



# AUDIT AND ADVISORY SERVICES

Chancellor's Expenses (BFB-G-45)

Audit

Project No. 16-676

June 20, 2017

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June 20, 2017

John Lohse  
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Nicholas Dirks  
Chancellor  
University of California, Berkeley

Interim Senior Vice President Lohse and Chancellor Dirks:

We have completed our audit of 2015 annual reporting on Chancellor's expenses as required by university policy, Business and Finance Bulletin G-45, and 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 in the Office of the Chancellor 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 Chancellor Nils Gilman  
Associate Chancellor Khira Griscavage  
Assistant Vice Chancellor and Controller Delphine Regalia  
Deputy Associate Chancellor and Chief Operations Officer Wanda Ellison Crockett

**University of California, Berkeley  
Audit and Advisory Services  
Chancellor’s Expenses (BFB-G-45)**

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# OVERVIEW

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## Executive Summary

The purpose of our audit was to review the campus “Annual Report of Fiscal Year Expenses for the President/Chancellor” (Annual Report of Fiscal Year Expenses) and the “Annual Report of Taxable Expenses for the President/Chancellor” (Annual Report of Taxable Expenses), both of which are required by university policy BFB-G-45, *Implementing Requirements on Expenses Incurred in Support of Official Responsibilities of the President and Chancellors*. The annual reports were reviewed for completeness and accuracy relative to amounts recorded on the campus general ledger and supporting documentation.

With respect to the Annual Report of Taxable Expenses, based upon our audit procedures, the process of preparing, reviewing, and approving the report appeared to operate effectively for the 2015 reporting period to ensure completeness and accuracy of reporting.

With respect to the Annual Report of Fiscal Year Expenses, the process of preparing, reviewing, and approving the report did not operate effectively for the 2015 reporting period to ensure completeness and accuracy of reporting.

- Expenses reportable under the “Capital Improvements” reporting category were underreported by approximately \$202,145. Seven Persian rugs were purchased for the University House. Ten rugs were traded in for \$183,245 against the purchase of new rugs. However, the trade-in value was not recognized on the general ledger. In addition, \$18,900 was included in the “Grounds Maintenance” reporting category for a bathroom renovation instead of “Capital Improvements”. The purchases of rugs were not appropriately capitalized in the university accounting records.
- The capital improvement project for a bathroom renovation in the University House exceeded the \$25,000 threshold for University President approval, which was not obtained.
- The log of official events, business meetings, and other activities held at the residence and supporting documentation of expenses incurred were incomplete and not available for the preparation of the Annual Report of Fiscal Year Expenses.

## **Source and Purpose of the Audit**

The purpose of our audit was to review the campus Annual Report of Fiscal Year Expenses for the fiscal year July 1, 2014 through June 30, 2015 and the Annual Report of Taxable Expenses for the reporting period November 1, 2014 through October 31, 2015 (collectively, the 2015 reports), both of which are required by university policy BFB-G-45, *Implementing Requirements on Expenses Incurred in Support of Official Responsibilities of the President and Chancellors*. The reports were reviewed for completeness and accuracy relative to amounts recorded on the campus general ledger and other supporting documentation.

## **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.

Our audit procedures included, but were not necessarily limited to, the following:

- obtaining copies of the 2015 reports, with attachments;
- obtaining an understanding of management's process to collect and record amounts reported on the 2015 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 2015 reports and inquiring with management on any differences including the root cause;
- assessing the overall accuracy and completeness of the amounts reported on the 2015 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 2015 reports.

Our fieldwork was conducted between February and June 2016.

## **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

With respect to the Annual Report of Taxable Expenses, based upon our audit procedures, the process of preparing, reviewing, and approving the report appeared to operate effectively for the 2015 reporting period to ensure completeness and accuracy of reporting.

With respect to the Annual Report of Fiscal Year Expenses, the process of preparing, reviewing, and approving the report did not operate effectively for the 2015 reporting period to ensure completeness and accuracy of reporting.

- Expenses reportable under the “Capital Improvements” reporting category were underreported by approximately \$202,145. Seven Persian rugs were purchased for the University House in the reporting period. Ten rugs were traded in for \$183,245 against the purchase of new rugs. However, the trade-in value was not recognized on the general ledger. In addition, a portion of the expenses (\$18,900), associated with a bathroom renovation project in the University House, was included in the “Grounds Maintenance” reporting category rather than under “Capital Improvements”. The purchases of rugs were not appropriately capitalized in the university accounting records.
- The total cost of the bathroom renovation project exceeded the \$25,000 threshold for University President approval, which was not obtained.
- The log of official events, business meetings, and other activities held at the residence and supporting documentation of expenses incurred were incomplete and not available for the preparation of the Annual Report of Fiscal Year Expenses.

