

AGENDA

COMMITTEE ON AUDIT

Meeting: 8:15 a.m., Wednesday, March 21, 2001
CSULB, University Student Union-Multipurpose Room ABC

Frederick W. Pierce, IV, Chair
Harold Goldwhite, Vice Chair
Murray L. Galinson
Shailesh J. Mehta
Neel I. Murarka
Stanley T. Wang

Consent Items

Approval of Minutes of Meeting of January 23, 2001

Discussion Items

1. Status Report on Current and Follow-up Internal Audit Assignments, *Information*

COMMITTEE ON AUDIT

**Trustees of The California State University
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California**

January 23, 2001

Members Present

Frederick W. Pierce IV, Chair
Harold Goldwhite, Vice Chair
Murray Galinson
Shailesh J. Mehta
Neel I. Murarka
Stanley T. Wang

Other Trustees Present

Roberta Achtenberg
William D. Campbell
Daniel N. Cartwright
Martha C. Fallgatter
Debra S. Farar
Laurence K. Gould, Jr., Chair of Board
William Hauck
Ralph R. Pesqueira
Dee Dee Myers
Ali C. Razi
Charles B. Reed, Chancellor

Chancellor's Office Staff

David S. Spence, Executive Vice Chancellor and Chief Academic Officer
Richard P. West, Executive Vice Chancellor, and Chief Financial Officer
Christine Helwick, General Counsel
Douglas X. Patiño, Vice Chancellor, University Advancement

Approval of Minutes

Chair Pierce called the meeting to order at 1:09 p.m. The minutes of the November 9, 2000 meeting were approved as submitted.

Audit

Status Reports on Current and Follow-up Internal Audit Assignments

Mr. Mandel presented the item by reporting the status of the following audit assignments and follow-up reviews:

FISMA – four audits have been completed, two audits are awaiting a campus response prior to finalization, report writing is being completed on three campus reviews, while fieldwork continues on three campuses.

Auxiliary Reviews – the number of campuses/auxiliaries to be reviewed has been reduced to 5/17 in order to accommodate the scope of the project. One campus audit, representing four auxiliaries has been completed, while report writing continues for four campus reviews/13 auxiliaries.

Hazardous Materials Management – the number of campuses to be reviewed has been reduced from eleven to nine as a result of a reduction in the number of available staff. Five audits have been completed, two audits are awaiting a campus response prior to finalization, while report writing is being completed on two campus reviews.

Student Health Centers – the number of campuses to be reviewed has been reduced from 11 to ten as a result of a reduction in the number of available staff. Six audits have been completed, two audits are awaiting a campus response prior to finalization, while report writing is being completed on two campus reviews.

Public Safety – the number of campuses to be reviewed has been reduced from 11 to eight as a result of a reduction in the number of available staff. Three audits have been completed, one audit is awaiting a campus response prior to finalization, while report writing is being completed on four campuses.

Follow-ups – currently tracking 30 prior campus (FISMA, Auxiliary Organizations, Student Records, Operation and Maintenance of Plant, and Continuing Education) and seven auxiliary organization reviews to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

Construction –six construction projects will be reviewed by KPMG. Audit fieldwork has commenced on these projects.

Mr. Mandel stated that the campuses have done an exceptional job of completing outstanding recommendations, and further noted that this is the least number of outstanding recommendations in the last two years.

Trustee Pierce joined Mr. Mandel in commending the campuses for so diligently responding and resolving open issues, and that the committee is pleased with the progress made on audit assignments.

Assignment of Functions to be Reviewed by the Office of the University Auditor for Calendar Year 2001

Mr. Mandel explained that the Office of the University Auditor (OUA) is required to perform Financial Internal Control (FISMA) reviews every other year on each campus, and will continue to do so with 11 this year. He added that the OUA continue to perform audits of Auxiliary Organizations, which will number 24 during this calendar year. Mr. Mandel added that, in order to complete the 24 above-mentioned audits, he is asking for the addition of two staff auditors.

In addition, Mr. Mandel noted that every five years the OUA is required to perform a review of CSU legislatively delegated authorities in the areas of Purchasing and Contracts, Leases, and Motor Vehicles. He stated that it had been five years since the last audit of Delegations of Authority and this area would be one of the three subjects to be reviewed during 2001. He also noted that Information Systems, as it related to all reviews, will be audited in 2001.

For the 2001 year, Mr. Mandel indicated that a training component to the audit plan with visits to at least half the campuses expected.

As for the additional two subject areas, Mr. Mandel recommended Development and Contracts & Grants. He noted that Development was an area that was visited five years ago and stated that it would now be subject to follow-up on prior recommendations, and visits to those campuses that were not previously reviewed.

Contracts & Grants, which was not on the risk assessment performed in 1999, is an area that has been recommended by the federal auditors from the National Science Foundation (NSF).

