

AGENDA

COMMITTEE ON AUDIT

Meeting: 2:45 p.m., Tuesday, November 10, 1998
Auditorium

Stanley T. Wang, Chair
Ali C. Razi, Vice Chair
Ronald L. Cedillos
Jim Considine
Harold Goldwhite
James H. Gray
Eric C. Mitchell
Joan Otomo-Corgel
Ralph R. Pesqueira

Consent Items

Approval of Minutes of Meeting of September 15, 1998

Discussion Items

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

**MINUTES OF MEETING OF
COMMITTEE ON AUDIT**

**Trustees of The California State University
Glenn S. Dumke Conference Center
400 Golden Shore
Long Beach, California
September 15, 1998**

Members Present

Stanley T. Wang, Chair
Ali C. Razi, Vice Chair
Ronald L. Cedillos
Harold Goldwhite
James H. Gray
Eric C. Mitchell
Joan Otomo-Corgel
Ralph R. Pesqueira

Members Absent

Jim Considine

Other Trustees Present

Martha C. Fallgatter
Maridel Moulton
Charles B. Reed, Chancellor

Chancellor's Office Staff

June M. Cooper, Senior Vice Chancellor and Interim Chief of Staff
David S. Spence, Executive Vice Chancellor
Richard P. West, Senior Vice Chancellor, Business and Finance
Christine Helwick, General Counsel
Larry Mandel, University Auditor

Presidential Liaisons

Manuel A. Esteban, President, California State University, Chico, present
Alexander Gonzalez, President, California State University, San Marcos, present

Approval of Minutes

Chair Wang called the meeting to order at 3:14 p.m. The minutes of May 13, 1998, were approved as submitted.

Status Report on Current and Follow-up Internal Audit Assignments

Larry Mandel, university auditor, presented the item and noted the following:

Audit

FISMA Audits—the 1998 audit plan called for the completion of twelve campus audits this year. Four of these audits have been completed, fieldwork is being performed on two campuses, report writing is in progress for three campuses, and an additional three audits will be completed by the end of this year.

Risk Management Audits—the 1998 audit plan called for the completion of eleven campus audits this year. Fieldwork has been completed on five campuses and auditors are currently writing reports on these audits. An additional five audits will be completed this year. Due to a redirection of effort for an investigative matter, this is a reduction of one from the original audit plan.

Continuing Education Audits—the 1998 audit plan called for the completion of eleven campus audits this year. One audit has been completed, two are in the fieldwork stage, six are in the report writing stage and two additional audits will be completed by the end of the year.

Information Systems Audits—an information systems risk assessment has been completed, and all campuses provided input into the plan. An audit plan has been developed for the remainder of calendar year 1998 and calendar year 1999 and will address such issues as year 2000, disaster recovery, the collaborative management system, systemwide internal partnerships, electronic commerce, and the FISMA IT portion of the financial internal control reports. Audits will not necessarily be performed in all of these areas, but audit staff will participate with review committees as they move forward.

Auxiliary Audit Program Development Review—the requirement for conducting reviews of campus auxiliaries has been discussed with the board. The audit program is being developed and emphasis will be given to compliance portions and internal control reviews of the auxiliaries. The Sacramento campus has volunteered to serve as a test site for continued audit program development; a preliminary review of two of their auxiliaries will commence on October 12. Mr. Mandel indicated that, in November 1998 or January 1999, he will return to the board to discuss the need for funding of additional positions necessary to successfully perform these reviews.

Follow-ups—the audit matrix denotes the progress made in closing recommendations on the thirty-seven follow-up audits that have open recommendations. All but four of the recommendations related to the Development audits have been satisfactorily addressed. On Delegations of Authority, only one item remains open. For Occupational Health follow-ups, responses have been received from most of the campuses. Although few recommendations have been closed on these audits, each campus is making progress in its attempts to implement the recommendations. In order to complete some of the recommendations, there is an issue of obtaining sufficient resources. Mr. Mandel asked Richard West, senior vice chancellor, business and finance, to address the board on this issue.

