



**New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor**

**Rutgers, The State University of New Jersey
Allocation and Transfer of Resources
Across Campuses**

July 1, 2013 to June 30, 2014

**Stephen M. Eells
State Auditor**

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The Honorable Stephen M. Sweeney
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Speaker of the General Assembly

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Enclosed is our report on the audit of the Rutgers, The State University of New Jersey, Allocation and Transfer of Resources Across Campuses for the period of July 1, 2013 to June 30, 2014. If you would like a personal briefing, please call me at (609) 847-3470.

Stephen M. Eells
State Auditor
December 16, 2015

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Scope

We have completed an audit of Rutgers, The State University of New Jersey, Allocation and Transfer of Resources Across Campuses for the period July 1, 2013 to June 30, 2014. Our audit covered the allocation of revenues and expenses across the university's campuses following the consolidation of units formerly part of the University of Medicine and Dentistry of New Jersey.

The university's primary mission is to provide instruction, research, public service, and healthcare. The major components of operating revenue were student tuition and fees, federal grants and contracts, and patient service revenues. Operating revenues and expenditures for fiscal year 2014 were \$2.3 billion and \$3.3 billion, respectively, resulting in a \$1 billion operating loss. The major components of non-operating revenue were state appropriations, and state paid fringe benefits. Non-operating revenues in combination with capital grants, gifts, and additions to permanent endowments offset operating losses resulting in a year-end increase in net position of \$68.2 million.

Objective

The objective of our audit was to determine the reasonableness of the allocation of revenues and expenditures used to measure the flow of resources across campuses as contained in the university's certified public report.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in the "New Jersey Medical and Health Sciences Education Restructuring Act", P. L. 2012 Ch. 45 and pursuant to Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In preparation for our testing, we studied legislation, reviewed audited financial statements and gained an understanding of the budget models utilized by the university and other documentation concerning funding for overhead costs that were available in the public domain. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our verification of calculations utilized in the allocation of resources and costs across the campuses. We also read the minutes from the university's board of governors and certain standing committees, as well as resolutions issued by the board. In addition, we interviewed members of the central university's management, as well as campus chancellors and their vice chancellors/chief financial officers to obtain an

understanding of their internal controls regarding allocations.

Conclusions

Our audit determined the university's allocation of revenues and expenditures used to measure the flow of resources across campuses as contained in their certified public report was reasonable. The university had developed a simplified allocation methodology for fiscal year 2014 in collaboration with the central university's budget office and the campuses' management to account for the flow of finances. In making this determination, we noted certain reportable conditions regarding legislative compliance with the type of financial data included in the report, the report's public access, and the report's delivery to the State Auditor.

Legislation and Allocation Methodology Summary

The New Jersey Medical and Health Sciences Education Restructuring Act (P.L. 2012 Ch. 45) transferred all schools, institutes, and centers of the University of Medicine and Dentistry of New Jersey (UMDNJ) except for the School of Osteopathic Medicine and University Hospital, to Rutgers, The State University of New Jersey, along with associated debts and related real and personal property. The School of Osteopathic Medicine was transferred to Rowan University, and University Hospital was designated a separate legal entity which would continue to serve as the principal teaching hospital for all of the former UMDNJ schools in the Newark area.

The legislation further stipulated that Rutgers, The State University of New Jersey (university), would establish an annual certified public reporting process of their finances to measure the flow of resources across the campuses of the university. The bill regarding this legislation was introduced before the State Assembly on June 14, 2012 which was later enacted on August 22, 2012. The legislation specified that the merger of these institutions would not take effect until July 1, 2013. The passage of this legislation did not provide the university ample time to adequately plan for the implementation of sophisticated mechanisms to measure the allocation of revenues and expenditures across the university's four campuses: Camden, Newark, New Brunswick and the Rutgers' Biological and Health Sciences (RBHS), and account for the integration of UMDNJ.

Prior to fiscal year 2014, the university prepared only one university-wide budget under the "All Funds Budgeting" (AFB) model, instituted in 2005, that employs a flat overhead rate on tuition dollars to fund overhead costs generated centrally for administrative and system-wide services which benefit the operations of the entire university. After the merger, in an effort to comply with the legislation, the university started preparing a budget for each campus, which was then consolidated into one university-wide budget.

