September 12, 2023

To: Distribution

Re: Budget Allocation Process
    Audit No. 08-23-0014

We have completed a review of the Budget Allocation Process as part of the 2022-23 annual audit services plan. The audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing. Enclosed is the report detailing the results of our work.

We sincerely appreciate the cooperation and assistance provided by the Office of Budget and Planning personnel during the review. If you have any questions, please contact me.

Respectfully submitted,

Ashley Andersen
Director
Audit and Advisory Services

Enclosure

Distribution

Budget and Planning
Kerry Bierman, Associate Vice Chancellor, Budget & Planning
Michael McGrogan, Budget Director

cc: Chancellor Henry Yang
    David Marshall, Executive Vice Chancellor
    Chuck Haines, Vice Chancellor - Chief Financial Officer
    Garry Mac Pherson, Vice Chancellor of Administrative Services
    UCSB Audit Committee
    Alexander Bustamante, Senior Vice President and Chief Compliance and Audit Officer
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Audit Report

Budget Allocation Process

September 12, 2023

Performed by:
Antonio Mañas Meléndez, Associate Audit Director
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Approved by:
Ashley Andersen, Audit Director

Report No. 08-23-0014
EXECUTIVE SUMMARY

OBJECTIVE

The primary purpose of this audit was to identify and assess the University of California Santa Barbara (UCSB) budget allocation practices and to perform a benchmark with other UC campuses. Our review particularly assessed whether:

- Campuswide decisions are made by the appropriate management level and properly documented (such as the amount to be allocated to divisions, potential budget cuts, etc.) and shared with stakeholders.

- The budget allocation process is documented, including roles and responsibilities of the parties involved in the process and decisions made.

- The budget model implemented at UCSB is consistent with budget models implemented at other UC campuses.

- Budget monitoring at the Office of Budget and Planning level is adequate.

- Adequate training or guidance is provided to campus departments to allow everyone involved in the process to perform their role adequately.

CONCLUSION

Based on the results of the work performed within the scope of the audit, we found:

- Several decision-making and consultation groups have been activated to discuss budget allocation. However, the campus community might benefit from further documenting how these committees operate.

- Divisions have a variety of internal rules to plan for their budget, based on their specificities. Guidelines could be enhanced and updated to ensure some level of common practices across campus, which would facilitate comparison and monitoring campuswide.

- The proactive campus consultation mentioned in the Budget Manual has mainly occurred at the division level and not at the department level in the last few years, in favor of a top-down approach resulting from a tight budget.\(^1\)

- Budget monitoring is shared between the departments and the Budget Office. However, resolution plans agreed upon with the divisions are not formalized.

- Budget-related top-down information to the campus community could be enhanced in order to facilitate the understanding of financial decisions made at the campus level.

\(^1\) The Office of Budget and Planning informed us that a department level consultation would require additional resources, because UCSB has 380 campus departments and the Budget Office count is three Full-Time Equivalents (FTE).
• Budget-related training to all users of the process would ensure adequate knowledge is shared and used, regardless of the users' level and background. This training could be incorporated into the new Financial System training.

At the time of our audit, UCSB is actively working on the implementation of a new financial system, and the Office of Budget and Planning is developing new budget processes and tools with the involvement of many campus Business Officers, Assistant Deans, and area Chief Financial Officers, as part of the Oracle Financial System implementation. The Budget Office is finalizing the development of some tools, such as control point dashboards, and plans to develop additional tools in the future. The new financial system and budget processes and tools within the Oracle Financial System are expected to go live in 2024, and should address several of the conclusions raised in this report. The conclusions presented here relate to the current situation.
OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

Our review included a research of budget allocation practices implemented in other University of California (UC) campuses; and a comparative assessment with UCSB budget allocation practices. Our assessment was focused on governance, budget model, monitoring, and training.

1. GOVERNANCE

OBSERVATION

UCSB has activated a Coordinating Committee on Budget Strategy (CCBS)\(^2\) to advise the Chancellor on budget issues and to discuss budget allocation strategies. We found that this initiative is consistent with at least five other UC campuses. In addition, the Indirect Cost Recovery (ICR)\(^3\) Committee advises on the ICR distributions.

However, the campus community might benefit from additional information on the decision-making process of these committees and on the role of each division and department in the data collection and allocation processes. In addition, some guidelines could be enhanced and updated to ensure some level of common practices across campus, which would facilitate comparison and monitoring campuswide.

Meetings

We reviewed the support documentation generated in three CCBS meetings\(^4\) during fiscal year 2022-23 and concluded it was adequate. For each meeting, a brief agenda and other supporting materials were documented. We verified that in all three meetings the budget deficit was discussed, as well as options to consider to address it, including solutions implemented on other campuses.

