Independent Consultant's Report

Third Report: Independent Assessment of CSA Recommendations

Date: January 16, 2018

Period: October 1, 2017 through January 8, 2018

Observations and Findings:

Since April 2017, the University of California Office of the President (UCOP) has instituted numerous initiatives to address the State Auditor's (CSA) recommendations. Over the past three months, we have attended 7 workgroup meetings, met with the President, attended two Executive Budget Committee meetings, reviewed documents prepared to support workgroup activities, reviewed benchmarks, and held numerous other conversations to understand UCOP efforts to meet the first major milestone set by the CSA at the one-year point, April 2018. Additionally, we reviewed the materials provided to the CSA in the UC's 6 month response and the comments CSA made in response to that 6 month report.

From our observations we see that each of the workgroups are diligently, purposefully, and authentically engaged in addressing the intent and form of the CSA's recommendations. Performance audits are designed to improve operations, accountability and transparency of public entities. It is important to remind the Regents and UCOP that the Reporting Standards for Performance Audits[1] state that "auditors should recommend actions to correct deficiencies and other findings identified during the audit and to improve programs and operations…" and that recommendations be "directed at resolving the cause of the identified deficiencies and findings…" Government audit standards state that "effective recommendations encourage improvements in the conduct of government programs and operations."[2] The auditee management and official leadership hold the responsibility for the manner that and extent to which recommendations are implemented to remediate the underlying cause. The UC Regents and UC management have discretion to design the method and form of corrective action and for ensuring the implementation of the corrective action plan.

UCOP is actively involved in many areas of improvement addressing not only the specific CSA recommendations but also undergoing an internal structural review—the organizational optimization report by Huron Consulting is currently in the final "exit conference" processes and will be presented to the Regents this month. Our informal conversations with the Executive Budget Committee members

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[1] Generally Accepted Government Auditing Standards (GAGAS), Chapter 7 Section 7.28
[2] Generally Accepted Government Auditing Standards (GAGAS), Chapter 7 Section 7.29

and with campus representatives suggest a more open and collaborative relationship developing between the UCOP and campuses over the past several months.

Given the depth and breadth of the CSA's recommendations, it is likely that some of the measures to meet the recommendations can reasonably be accomplished in the near term, whereas others will take far longer to achieve. This is reflected in the CSA's three-year window allotted for full compliance. The CSA's response to the UCOP's 6-month progress report reflected that only a few recommendations were fully or partially implemented but were instead still pending. We understand the auditor's position to not accept implementation prematurely. Although the UCOP endeavors to meet the first major milestone of April 2018 for many of the recommendations, clearly there is much to do and much will be completed in the final months of the year-long period. This report includes work conducted by the UCOP since our October quarterly report was submitted through the beginning of January 2018.

Recommendations were addressed to both the University of California Regents and the UCOP. While the scope of our responsibility is, on behalf of the Regents, to monitor the UCOP's efforts to implement the CSA's recommendations and not to monitor those matters directed to the Regents, the financial audit of the Office of the President operations, in particular, warrants our attention.

- The CSA found "to ensure that the Office of the President's financial safeguards are adequate, the Regents should require the Office of the President to engage in a financial audit of only the Office of the President's operations."

  UCOP engaged PricewaterhouseCoopers (PwC) to conduct an audit of its operations as a department of the University of California. Generally, UC departments, including the campuses, do not prepare full financial statements for a business type activity that would include Statement of Net Position and Statements of Cash Flow as each department is combined into the financial statements for the entire UC entity and audited annually. The scope of the audit recommended by the CSA was understood by UC to be an audit of the UCOP operations which would include the revenues and expenses of the department. Understandably, on a financial accounting basis, pulling the UCOP departmental components out of the much larger entity was challenging and expensive.

  We interviewed the PwC lead audit partner and he viewed the CSA's desired goal was to provide transparency into the UCOP operations through audited financial transactions. The audit would also present information to realign budget practices allowing for audited numbers to be compared budget amounts, and provide a benchmark and format for budgeting and reporting for periods subsequent to year-end June 30, 2017.

  The CSA did not accept the audit report and raised several issues including the audit providing only a report of revenue and expenses and not a full set of financial statements, not including a separate report of internal controls for UCOP, and the inclusion and/or lack of segregation of large programs. Because UCOP is a department of the University of California and not a separate operation, conducting the work to separate out UCOP data from the whole

and developing the requested information is time intensive and expensive. In considering the CSA request for these reports, the Regents should obtain time and cost estimates relative to these efforts. Additionally, we understand that the university, university auditors, and the CSA are in discussions as to further work to be done to satisfy the informational needs of the CSA.

CSA RECOMMENDATIONS ADDRESSED TO UCOP

The CSA offered some 40 recommendations to the UCOP. Its recommendation to reconvene the campus budget committee has a broader impact than just one of the areas for recommended improvements and is addressed first. We categorize the remaining CSA recommendations into the seven primary topics that generally mirror the workgroups established by UCOP to implement these findings—Salaries, Employee Benefits and Reimbursement, Workforce Planning, Fund Restrictions, Reserve Policy, Systemwide Initiatives, Budget Process, and Budget Presentation.

