AGENDA

COMMITTEE ON AUDIT

Meeting: 9:30 a.m., Wednesday, March 17, 2004
Arena Floor - Save Mart Center

Shailesh J. Mehta, Chair
Roberta Achtenberg, Vice Chair
Debra Farar
William Hauck
Frederick W. Pierce, IV

Consent Items

Approval of Minutes of Meeting of January 27, 2004

Discussion Items

1. Status Report on Current and Follow-up Internal Audit Assignments, Information
3. Corrective Action Plan for Findings in the Single Audit Reports, Information
MINUTES OF THE MEETING OF
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 27, 2004

Members Present

Shailesh J. Mehta, Chair
Debra S. Farar
Frederick W. Pierce, IV

Members Absent

Roberta Achtenberg, Vice Chair
William Hauck

Other Trustees Present

Murray L. Galinson
Kathleen E. Kaiser
M. Alexander Lopez
Ralph R. Pesqueira
Kyriakos Tsakopoulos
Anthony M. Vitti
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
Larry Mandel, University Auditor
Jackie McClain, Vice Chancellor, Human Resources

Chair Mehta called the meeting to order at 4:07 p.m.

Approval of Minutes

The minutes of the meeting of November 19, 2003, were approved as submitted.
Audit

Status Report on Current and Follow-up Internal Audit Assignments

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

**FISMA** – Four audits have been completed, report writing is being completed on three campus reviews, and fieldwork is taking place at four campuses.

**Auxiliary Organizations** – Three campus/eleven auxiliary reviews await a response prior to finalization, and report writing is being completed on five campus/eighteen auxiliary reviews.

**Employee Relations** – Three audits have been completed, one audit awaits a campus response prior to finalization, and report writing is being completed on five campus reviews.

**Risk Management and Insurance** – Five audits have been completed, one audit awaits a campus response prior to finalization, and report writing is being completed on three campus reviews.

**Disaster/Contingency Planning** – Two audits have been completed, one audit awaits a campus response prior to finalization, and report writing is being completed on six campus reviews.

**Follow-up** – Currently tracking approximately 50 prior audits (Special Investigations, FISMA, Auxiliary Organizations, Financial Aid, and Disability Support and Accommodations) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

**Construction** – For fiscal year 2002/03, six construction projects have been completed by KPMG with coordination from the Office of the University Auditor. Follow-up reviews are currently in process for these projects. Current construction assignments for fiscal year 2003/04 are on schedule. Two of these projects are in the report-writing stage, and one project is in the fieldwork stage.

Mr. Mandel stated that the campuses have done an exceptional job in completing the recommendations and are to be commended for their efforts. He further stated that only one campus has outstanding recommendations beyond the 9-month target of completion, and the Office of the University Auditor (OUA) has been assisting them with the closing of these recommendations.

Trustee Kaiser asked for an explanation as to why three campuses have not completed any of the outstanding recommendations, specifically Financial Aid at California State University (CSU) Chico; CSU Monterey Bay; and Systemwide.

Mr. Mandel responded that documentation demonstrating the completion of outstanding recommendations at CSU Monterey Bay was received today and is in the process of being
Audit

reviewed by OUA management. He stated that he would have to defer to the campus presidents regarding information on CSU Chico and Systemwide.

Chancellor Reed responded that he would research the issue and provide a timely explanation to the Committee members for Systemwide.

Trustee Mehta inquired about the outstanding recommendations pertaining to Auxiliary Organizations at CSU Sacramento.

Dr. Alexander Gonzalez, president, CSU Sacramento, responded that the delay in completing the outstanding recommendations was due to the establishment and review of several policies in some of the auxiliary organizations and anticipated completion within a few weeks.

**Assignment of Functions to be Reviewed by the Office of the University Auditor for Calendar Year 2004**

Mr. Mandel explained that each year at the January meeting of the Board of Trustees, the Committee on Audit selects the three subject area audit assignments for the OUA and approves the audit plan for the year. He further explained that in addition to the subject area assignments, financial internal control (FISMA); auxiliary organization reviews; and construction reviews, which are performed by KPMG, are planned for calendar year 2004.

Mr. Mandel stated that this is the second year of a three-year risk assessment that was completed in the last quarter of calendar year 2002. He further stated that the results of the 2002 risk assessment were used to assist in the selection of the audit assignments. He explained that Audit Item 2, Attachment A lists 29 prospective audit topics that represent the top 50 percent of risk and indicates the time last audited by the OUA. Based on the risk assessment, subject areas reviewed in the recent past, and discussion with the Executive Audit Committee, which is represented by four CSU presidents and the executive vice chancellor/chief financial officer, the following three subject areas were recommended for consideration for calendar year 2004: Admissions, Human Relations/Personnel, and Student Activities.