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## SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

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### Purchase of Furnishings (Rugs) for the Chancellor's Residence

#### Observation

Persian rugs purchased for the Chancellor's residence were understated by \$183,245 on the Annual Report of Fiscal Year Expenses under "Capital Improvements" and on the campus general ledger. The total acquisition value per vendor invoices was \$274,568. However, the transaction amounts recorded in campus procurement and general ledger systems reflected the net amount of the purchase after subtracting the trade-in value of the rugs surrendered in the exchange.

In addition, our review of these transactions gave rise to the following control deficiencies.

- As an after-the-fact transaction, competitive bidding was not sought as required by BFB-BUS-43 (*Materiel Management*) for a transaction involving an expenditure of more than \$100,000 annually for goods. The procurement documentation did not include a sole source justification.
- The furnishings were charged to a miscellaneous expense account in the general ledger instead of inventorial equipment. As a result, the purchased assets were expensed and not capitalized or recorded in the Berkeley Equipment Tracking System (BETS). The scheduled useful life is ten years. With the limited number of items included in BETS, it does not appear that there is a full inventory of assets for the University House.
- The disposition of the traded-in assets was not reflected on the campus general ledger or in BETS. Ten rugs were traded in, only six were in BETS with an approximate book value of \$11,000 at the time of the transaction. There was no reconciliation of the traded-in rugs with those in inventory. The trade-in values appear to reasonably compensate the university for the surrendered rugs given the acquisition value of the inventoried rugs. However, the value was not independently validated.
- Given the apparent appreciation in market value, and the hand-made and unique nature of the rugs, the assets may be works of fine art. The assets may warrant scheduling under the fine arts insurance program.

As after-the-fact transactions generally involve management override of internal controls, additional attention is likely required to assure accurate accounting.

#### Management Response and Action Plan

Management agrees with the observations and has proposed corrective action plans that, if implemented, should reasonably address the observations noted herein. The rugs traded have been subsequently removed and the new rugs have been entered into the university equipment management system (BETS) to capture the value of the updated inventory. Additionally, staff

have performed a comprehensive review and developed an inventory of all furnishings, equipment, art and household items. Risk Services was apprised of the recent transaction of the rugs and has included them as assets under the fine arts insurance program for FY 17. Finally, the staff at University House, charged with the responsibility of managing the day-to-day operations were retrained regarding UC equipment management and housing policy in accordance with BUS 29 and 43 policies to improve internal controls in the future.

## **Approval of Capital Improvements to Chancellor's Residence**

### **Observation**

The capital improvement to one of University House's bathrooms (e.g. bathroom renovation) did not receive approval from the University President as required by Regents Policy 7708 (*University-Provided Housing*) when the project exceeds \$25,000. While the issue of obtaining approval was raised in the course of the project, it did not appear that responsibility for obtaining approval was clearly delegated. The bathroom project was initiated as a repair and maintenance project. After further assessment, the bathroom project expanded to a renovation.

Additionally, campus partners did not appear to share a common understanding of capital versus repair and maintenance expenditures. The UC Facilities Manual defines both maintenance and repair. Maintenance is the upkeep of property, machinery, systems, and facilities, including buildings, utility infrastructure, roads, and grounds. Maintenance consists of those activities necessary to keep facilities and systems operational and in good working order. It also consists of the preservation, but not the improvement, of buildings and grounds, other real property improvements and their components. Repair means to restore property, machinery, systems, and facilities, including buildings, roads, and grounds and their components to working order. While the UC Facilities Manual does not explicitly define capital improvements, it is generally accepted that capital improvements are non-routine and increase the value or extend the useful life of the property or one of its structural components.

The cost of the bathroom renovation, which exceeded \$50,000, was erroneously recorded on the Annual Report of Fiscal Year Expenses in two separate accounts, the "Capital Improvements" costs account and the "Grounds Maintenance" expenses account. Again, the result being an understatement of the "Capital Improvements" costs account of approximately \$18,900, in addition to an overstatement of the "Grounds Maintenance" expenses account for the same amount.