EXECUTIVE BUDGET COMMITTEE

The CSA recommended the reconstitution of the campus budget committee that is officially reconvened as the Executive Budget Committee (EBC). Like the auditor, we consider this recommendation fully implemented. We commend the UCOP for the full development of this recommendation. The committee is constituted of representatives from all campuses and the Academic Senate as well as key UCOP leaders. A charter was developed, chair chosen, and the committee has met a number of times. Three meetings, including the first we attended on December 15, 2017, included budget presentations by all UCOP divisions that included "deep dives"—the divisions presented their core operations and missions, programs, organizational structure, budget components, what each department does and related responsibilities. Committee members asked probing questions and sought details, and UCOP representatives responded appropriately and respectfully. Typically, these day-long meetings are primarily attended in person with a few members attending by conference call.

We also joined the January 8, 2018 meeting; the EBC set a shortened agenda as not all members had submitted the areas and issues to drive the needed detailed discussions that will be picked up in the future meetings. Topics of the January meeting included:

- Proposed policy relating to the Central Operating Reserve and the plans for the strategic reserve;

- Definitions for statewide initiatives and programs;

- CSA's response to the 6-month report and the UCOP's plans to address the auditor's concerns. In particular, some EBC members voiced concerns about the perceived interference of the auditor in the management and operations over UC and UCOP, time and resources spent to address the auditor's recommendations as well as the relative value added. Additionally, some members voiced concerns over the impact of diverting attention to audit issues when trying to implement UCPath and CareerTracks particularly in terms of the

magnitude and volume of projects required to address recommendations; and, particularly concerns about the morale of all the UCOP employees.

- Timeline and sharing of the UCOP optimization review and EBC's use of this information.

Generally, EBC is looking forward to being an effective and valuable committee to the UC and looks to the future where it can focus its attention on UC driven efforts rather than on areas relating to the CSA audit. EBC will meet again for a full-day meeting February 2, 2018. We plan to attend all meetings of the EBC in the near term.

SALARIES

The CSA raised a number of issues related to the levels and comparability of salaries for executives (Senior Management Group or SMG employees), administrators, managers, and non-represented employees and staff both at UCOP and systemwide, as well as the width of existing salary ranges.

In the response to the 6-month report, the CSA determined that all its recommendations to the UCOP were pending; we agree with that assessment – in October 2017 UCOP was in the development stages of addressing the many issues raised and had not yet reached the level of implementation. Our review reveals that UCOP is making good faith efforts to meet each of the auditor recommendations. In fact, we have witnessed the workgroup's unrelenting efforts and, given the complexity and magnitude of the projects required to meet the recommendations, we see that UCOP has made considerable and genuine progress.

The issue of greatest contention is the underlying philosophy and determination of whether UC employee duties, responsibilities, knowledge, and skills are comparable to state employees, including employees of CSU. Our assessment following best practices for compensation and classification matters is that some UC employees have duties and responsibilities comparable to state and CSU positions and some do not; the appropriate peer or market group will depend upon the position. Nonetheless, the UCOP is committed to including state and CSU employees in the salary studies and has made significant progress in identifying job groupings to accomplish the goals set by the Legislature and recommended by the CSA.

- **Compensation Policy and Philosophy**. Best practices in classification and compensation studies provide that the entity develop and follow a compensation policy and formal compensation philosophy. Regent's Policy 7203, "Policy on Universitywide and Senior Leadership Compensation" requires the adoption of "goals of obtaining, prioritizing, and directing funds, to the extent that they are available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015-2016…" Despite this policy, we understand that provisions stipulated in the policy were applied only in the two years following its adoption. Subsequently, budgetary challenges and other factors have dictated compensation decisions. Nonetheless, UCOP activities use market information, particularly involving SMG positions, and includes annual reviews of the market. Further, UCOP has implemented the CareerTracks human resource system to

advance the process for non-SMG employees to be more functionally oriented and to bring uniformity, consistency, and rigor to the systemwide classification and compensation system. CareerTracks has been implemented in 12 of 17 locations systemwide (including medical centers).

- **Regent's Policy 7203**: This policy seems to be in conflict with the CSA and legislative direction that UC salaries align or include weighting of State salaries. State salaries are traditionally based on historic levels that are adjusted for cost of living and annual step increases that are fundamentally time-in-grade. CalHR has recently recognized that some civil service rules governing hiring and promotions (particularly for information technology positions) are 30 years out of date[3]. As a part of the various studies and efforts undertaken to address the CSA recommendations, the Regent's policy may need revision or reaffirmation.

- **Regents Task Force**. The Regents convened in early January 2018 a Regent's task force to specifically address the executive (Senior Management Group) compensation strategy and policy. This group will investigate the criteria for setting executive salaries including such issues as the appropriate mix of higher education, industry, and state positions/salaries in determining UC executive compensation levels. This group is expected to complete its work in early February 2018. UCOP has engaged outside experts to assist in these efforts. As classification and compensation matters should be consistent and aligned level-to-level, the findings and decisions directed by the Regents as a result of the workgroup may strongly impact the ongoing work of the UCOP salaries workgroups as decisions may apply to the approach taken systemwide.