Trustee Kaiser inquired as to the reason for not selecting Intercollegiate Athletics as one of the subject area assignments.

Mr. Mandel explained that Intercollegiate Athletics receives both financial and programmatic reviews each year and therefore stated his opinion that internal audits are not necessarily required.

Chair Mehta called for a motion to approve the Committee resolution. A motion was then made and the resolution was passed unanimously to approve the audit plan for calendar year 2004.

Mr. Mandel presented the item by explaining that, per CSU’s contract with KPMG, six construction reviews have been completed. Mr. Mandel then introduced Mr. Mark Thomas, partner in charge from KPMG, who discussed the construction assignments for 2002/03.

Mr. Thomas explained that KPMG performs post-completion construction reviews with coordination from the OUA. He indicated that the six projects reviewed for fiscal year 2002/03 represented more than $120 million and that these reviews included projects at the Humboldt, Chico, San Marcos, Sonoma, Dominguez Hills, and Fullerton campuses. He further indicated that approximately 30 recommendations were included in the construction report pertaining to procedural documentation, liquidating damages, qualifications of contractors, etc. He stated that no major issues were identified during the review.

Trustee Kaiser inquired as to the outstanding recommendations pertaining to the Bell Memorial Union construction project at CSU Chico.

Dr. Scott McNall, interim president, CSU Chico, responded that the recommendation pertains to a settlement agreement in which negotiations are currently ongoing.

Trustee Mehta inquired regarding the accountability of implementing the 30 recommendations included in the construction report.

Mr. Mandel stated that accountability for the completion of outstanding construction recommendations is the same as required for the other subject audit areas. He explained that documentation demonstrating completion of the recommendations is required to be submitted to the OUA for review.

Trustee Mehta inquired as to the method for reporting the completion of recommendations to the Committee members.

Mr. Mandel explained that the completion of recommendations is indicated on the status reports that are distributed to the board members for the Committee meeting.

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

Mr. Dennis Hordyk, assistant vice chancellor, financial services, stated that this is the second year in which the California State University’s (University’s) basic financial statements were prepared in accordance with the new governmental accounting standards, GASB Statements 34, 35, 37, and 38. He further stated that the new format allows for the comparison of fiscal years ended June 30, 2003 and 2002. He explained that the financial statements are comprised of four parts as follows: Management Discussion and Analysis, which provides an overview of the
financial position of the activities of the University for fiscal year ending June 30, 2003 in its entirety, including recognized auxiliary organizations; the Statement of Net Assets, which is the University’s balance sheet and presents information on all assets and liabilities; the Statement of Revenues, Expenses, and Changes in Net Assets, which is the University’s income statement and details how the net assets changed during the most recent fiscal year; and Statement of Cash Flows, which presents the changes in cash and cash equivalents.

Mr. Hordyk indicated that in an effort to find solutions to the state’s budget deficit, the University’s budget was reduced by $102.6 million, and $22.8 million was redistributed to fund health care and compensation costs for a total of unfunded costs and reductions of $125.4 million. To achieve its goal to serve total budgeted enrollment for fiscal year 2002/03, the University reduced funding for technology equipment, scheduled maintenance, and academic and administrative support. In addition, as approved by the board, the undergraduate student fee was increased at mid-year by 10 percent and the graduate student fee by 15 percent. He reported that total net assets increased $578.9 million, primarily in the investment in capital assets, net of related debt, and restricted expendable net assets categories. He also reported that enrollment increased by 5 percent, from 422,904 in fiscal year 2002 to 443,814 in fiscal year 2003.

Trustee Mehta asked if the increase in net assets was partially due to the reduction in University debt.

Chancellor Reed responded that for general obligation funded capital projects, the University would have the assets recorded on the University’s financial statements, but the debt would be carried as an obligation at the State level.

Mr. West provided additional clarification by explaining that state appropriations, noncapital for both fiscal years 2003 and 2002 are almost exactly the same, approximately $2.6 million. However, student fee revenue increased by approximately $60 million. Therefore, although the University’s overall balance sheet increased in total activity, the funding per student decreased due to growth in the number of students.

Trustee Pierce asked whether the approximately $500-million increase in non-current assets was a result of unexpended funds from the bond issue.

Mr. West responded that the increase primarily resulted from the proceeds of the issuance of the Systemwide Revenue Bonds.

