonstrated.

Management Response and Action Plan

Management acknowledges there have been some deficiencies in the review of the program UC Office of the President cost analysis reports. Management intends to institute internal and external processes to ensure there is not only greater oversight but also a more comprehensive understanding of each program's business practices. Management expects to implement these new processes in the next several years. Management also acknowledges a thorough review of the methodologies and criteria for determining programs' cost allocations, related to shared resources, is warranted to ensure full costing.

Periodic Assessment of Financial Viability

Observation

SSGDPs are subject to the regular campus academic review process, and are also indirectly financially evaluated through annual campus budget review procedures. However, campus review procedures related to SSGDPs do not currently entail a detailed assessment of program financial results and on-going financial viability. Further, protocols and accountabilities for determining ongoing financial viability have not been delineated.

Until recently, SSGDPs on campus included only a few that could readily maintain their self-supporting status, and there has not been a significant impetus to consider and/or implement potential changes to review protocols and criteria. Given the recent and anticipated expansion of SSGDP offerings across a wider range of professional areas, an assessment and updating of on-going program financial evaluation protocols and criteria for SSGDPs is warranted. Policy implementation guidelines establish that programs "are expected to become fully self-supporting within three years". It would appear helpful for any such financial reviews to coincide with this initial three-year interval, and potentially be reperformed on a periodic basis going forward. Given the Campus Budget Office's existing role as the financial partner to these programs, CBO is well-positioned to perform this review. Review results could then be shared with the Graduate Division for further coordination with the Graduate Council, as warranted.

Management Response and Action Plan

Management agrees the current campus academic review processes are not as robust as they should be. Management intends to implement various protocols in the next few years (such as the verification of all costs and an enhanced understanding of how schools/departments are

reimbursed for indirect costs) to ensure the financial viability of these programs. Additionally, the Campus Budget Office will periodically perform a detailed financial review of each program, including a new program review after its first three years, and share these results with the Graduate Division. Finally, management aims to periodically assess and refine the campus' protocols and criteria for these programs so as to ensure we continue to maintain a proactive role with these programs.