- **Appropriately Weighting State Salaries**. Determining the appropriate weighting of State salaries in compensation setting practices is important. Over the past few months the UCOP has conducted benchmarking reviews of other AAU university practices relating to compensation. What remains at issue is defining the groups that are peers to UC—state employees, industry, and/or higher education institutions. Classification and compensation best practices would suggest it depends upon the position. Developing a single formula for applying data from higher education and industry compensation surveys and state positions across all UC positions may be inappropriate.

Our experience and advice of our classification and compensation subject matter expert suggests that the inclusion and application of state positions is more complex than suggested by the CSA. It can be appropriately argued that the State of California is not a labor competitor: only some State positions are located in the geographical area of UCOP positions (e.g. Sacramento vs Oakland) and SMG positions are typically recruited nationwide; and some positions warrant certain minimum requirements, such as post graduate credentials, which are not common in state positions. In addition, it is likely that only in some cases would

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[3] Sacramento Bee, January 11, 2018 "State government aims to remake its Macintosh policies for the iPhone era," by Adam Ashton.

CSU be a comparable employer, since it is not a research university, does not have medical institutions, and the State performs many of CSU's core operational functions.

Regardless, as the CSA and Legislature seek changes to ensure that the University is setting salaries and salary ranges accurately, appropriately, and reasonably, and with the inclusion of CSU and State positions—when UCOP includes these salaries in the analysis these elements should be properly weighted. Specifically, our subject matter expert confirms that UCOP human resources uses reliable and dependable published surveys to determine the market rates for their positions. Such surveys include multiple employers in each analyses. If the CSU/State data were included on an equal basis with the published surveys, it would inappropriately give more weight to one employer (and in many cases, one incumbent). Since surveys include many employers, often 20-25 or more—assigning this group equivalent to one employer, the State, is not a best or appropriate practice for setting compensation. One option is that the data from CSU/State could be weighted as if it were one participant in the total of all survey participants. For example, most surveys provide the number of participants and total number of incumbents with a match to the position. If Survey A had 20 participants and Survey B had 19 participants, the weight assigned to the individual CSU or State data point would be one of 40, Survey A as 20/40 or the total and Survey B as 19/40 of the total. Thus, under best practices the state data would be applied as 1/40th. Nonetheless, the UCOP is committed to applying a much greater weight of State salaries in its analyses.

Of further note in this area, when considering CSU/State data where applicable, published surveys which include a significant mix of public sector participants can be used. For example, the Economic Research Institute (ERI) Salary Assessor includes a factor for "Industry" when obtaining market information. One of the industries included is Public Administration – All Sectors, which is further sub-divided into Government Support Services and Public Education, among others. Use of information from this industry, combined with information from other sectors where UC competes for employees, would provide HR with additional market information which could be appropriately incorporated when establishing salary ranges.

The salaries workgroups have been developing formulas for compensation setting that would weigh higher education surveys at about 50 percent and depending upon the number of comparables found for state and industry a weighting between those two would comprise the other 50 percent. As stated above, the decisions of the Regents compensation task force may impact the weighting formulas.

- **Progress on Classification Identification and Compensation Comparisons**. UCOP has mined data from the 12 UC locations on CareerTracks and has identified some 300 jobs out of 750 non-SMG staff jobs that currently have comparable matches in their salary surveys. UCOP has identified that approximately 120 of those positions have comparable matches to state positions. UCOP has been working directly with CalHR to obtain requisite data to compare and align positions; this has been a time consuming process for both the state and UCOP as the state does not commonly conduct salary surveys and does not have readily

available information that facilitates such comparisons. UCOP is currently undertaking a similar process and analysis to match nearly 100 SMG jobs to state and CSU positions. The following graphic depicts the CareerTracks salaries where the workgroup found matches thus far.

≈750 UC positions → ≈300 positions can be matched to marketplace[1] → ≈120 positions matched to CalHR

[1] Matched to some 35 market surveys used in compensation studies

- **Width of Salary Ranges**. We agree with the CSA that UC staff salary ranges are too wide. While one of the reasons offered as to why the ranges are so wide is the intent to minimize the impact on incumbents of transitioning from a non-market-based classification and salary structure to CareerTracks, which UCOP considers a market-based classification and salary structure. The salaries workgroup is committed to narrowing the ranges once the median is set and the percentiles determined. We will continue to monitor those decisions.

- **Defining Competitive Labor Market**. In UCOP's 6-month report to the CSA, it included a document "Defining the Competitive Labor Market for Compensation Programs," which the UCOP compiled from LinkedIn online data in an attempt to "identify our competitors for talent." As a result of our review (and that of our subject matter expert), and further discussions regarding this report, we suggest that the results are imprecise and must be used in a general sense. UCOP was unable to link the nature and levels of positions left to those acquired. As such, the results for the referenced 1,655 UC staff (of the approximate 9,000 leaving UC during the period) lost to other organizations should only be used as a context for identifying the competitive market.

EMPLOYEE BENEFITS AND REIMBURSEMENT

The CSA identified 10 "employee benefits" for evaluation. The UCOP conducted benchmarking to the State, CSU and other universities and adopted changes to address CSA concerns. We agree that many of categories are indeed employee benefits but we view others, particularly meals and lodging as reimbursements for job related costs. Two of the recommendations relate to Regents policies and, therefore, the President can attach administrative controls to those policies but only the Regents may change them. The other areas are mainly controlled by university or administrative policies or guidance and do not require Regents actions. We listed Regent's policy issues first.