Mr. Hordyk stated that the University’s investment in capital assets included eight construction projects on various campuses. He also stated that the major factor for the increase in long-term debt was the issuance of Systemwide Revenue Bonds in the amount of $342,725,000 in 2003.

Mr. Hordyk noted that the largest component of revenues is state appropriations, which accounted for 63 percent of the University’s revenues; this was an increase of 12 percent from
the prior year and was related to capital programs. Specifically, state appropriations, non-capital increased by approximately $4 million, and state appropriations, capital increased by approximately $344 million. This increase in State funded capital projects, which has no corresponding debt, is the single largest component of the overall increase in net assets. He also noted that student tuition and fees increased by $62.7 million, which is the second largest component of revenues.

Mr. Hordyk reported that approximately 70 percent of the total operating expenses supported instructionally related activities, which is the primary function of the University and includes all mission-critical educational support activities of student services, academic support, grants and scholarships, public service, and research to direct classroom instruction. In addition, instructional expenses increased by $117.8 million in the current fiscal year to support enrollment growth.

Mr. Hordyk explained that the last page of the Management’s Discussion and Analysis discusses economic factors for the future of the University and describes the proposed budget, the $23.8-million current year budget reduction, the 30-percent fee increase for students, and the 2004 School Bond (Proposition 55).

Mr. Hordyk introduced Mr. Mark Thomas, partner, KPMG, who discussed the Independent Auditors’ Report of the University’s basic financial statements.

Mr. Thomas commended the University in its detailed presentation of the financial statements, which includes a complete and comprehensive view of the CSU system, not only of the University proper but also of the auxiliary organizations. He acknowledged that it was a monumental task for both the CSU and KPMG staffs to prepare a document that incorporates more than 110 separate entities consolidated into one set of financial statements. In addition, he stated that the National Association of Colleges and Business Officers has requested to use sections of the CSU’s financial statements as examples for other universities across the country this year.

Mr. Thomas stated that the Independent Auditors’ Report provides an unqualified, clean opinion on the CSU’s basic financial statements.

Trustee Mehta complimented Mr. West for his accomplishment with the completion of the financial statements, especially in light of the previously large amount of turnover in staff and the question of continuity of the knowledge base.

Mr. West commended Mr. Hordyk for his efforts in the rebuilding of the accounting staff over a two-year period and for the application of the new GASB statements in the completion of the financial statements.

**Single Audit Report of Federal Funds**
Mr. Thomas explained that because the CSU is a large recipient of federal funds, it is subjected to Office of Management and Budget (OMB) Circular A-133, or Single Audit Act. He further explained that the federal funds are for programs associated with the University only and does not include the auxiliary organizations. He noted that the University has a grand total of $1.1 billion in federal funds; of that $1.1 billion, $1.08 billion (95%) is for student financial aid.

Mr. Thomas discussed the five recommendations included in the Single Audit Reports. He stated that two recommendations pertain to the financial statement preparation process. Two campuses (San Francisco State and CSU Fresno) had significant difficulty in completing the financial statement audit process, preparing financial information for the audit, etc. He indicated that he had discussed the findings with both campuses and they agree with the recommendations and have submitted acceptable corrective actions plans.

Mr. Thomas reported that the remaining three recommendations are as follows: misappropriation of assets at San Francisco State; timing issues of submission of required information at CSU Fresno; and reconciliation issues at CSU San Marcos. All three campuses agree with the recommendations and have submitted corrective action plans.

Trustee Mehta asked whether any money was recovered from the misappropriation at San Francisco State and also inquired as to how such a large amount of money could be misappropriated.

Dr. Robert A. Corrigan, president, San Francisco State University, responded that the employee who embezzled the money had been tried and convicted and will serve a considerable amount of time in prison. He stated that it is doubtful that any of the money will be recovered. He further stated that corrective action has been taken on this issue. He explained that in order to allocate more money into the classrooms, management positions were kept at a minimum; however, due to this misappropriation, additional management positions are being created and filled.

Mr. West agreed with President Corrigan’s comment and reinforced the notion that there is heightened risk exposure associated with the reduction of employees and when positions are kept open for longer periods of time. He indicated that campuses are sometimes under pressure to keep the positions open or try to redirect funds to save classroom instruction, which is a desirable goal, but there are trade offs.

Trustee Mehta agreed with President Corrigan but expressed his concern regarding the risk associated with the reduction of employees in order to save costs. He then inquired as to whether there were any reductions in the OUA staff.

Mr. Mandel responded that no reductions have been made to the audit staff.

