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Subject: *Budget Planning & Monitoring (Deficit Spending)*
Audit & Management Advisory Services Project #2011-01

The final audit report for Budget Planning & Monitoring (Deficit Spending), Audit & Management Advisory Services Project #2011-01, is attached. We would like to thank all members of participating departments for their cooperation and assistance during the audit.

Because we were able to reach agreement regarding corrective actions to be taken in response to the audit recommendations, a formal response to the report is not requested. The findings included in this report will be added to our follow-up system. We will contact you at the appropriate time to evaluate the status of the corrective actions. At that time, we may need to perform additional audit procedures to validate that actions have been taken prior to closing the audit findings.

UC wide policy requires that all draft audit reports, both printed and electronic, be destroyed after the final report is issued. Because draft reports can contain sensitive information, please either return these documents to AMAS or destroy them at this time.

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Attachment

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AUDIT & MANAGEMENT ADVISORY SERVICES



University of California
San Diego

**Budget Planning and Monitoring
(Deficit Spending)
June 2011**

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Project Number: 2011-01

Budget Planning and Monitoring (Deficit Spending)
Audit & Management Advisory Services Project 2011-01

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I. Background

Audit & Management Advisory Services (AMAS) has completed a review of campus budget planning and monitoring processes as part of the approved audit plan for Fiscal Year 2010-11. This report summarizes the results of our review.

The University of California prepares an annual financial statement in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred and measurable. In order to ensure the observance of restrictions and limitations placed on the resources available to the University, the accounts are maintained in accordance with the principles of fund accounting. The fundamental purpose of fund accounting is to properly account for all resources received and used. Fund accounting classifies all resources into funds according to the specific limitations that were placed on them by their providers. Classification recognizes the stewardship responsibility inherent in accepting restricted resources from outside parties.

Each fund is a self-balancing set of accounts. Each fund has its own revenues, expenditures, transfers, assets, liabilities and a fund balance. A change in fund balance represents the difference between fund additions (revenues and transfers in) and deductions (expenditures and transfers out). A fund balance is identified as the net difference between a fund's assets and liabilities. There are numerous restrictions placed on the University's resources, thus the University has a large number of individual accounts. Assessment of fund level balances provides a comprehensive means for testing the account categories for overdrafts.

Because individual funds are often distributed across the University of California, San Diego (UCSD) campus to multiple organizations, and multiple Administrative Officials, the IFIS organization code level provides the most meaningful level for evaluating individual accountability and compliance with policy and stewardship for University resources. An index is a seven character code used to indicate a specific combination of Fund, Organization, and Program codes (FOP). More than one index may point to the same FOP. This allows a department to keep track of expenditures for unique activities that are on the same FOP.

II. Audit Objective, Scope, and Procedures

The primary objective of our review was to review and evaluate campus policies, practices, and tools utilized for monitoring financial balances, specifically significant financial year-end deficit and surplus balances. A secondary objective was to evaluate the potential impact of pending University of California budgetary changes, referred to as the Funding Streams Initiative, on the policies, practices and tools noted above.

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The scope of our review included an assessment of the roles of the Campus Budget Office, the Controller's Office, General Accounting, and campus departments. Our scope also included an assessment of the campus use of the Financial Link Overdraft Reporting System, for monitoring financial balances and documenting plans for resolving significant financial deficits.

In order to achieve our objectives we completed the following:

- Reviewed applicable University and campus policies and procedures for budget monitoring and accountability; and accounting literature regarding fund accounting practices;
- Reviewed and evaluated the campus Overdraft Policy and the Overdraft Reporting System (the OD System) available via Financial Link;
- Reviewed campus processes for using the OD System, including the process for establishing a user Profile, generating financial balance reports based on defined criteria, and documenting notes such as plans for deficit resolution;
- Examined a sample of Profiles and corresponding financial balances reports;
- Interviewed members of the following offices to gain an understanding of their processes for monitoring financial balances, tools and reports used in the process, recent process changes, and significant concerns:
 - The Campus Budget Office,
 - The Controller's Office, and
 - Business & Financial Services (BFS) General Accounting Division;
- Evaluated overdraft monitoring processes performed by a sample of UCSD departments and interviewed Department Business Officers to gain an understanding of their use of the OD System, and obtain any concerns or suggestions that they had for improvement of overdraft tools;
- Interviewed the UCSD Foundation Controller to discuss concerns regarding Foundation gift fund balances and corresponding campus department account balances; and examined her analysis of account balances as of April 30, 2011;
- Reviewed documentation regarding the University of California, Office of the President (UCOP) Funding Streams Initiative;
- Reviewed the overdraft monitoring process for the School of Medicine (SOM) and Scripps Institute of Oceanography (SIO); and evaluated their respective progress in meeting their documented reduction plan; and
- Reviewed current University policy regarding Short-Term Investment Pool (STIP) proceeds – *Distribution of Income Business and Financial Bulletin A-60*.

III. Conclusion

Based on our review, we concluded that the campus policy, practices and tools for monitoring financial balance variances and overdraft balances vary significantly across departments, and require improvement. Our interviews with the campus offices of

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Budget, General Accounting and the Controller's Office indicated that they all realize the importance of the budget monitoring process. Although the Overdraft Reporting System is both useful and readily available to departments, it is not used extensively. Due to a number of factors, campus procedures for monitoring financial balances have not resulted in the timely resolution of significant deficits.

IV. Observations and Management Corrective Actions

Overdraft Reporting and Monitoring

A. Deficit Balances

Some significant financial deficits have not been resolved in a timely manner.

The modification of the fiscal closing process several years ago resulted in less scrutiny of fund balances in overdraft. In an UCSD campus notice dated May 8, 1996, significant changes in the fiscal closing were announced as follows:

"The major change in practice to facilitate accomplishing the new fiscal closing process is to not lapse any General Fund or other current unrestricted funds balances at the departmental level. Generally, all such budget balances, whether positive or negative, will automatically be carried forward to the new fiscal year in the same department where they resided as of year end. However, it is campus policy that academic salary dollars do not carry forward. Also, the revised process does not change any budgetary controls which may be required within specific Vice Chancellors' areas, which will be specified in closing instructions you will receive from the appropriate Vice Chancellor's Office."

"Since General Fund balances do not lapse at year end at the departmental level, all of the previous extraordinary lien activity associated with covering those funds will be unnecessary and should not be done..."

The Campus Budget Office has recently implemented a process for closely monitoring carry forward balances, as a component of the annual budget development process. While the focus of that process is not on identifying deficits, when significant deficits are noted, they are brought to the attention of the cognizant offices for appropriate action. However, there are still large deficits at the department, organization, and program levels that need to be addressed and more aggressively resolved by campus Administrative Officials.

For example, in our review of Vice Chancellor Health Sciences (VCHS) Executive Accounts Expanded Review (Audit Report #2009-08D; May 27, 2009) we identified significant deficits in State General and Indirect Cost Recovery

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Funds in one VCHS organization 414992 in the net amount of \$17.8M at June 30, 2008 fiscal year 2007-08. As a result VCHS management agreed to implement a routine process for detecting and resolving overdrafts in a timely manner, and developed a multi-year deficit reduction plan to re-direct incremental funds and released discretionary funds including STIP and enterprise development funds to eliminate the deficits over time. The plan also included adherence to a strict cash management policy and allocating commitments on an as needed basis. The written plan was submitted to the Campus Controller. The table below summarizes the related year-end balances since June 30, 2008.