- **Automobile Allowance.** Regents Policy 7709 sets forth the provisions for automobile allowances available to designated Senior Management Group (SMG) systemwide. To

address the CSA recommendation, the President issued an "administrative note" that suspends the approval of automobile allowances for new hires or appointees. Applying the policy on a prospective basis allows employees currently approved for these benefits to continue in the Regent's approved program. The CSA argues that the administrative action is temporary in nature and the policy should be changed by the Regents. By adding a provision to the policy that stipulates the employees appointed to the designated SMG positions after a date certain are no longer eligible to participate allows the policy to remain in effect for those employees already in the program and memorializes Regent intent. Nonetheless, future Regent actions could reinstate the policy.

- **Relocation Allowance.** Regents Policy 7711 provides for a relocation allowance for certain SMG hires. In response to the CSA recommendations, the President added an administrative note stating that she is "no longer recommending or approving cash relocation allowances for new hires or new appointees." The CSA considers this recommendation to be fully implemented (in conjunction with the amendments to the moving and relocation allowance provisions that follow) although the Regents policy remains in effect with a controlling administrative note.

- **Moving and Relocation**. In conjunction with the President's termination of approving the Regents relocation allowances, UCOP updated the FBF Policy G-13 governing moving and relocation expenses to accommodate, closely control, and align provisions with Internal Revenue Service Codes. The policy is effective October 15, 2017.

- **Senior Management Supplemental Benefit Program.** Under this program, following PPSM II-71 Senior Management Supplemental Benefit Program, the UC President is the "policy approver" whereas the aforementioned automobile allowance policy states the Regents are the policy approver. While Regents policy lists this program as a "benefit"[4], unlike compensation, Regents policy does not directly address this issue. In response to the CSA report, the President added an administrative note that she will not be recommending or approving participation in this benefit program for new hires or appointees, thus applying an attrition approach to terminating the benefit. The CSA believes that the "regents take action to approve policy changes that affect compensation of SMG employees…" While the Regents policy could be amended to remove or footnote the listing within the benefits, it appears that the policy itself is a President's policy as the policy approver for this matter.

- **Stipends—PPSM-30**. This policy addresses "administrative stipends" for employees temporarily assigned, for at least 30 days, responsibilities of a higher level position or duties not part of the employee's regular position and may not exceed 25 percent of the employee's base pay. Generally, this assignment should not exceed one year. Rules for State non-

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[4] Regents Policy 7200 defines "total compensation" and separates "all salaries and cash payments" that would be considered W-2 reportable from "any benefits and perquisites " that include senior management supplemental benefit program contributions and severance or separation agreement benefits.

represented employees, as established in California Code of Regulations[5], address "Out of Class Assignments" and allows eligibility sooner to employees undertaking out-of-class assignments (15 days or more). These regulations stipulate that pay for the assignment shall be "the rate of pay the excluded employee would receive if appointed to the higher class for the entire duration of the assignment" but does not set limitations for the percentage. In response to the CSA, UCOP reissued procedures relating to PPSM-30 reiterating the approval process for stipends and reducing the amount of the stipend from up to 25 percent of employee base pay to up to 20 percent of employee base pay. The UCOP intends to formally amend the policy.

- **Retirement Events, Morale Building, STAR Awards Programs/Performance Awards.** UCOP policies provide for a number of cash and non-cash awards for various purposes. UCOP has reduced, restricted, or entirely curtailed some of these programs in response to CSA recommendations. The use of UCOP funds for retirement appreciation events and gifts is no longer allowed. The STAR program is reduced from a maximum of the lesser of 10% of salary or $5,000 to a maximum of $500 one time annually and Spot Awards are limited to a maximum of $75. Morale building events are limited and the process prescribed. As these are administrative policies, the UCOP has oversight; the CSA has accepted these changes.

- **Business Meetings and Entertainment**. UC has systemwide policies related to business meals and entertainment. UCOP has restricted these expenses, under morale building and entertainment provisions to $19 per person or $500 for an event, whichever is less. Moreover, such events are limited to once annually. These changes apply to UCOP only and have not been issued systemwide, as campuses found that such restrictions would severely limit necessary activities related to the core mission. Campuses (and UCOP) can adopt more restrictive provisions and communicate these local rules on their websites.

- **Cell phones**. Effective October 15, 2017, the UCOP issued more stringent mobile device policies and practices. Through UCOP telecommunications, all current mobile devices and plans will be reviewed for compliance with the new policy and practices and Chiefs of Staff are directed to review the mobile device inventory within their departments to validate eligibility against the new criteria. The CSA considers this recommendation complete.

- **Meals and Lodging.** In May 2017, UCOP amended the University's G-28 Travel Policy to limit meals and incidental expenses. The new limits are within those set by the State and CSU. Regent Perez noted concern with the process for controlling the instances of lodging above the limit. The UC policy requires that the traveler must submit written justification of why a rate under the cap cannot be obtained, and provide screen shots of price comparisons within the proximity of the meeting location, stating the comparison should be done at time of booking. The State's provisions require prior approval of the excess rate using a request form[6] that requires a listing of at least three contacted hotels in the vicinity and certain

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[5] California Code of Regulations §599.810
[6] STD 255C

documentation including evidence showing a reasonable effort to find lodging at state-specified rates. The CSA accepted the amended travel rules as they align with CSU.