Mr. West stated that, although progress has been made in this area, there is more work to be done. He pointed out that he is currently working with campus presidents and Executive Vice Chancellor Spence on the issue. Mr. West emphasized that, because many of the responsibilities associated with risk management and occupational health and safety involve instruction and supervision of students in chemistry and physics labs where toxic chemicals are present, it is essential to have

coordination with all campuses and faculty. He indicated that the issues will be monitored and discussed with Executive Council and others, and the board will be apprised of the progress made on this issue.

Mr. Mandel asked if there were any questions regarding the items covered.

Trustee Otomo-Corgel inquired as to what would be a reasonable expectation for the amount of time necessary to implement and close recommendations.

Mr. Mandel explained that, in order to determine the progress made by campuses, follow-up inquiries are made at six-month intervals after completion of each audit. Ideally, recommendations should be closed within a six-month to one-year period. However, this is dependent upon the complexity of the recommendations and the resources necessary to implement them. In audits such as those of hazardous materials, which often require additional resources, the one-year time frame has been extended. Accordingly, it is often a matter of how quickly the campuses can acquire the necessary resources in order to close recommendations.

Chancellor Reed stated that he discussed the issue of emergency preparedness safety with the campus presidents. He spoke of the fire that recently occurred at the Los Angeles campus and the heightened interest in ensuring that recommendations are implemented. He indicated that Richard West's staff would double their efforts in ensuring that recommendations are implemented.

Trustee Pesqueira inquired as to whether the fire brought to light any inconsistencies or shortages.

President Rosser explained that the fire marshal who investigated the incident stated that the fire was the result of an accident, and there was no arson. In terms of the suppression systems and safety equipment on other floors within the buildings, the systems that were in place operated effectively, and the fire alarm went off within approximately two minutes after the fire started. Students working in the lab also reported the fire within this time frame. The fire doors were closed. In terms of the laboratory, the systems that were in place essentially saved the seventh and eighth floors of the university's Physical Sciences building. President Rosser added that, with regard to whether there are things that can be improved upon, the answer is yes, and the campus is pursuing improvements in certain areas. Some citations may occur. The campus is also deciphering information that could benefit all campuses in terms of actions that can be taken to mitigate such occurrences. Information will be compiled so that other campuses can learn from the incident. Efforts are being made to become more proactive and ensure that the campus is safe for both faculty and students. Due to a lack of resources, however, the campus has a backlog of items that are related to this.

Trustee Pesqueira inquired as to whether any citations were due to negligence on the part of the CSU.

President Rosser responded by stating that it was not as much a question of negligence as a question of resources necessary to do the things that are required. In taking a preventative maintenance perspective, some issues can be mitigated. As a result of this incident, the campus views itself in the way that the Northridge campus did after the Northridge earthquake, in that efforts are being made to ensure that the campus is safe to work within and will recover quickly from the incident.

Trustee Mitchell referred to the two auxiliaries scheduled for audit at the Sacramento campus and asked which auxiliaries would be audited. He also inquired as to whether a more lengthy discussion on this topic would be held during the November meeting.

Mr. Mandel indicated that the CSUS Foundation and CSUS Trust Foundation would be reviewed for purposes of preliminary planning. Because the auditor-in-charge will still be in the fieldwork stage as of the November board meeting, a lengthy discussion of this area will most likely take place at the January 1999 board meeting.

Chair Wang noted that there were two items on the follow-up matrix, one from San Jose and another from Humboldt, that were nearly two years old. He asked why the items had not been closed and whether there had been any problems.

President Caret stated that the item for the San Jose campus is one on which staff have been working since it was brought forward. He explained that it was a matter of getting computer systems in place, and there are different computer database systems in terms of development items that can provide a compilation of a variety of financial reports on gifts that have been received. He further stated that his development staff has been working on the management information systems in order to allow these systems to report to each other.

Chair Wang stated that he understood the fact that some items could not be closed quickly; however, he conveyed his belief that follow-up audit items should be closed within two years. He further articulated that viable suggestions should be made to assist the campus in areas where recommendations could be closed. He referred to the outstanding recommendation for the Humboldt campus and asked about the nature of and corrective action to be taken on the open recommendation.