**Adjournment**

The meeting was adjourned at 4:45 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 2004 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, Admissions/Evaluations, Human Resources, Student Activities, Information Systems, and Construction. In addition, follow-up on past assignments (Special Investigations, FISMA, Auxiliary Organizations, Financial Aid, Disability Support and Accommodations, Employee Relations, Risk Management and Insurance, and Disaster/Contingency Planning) is currently being conducted on approximately 45 prior campus/auxiliary/investigative reviews. Attachment A summarizes the reviews in tabular form. An up-to-date Attachment A will be distributed at the Committee meeting.

Status Report on Current and Follow-up Internal Audit Assignments

At the January 2004 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, Admissions/Evaluations, Human Resources, Student Activities, Information Systems, and Construction.

FISMA

The audit plan indicated that approximately 136 staff weeks of activity (17 percent of the plan) would be devoted to auditing financial internal controls on 12 campuses. Four audits have been completed, report writing is being completed on four campus reviews, and fieldwork is currently taking place at three campuses.

Auxiliary Organizations

The audit plan indicated that approximately 243 staff weeks of activity (31 percent of the plan) would be devoted to auditing internal compliance/internal control at 8 campuses/27 auxiliaries. Report writing is being completed on two campus/six auxiliary reviews.
Admissions/Evaluations

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of ten campuses to ensure proper management of admissions and evaluations activities through a review of the related control environment; processing of applications for admission; evaluations of student records; application fee and waiver controls; and the protection of confidential admission and evaluation data. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Human Resources

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of ten campuses to ensure proper management of human resources activities through a review of the related control environment; recruitment and advertising practices; the selection and orientation of new employees; employee compensation and selected benefits programs; and the protection of confidential employee information. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Student Activities

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the audit plan) would be devoted to a review of ten campuses to evaluate the effectiveness of operating controls and governance processes pertaining to student activities (including intramural and club sports but excluding intercollegiate athletics), student clubs and organizations (including the fraternities and sororities), and student judicial affairs. 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 43 staff weeks of activity (5 percent of the plan) would be devoted to review of systemwide projects such as: Disaster Recovery, Common Management Systems (CMS), 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 30 staff weeks of activity (4 percent of the plan) would be devoted to follow-up on prior audit recommendations. The Office of the University Auditor is currently tracking approximately 45 prior audits (Special Investigations, FISMA, Auxiliary Organizations, Financial Aid, Disability Support and Accommodations, Employee Relations, Risk Management and Insurance, and Disaster/Contingency Planning) 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 (5 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

The audit plan indicated that approximately five staff weeks of activity (1 percent of the plan) would be devoted to coordination of construction auditing. For the 2003/04 fiscal year, six construction projects are being reviewed by KPMG with coordination from the Office of the University Auditor. Areas under review include construction bid process, change orders, project management services, contractor compliance, liquidated damages, and cost verification of major equipment and construction components. Three audits are in the report writing stage, while fieldwork is currently being completed for one audit.

Training

The audit plan indicated that approximately ten staff weeks of activity (1 percent of the plan) would be devoted to training in control self-assessment. The program consists of a two-day workshop where risk assessment/mitigation and internal control training will be provided and a targeted risk assessment profile will be developed. In addition, the Office of the University Auditor is planning two, one-day workshops on various aspects of audit coordination and process.
### Status Report on Current and Follow-Up Internal Audit Assignments
(as of 3/3/2004)

<table>
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<th>Auxiliary Organizations</th>
<th>Financial Aid</th>
<th>Disability Support</th>
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**FW** = Field Work In Progress  
**RW** = Report Writing In Progress  
**AI** = Audit Incomplete (awaiting formal exit conference and/or campus response)  
**AC** = Audit Complete

* The number of recommendations satisfactorily addressed follows by the number of recommendations in the original report. A "0" in a column is used as a placeholder until such time as documentation is provided to the OUA evidencing that a recommendation has been satisfactorily addressed; significant progress may have been made prior to that time.