SYSTEMWIDE INITIATIVES

In total, 8 CSA recommendations relate to Systemwide Initiatives and were assigned to this workgroup. UCOP has developed and continues to refine a comprehensive catalogue of its services, programs and initiatives along with definitions of the type and scope of these activities. The workgroup refined the UCOP-affiliated programs and initiatives into five categories: federal/state program, campus program, systemwide program, statewide initiative, and Presidential initiative.

- This workgroup developed a comprehensive matrix that identifies name, category, program summary, funding summary, stakeholders, and funding amounts and sources. Initial efforts of the workgroup were to reconcile the listing back to that used by the CSA and this effort has been completed. Efforts of the workgroup going forward will be based upon the UCOP "post reconciliation" listing of 73 programs and initiatives. The listing is still in refinement and may change as programs are reviewed. Funding sources and annual costs have been identified for the various programs and initiatives. This is the first step in the process that will result in systemwide guidance for identifying and budgeting for these programs and initiatives, which is due in April 2018.

- Definitions for categories--UCOP provided a categorization decision model and draft definitions to the EBC on January 8, 2018. These definitions encompassed UCOP-affiliated functions funded either wholly or in part through UCOP and/or receive state funds through annual set-aside allocations.

  - o Draft definitions provided to the EBC included one for "centralized administrative services," as well as definitions for state/federal programs, campus programs, systemwide programs, systemwide initiatives, and Presidential initiatives.

  - o Definitions include components related to whether funds for the program are on-going or permanent, or "time-bound" or one-time funds.

  - o EBC provided thoughtful feedback on these definitions and categorization components which will be considered by UCOP prior to presenting the draft of these provisions to the President in the near future.

- As a part of the cataloguing and developing definitions for the various types of its programs, services, and initiatives, this workgroup is developing a systematic strategy for evaluating the systemwide programs and initiatives for both the short-term and for long-term/ongoing assessments. The group's strategy document seeks to establish a methodology with criteria, performance metrics (purpose, inputs/programming, outputs/direct results, outcomes/impacts) for evaluating, frequency of assessments, and reporting on each program and initiative. Our review of the draft documents and observations during the meetings suggest significant

progress in achieving the evaluative methodology, identifying potential evaluative bodies, and the frequency of such efforts.

- Using the matrix of systemwide programs and initiatives, the UCOP identified and reported to the Legislature and Department of Finance on the programs and funding sources from which it will redirect funding to achieve the $15 million needed for enrollment growth. The Legislature, through budget control language (AB 97), accelerated expected execution of certain aspects that relate to the CSA recommendations and the UCOP responded to these directives in December 2017. AB 97 generally required the UCOP to: 1) list the existing programs of UCOP; and, 2) provide funding level changes to UCOP expenditures to accommodate 1,500 additional ungraduated students for the 2018-19 academic year. The first aspect of the AB 97 requirement aligned with one of the CSA recommendations that stipulates that UCOP report on programs and initiatives including purpose, cost, and funding source by April 2018.

- A key component raised by the CSA in the 6-month report response under statewide initiatives and programs relates to the listing of the initiatives not reconciling back to the draft UCOP budget. What the auditor has not considered here is that this matter crosses into other issue areas such as financial statement audit, independent consultant's review of the UCOP structure, restricted funds, and budget process. At the October milestone—only half way into the period allotted—the budget was draft, the initiatives worksheet was draft, and all the other processes were and continue to evolve. We anticipate that as each workgroup addresses its responsibilities that changes, realignment, and corrections will occur and impact the workbook and the budget. It may be unrealistic to have all of the elements coordinated by April 2018.

Continuing efforts should address the budget, cost and priorities of these programs. Attention should be given in the UCOP's critical assessment of priorities and spending to ensure that funding aligns with the services, programs, and initiatives having the highest priority, greatest impact, and best use of the funding.

WORKFORCE PLANNING

Workforce planning is a key element in strategic planning and budgeting. Generally, the CSA recommendations align with the CalHR five-phase model for developing a workforce plan. The CSA recommended that UCOP fulfill Phase I of the CalHR plan by April 2018 with phase II complete by April 2019, and the final three phases by April 2020. The auditor's recommendations for the Phase II (April 2019) included obtaining input from the campuses and students regarding the elements of the UC's operations that are critical and which could be potentially eliminated.

The UCOP adopted project goals for this workgroup that implement best practices for human resources workforce planning, including but not limited to CalHR, as part of a strategic plan for UCOP. The plan leverages input from stakeholders, including campuses and students, to assess current and future staffing and competency gaps; implement workforce planning strategy covering a 3-5 year

period; and, assess and evaluate workforce planning strategies annually against defined performance metrics.

UCOP workgroup's objectives are broader than CalHR's model:

- CSA's recommendations are focused specifically on implementing the five steps in CalHR's workforce planning model. UCOP's project goals state its strategic planning efforts will include workforce best and leading practices, as well as CalHR.

  If UCOP chooses to implement a different set of workforce planning best practices, a crosswalk linking the CalHR's five steps to the one used will be needed to fulfill this recommendation.