Roles and Responsibilities

CCBS roles and responsibilities are documented in a Budget Manual that includes the list of permanent members and a brief description of their responsibilities. As an advisory committee to the Chancellor, the CCBS is consulted on the upcoming budget cycle. This committee does not set budget policy nor do members have final approval authority on the budget process. To help the CCBS in their consultation role, the Office of Budget and Planning provides a workbook containing revenues and expenditures estimations\(^5\). General responsibilities include:

- Helping guide the campus budget planning process.

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\(^2\) Members of the CCBS include senior administrators, academic senate, faculty, deans, students, and staff.

\(^3\) Indirect cost recovery funds (i.e., ICR or "overhead") are monies received by the university in reimbursement for services rendered in support of grants and contracts. ICR funds are paid to the University by the granting agencies as reimbursement for indirect support provided to the grants and contracts.

\(^4\) These meetings were held in March 2022 and April 2023.

\(^5\) The budget cycle is presented in the Background section.
• Insuring an open and informative process to share information relevant to the budget process and provide opportunity for feedback.

• Developing principles and guidelines to help face the challenge of budget reductions in the near term and to accomplish fiscal stability in the long term.

• Reviewing and analyzing funding options for campus implementation.

• Recommending annual funding plan based on available revenues and campus priorities.

However, there is no guidelines on the potential role of the departments and on how their financial information and specific objectives and challenges would be reported to the Office of Budget and Planning to be considered during the preparation of the budget plan.

The Budget Office focuses on communications at the divisional levels. The campus' current budget model is distributed, and departments receive budget instructions from their Vice Chancellors. Clarifying budget and planning expectations regarding the flow of the budget and the level of budget autonomy within the Vice-Chancellor areas might contribute to a better understanding of the budget cycle and improve communications at the department level.

In addition, although the divisions are represented in the CCBS, which is described as a consultative role, there is no indication of how the decisions are formalized and communicated to the Office of Budget and Planning and to the campus community. Clarifying how the information is used, and how decisions are made, might enhance the campus community adherence to adequate budget planning based on the strategic decisions made. This adherence is particularly critical in times of restricted budget.

Guidelines and Procedures

Our review shows that UCSB has documented several procedures targeting the departments and related to the budget process. Although the framework of budget management is documented in the Budget Manual, and specific processes like the Staffing Process\(^6\) are described in detail, additional guidance would facilitate homogeneous budget management and allocation practices\(^7\) across campus departments. This guidance could include instructions related to the level of detail and the information departments are expected to report to the Budget Office, including possible options to manage and track the divisions and department’s budget, or possible ways to prioritize expenditures in alignment with campuswide goals. In addition, some documentation used to plan for budget needs to be updated.

The Budget Manual provides an overview of the budget context, and describes the strategy adopted, particularly in terms of the academic plan, and impacts to other core funds. In addition, it details planning principles aiming at guiding the campus through the reductions in State funding. Furthermore, processes have been described in detail, such as the Staffing Process, and Transfer of Funds (TOF)\(^8\).

\(^6\) The Staffing Process is a document from the Office of Budget and Planning describing the allocation of funding for permanent career employees balanced with UCPath position data.

\(^7\) For more information on the diversity of practices on campus, see section Budget Model.

\(^8\) Transfer of Funds allow transfers of permanent and current expenditure funds from one chart string to another.
Specifically, the Budget Manual provides the following information:

- Budget plan development, including the strategic academic plan and long-term plans for UCSB

- Budget overview, including a brief description of the CCBS (members and responsibilities)

- Budget concepts and planning parameters, such as:
  - Revenue (State funds, tuitions, etc.)
  - Enrollment (undergraduate and graduate students)
  - Faculty FTE, driven by enrollment growth
  - Teaching Assistant positions driven by enrollment growth
  - Financial Aid, driven by enrollment growth and policy
  - Operations and maintenance budgeting added to the Facility Management budget
  - Salary and benefit cost increases, driven primarily by programs approved by the UC Regents and University of California Office of the President (UCOP)
  - Other, such as faculty recruitment, staff support, or equipment replacement

However, the Budget Manual is a high-level document, and does not provide detailed instructions to the departments on how to determine priorities or establish budget plans within the Divisions. We acknowledge that the budget allocation process complexity requires some flexibility, and cannot be described fully in detail\(^9\).

We identified through our interviews with financial personnel from three campus units that the absence of campuswide operational standards leads to practices that vary greatly, as described in the next section. For example, some divisions internally conduct proactive budget calls, while others expect their departments to formalize a request only if they need additional funding. The documentation to be provided in the case of a request is up to each division.