General & Indirect Cost Recovery Funds Organization #414992					
<i>(Med School Academic Departments Unallocated)</i>					
Fund	Fund Title	Balance FY 2008	Balance FY 2009	Balance FY 2010	Balance FY 2011
05397A	Educational Fund ARRA	(\$2,909,753)	(\$2,489,288)	(\$3,642,478)	\$4,705,572
07427A	University Opportunity Fund ARRA	(\$3,079,396)	(\$5,791,784)	(\$5,616,212)	(\$6,260,418)
19900A	General Fund	(\$5,903,837)	(\$966,204)	(\$2,534,513)	\$12,750
19933A	State Approp/UC Gen Fund/Fed Ovrhd	(\$3,230,856)	(\$3,699,110)	(\$4,410,591)	(\$15,588,408)
69750A	Contract and Grant Admin ARRA	(\$2,698,988)	(\$5,401,097)	(\$5,572,776)	(\$3,891,847)
<i>General & ICR Combined Balance</i>		(\$17,822,830)	(\$18,345,474)	(\$21,774,560)	(\$21,022,351)
<i>Other Funds</i>		\$6,747,197	\$6,255,502	\$9,148,818	\$8,445,292
Overall Balance		(\$11,075,632)	(\$12,089,972)	(\$12,625,741)	(\$12,577,059)

As the table above indicates, the deficit reduction plan has not resulted in any meaningful progress toward resolving the financial deficit.

SIO also has a deficit reduction plan on file with the Controller's Office. Since June 2008, SIO has improved their overall balance in the Vice Chancellors General Fund (19900). However, even though their overall balance has

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improved, SIO still has a deficit for organization 416400 that needs to be closely monitored by the Controller and SIO management to achieve a final resolution.

Vice Chancellor Marine Sciences General Funds					
Fund	Fund Title	Balance FY 2008	Balance FY 2009	Balance FY 2010	Balance FY 2010
19900 Org. 416400	General Funds	(\$12,414,935)	(\$14,786,321)	(\$18,292,967)	(\$4,914,028)
Other 19900	Other General Funds	\$9,954,864	\$15,332,891	\$20,202,084	\$12,833,628
Overall Balance		(\$2,460,071)	\$546,570	\$1,909,117	\$7,919,599

B. Campus Policy

The current UCSD overdraft policy requires departments to routinely monitor accounts in overdraft. However, this policy lacks clarity and has never been formally published in the campus Policies and Procedures (PPM) maintained by UCSD Policy and Records Administration.

The final draft of the PPM was completed and forwarded to the Campus Controller for review and approval in calendar year 2000. This “Overdraft PPM” is available via a link on the Blink web page entitled Overdraft Reporting at:

<http://blink.ucsd.edu/finance/tools/overdraft/>

The Overdraft PPM on Blink defines an overdraft as a negative financial position caused generally by spending in excess of an authorized or available funding, which represents an unacceptable financial condition¹. The authorized funding limit is reflected in the "budget" balance contained in the campus accounting system. The Overdraft PPM also defines Administrative Officials subject to the PPM, and their responsibilities. In the case of an overdraft of more than \$10,000 for more than 60 days, Administrative Officials or their designees need to determine the cause, evaluate the activity, and take corrective action.

The policy defines the responsibilities of the Campus Controller to monitor financial balances, and states that the Controller is responsible to ensure that final resolution is effectively achieved. However, the policy does not provide any consequences for non-compliance, nor does it outline how financial deficits may

¹ Financial balances are calculated as net budgetary allocations and transfers-in minus expenditures and transfers-out. Overdrafts can be resolved by additional budgetary allocations or transfers-in, or by transferring expenses to other funding sources.

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be resolved centrally in cases where cognizant Administrative Officials do not fulfill their responsibilities for correcting overdrafts in a timely manner.

The Overdraft PPM does not explicitly provide that the Controller will direct central personnel to process financial journal vouchers (or transfers) to address significant financial overdrafts that have not been resolved by cognizant Administrative Officials in a timely manner. Similarly, the policy does not provide that the Campus Budget Office will direct personnel to process budgetary journal vouchers (or transfers) to address significant financial overdrafts that have not been resolved. In fact, the policy is silent as to any responsibilities of the Campus Budget Office.

Current policy permits the development of multi-year plans but does not require that such plans be reapproved annually. Further, current policy does not require Vice Chancellor approval for deficit reduction plans, nor does it establish guidelines for how long a deficit should be permitted to remain.