- CSA's Phase II, 2019 recommendation includes having UCOP consider stakeholder input to identify which elements of UCOP's organization are of critical importance and which elements could potentially be eliminated or downsized by April 2019. UCOP's project goal to leverage stakeholder input needs to include specific steps to obtain each stakeholder's perspective regarding identifying elements of critical importance or those that could potentially be eliminated or downsized. We understand that the EBC, which includes members from each campus and the Academic Senate, will be asked to advise the workgroup on the programmatic matters. The workgroup will also obtain information from the Huron report once released.

- To fully meet this recommendation by April 2019, UCOP will need to assure that input is sought from stakeholders, including campuses and students, on UCOP's areas of critical importance and/or that could potentially be eliminated or downsized.

The workgroup has expanded to include a broader range of UCOP stakeholders including adding an additional campus representative from U.C. Irvine who was recently involved in a workforce planning effort at that campus. In January 2018, the progress thus far will be presented to the expanded workgroup to discuss with the group issues relating to benchmarking, stakeholders, and obtaining executive buy-in. It will also share data collected relative to turnover, attrition, succession, talent acquisition, and diversity.

During this reporting period, the workgroup concentrated on the following:

- Developed and is refining a project plan that includes deliverables and timeframes. The plan incorporates the CalHR five steps.

  - Identified stakeholders including Regents, UCOP executives, campus and Academic Senate members on the Executive Budget Committee (EBC), systemwide HR and leadership HR council, employee/labor representatives.

    The stakeholder list does not currently include student contacts for input on elements of critical importance or potential elimination or downsizing being gathered. However,

we have seen campus and Academic Senate members critiquing and discussing UCOP programs during EBC meetings.

- Developed the UCOP workforce talent needs and workforce trends both internal, such as, Divisional strategic plans, technological, economic and cultural shifts; and external pressures including private sector competition, regional challenges and environmental factors.

- Developing a template to project staffing levels and needs with specific positions and associated costs. It is piloting this template at UCOP. The template will involve all positions including students and interns, projected personnel actions (promotions, merits, retirements), staffing needs, position changes (eliminations, reclassifications, moves), and pay rates.

- Identified and contacted 26 AAU benchmark universities. The process includes trying to obtain relevant information through email, survey, and phone calls. Information from only three universities has been obtained thus far, but follow-up plans are in place.

The workforce planning workgroup has invested significant resources (of management and staff time and effort) to develop a workforce plan that will benefit UCOP into the future. However, the first deliverable deadline imposed by the CSA is only three months away. Although the workgroup has outlined a number of tasks and activities that need to be completed by April 2018, several of the stakeholder tasks have not yet started (planned for mid-January) and in-depth campus and student input does not start until April 2018.

FUND RESERVES

One of the recommendations to be implemented by April 2018 was for UCOP to develop a reserve policy that governs how large its reserves should be and for what purposes these reserves can be used.

The workgroup benchmarked against a broad group of entities including State of California, CSU system, 10 university systems, 13 public and private universities, 3 cities, and a private foundation. It obtained usable data from these entities except for three university systems.

The group assessed all the major areas of funds held by UCOP including building and equipment reserves, program reserves, strategic priorities reserves, and operating reserves. These categories included funds related to its facilities (Oakland buildings, UC Washington, UC Sacramento, UCPath Center – Riverside, Blake House, and Casa de Mexico); programs including UC Press, UC Washington, and EAP; and strategic priorities such as carryover balances, President's Initiative Fund, and central operations. In total, the group identified approximately $94.1 million in reserves.

The Fund Reserve workgroup determined that it would focus on two reserve pools, central operating reserve and strategic priorities reserve. It has developed and forwarded to the Regents a recommended policy for the Central Operating Reserve. The strategic priorities reserve is not yet complete—UCOP indicates that this reserve will be addressed in conjunction with the work done relative to the President's strategic priorities and the statewide priorities work. At the January 8, 2018

EBC meeting, the issue of the strategic reserve was raised and UCOP indicated that in the fiscal year 2017-18 budget this reserve is in process and that stronger guidelines will likely cut the balance in half and require all items to go through the budget. Further, the EBC was told that guidance will be forthcoming that will require more detail to be provided in the requests for such funding and subsequent reporting on the fund usage. We will continue to monitor this issue.

It determined, and we agree, that since the building and IT infrastructure reserves are self-funded and already established, they need not be addressed at this time.

It also decided that housing (must maintain reserve of at least 25% of debt service), medical centers, UC SHIP, insurance, and campus reserves are outside the scope of the workgroup. While for the purposes of meeting CSA recommendations these groups are outside the scope of the workgroup, we believe that over the next few years the UCOP should review each of these reserves to determine appropriate levels and ensure they remain within those parameters.

The workgroup stipulated that program reserves such as EAP, UC Press, UC Washington DC and others deemed self-funded are stipulated by policy and that policies vary program to program. We recommend that these policies be addressed after the Statewide Initiatives workgroup completes its assessments to ensure that the reserve policies are aligned with the focus and needs of the UC system.

The Central Operating Reserve is intended to support the UCOP in the event of a one-time disruption of funding. The reserve should be available funds within 3 working days.