In addition, the following documents, used to plan for future budgets, need to be reviewed and potentially updated:

- The Budget Manual has not been updated since 2017, although the financial situation and the budget approach might have been adjusted\(^10\).

- The reserve guidelines, addressing cash balancing, has not been updated since 2018. This document provides guidance on the reserves to be maintained by core funded units, the expenditure of their gift funds, and capital project cash balances.

- The Campus Assessment table, providing rates to be used to calculate indirect recovery costs, gift assessments, and Information Technology Services among other fees, had not been updated since fiscal year 2016-17 at the time of the review. An updated version has been posted during the audit.

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\(^9\) The Office of Budget and Planning informed us that a department level consultation would require additional resources.

\(^10\) The new Oracle Financial System, as well as the new budget process and tools expected to go live in 2024 will result in significant material changes to the Budget Manual.
Although the content of these guidelines might still be relevant, they should be reviewed to ensure they still apply within the current processes.

RECOMMENDATION

We recommend the Office of Budget and Planning, in consultation with the Coordinating Committee on Budget Strategy (CCBS), evaluate clarifying the role of the divisions and the departments in the budget allocation process, including the information they are expected to provide for review and the feedback they can receive after deliberation.

MANAGEMENT RESPONSE

The Office of Budget and Planning will clarify the role of the divisions and the departments in the budget allocation process, if any, including the information they are expected to provide for review, and the feedback they can receive after deliberation. In particular, the following will be documented:

- The process of reviewing financial data on a regular basis. This includes what financial data and specific formats and frequency.
- Whether the Budget Office and/or the CCBS will provide feedback on budget requests submitted by the divisions, and at what frequency.
- The Office of Budget and Planning will provide a written confirmation of any allocation decision to the appropriate divisional control point.

Audit and Advisory Services will follow up on the status of these issues by November 30, 2023.

RECOMMENDATION

We recommend the Office of Budget and Planning review the following documents and verify they are up-to-date:

- The Budget Manual
- The Reserve Guidelines

MANAGEMENT RESPONSE

The Office of Budget and Planning will review the following documents and verify they are up-to-date:

- The Budget Manual
- The Reserve Guidelines

A new dated version will be released to clarify this is up-to-date and valid.

Audit and Advisory Services will follow up on the status of these issues by October 31, 2023.
2. BUDGET MODEL

OBSERVATION

Our review shows that for the campus budget allocation, the campus follows an incremental budget model\(^{11}\) that includes regular consultation of the campus on the budget allocation. Before each budget cycle, the CCBS is provided with estimated financial information during consultation meetings. However, a proactive consultation at the department level has not been formalized consistently in the last few years, that would help the CCBS and the Office of Budget and Planning to identify more accurately departmental needs and challenges.

At the division level, we identified local processes to allocate the budget. Although there are no requirements to have standardized models across campus, and there are advantages in adjusting the models to specific situations, more consistency might facilitate the overall monitoring of the budget and facilitate comparison between the divisions and the departments. Having a better understanding of the allocation within the divisions might improve the ability of the Office of Budget and Planning to evaluate and reassess the campuswide budget allocation if necessary.

Campuswide Model

The UCSB incremental budget model\(^{12}\) consists in allocating the same budget as prior years to the divisions, complemented with funds covering mandatory increases such as salary increases or compliance expenses. Departments receive their budget instructions from their Vice-Chancellors.

The current Budget Manual determines two principles to guide the campus in allocating funds:

- A framework for resource allocation that includes decision making strategies\(^ {13}\)
- A managed enrollment growth plan

As per the Budget Manual, UCSB has chosen the following process to develop the annual budget:

- Consult the campus
- Review the result of the consultation
- Approve the budget plan
- Implement the budget plan through TOFs to the divisions and departments

We reviewed the materials provided by the Office of Budget and Planning for the CCBS consultation, that includes representatives of each division. This material includes recurring increment and new funding, and covers salaries, enrollment revenues, capital expenditures, among other financial short and long-term data. It also provides the estimated allocation to

\(^{11}\) For more information on the main budget models, and on the incremental model in particular, see the Background section.

\(^{12}\) For more information on the main budget models, and on the incremental model in particular, see the Background section.

\(^{13}\) For example, funds could be allocated based on priorities around professional schools, diversity, interdisciplinarity, etc.
core funds\textsuperscript{14} and the estimated deficit for fiscal year 2022-23\textsuperscript{15}, as well as adjustments to the previous year assumptions. However, an actual versus estimated cost analysis at the division level could be used to identify budgeting trends and facilitate readjustment of the budget allocation.