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

Management agrees with the observations and has proposed corrective actions that, if implemented, should reasonably address the observations noted above. The campus has consulted with the UC Office of the President, to determine if retroactive approval for the bathroom project is required, and if so, the request will be submitted for approval by early February. We have been subsequently advised no further action is needed.

Management has taken additional steps however to ensure capital projects are in compliance with G-45 policy. We have provided and discussed with the campus Design and Construction



department project leadership team the local (i.e., Division review and authorization process) and systemwide approval process for capital projects. Additionally, the appropriate parties in Design and Construction have subsequently been provided UCOP Approval Guidelines for Capital Projects for Presidents' and Chancellor's Residences and Offices to ensure a clear understanding of the approval process for capital improvements. Furthermore, we will continue to work with Facilities Services and campus Design and Construction on improving the coordination and approval process of capital projects to ensure consistent attribution of associated costs are classified appropriately (be it capital improvement or general maintenance) to improve internal controls in the future.

## **Timely Preparation and Approval of Travel and Entertainment Expenses**

### **Observation**

University House staff record all entertainment expenses occurring at the Chancellor's residence using an event log in accordance with BFB-G-45 and maintains event packets that include the supporting documentation for all event expenses. These event packets and supporting documents are then submitted to the Chancellor's Immediate Office for review and reconciliation to the general ledger as part of the preparation of the Annual Report of Fiscal Year Expenses.

Our review of the event packets of supporting expense documentation and event log for FY2015 prepared by the University House staff noted that three of the five sampled event packets did not include supporting documentation for the event's expenses, such as food, beverage, and services or the event's expense detail was not recorded on the log. The result of these deficiencies impacts the ability of the Chancellor's Immediate Office to accurately and completely reconcile the total dollar amount of these events to the campus general ledger and represent transactions on the Annual Report of Fiscal Year Expenses. In addition, the event packets were not available for preparation of the annual report.

Additionally, according to university policies BFB-G-28, *Travel Regulations*, and BUS-79, *Expenditures for Entertainment, Business Meetings, and Other Occasions*, the campus Controller's Office is responsible for approving the Chancellor's travel and entertainment expenses. The Chancellor's Immediate Office records travel and non-University House entertainment expenses on a monthly travel and entertainment spreadsheet which includes, for example, the official business purpose for the expense, travel and entertainment details, expense amounts, and funding source.

Based on our review of the submission of the Chancellor's monthly travel and entertainment spreadsheets to the campus Controller's Office for FY2015, we noted that these spreadsheets were not being submitted at least monthly to the Controller's Office in accordance with BUS-79. Instead, the spreadsheets were submitted to the Controller's Office on two separate occasions during the year. The first submission included the Chancellor's travel and entertainment expenses incurred during the months of July 2014 through April 2015 and the second submission included expenses incurred during the months of May 2015 and June 2015. The Controller's Office approved these expenses on August 5, 2015 and December 4, 2015, respectively. Additionally, in reference to the above mentioned Chancellor's residence event log for FY2015, the Controller's Office did not receive the log for review and approval.

## Management Response and Action Plan

Management agrees with the observations and has proposed action plans that, if implemented, should reasonably address the comments noted above. The Business Office developed a business process map for University House personnel responsible for preparing the events packets and updating the events list. The events list and all applicable university forms were added to the Google drive along with instructions on how to complete the forms. The events list report was created in an Excel worksheet to ensure the proper tracking, recording, and calculation of event costs by date and activity by policy.

Additional training was provided to the staff at University House on BUS-79, *Expenditures for Entertainment, Business Meetings, and Other Occasions*. A schedule of deliverables was reviewed with the staff to ensure the compliance review is done promptly and the financial data is available for the Controller's Office.

Based on senior management's assessment of University House operations, it was determined additional attention and expertise was needed. Consequently, the oversight of the compliance functions of the University House events management included the reassignment of the management function from the Special Advisor to the Chancellor to the Deputy Associate Chancellor effective January 2017.

Finally, with the turnover of staff that manages the Chancellor's calendar and prepares the monthly travel and entertainment report, management will provide additional training to ensure the appropriate documentation and business purpose is supported and reported on a timely basis. Additionally, management has requested the supervisor conduct spot audits of the consolidated travel and entertainment report periodically to ensure accuracy and completeness of the information and timeliness of the reporting.

The Chancellor's and Controller's Offices are committed to continuously assessing the best strategies in the conduct of the compliance review, reporting, and certification of the Chancellor's travel and entertainment promptly consistent with standard accounting practices. Management will continue to assess process improvement efforts to strengthen internal controls.