- $15 million (or at least 3.5%) from the President's Endowment Fund

- If needs exceed the $15 million reserve, the proposed policy stipulates that the Central Operating Reserve can be supplemented up to an additional $100 million (or up to three months of operations) from other sources such as loan from the STIP or special payout from unrestricted endowment funds as recommended by the Chief Financial Officer.

In our view, the $15 million reserve is reasonable; it covers approximately 9 to 10 days of operations or two business weeks. One-time disruption of longer than two weeks should require extraordinary measures and attention; with the STIP available, the UCOP should have the means available to meet most extraordinary demands.

FUND RESTRICTIONS

The CSA voiced strong concerns regarding the UCOP's budget information. Specific recommendations required that the UCOP identify all funds, identify whether funds are restricted or not, and determine if any funds could be relocated from UCOP back to campuses. A critical aspect of this recommendation is determining an "inventory" of all funds, tracing the nature and underlying provisions for the use of those funds, and evaluating when a fund could be reclassified as unrestricted and be available for systemwide spending.

The workgroup has made great strides in this area.

- Identified 534 different funds.

- Created draft definitions to categorize the funds for this purpose and for the long term. The GAAP definition is complete covering net investment in capital assets, restricted (non-expendable, expendable) and unrestricted. The "budget" definition is not yet complete; as there are some funds that do not meet GAAP restrictions, these include a number of funds that are special purpose and will require some type of designated category that will ensure funds are appropriately classified to ensure proper use and/or approval by the Regents.

- Created a workbook detailing a number of attributes including year-end balance, three year average balance (to evaluate whether fund is stale or is active with low/no balance at year end), whether the fund meets GAAP definitions as restricted/unrestricted, whether the fund is deemed by UCOP budget definitions as restricted/unrestricted.

- Those funds deemed as both GAAP and budget restricted are considered restricted and not subject to further review. Similarly, those funds determined to be unrestricted by GAAP and budget will be considered discretionary.

- 244 funds do not meet the two above definitions are currently being investigated. These funds total approximately $183 million.

We viewed the workbook and all funds had many of the attributes complete with a focus to have all funds investigated by the end of January. It appears that some funds will be stale and eligible to closeout and others may be combined.

The workgroup plans to present information for all 534 funds to the EBC at the February 2, 2018 meeting for discussion; Sjoberg Evashenk will attend this meeting and assess the completeness of the data. The workgroup plans an information item for presentation to the Regents in March 2018.

BUDGET DEVELOPMENT

Several recommendations offered by the CSA relate to budget development processes. Like many public entities, UCOP manages a budget of nearly $800 million using legacy financial systems and inadequate budget tools to facilitate and support budget development and reporting processes. UCOP acknowledges that it had not adopted many best practices for budgeting such as forecasting, multi-year budgeting, workforce planning, and others and plans to adopt best practices.

Overall, the tasks involved with meeting the CSA recommendations and achieving the internal goals of the UCOP for budgeting are formidable.

- **Financial and budget systems and data**. A key component of the process is reliable financial data in appropriate and sufficient detail. UCOP relies on UCLA's antiquated system that has limited functionality in these matters and does not interface with the UCOP budget

system. UCLA recently chose a new financial system and has issued an RFP for an implementation partner. The system rollout (anticipated to take 24-36 months) is delayed until at least September 2018, after the campus implements UC Path. Because a new budget system should interface with the financial system and UCLA's is imminent but delayed, UCOP has postponed the acquisition of a new budget system and instead in December 2017 engaged IBM to develop some incremental improvements to UCOP's COGNOS TM1 system. The cost, timing, and nature of these improvements is under discussion. Concurrently, UCOP may evaluate the feasibility of moving forward with a budget system replacement independent of UCLA's general ledger project.

- **Optimization study**. The contracted UCOP Optimization (Huron report) study sought to assess the UCOP structure and provide opportunities for optimization of its operations. The study was completed the first of January; as of the end of this review period, we know the results were shared with the President and sharing of such results would occur over the following two or so weeks. We do not yet know the results of that engagement but expect to see the report and be informed of the President's plans in the very near future. Decisions made based upon the optimization report results could have a significant impact on budget development—as the budget workgroup does not yet know the complete extent, scale, or timing of potential changes, it cannot anticipate full the impact on the FY 2018-19 budget until final decisions on alternatives are reached.

- **AB 97**. On December 8, 2017, President Napolitano provided the budget plan to divert $15 million of UCOP funds for supporting 1,500 new UC students. Fund sources originated from several areas of the UCOP operating budget ($6 million), $2 million from the Presidential Initiatives Fund, $3 million from California Lottery Funds, and reductions of inflationary adjustments to set-aside programs ($2.457 million) and other programmatic reductions of $1.486 million. Budget development for FY 2018-19 will incorporate these reductions.

- **Implementation of the CSA Budget Model**. UCOP decided to implement a two-phase approach for developing the FY 2018-19 budget. On November 15, 2017 guidance for "Phase 1 Budgeting" was issued. Phase I focused on creating "clean baseline budgets" and detailed expense review. Deliverables for phase I were due by December 19, 2017, and required flat expense budgets with a 12 percent reduction in travel and meeting expense (to offset the diversion for AB 97 of $400,000) premised on a zero-based budgeting approach; and, a flat headcount with any new position requests or new activities absorbed within the division and stipulating that salary savings should not be relied upon as these amounts will be swept and kept to an overall division level ceiling. Phase 2 will focus on revised plans and will include specific budget targets.