C. Overdraft Reporting System

The Overdraft Reporting System does not have any standardized reports. In addition, the campus does not offer any training in the use of this tool.

The previously active campus SPEAR² team finalized the OD System and made it available to the campus via Financial Link in Calendar Year 2000. In order to use the OD System, a user needs to define a Profile, and then define a report using IFIS³ parameters. As of June 2011, there were only 516 Profiles established in the OD System, and many of these were established by central offices such as the General Accounting Division, and the Campus Budget Office. Based on the number of established Profiles, relative to the number of campus IFIS users and funds, it appears that the OD System was not being used effectively by campus departments. Further, we noted that plans for addressing significant financial deficits were not being documented in the system.

SAS 112 – *Statement of Auditing Standards No. 112 (SAS 112)*, "Communicating Internal Control Related Matters Identified in an Audit," is an accounting standard that establishes guidelines for identifying and documenting internal control concerns. SAS 112 establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements.

² Sponsored Project Electronic Administration Redesign.

³ Integrated Financial Information System.

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Per requirements defined by the Campus Controller, all departments must certify and document key controls to demonstrate that key internal control activities are being performed regularly. The objective of this requirement is to ensure that existing key controls are in place and that UCSD can demonstrate, through documentation that they are operating as intended. The monthly review and monitoring of overdraft balances is included as a key internal control for SAS 112 Compliance, and the OD System is listed as one available means to assist departments in providing evidence that a review of overdrafts has been completed. However, the SAS 112 certification process does not mandate use of the OD System.

Currently, there is not any central process to verify that departments are monitoring overdrafts, or to determine how many are using the OD System for this purpose.

An on-line tool for certifying key controls has been developed by the Controller's Office and is currently in the implementation stage. This system may increase the awareness of key controls, and those which may require improvement, including the monitoring and resolution of department overdrafts.

D. Short Term Investment Pool Distribution and Policy

Distribution of STIP earnings has unintentionally provided financial incentive for Administrative Officials to not comply with policy.

The Treasurer's Office at the UC Office of the President (UCOP) invests available University cash in STIP. Quarterly, UCOP distributes total pool earnings to the individual UC campuses based on the net cash balances of campus funds as a whole.

STIP distribution is based on the average daily cash balance of individual funds. A fund with a positive average daily cash balance produces STIP earnings, or positive STIP. A fund with a negative cash balance produces STIP charges, or negative STIP. Although STIP is calculated for individual funds, it isn't distributed to individual funds. UCOP and UCSD policy determine whether an individual fund's STIP is distributed to that fund, to the fund's cognizant Vice Chancellor, or to the Chancellor. Most funds receiving individual STIP are in the donation and private grant fund ranges.

The Campus Budget Office has observed instances where it appeared that Department Administrative Officials were maintaining large surpluses in STIP-earning funds, while maintaining large deficits in non-STIP earning funds, in order to maximize STIP income to the organizational unit. This practice is clearly

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inconsistent with the concept of good stewardship in a fund accounting environment.

Effective November 2010 (for the 1st quarter of 2010-11 STIP earnings) all STIP earnings are returned entirely to the source campus, as the first stage of implementing the UCOP Funding Streams Initiative. Consequently, it is currently an ideal time to make changes to local STIP Distribution policies to eliminate potential incentives for not complying with policy.

E. Foundation Accounts with Surplus Balances

The UCSD Foundation Controller has observed that there are a number of campus department Foundation accounts with surplus balances, which have deficit balances in corresponding Regents departmental accounts.

The Foundation policy is to transfer funds from department Foundation accounts to Regents department accounts only upon a request from department business officers. We validated the Foundation's analysis. The table below summarizes the top ten largest Regent departmental deficit balances as of April 30, 2011.