Trustee Pierce added additional detail to consider as the committee reviewed both the request for additional staffing and the selection of audit items for the upcoming year. He noted that the auxiliaries are already supporting four audit positions and suggested that placing the funding responsibility upon them for an additional two positions was an undue burden.

Audit

As to the selection of audit topics, Trustee Pierce indicated his belief that, rather than audit Contracts and Grants, which already receives federal auditing, the committee should select another area that has not been reviewed in a long time.

Trustee Goldwhite also expressed concern over additional charges to the auxiliaries. He asked Mr. Mandel to clarify the current level of auditing of Contracts and Grants and why it was a concern for the federal auditors.

Mr. Mandel explained that the auditors from the National Science Foundation were currently reviewing federal award cost sharing provisions and had noted deficiencies in both policies and procedures and system audit effort. The auditors suggested that there should be some level of audit done within the system prior to the time that they come. They thought that any work done would be both of help to the system and may be relied to reduce their fieldwork.

Mr. West mentioned that there is enough activity in the area of Grants & Contracts on the non-auxiliary side that it would be appropriate for the area to be reviewed to keep the committee informed.

Mr. Cartwright expressed concern that when reviews are conducted at non-profit student auxiliaries, the chargebacks can be burdensome to existing tight budgets.

Dr. Reed mentioned that the operation of our auxiliaries is the biggest risk in our system, representing between 950 million and one billion dollars and that reviews should continue. He added that the state is not responsible for the support of the auxiliaries, and that we should try to get the auxiliaries on their own as quickly as possible. He added that it may be more prudent to conduct auxiliary reviews every three years, instead of two, thus reducing the need from four to two additional staff positions.

Dr. Reed expressed concern over the management of Contracts and Grants indicating that, risk wise, the area would be right behind the auxiliaries. He noted that the CSU has very few audits by federal auditors. He also expressed his concern with the inconsistency of our overhead rates and how they are being set and managed.

Trustee Galinson questioned if there are other audits that are charged back to the campuses and the auxiliary audits are performed by the university, not by the auxiliary and charging the auxiliary the cost of the audit may be unnecessary.

Mr. West noted that charging an overhead rate to non-state funded organizations for state support, which may include audit, is a common practice.

Trustee Murarka also expressed concern about placing undue financial burdens on the auxiliaries and agreed with Dr. Reed that auditing every three years versus two may be more appropriate.

Trustee Murarka added that the area of student fees should be considered for audit as one of the three subject areas.

Mr. West responded that student fees might be a more appropriate topic for next year due to the fact that a recently Executive Order in this area had recently been issued.

Trustee Goldwhite questioned if any campus has ever been encouraged to revise their overhead rates to include an audit segment.

Trustee Pierce explained the difference between federal auditors coming to the campuses/auxiliaries to review contracts and grants and the required A-133 audit of federal funds received. He noted that even though the system may not have federal auditors coming in very often, each auxiliary and the system receive yearly A-133 reviews.

Mr. West noted the important distinction Trustee Pierce had made. He also noted that we are beginning to have on-site audits by federal auditors and that it is important to have a consistent strategy with regard to overhead and cost sharing. For this reason, he indicated that the Executive Audit Committee thought that reviews by the internal audit staff prior to federal agency review would prove to be beneficial.

Trustee Achtenberg, while supporting the addition of two positions, questioned whether there was a way of charging a differential fee to the auxiliaries, to mitigate the cost of the audits.

Mr. Mandel explained that there are 80 auxiliaries in the system and when fees are assessed, they are done so based upon prior year expenditures; therefore, a differential fee is assessed.

Trustee Achtenberg indicated her support for an audit of Contracts and Grants citing the complexity in the area and the suggestion by the NSF auditors that we increase our audit effort here.

Trustee Cartwright, again expressed his concern with additional costs for auditors noting that an A.S. may have to cut a program to pay for its share of any additional audit staff.

Trustee Pierce summarized the various options before the committee.

Trustee Mehta suggested that because auxiliaries vary in size, there may not be a need to audit all of them on the same cycle. Some may need a review more often, some less often.

Trustee Galinson, while noting that it is important to perform as many auxiliary reviews as frequently as possible, again questioned charging the auxiliaries, when they did not request the audits.

Audit

Mr. West explained that, while the trustees are responsible for oversight over multiple funds, there are only certain charges that are appropriate to state funds and it is expected that the other funds pay their fair share of oversight responsibilities.

Trustee Hauck asked if the system could pay a portion of the cost of the audits should we decide to audit some of the bigger auxiliaries more often.

Mr. West explained the risk associated with not charging the auxiliaries and cited previous state audit findings, which noted that charges should go to the originating fund source. He explained that this is the same way the state charges the CSU for overhead costs.