** The number of months recommendations have been outstanding (since the formal campus exit conference).

* The number of auxiliary organizations reviewed.
# Status Report on Current and Follow-Up Construction Audit Assignments

(as of 3/3/2004)

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<td>Campus</td>
<td>RW</td>
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<td>2002/03</td>
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<td>CH-630</td>
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<td>Bender</td>
<td>$28,422,060</td>
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<td>Jun-01</td>
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<td>HUM HUM</td>
<td>Infrastructure Improvements</td>
<td>Malicraft, Inc</td>
<td>$19,618,000</td>
<td>11/1/1996</td>
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<td>3/4/5</td>
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<td>SON SON</td>
<td>Remodel Salazar Bldg</td>
<td>West Coast Contract</td>
<td>$20,153,000</td>
<td>9/1/1999</td>
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<td>8/8</td>
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<td>SM SM</td>
<td>Academic II Bldgs 26, 27, &amp; 37</td>
<td>Swinerton Walberg</td>
<td>$33,665,000</td>
<td>8/1/1998</td>
<td>Jun-02</td>
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<td>FUL FUL</td>
<td>Student Housing Expansion</td>
<td>S J Amoroso</td>
<td>$22,404,000</td>
<td>1/1/2000</td>
<td>Aug-02</td>
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<td>0/2/5</td>
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<td>DH DH</td>
<td>Technology Center/Adm. Bldg</td>
<td>S J Amoroso</td>
<td>$30,915,000</td>
<td>8/1/1998</td>
<td>Oct-02</td>
<td>Campus</td>
<td>AC</td>
<td>5/8</td>
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</table>

*FW = Field Work in Progress; RW = Report Writing in Progress; AI = Audit Incomplete (awaiting response); AC = Audit Complete

**The number of recommendations satisfactorily addressed followed by the number of recommendations in the original report.

***The number of months that recommendations have been outstanding (since the formal exit conference).
COMMITTEE ON AUDIT


Presentation By

Richard P. West  
Executive Vice Chancellor and  
Chief Financial Officer

Background

On March 11, 2003, the California State Auditor released its report of the California State University’s Common Management System (CMS). This audit had been requested by Senator Richard Alarcon (D-Los Angeles) and Assembly Member Manny Diaz (D-San Jose), both members of the Joint Legislative Audit Committee (JLAC), on behalf of the California Faculty Association (CFA) and the California State Employees Association (CSEA). The final report includes 30 recommendations for the California State University. The University administration has taken very seriously the concerns raised in the auditors’ report and has taken action on all 30 of the audit’s recommendations through executive order, policies and procedures and proposed legislation. The JLAC has held two hearings on the results of the audit and held special hearings at two of our campuses. We have continued our efforts to provide state policymakers information regarding the CMS project, including the fact that currently 19 campuses are relying on at least some portion of CMS to handle their day-to-day operations as well as the benefits of this one-time investment for students, faculty, staff, system and state.

The CSU has appreciated the ongoing dialogue provided by both the auditor and the Joint Legislative Audit Committee as the university has finalized its responses to the auditor’s recommendations. The audit has been extremely beneficial to the CSU and has highlighted ways that the CSU can make such projects even more effective in the future. It has also helped improve the current CMS project. The university has put in place several new policies and procedures as a result of the audit that have helped improve development and operations of information technology across the university.

A copy of the final status report will be provided to the Board of Trustees at the meeting.
COMMITTEE ON AUDIT

Corrective Action Plan for Findings in the Single Audit Reports

Presentation By:

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

The following is a list of the corrective actions taken by those campuses with audit findings in the Single Audit for the fiscal year ending June 30, 2003:

San Francisco State University

San Francisco State had two audit findings: 03-01 (Financial Statement Preparation Process) and 03-03 (Misappropriation of Assets).

With respect to 03-01, the campus has taken steps to remedy the problem, including changes in organizational structure that created a new Financial Reporting unit that reports directly to Associate Vice President (AVP) for Fiscal Affairs, adding staff resources dedicated to financial reporting, and strengthening the review process for the reporting package. The campus expects to complete all corrective steps by March 18, 2004, including the funding issue.

With respect to 03-03, the corrective action plan was already completed by June 30, 2003.

California State University, Fresno

Fresno had two audit findings: 03-02 (Financial Statement Preparation Process) and 03-04 (Financial Reporting of Pell Payment Data to the U.S. Department of Education).

With respect to 03-02, as of the end of February the campus has completed the corrective action plan by assigning the Manager of General Accounting the responsibility of becoming familiar with the GAAP conversion process to augment those individuals working with the GAAP conversion process, and by strengthening review of the audit schedules and the reporting package prior to submission.
With respect to 03-04, the corrective action plan was completed by December 31, 2003 with the submission of the required data by the extended deadline granted by the Department of Education.

**California State University, San Marcos**

San Marcos had one audit finding: 03-05 (Direct Loan Program Reconciliations).

The campus is in the process of developing a procedure to ensure a monthly reconciliation of Direct Student Loans in the future and also clearing the backlog. These steps will be completed by June 30, 2004.