Fund	Fund Title	Department	Foundation Expendable Balance (A)	Campus Regents Expendable Balance (B)	Expendable Cash Balance as of April 30, 2011 (A – B)
2095	UCSD Cardiovascular Center Special Events	Medicine - Cardiovascular Center	\$1,219,467	(\$651,564)	\$567,903
1248	Diabetes Research	Medicine - Metabolic Diseases	\$8,928	(\$439,465)	(\$430,537)
3391	Friedkin Family Cardiovascular Imaging Program	Medicine - Cardiovascular Center	\$1,083,766	(\$339,903)	\$743,863
4445	Spinal Cord Primate Research	Neurosciences	\$149,377	(\$335,746)	(\$186,369)
4382	Spinal Cord Injury Research	Neurosciences	\$1,055,665	(\$245,488)	\$810,177
4158	Center on Pacific Economies/Pacific Fellows	Intl. Relations / Pacific Studies – Dean's Office	\$530,000	(\$240,841)	\$289,159

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Fund	Fund Title	Department	Foundation Expendable Balance (A)	Campus Regents Expendable Balance (B)	Expendable Cash Balance as of April 30,2011 (A – B)
3144	Engelkirk Structural Engineering Center at Elliot Field	Jacob’s School of Engineering Dean’s Office	\$202,280	(\$230,443)	(\$28,163)
1018	Alumni Loyalty Endowment Fund	Advancement Services – Alumni Relations	\$134,716	(\$212,511)	(\$77,795)
2031	University Anesthesia Fund ITRF Pool 2	Anesthesiology	\$503,033	(\$212,191)	\$290,842
1687	Olefsky Research Fund	Medicine - Metabolic Diseases	\$0	(\$168,102)	(\$168,102)

Unfortunately, the current condition may worsen as a result of campus departmental workload and reduced administrative resources. In recent months, budget has been severely impacted by the reduction of state support. As a result, the campus has dramatically reduced the number of administrative personnel including department business officers. At the same time, the campus has increasingly been subject to audits by research sponsors’ auditors and agents. Consequently, deficits may worsen due to prioritization of workload and resources.

Management Corrective Actions:

1. The Campus Controller in collaboration with the Campus Budget Office will:
 - A. Lead a representative task force to evaluate the current Overdraft policy posted on BLINK to determine how it can be improved and made into an official document or formalized as policy on BLINK. This task force will be established by calendar year end and complete its work by fiscal year end 2011-12.

The following policy modifications will be considered:

- Incorporate consequences for non-compliance and procedures for how documentation on how financial deficits may be

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resolved centrally in cases where cognizant Department Administrative Officials do not fulfill their responsibilities for correcting overdrafts in a timely manner. Include explicit language that states that the Controller and/or Campus Budget Office will direct central personnel to process financial journal vouchers (or transfers) to address significant financial overdrafts that have not been resolved by cognizant Administrative Officials in a timely manner.

- Incorporate into the Overdraft policy strict verbiage that allows no deficit balances in department gift funds which correlate to department foundation accounts. Include procedures and consequences of non-compliance requiring that Regent and foundation funds be reviewed and balanced throughout the year and deficit balances be resolved via transfer of funds.
- Require all deficits less than a set amount at the fund-organization-program level to be resolved at fiscal year end. Require that those greater than that amount may be carried forward only if a written deficit plan has been approved by the Vice Chancellor and the Campus Controller and/or Campus Budget Office. Require that all multi-year deficit reduction plans be updated and reapproved annually.
- Decrease the time allowed for deficits to remain. Deficits below a threshold to be defined by the committee should be resolved within 180 days. Deficits above that threshold should have a resolution plan in place within 180 days that has a duration for complete resolution that is agreed upon by the Controller, in consultation with the Chief Budget Officer.

B. Create a representative work group to review the overdraft reporting tool and make it a required and more effective tool. Consider the use of standard reports and training classes. Review department management concerns and suggestions for improvement. This work group will define the requirements for revision or replacement of the current overdraft reporting tool by end of third quarter, 2011-12, and implementation will depend on availability of ACT and/or other resources.

2. The Chancellor's Budget Review Work Group will evaluate the current STIP policy and revise it in a manner that ensures proper financial incentives and consequences are in place to promote compliance with policy and its intent.