In addition, the Office of Budget and Planning has not consistently requested departments’ budget plans\textsuperscript{16} and CCBS consultation does not involve preparation of a plan to be submitted for review. As mentioned in the prior section, the Budget Office focuses on communication at the divisional and Vice-Chancellors level, while the departments are to receive budget instructions from their Vice Chancellor. The absence of department level consultation could limit the effectiveness of the discussions to adjust or modify the budget allocation at the campuswide level, which could be a necessity in a time of deficit. This practice of consulting the campus and having the divisions prepare a plan for the upcoming year has been identified in six campuses out of nine according to our review. In addition, sound practices would suggest that reassessing the budget on a yearly basis, for example through a zero-based budget model\textsuperscript{17}, could help in the case of a tight budget. Our review could not confirm the number of staff members allocated to budget processes on UC campuses. However, we acknowledge that UCSB, with only three staff members, could be among the budget offices with less resources in the UC System. The Budget Office might have an opportunity for improvement by evaluating budget allocation processes implemented on other campuses.

In fact, the Association of Chartered Certified Accountants (ACCA) recognizes the following advantages of a zero-based budget model, in opposition to an incremental model:

- The annual reevaluation allows inefficient or obsolete activities to be removed
- Employees motivation is increased due to a bottom-up approach
- It allows agility and flexibility due to constant reevaluation
- The budget allocation is more efficient

Following what other campuses have been implementing, and based on budget theories, reevaluating the current budget model might help address current challenges, such as the structural deficit. Considering the complexity of the campus budget, the challenges of change management, and some disadvantages of the implementation of a zero-based budget model\textsuperscript{18}, the Office of Budget and Planning should explore a hybrid model in the future.

Table 1 shows the closest budget models implemented on the other UC campuses, and whether the local budget office consults with the campus during the budget allocation process.

Our review shows that UC Campuses have opted for a diversity of budget models, more or less inclusive of their campus feedback\textsuperscript{19}. More specifically:

- Four campuses tend to follow a hybrid model (a combination of two or more models), two of them with campus consultation (budget call).

\textsuperscript{14} Core funds are recurring financial resources. They primarily consist of state appropriation, tuition, non-resident tuition, student services fee, and overhead funds.
\textsuperscript{15} This includes operational allocations (for example salary cost increases, benefit cost increases, compliance), program allocations, capital allocations and other allocations.
\textsuperscript{16} Via fulfilling templates or via meetings.
\textsuperscript{17} More information on zero-based budget is described in Background section.
\textsuperscript{18} Such as necessary training for departmental managers and resource consumption.
\textsuperscript{19} This analysis is based on the information available on the campuses’ websites.
• Three campuses out of ten\textsuperscript{20}, including UCSB, tend to have an incremental budget model. One of them still includes a campus consultation in its process.

• Two other campuses have opted for a different model (incentive-based or zero-based) that includes campus consultation.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Budget Models on UC Campuses\textsuperscript{21}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Campus</td>
<td>Budget Model*</td>
</tr>
<tr>
<td>UC Santa Barbara</td>
<td>Incremental</td>
</tr>
<tr>
<td>UC Berkeley</td>
<td>Not explicit (possible zero-based budget)</td>
</tr>
<tr>
<td>UC Davis</td>
<td>Hybrid</td>
</tr>
<tr>
<td>UC Irvine</td>
<td>Incremental</td>
</tr>
<tr>
<td>UC Los Angeles</td>
<td>Bruin Budget Model (hybrid and tailored)</td>
</tr>
<tr>
<td>UC Merced</td>
<td>Hybrid</td>
</tr>
<tr>
<td>UC Riverside</td>
<td>Incentive-based (transitioned from incremental)</td>
</tr>
<tr>
<td>UC San Diego</td>
<td>Incremental</td>
</tr>
<tr>
<td>UC San Francisco</td>
<td>Unknown</td>
</tr>
<tr>
<td>UC Santa Cruz</td>
<td>Hybrid</td>
</tr>
</tbody>
</table>

Source: Auditor analysis based on documentation available on UC campuses websites.

\* The Budget model was published, but we did not verify if they are operational.

Over all, six campuses out of ten include a campus consultation in their process. This consultation includes in some cases a request to the divisions to document their priorities for the upcoming year, to explain how they align with the institutional goals, to describe their needs and strategies to meet these priorities, and to identify risks of not meeting these goals. Templates are provided to the divisions to guide them in this planning task. It should be noted that resources allocated to the budget offices vary across the UC system\textsuperscript{23}.