  Budgeteers will meet in January 2018 to review the results of the phase 1 and plan to discuss if and how changes resulting from the optimization plan will be incorporated.

- **Budgeting Temporary Funds**. Documents indicate that the FY 2018-19 budget will appropriately reflect all funds and expenses of UCOP including those historically considered

temporary (undisclosed or discretionary) and not reflected in the budget documents. Moreover, documents indicate that the President's Initiative Fund (approximately $7.8 million after AB 97 reductions), will be consolidated into the Strategic Priorities Fund which combined will be approximately $30 million or half of the former combined amount of approximately $60 million. Further, UCOP is improving its formal decision memo process for requesting these one-time funds that will require not only upfront justification, documentation, and approval but oversight and reporting on these funds. Some projects approved from these funds will be paid on a reimbursement basis.

- **Best Practices.** The budget workgroup has researched best practices[7] and addressed many areas including planning, analytics, and forecasting (with a focus on aligning resources to strategic achievement and goals and the shifting of resources to meet shifts in priorities); developing and maintaining stakeholder involvement in budgets and related policies and principles; budget sustainability; types and styles of budgets; approaches to budgeting and budget steps; key success factors and targets; financial planning and analysis (multi-year budgets, metrics and dashboards, modeling and scenarios); strategic planning; reserves and balances; and, reporting, accountability, and transparency.

We have reviewed the guidance and directives, attended budget development workgroup meetings, and conducted other conversations to follow the progress of these initiatives. January and February 2018 will be crucial periods for accomplishing goals and CSA deadlines; we will closely monitor and review data as they are available.

BUDGET PRESENTATION

The CSA found several inadequacies relating to the visibility and detail of UCOP budget information presented to the Regents. Recommendations by the CSA include suggestions of format for budget reporting and some best practices:

- Inclusion of all budgetary allocations from "disclosed" and "undisclosed" budgets and related adjustments, as mentioned above.

- Separate display of receipts and expenditures that pass-through UCOP to campuses as well as expenditures related to administrative services provided by UCOP to campuses on a fee-for-service basis that are in addition to services provided and displayed in the operating budget.

- Convey budget to actual results.

- Show reserve balances.

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[7] Supporting documents include guidance from GFOA and National Association of State Budget Officers (NASBO) which incorporates GASB guidance.

The auditor also suggested a practice that is both a factor of budget development and display—basing proposed budget amounts on projected actual expenditures (rather than prior year budget) showing adjustments as needed for program changes.

The budget presentation aspect of the UCOP's efforts is iterative; providing the Regents with improved and more detailed budget information in the near term—for the FY 2017-18 budget while simultaneously identifying and developing new approaches, tools, and reporting to be applied for the FY 2018-19 and future years budgeting—including workforce development tools being developed and piloted by UCOP Human Resources (a separate category in this report).

In the following we offer particular observations:

- In May 2017, UCOP delivered to the Regents a FY 2017-18 budget presentation for approval that sought to provide early adoption of the CSA recommendations for conveying budgetary data. UCOP recognizes that in its efforts to quickly adopt the new detail and format of the presentation, the budget data included some imprecise projections and data. The budget presentation made to the Regents in July 2017 provided greater detail than the June format. In particular, information related to the strategic reserve balance, funding for initiatives, and the impacts of the legislative move to directly fund UCOP rather than through the assessment model.

- Using the audited financial statements for FY 2016-17, the November 2017 presentation to the Regents provided a reconciliation of that year's budget to actual results as well as comparing numbers back to actual expenses for the year projected in May.

- UCOP is compiling financial information to provide a six-month budget to actual presentation to the Regents in March 2018. We will assess the results of these efforts in our next quarterly report.

- The budget workgroups have researched best practices relating to budget presentation. Key points the workgroup identified include transparent and ongoing communications with internal and external stakeholders that are not reliant on one-time presentations but rather on-going dialogue.

- In January 2018, UCOP engaged an outside consultant to assist not only in the development of the budget but also to assist in the presentation of budgetary information to the Regents. The budget presentation workgroup's schedule and timeline reflects that the group will develop and circulate for feedback within UCOP stakeholders budget presentation prototypes in January and February 2018 with a goal to review the best potential approaches with the President and the Regents in March 2018.

- The deadline to provide the CSA the revised budget format and process is April 2018, which is ahead of the formal FY 2018-19 budget presentation to the Regents at the end of May

2018. UCOP will consult with the Regents to determine the appropriate information to share with the CSA to satisfy the requirement.

Given that the current efforts of both the budget development and budget presentation groups are dynamic and evolving, most of the key decisions have yet to be made. Reasonable and noteworthy efforts are on-going and we see a genuine intent to not only address the CSA recommendations but to vastly improve the usability, meaning, and content of the budget information to monitor UCOP operations and for decision making purposes.

Overall, although each workgroup timelines intend to achieve the April 2018 deadlines and milestones set forth by CSA, considerable work must be accomplished by UCOP over the next three months. Our efforts will continue to track the progress of each of the working groups to meet the internal milestones and CSA recommendations.