Mr. Mandel stated that the recommendation pertains to developing a written disaster recovery plan. He explained that discussions to develop agreements to provide equipment on short notice, should a disaster occur, have commenced with vendors and the target date for completion is December 1998. The campus is also working on documenting operational procedures for disaster recovery teams. The target date for completing the documentation for the Rapid Response Team is September 1998 and the target date for completion for other teams is December 1998.

Trustee Wang stated that it is important to continue regular follow-ups of the progress made by campuses in their efforts to close recommendations. Mr. Mandel responded by stating that, in order to ensure that recommendations are implemented, he will continue his discussions with the campuses.

Report on Construction Auditing in the CSU—1997-98

Mr. Mandel presented Agenda Item #2 by stating that construction auditing in the CSU was performed on a contract basis with KPMG Peat Marwick for fiscal year 1997-98. Six completed construction projects were originally planned for review; however, only four were completed. The remaining two projects were not completed within the fiscal year and the contract was modified accordingly. Mr. Mandel asked Mark Thomas of KPMG Peat Marwick, who was in charge of the reviews, to continue with the presentation of the item.

Mr. Thomas stated that construction audits were completed for projects on the Long Beach, Los Angeles, San Diego, and San Francisco campuses. He noted that, because there had not been a great deal of construction auditing in the CSU, there was a fair amount of guessing what the issues would be and what areas should be reviewed. Mr. Thomas stated that he and his staff found that, procedurally, the construction area looks very good. Workplace certifications are in place and insurance coverages are adequate and in compliance. KPMG found PP&D to be very cooperative in the process and very zealous in the negotiation process and in protecting the interests of the CSU. There were issues related to the conduct of the audit, including a situation where it was discovered that a contractor was less than forthright and withheld information. In response, PP&D was instrumental in obtaining records for KPMG.

Mr. Thomas stated that, as a result of what transpired during the construction audit fieldwork, he and Mr. Mandel were considering a revision of the scope of future construction audits. CSU's concept of decentralization will push some areas of construction management out to the campuses, which could create some issues, and KPMG is looking into these issues. Additionally, issues relating to the closeout process are being discussed. Mr. Thomas indicated that both KPMG and Mr. Mandel believe that, from an audit perspective, more attention should be devoted to this area.

Mr. Thomas went on to state that, in reference to the completed audit report, there were a number of findings and each finding had been responded to. There was not, however, complete agreement with all the findings and responses. This is to be expected. There are some areas in which PP&D has taken major steps in areas that could save the CSU hundreds of thousands of dollars. This will result in very positive outcomes, and Mr. Thomas indicated that he was encouraged by all of this.

Mr. Wang commented that, generally speaking, the report is very good. However, he suggested that the format be standardized, pointing out that project descriptions are included in some reports while they are excluded in others. Mr. Wang also expressed concern over the issue of overpayments as they relate to change orders. He stated that, when overpayments are small amounts, it is an issue that should be discussed with the campus planning committee. However, some change orders are much larger. On annual expenditures of \$250,000,000, a 10 percent change order would translate to \$25,000,000, which is substantial. In addition, Mr. Wang pointed out that contractors are profit-oriented and, in some cases, their profit margins are high. However, he indicated that guidance was needed as to what kind of profit margin should be offered to these contractors.

Mr. Thomas responded by stating that the area of potential cost savings is one which PP&D is currently reviewing. As a comparison, he noted that the UC system allows a markup of 5 percent on its change orders, a very low number. The number for the CSU system is approximately 15 percent, a number that is on the high side.

Pat Drohan, deputy senior director, PP&D, stated that the 15 percent figure includes direct and indirect costs, including all overhead and profit due a contractor on change orders. He added that, in the industry and other agencies, the indirect costs are factored in a different way so that some agencies can allow for a lower percentage of overhead and profit. On the downside of that practice, those agencies are often confronted with more claims with regard to those costs and how the

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contractors can be compensated for them. His department, however, is looking into the issue of a sliding scale (for percentage markup) and is conducting a survey to determine what would be the most effective program.