\textit{Divisions Practices}

We interviewed three of the main divisions or reporting areas to determine how they are involved in the allocation process. These divisions have a variety of internal rules to plan for their budget, based on their internal specificities. Although flexibility and tailored processes is not a weakness in itself, some level of standardization would facilitate comparison and monitoring at the campuswide level. Specifically:

• Housing, Dining, and Auxiliary Enterprises (HDAE)\textsuperscript{24} conducts a budget call, and obtains data from their units based on local templates. It should be noted that this department is not representative of several campus departments, due to including auxiliary units and to

\textsuperscript{20} For three campuses, no information was identified on the website, or the information was unclear.

\textsuperscript{21} The budget models listed in this tables are the closest models as per the documentation available on each campus’ website.

\textsuperscript{22} As announced in the available documentation on each campus’ website. Procedures available online were not considered enough proof to conclude a consultation happened.

\textsuperscript{23} UCSB Budget Office has three dedicated staff members.

\textsuperscript{24} Housing, Dining, and Auxiliary Enterprises (HDAE) is a reporting department within the Administrative Services Division.
its capacity to generate its own revenue.

- Student Affairs has been trying to move to a zero-based budget since fiscal year 2018-19. They reported it to be challenging because they do not have any standardized tool to manage budget consistently across the Division. However, they conduct budget calls every year with their departments, and make decisions based on the information provided.

- The Office of the Executive Vice-Chancellor has an annual process to ask for the annual plan from their direct report units. However, they do not proactively ask the academic departments that do not report to them. For these academic departments, the Dean is responsible to request budget increases if needed. This would be documented in a formal document, and the response would be provided in a memo from the Executive Vice Chancellor. The deans are also responsible for budget monitoring in their divisions, especially when it comes to instructional budget.

The diversity of budget allocation and management processes across campus suggests that implementing a standardized budget call for most of the campus departments might be a better option to leverage best practices already implemented in the divisions while allowing a regular review of the budgets allocated.

RECOMMENDATION

We recommend the Office of Budget and Planning, in consultation with the CCBS, implement the most adequate way to present the data used during the consultation on budget, and create materials that would present this data. This could include trend analysis, or division-based analysis.

MANAGEMENT RESPONSE

The Office of Budget and Planning will assess the most suitable way to present the data used during the consultation on the annual budget, and create materials that would present this data. This will include:

- Standard documents that will be available during the consultative process (for example trend analysis, financial forecast, etc.)

- Development of standardized templates that will support a future campus budget process that is underway as part of the FMM project.

- Clarify any budget reallocation processes and provide access to data that will assist divisions in the reallocation of resources within their areas.

Audit and Advisory Services will follow up on the status of these issues by November 30, 2023.

RECOMMENDATION

We recommend the Office of Budget and Planning evaluate transitioning from an incremental budget model to a model that would allow for regular revision of the budgets allocated across campus, a more accurate alignment with the current campus strategy, and a more active
involvement of the divisions to prepare and propose their individual plans.

**MANAGEMENT RESPONSE**

The Office of Budget and Planning will evaluate alternative budget models versus the current incremental model followed for core funds. Alternative models evaluated would seek to improve annual revisions to the budgets allocated across campus to more accurately align with the current campus strategy and priorities, and solicit greater involvement of the divisions in preparing an annual plan.

*Audit and Advisory Services will follow up on the status of these issues by November 30, 2023.*

**3. MONITORING AND REPORTING**

**OBSERVATION**

Our review shows that budget monitoring is shared between the departments and the Office of Budget and Planning. We were informed that the quality and quantity of the financial data shared would improve with the new Financial System, expected to be implemented in FY 2024-25. In addition, the Office of Budget and Planning informed us that resolution plans agreed upon with the departments to address deficits are not formalized. Such formalization would increase the accountability of the cost centers by requiring the identification of sustainable solutions, and would facilitate monitoring from the Office of Budget and Planning. Finally, providing additional budget-related information might facilitate a better understanding of the budget allocation at the campus level.

*Monitoring*

Departments are ultimately responsible for balancing their budget. However, the Office of Budget and Planning oversees budget sustainability at the division level, including the following:

- On-going reviews of carry-forwards on core funds with departments, including negative balances and/or unused appropriations.
- Review of core funds at year end, to ensure they zero-out. Departments must provide justifications of their unused budgeted allocations and deficits, if any, at fiscal close.
- Quarterly financial reviews and discussions related to budget and finance issues with the control points. This was implemented in fiscal year 2022-23.
- Provides budget sustainability status to Vice Chancellors, Deans, and other divisional leadership. The current process does not include formal resolution plans. We were informed that the Office of Budget and Planning was planning on making it more formal by requesting the divisions to document it.