Trustee Cartwright questioned why a system mandated audit, performed by a system auditor, shouldn't be paid for by the system.

Trustee Galinson agreed that, in an effort to complete the audits faster, two positions should be added and that they should be paid for by the system.

Trustee Pierce stated the options of adding two auditors, and not charging them to the auxiliaries, or working out the schedule with the existing staff.

Mr. West again mentioned the risks associated with funding by the system while noting that it was a rather modest amount of expenditure to gain the needed coverage.

Trustee Hauck made a motion to add two staff positions and fund those positions by the system. He further suggested that the university auditor develop a priority-auditing scheme, including his evaluation of risk in relation to frequency of audits.

Trustee Pierce requested that a member of the committee to be the maker of Trustee Hauck's motion.

Mr. Galinson offered to be the maker of the motion as worded by Trustee Hauck.

Trustee Murarka questioned whether one of the subject areas was being removed from consideration in order to use those resources for the auxiliary reviews.

Trustee Pierce indicated that the three subject area audits would continue and that the motion was that the system fund two additional positions to be used for the auditing of auxiliaries.

Trustee Pierce recognized Charles Brink as a member of the public who wished to speak to the Committee on Audit.

Mr. Brink spoke about the operation of the North Campus auxiliary organization at CSU, Northridge, and the difficulty he was having obtaining information about the North

Campus project. He asked the Committee to conduct a review of the North Campus project.

Trustee Pierce thanked Mr. Brink for his comments, and asked for a vote on the motion before the Committee to add two positions to the staff of the Office of the University Auditor to be funded from the general fund. The motion carried.

Trustee Pierce noted that the second item to be addressed was the subject areas of audit for the current year.

Trustee Goldwhite made a motion that Delegations of Authority, Contracts and Grants, and Development be the three subject areas for review. The motion was approved.

Quality Assurance Review of the Office of the University Auditor

Mr. Mandel presented the item and indicated that Government Code Section 1236 requires that all state agencies which conduct internal audits do so in conformity with the *Standards for the Professional Practice of Internal Auditing* as promulgated by the Institute of Internal Auditors. He noted that the purpose of the review was to issue an opinion on the OUA's compliance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing (Standards)*. Mr. Mandel introduced Kent Kay, General Auditor for the University of Alabama system and the leader of the three member team which conducted the review.

Mr. Kay made reference to the five general and twenty-five specific IIA *Standards* by which the OUA was to be measured. He indicated that the OUA was in full compliance with each standard. He discussed the general standards of Independence Professional Proficiency, Scope of Work, Performance of Audit Work, and Management. Mr. Kay noted that the OUA is organizationally placed in an area where it has adequate independence and objectivity; that the auditors are very well qualified and have made a commitment to assisting the CSU system in performance of their audits; that the scope of work, including follow-up is on task; that planning, fieldwork, reporting and follow-up provided reliable opinions and quality information; and, that there is quality management as evidenced by policies and procedures, audit plans, manuals, continuing education, and internal and external reviews.

Mr. Kay next discussed the specific recommendations contained in the report. He noted that the recommendations speak to such issues as a self-evaluation by the audit committee; continual updating of each auditor's acknowledgement of the IIA Code of Ethics; continual assessment by the Committee of audit staff size in relation to risk; physical location of auditors – whether to locate them regionally; the use of computer assisted audit techniques; and, the possible use of external auditors to expand the scope of the auxiliary reviews.

After asking if there were any questions, Trustee Pierce thanked Mr. Kay for his report.

Report of the Systemwide Audit in Accordance with Generally Accepted Accounting Principles Including the Report to Management

Mr. West noted there were two reports included with the agenda item. He first referred to the financial documents, which include the balance sheet and income statement for the entire university system. The documents include all funding sources, including auxiliary funding.

Mr. West announced this was the fourth year of presentation of our financial statements. The financial statements incorporate the 23 campuses within the system, as well as the 78 separately incorporated auxiliaries. Mr. West briefly outlined the various fund categories and their purposes. He also presented a short overview of the balance sheet contents.

Mr. West stated that Mr. Thomas would provide detailed information on the management letter. Mr. Thomas presented an overview of the letter and noted that there were two significant items that required attention; tax issues and auxiliary organizations. He also mentioned the increased risk on the issue of Contracts and Grants, and tax compliance on non-resident alien issues.

Single Audit Report of Federal Funds

Mr. Thomas made a clear distinction between the financial statement and the single audit report. The single audit report addresses compliance and internal controls surrounding federal funds received by the CSU.

The first finding in the single audit report deals with unofficial withdrawals. This is when students simply stop coming to school and how to determine when they do; and how to calculate the various refunds to programs and other financial implications involved. Mr. Thomas cited it was a very difficult issue and that the federal government will be changing the rules to make this problem more manageable.