Chair Wang stated that two items, which include the 15 percent markup and the profit margin, should be explored. He inquired about how much was paid to contractors for profit margin.

Mr. Drohan interjected by stating that contractors' profit margins are built into their bids and are based on the competitive marketplace at the time of bid. He stated that in 1991, at the depth of the state's recession, the system was getting tremendous bid savings and profit margins were down to zero. Contractors were taking bids just to keep their employees on the payroll. This example highlights the fact that profit margins are a function of the marketplace. As it relates to change orders, the 15 percent includes 10 percent for overhead and 5 percent for profit margin. This is the typical structure that is in our contract documents for overhead and profit allowed to contractors.

Adjournment

The meeting adjourned at 3:42 p.m.

BRIEF

Information Item

Agenda Item 1
November 10-11, 1998

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 1998 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Risk Management and Insurance, and Continuing Education. In addition, follow-up on past assignments (FISMA, Development, Delegations of Authority, Occupational Health, and Seismic Safety) is currently being conducted on prior campus reviews. Attachment A, summarizing the reviews in tabular form, will be distributed at the committee meeting.

ITEM

2

Agenda Item 1
November 10-11, 1998

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

At the January 1998 meeting of the Committee on Audit, an audit plan was approved calling for the review of the following subject areas: FISMA (Financial Internal Controls), Risk Management and Insurance, Continuing Education, Information Systems Auditing, and Construction Auditing.

FISMA

The audit plan indicated that approximately 137 staff weeks of activity (32 percent of the plan) would be devoted to auditing financial internal controls on twelve campuses. Six of the audits have been completed, fieldwork is continuing at three campuses, while report writing continues for an additional three campuses.

Risk Management and Insurance

The audit plan indicated that approximately 106 staff weeks of activity (25 percent of the plan) would be devoted to a review of risk and liability assessments, insurance coverage and carriers, mitigation and loss prevention programs, and claims reviews and processing at eleven campuses. One of the audits has been completed, report writing is now in process for five of the campus reviews, while fieldwork is continuing at two campuses. A ninth review is scheduled to begin on November 16. This is a reduction of two reviews from the original plan due to a reallocation of resources to perform an investigation and to begin planning for the review of auxiliaries.

Continuing Education

The audit plan indicated that approximately 106 staff weeks of activity (25 percent of the audit plan) would be devoted to a review of continuing education programs and Continuing Education Revenue Fund operations at eleven campuses. Three audits have been completed, report writing is now in process for six campuses, while fieldwork is continuing at one campus. The eleventh review is scheduled to begin on November 16.

Information Systems

The audit plan indicated that approximately 40 staff weeks of activity (9 percent of the plan) would be devoted to the development of an information systems (IS) risk assessment and subsequent IS audit plan. The risk assessment has been completed and an audit plan has been developed for the rest of this year and 1999. The plan addresses the following areas: Year 2000, Disaster Recovery, Collaborative Management Systems (CMS), Systemwide Internal Partnership (SIP), Electronic Commerce, and the Information Technology section of FISMA reviews.

Follow-ups

The audit plan indicated that approximately 13 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 thirty-seven prior audits (FISMA, Development, Delegations of Authority,

Occupational Health, and Seismic Safety) to determine the responsiveness of the corrective action taken for each recommendation and determining whether additional action may be required.

Consultations and Investigations

The audit plan indicated that approximately 13 staff weeks of activity (3 percent of the plan) would be devoted to campus consultations and special requests. The Office of the University Auditor consults with the campuses on an ongoing basis. One investigation has taken place during 1998.

Auxiliary Audit Program Development and Review

The audit plan indicated that approximately 9 staff weeks of activity (2 percent of the plan) would be devoted to developing an audit program covering internal compliance/internal controls and reviewing campus submissions. The original audit plan envisioned the use of external auditors to complete the reviews. Extensive discussions with representatives from external audit firms have led to a determination that their costs would be prohibitive for the desired scope and attestation. Internal audit staff will be used for these reviews. A preliminary survey/review is currently under way at the CSU Sacramento Foundation and Trust Foundation to determine both a reasonable scope for auxiliary reviews and additional internal audit resource needs to complete the reviews.