In addition, the university worked with the individual campuses' management in developing a new modified version of their allocation procedures for centrally generated revenues and expenses to ensure an equitable distribution across the campuses utilizing three metrics: research, student, and a blended rate. These metrics were based upon fiscal year 2013 year-end data regarding grant expenditures, student course credits, and research dollars generated by each

campus. We confirmed this information through interviews with management of all four campuses and verified that the formulas utilized by the university to achieve these allocations were materially accurate. We were also able to determine revenues and expenditures for fiscal year 2014 were in agreement with the university's audited financial statement as a whole.

We were informed that the same three metrics utilized in fiscal year 2014 were again used in 2015 in combination with the university's AFB model. During our interviews we learned that the campuses were not afforded an adequate explanation as to how the flat overhead rate had been calculated and what exactly the funds covered, which led to misunderstandings between the campuses and the university's central management. To address this issue, on July 1, 2015 the university implemented a new budget model known as "Responsibility Center Management" (RCM), which should provide increased accountability and transparency among all the campuses and schools, since each school will be responsible for their own management and funding.

Under RCM, all campus Chief Financial Officers (CFOs) were active participants in the development of ten cost pools utilized to allocate overhead costs, eliminating the use of the flat overhead rate. Prior to implementation, the CFOs were provided opportunities to review and question budgets and costs associated with central providers. In addition, the CFOs were able to view all of the accounts and cost information for all the campuses, not just their own campus, allowing them opportunity to test the calculations, make adjustments, and vet the figures before reaching a collaborative agreement among themselves and central management's budget office that the revenues and expenditures have been equitably distributed among the campuses. The university's central management has stated that the RCM budgeting model provides greater transparency and more accurately reflects the requirements of the legislation. Fiscal year 2016 will serve as the baseline for future reviews of the RCM allocation methodology.

Reporting Compliance

The annual certified public reporting process established by the university needs improvements.

The legislation requires the university to establish an annual certified public reporting process of their finances in order to measure the flow of resources across the campuses. The university's effort to comply with this legislation resulted in the production of an expanded budget for fiscal year 2014 utilizing a simplified allocation methodology for each of the university's four campuses. The budgets were certified by the university's Senior Vice President for Finance and Treasurer, before the board of governors' Finance and Facilities Committee, and then approved by the board of governors through resolution. However, the minutes of the board recording this resolution are only available to the public upon request.

In addition, this report was not provided as required by legislation to the State Auditor until a request was made by this office. Our review of this report determined its content to be incomplete because it did not include a final actual accounting of the finances across the campuses of the university.

Upon additional inquiry, the university did provide a copy of their Statement of Budgeted Operating Revenues and Expenses for fiscal year 2014 which reflects budget to actual activities at three different levels: university-wide, the four individual campuses, and the central allocations in total for each line item of the statement. This document was originally prepared for the board of governors' Finance and Facilities Committee as supplementary information and was marked "Preliminary and Confidential 10/30/14". We utilized this document to verify that the university's allocation methodology was properly calculated and that the total revenues and expenditures were materially in agreement with the university's audited Financial Statement of Revenues, Expenditures, and Changes in Net Position for fiscal year 2014.

Recommendation

We recommend the university establish an annual certified public reporting process that, in addition to its budget, includes a budget to actual comparison of the university's finances. In addition, this report should be provided to the State Auditor within an appropriate time frame to allow for its timely review. This report should also be easily accessible to the public, as required by law.

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December 7, 2015

Mr. Gregory Pica
Assistant State Auditor
New Jersey State Legislature
Office of the State Auditor
125 South Warren Street
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Dear Mr. Pica,

We received and reviewed your office's confidential draft report on the allocation and transfer of resources across the campuses of Rutgers, The State University of New Jersey. We are pleased with the report's basic conclusion that the university's allocation of revenues and expenditures used to measure the flow of resources across campuses is reasonable.

We accept the report's recommendations regarding improvements to the reporting process. To increase the public visibility of the Board of Governor's resolution approving the university's budget, we will include the resolution and related budget more prominently on the website of my office and will send a copy to your office as soon as it is approved annually. In addition, we will have the board accept the budget-to-actuals report by campus, display that analysis prominently on my website, and forward a copy to your office annually.

We appreciate greatly the time and effort that the audit team devoted to understanding the university at a complex transition period.

Sincerely,

A handwritten signature in black ink that reads "J. Michael Gower". The signature is written in a cursive style with a large, stylized "J" and "G".

J. Michael Gower
Senior Vice President for Finance and Treasurer