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25 Our review focused on processes within the Office of Budget and Planning, and we did not assess departmental monitoring processes.
The Office of Budget and Planning uses the tool Asana\textsuperscript{26} to track their processes and monitoring of the campus budget and required transactions. Each task is assigned a responsible person in the budget team, a due date, and a priority level. The tasks include, for example, communications that need to go out, requests to be made, and expected deliverables.

\textit{Reporting}

The main source of budget-related information for the divisions and departments is through regular meetings:

- The CCBS is an opportunity for the divisions leadership to obtain campuswide information on the financial situation of UCSB and on the budget. As mentioned earlier, this information is documented in meeting materials.
- The Office of Budget and Planning regularly meets with divisional leadership to discuss the financial situation of their organizational unit.
- The Office of Budget & Planning, with the collaboration of the Vice Chancellor - Chief Financial Officer, provides feedback to divisions and areas regarding the information presented to CCBS and the recommendations from the committee.

We found that the only information publicly available, apart from guidelines, is the annual budget. The context of the budget decisions, such as the evolution of State Funds or new compliance requirements is not public, nor are clarifications on how the deficit is being addressed. Additional information might help the campus to understand the budget allocation process, and the possible restrictions implemented. For example:

- Information on the financial context and decisions of UCSB
- Description of UCSB funding sources and the operating budget
- Description of how decisions are made for a particular year
- Frequently Asked Questions (FAQ) section that could quickly address the more common questions campus employees have about the budget process and tools, without requiring the Office of Budget and Planning’s time

As a comparison, our review of other campuses practices show that the information publicly shared varies both in format and in content. At least three campuses publish agendas and or minutes of their budget committee, and eight campuses provide public information on the financial context, either through annual reports, information letters from the Chancellor, or letters announcing the budget call.

\textbf{RECOMMENDATION}

We recommend the Office of Budget and Planning ensure resolution plans prepared by the divisions to address deficits or financial challenges are formalized and followed-up on.

\textsuperscript{26} Asana is a web and mobile "work management" platform.
MANAGEMENT RESPONSE

The Office of Budget and Planning will ensure resolution plans prepared by the divisions to address deficit or financial issues are formalized and followed-up on. Resolution plans will be discussed with control points and documented. There will be a follow-up within an agreed upon specified time period for these plans, and statuses will be documented.

Audit and Advisory Services will follow up on the status of these issues by November 30, 2023.

4. TRAINING AND AWARENESS

OBSERVATION

Our review did not identify any specific training related to budget allocation or budget management. However, some guidelines are detailed enough to be used as training materials. In addition, the new financial system expected to be implemented in FY 2024-25 will provide training and additional resources to standardize budget processes.

Some guidelines such as the Staffing Process or the TOF procedure are detailed enough to be used as training materials. In addition, we were informed that the committees are an opportunity to explain the budget to divisional leadership:

- The Vice Chancellor - Chief Financial Officer offers introductory training to all new members of the CCBS and the ICR Committee.

- CCBS meetings are often used to explain the principles of financial management.

However, it would be useful to have dedicated training to ensure all the players involved in budget allocation, at all levels, have the same knowledge regardless of their background (financial, administrative, academic, etc.).

It should be noted that the future financial system is expected to be implemented in FY 2024-25, and should facilitate standardization of budget management and monitoring at the department level. Training sessions are being organized campuswide on this new system.

GENERAL INFORMATION

BACKGROUND

Systemwide State Budget Allocation\textsuperscript{27}

The State budget process for UC takes between 12 and 15 months from the initial planning by UCOP until the campus receives final allocation instructions after the State budget is approved.

The normal simplified timetable is as follows:

- From July to September, Campus completes and submits required “budget tables” to

\textsuperscript{27} Source: Budget Manual and auditors Visio chart.
UCOP. UCOP develops the Regents budget draft and begins systemwide consultation on budget plan.

- From October to December, the Regents adopt UC Budget Plan and submit it to the State for review and consideration.

- From January to March, the Governor’s Budget Proposal for fiscal year beginning July 1 is released. Comparison to UC Budget Plan is made at that time to determine differences and develop plans to reduce funding differences, if any. Legislature holds hearings on the budget proposal.

- From April to June, legislative hearings continue. Governor submits “May Revise Budget” which updates the plan based on new revenue and expense information. Assembly and Senate work together to reconcile differences and approve State Budget Plan for Governor signature.

- From July to September, UCOP reviews approved State Budget and makes final allocations to each campus.

Figure 1: State Budget Process.