Mr. Thomas reported the second finding was the Head Start program at San Francisco.

Trustee Hauck asked Mr. Thomas about areas of particular significance since these reviews began four years ago.

Mr. Thomas talked about the evolution of the audit process, the inclusion of the auxiliary organization in the financial statements, the interest of taxing agencies in the areas of UBIT and non-resident aliens, and the large projects undertaken by the system, especially the PeopleSoft implementation.

Trustee Galinson asked if the financial statements of the auxiliary organizations were available to the public. Mr. West responded in the affirmative.

Trustee Hauck asked if there was a library of statements, and Mr. West replied that we receive them all on a regular basis and rely upon the external auditors to review them and incorporate their results into the single external audit report for the system.

Trustee Galinson asked if our auditors review the auxiliary audits.

Mr. Mandel indicated that his office reviews the reports and takes note of areas/comments, which would affect the performance/operational audits of the auxiliaries.

Adjournment

The meeting adjourned at 2:24 p.m..

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

Presentation By

Larry Mandel
University Auditor

Summary

This item includes both a status report on the 2001 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Auxiliary Organizations, Delegations of Authority, Contracts and Grants, Development, Information Systems and Construction. In addition, follow-up on past assignments (FISMA, Auxiliary Organizations, Continuing Education, Student Records, Operations and Maintenance of Plant, Student Health Centers, Hazardous Material Management, and Public Safety) is currently being conducted on 40 prior campus reviews. Attachment A, summarizing the reviews in tabular form, will be distributed at the committee meeting.

Status Report on Current and Follow-up Internal Audit Assignments

At the January 2001 meeting of the Committee on Audit, an audit plan calling for the review of the following subject areas was approved: FISMA (Financial Internal Controls), Auxiliary Organizations, Delegations of Authority, Contracts and Grants, Development, Information Systems, and Construction.

FISMA

The audit plan indicated that approximately 119 staff weeks of activity (16 percent of the plan) would be devoted to auditing financial internal controls on 11 campuses. Fieldwork is currently taking place at four campuses.

Auxiliary Organizations

The audit plan indicated that approximately 165 staff weeks of activity (23 percent of the plan) would be devoted to auditing internal compliance/internal control at 8 campuses/24 auxiliaries. Fieldwork is currently taking place at two campuses/seven auxiliaries.

Delegations of Authority

The audit plan indicated that approximately 94 staff weeks of activity (13 percent of the plan) would be devoted to a review of 10 campuses on areas delegated to the CSU by the legislature.

These areas include Purchasing/Contracting, Leasing, and Motor Vehicles. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Contracts and Grants

The audit plan indicated that approximately 94 staff weeks of activity (13 percent of the plan) would be devoted to a review of 10 campuses on solicitation activities and project approval; contract/grant budgeting and financial planning; cost accounting, allocation, and transfer processes; and award administration. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Development

The audit plan indicated that approximately 94 staff weeks of activity (13 percent of the audit plan) would be devoted to a review of 10 campuses on cash contributions and donations of property and services, controls over the analysis of development needs, identification of prospective donors, solicitation and acknowledgment of donations, valuation of non-monetary donations, recording gifts and posting to accounting records, expending donated funds, and preparation of reports on development activity. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Information Systems

The audit plan indicated that approximately 40 staff weeks of activity (5 percent of the plan) would be devoted to review of systemwide projects such as: Disaster Recovery, Collaborative Management Systems (CMS), Systemwide Internal Partnership (SIP), and Web Security. In addition, support will be provided in the area of financial internal controls for both campus (FISMA) and auxiliary audits. Review and training are ongoing.

Follow-ups

The audit plan indicated that approximately 25 staff weeks of activity (3 percent of the plan) would be devoted to follow-up on prior audit recommendations. The Office of the University Auditor is currently

tracking 40 prior audits (FISMA, Auxiliary Organizations, Continuing Education, Student Records, Operations and Maintenance of Plant, Student Health Centers, Hazardous Material Management, and Public Safety) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

Consultations and Investigations

The audit plan indicated that approximately 43 staff weeks of activity (6 percent of the plan) would be devoted to campus consultations and special requests. The Office of the University Auditor is periodically called upon to provide consultation to the campuses and/or to perform special audit requests made by the chancellor. Typically, the special requests are investigative in nature and often are the result of alleged defalcations or conflicts of interest.

Construction

For the 2000/01 fiscal year, six construction projects are being reviewed by KPMG Peat Marwick with coordination from the Office of the University Auditor. Areas under review include change orders, project management services, contractor compliance, liquidated damages, close out documents, and cost verification of major equipment and construction components. Four of the projects are in the fieldwork or report writing stage at this time.