Capital Planning

There is a separate annual capital budgeting process. The capital financial plan is updated every year, led by the Capital Development Office (within the Office of Budget and Planning) in consultation with the Campus Planning Committee. The annual capital plan is a planning document that incorporates capital development plans for all units (including HDAE) and is also incorporated into the campus debt modeling. The plan is posted on the UCOP website after review and approval by the UC Regents. Capital planning is a major component of

28 https://bap.ucsb.edu/capital-development/campus-planning-committee
29 https://www.ucop.edu/capital-planning/resources/index.html
budget planning, but it has not been evaluated because it is outside of the scope of this review.

UCSB Budget

The development of the Annual Budget Plan for core-funded activities is one of the responsibilities of the Office of Budget and Planning, in consultation with the Coordinating Committee on Budget Strategy (CCBS) and in alignment with UCSB priorities. These priorities are not under the Office of Budget and Planning responsibilities, and are discussed with all divisions.

<table>
<thead>
<tr>
<th>Functional Area</th>
<th>Total</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instruction</td>
<td>$388,608,453</td>
<td>38%</td>
</tr>
<tr>
<td>Auxiliary Enterprises</td>
<td>$134,773,023</td>
<td>13%</td>
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<tr>
<td>Institutional Support</td>
<td>$117,790,087</td>
<td>11%</td>
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<tr>
<td>Student Financial Aid</td>
<td>$115,844,842</td>
<td>11%</td>
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<tr>
<td>Academic Support</td>
<td>$99,187,000</td>
<td>10%</td>
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<td>Maint. &amp; Oper. Of Plant</td>
<td>$100,275,327</td>
<td>10%</td>
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<tr>
<td>Student Services</td>
<td>$90,913,042</td>
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<td>Research</td>
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</tr>
<tr>
<td>Public Service</td>
<td>$5,304,362</td>
<td>1%</td>
</tr>
<tr>
<td>Provision for Allocation</td>
<td>$(44,193,761)</td>
<td>-4%*</td>
</tr>
<tr>
<td>Total</td>
<td>$1,032,056,242</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Office of Budget and Planning.

* Negative percentage indicates the deficit allocation.

Table 2 shows the budget allocation by functional area for fiscal year 2022-23. The first functional area is instruction, with 38% of the budgeted funding, followed by auxiliary enterprises, institutional support, financial aid, academic support, maintenance, and student services, that all received between 9 and 11% of the budget. Research is far behind with 2%, which is explained by the fact that this area is largely supported by “non-budgeted” funds such as grants, meaning they are not included in the permanent budget. These “non-budgeted” funds are mostly restricted and directed at specific projects.

Budgeting Models

Some of the main budget approaches acknowledged by the Institute of Internal Auditors (IIA) are the following:

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30 Non-budgeted funds were not covered by this review.
31 Source: The Institute of Internal Auditors (IIA). The IIA is the internal audit profession's leader in standards, certification, education, research, and technical guidance throughout the world.
Incremental Budgeting

Incremental budgeting is the traditional budgeting method whereby the budget is prepared by taking the current period's budget or actual performance as a base, with incremental amounts then being added for the new budget period. These incremental amounts will include adjustments for things such as inflation, or planned increases in sales prices and costs. UCSB has implemented this budget model approach.

One of the advantages of the incremental technique, as suggested by the Association of Chartered Certified Accountants (ACCA), is that it promotes consistency and understanding across the organization. However, this technique also has drawbacks, such as:

- It assumes that costs are still needed, year after year.
- It does not reevaluate the needs nor does it require to justify past costs.
- It is an incentive to spend the whole budget, to avoid losing it the following year.

Zero-based Budgeting

With zero-based budgeting, the budgeting process starts from a base of zero, with no reference being made to the prior period's budget or actual performance. All of the budget headings, therefore, literally start with a balance of zero, rather than under incremental budgeting, when they all start with a balance at least equal to last year's budget or spend. Every department function is then reviewed comprehensively, with all expenditure requiring approval, rather than just the incremental expenditure requiring approval.

Zero-based budgeting historically emerged to respond to a need for closer budget management, requiring the identification of objectives, outputs, expected results, and detailed costs for each program, which implies a high level of transparency. The identified drawbacks are as follows:

- It requires training for departmental managers.
- It is time and resource consuming.
- IT systems must be able to follow the pace.
- It might be less flexible if unexpected expense occurs during the year.
- Not using prior budgets can lead to ignoring experience from previous years.

Project Budgeting

Project budgets are used when a project is completely separate from other elements of an organization or is the only element of a company. This includes projects like a movie or an aircraft. Project budgets are also used for smaller projects. When these projects use resources and staff that are committed to an entire organization, care must be taken that the project budget links to appropriate responsibility centers.

Activity Based Budgeting

Activity-Based Budgeting (ABB) focuses on activities that result in costs for the company. ABB proponents feel that traditional budgeting, which focuses on departments or products,
obscures the relationship between costs and outputs by oversimplifying the measurements into volume drivers like labor hours, machine hours, or outputs for an entire department. ABB adds activity-based cost drivers, such as the number of set-ups in an operation, to make a clear connection between resource consumption and output. This allows managers to see how resource demands are affected by changes in offerings, product designs, manufacturing processes, market share, and customer base.

**Kaizen Budgeting**

A Kaizen budget ("kaizen" is Japanese for continuous improvement) is a continuous improvement budgeting method that focuses on planned future operating processes. Kaizen budgeting starts by identifying areas of improvement and determining changes needed to achieve the future state. Budgets are prepared based on the improved practices or procedures, which typically results in more efficient, lower-cost budgets.

The benefits of a Kaizen budget include its proactive changes, which are often mandated by organizational policies that attempt to lower costs without sacrificing productivity. The drawbacks include:

- Managers may lower quality levels or move production processes to cheaper labor markets.
- Some projects that should have been cut or added may be ignored in favor of incremental improvements.

**Core Funds**

Core funds are recurring financial resources. They primarily consist of state appropriation, tuition, non-resident tuition, student services fee, and overhead funds. They provide permanent support for the core mission activities of the University: instruction, research, and public service, as well as the administrative and support services needed to carry out these activities.

**Structural Deficit**

A structural deficit exists when current year recurring revenues are surpassed by current year recurring expenses. In other words, funds must be moved from the reserves to balance the budget. In the absence of new resources to replenish funds, the net result is a reduction to reserves, which is not sustainable. Impacts to core funds revenue and expenses can contribute to a structural deficit.

UCSB has been in a budget deficit for the last two years, due to unexpected expenses during Covid-19, to the growth in mandatory cost increases, and restrictions on growth. The projected deficit was $50,168,348 for 2022 and $78,002,986 for 2023.

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33 [Source: UCSB Budget Manual and UC Irvine Budget Office website.](#)

34 [Our review was limited to the last two years. Structural deficit means that the granted authority to spend exceeded available resources in a year (excluding reserves/carryforward).](#)

35 [Workbooks for FY 2021-22 and FY 2022-23. Workbooks are materials presented to the CCBS for consultation, and to the Chancellor for approval.](#)
SCOPE

Our review focused on permanent budget. Capital budgeting was not included in this audit. In particular, the scope of our audit included:

- Creating a framework based on all nine other UC campuses and other best practices.
- Reviewing the Office of Budget and Planning website, budget-related documents, emails and announcements, presentations prepared for the CCBS, as well as the Budget Manual and the Staffing Process.
- Interviewing campus managers involved in the budget allocation process including the Director of Budget, the Executive Director for Academic Affairs, the Chief Financial Officer for Administrative Services, and the Chief Financial Officer for Student Affairs.
- Conducting a benchmark based on the framework created and on governance, budget model, monitoring, and training.

CRITERIA

Our audit was based upon standards as set forth in the UC and UCSB policies, best practices, and other guidance relevant to the scope of the review. This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

In particular, we reviewed:

- *The Budget Manual*, campus manual of the budget process released by the Office of Budget and Planning on 2017
- The Staffing Process, document from the Office of Budget and Planning describing the allocation of staff in UCPath
- CCBS meetings materials (March 2022 and April 2023)
- Housing, Dining, and Auxiliary Enterprises budget management documentation, including:
  - Budget memo to the division from February 2023
  - Budget forecast preparation documentation
- Documentation from all nine other UC campuses including:
  - Budget cycle or call process descriptions
  - Budget guidelines
  - Budget-related communications (budget call letters, annual reports, etc.)
  - Path to Transformation Budget Redesign Process, describing the UC Riverside (UCR) project to redesign the budget process in 2015
Redesign a Budget Model with a Grassroots Approach\textsuperscript{36}, a planning story of the UCR redesign project by prior Vice Chancellor of Planning & Budget Maria Anguiano, and Jason Rodriguez from UCR Planning team

- Budget development description for the State of California (Budget Development 6120 – ca.gov).
- “Comparing budgeting techniques (Incremental v ZBB)", by the Association of Chartered Certified Accountants (ACCA).
- Training content for Certified Internal Auditor (CIA) certification, Part 3 – “Operating Plans and Budgets”, by the Institute of Internal Auditors (IAA).

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\textsuperscript{36} Planning for Higher Education Journal | V45N3 April–June 2017.