LOTTERY FUNDS

SONOMA STATE UNIVERSITY

Audit Report 14-24
May 7, 2014

Members, Committee on Audit

Lupe C. Garcia, Chair
Adam Day, Vice Chair
Rebecca D. Eisen  Steven M. Glazer
Hugo Morales

Staff

Vice Chancellor and Chief Audit Officer: Larry Mandel
Senior Director: Michelle Schlack
Audit Manager: Ann Hough

BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY
CONTENTS

Executive Summary ...................................................................................................................................... 1

Introduction................................................................................................................................................... 2
  Background ............................................................................................................................................... 2
  Purpose ...................................................................................................................................................... 4
  Scope and Methodology ............................................................................................................................ 5

OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

Campus Program Expenditures ..................................................................................................................... 6
APPENDICES

APPENDIX A: Personnel Contacted
APPENDIX B: Campus Response
APPENDIX C: Chancellor’s Acceptance

ABBREVIATIONS

Act The California State Lottery Act of 1984
BOT Board of Trustees
CO Chancellor’s Office
CSU California State University
EO Executive Order
FY Fiscal Year
LF Lottery Funds
OAAS Office of Audit and Advisory Services
EXECUTIVE SUMMARY

As a result of a systemwide risk assessment conducted by the Office of Audit and Advisory Services (OAAS) during the last quarter of 2013, the Board of Trustees, at its January 2014 meeting, directed that Lottery Funds (LF) be reviewed. The OAAS has never reviewed lottery funds as a stand-alone audit.

We visited the Sonoma State University campus from January 27, 2014, through February 28, 2014, and audited the procedures in effect at that time.

In our opinion, except for the effect of the weaknesses described below, the fiscal, operational, and administrative controls for LF activities as of February 28, 2014, taken as a whole, were sufficient to meet the objectives stated in the “Purpose” section of this report. Areas of concern include: campus program expenditures.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

The following summary provides management with an overview of conditions requiring attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [ ] refer to page numbers in the report.

CAMPUS PROGRAM EXPENDITURES [6]

Campus administration of lottery fund expenditures needed improvement. Specifically, certain expenditures were prohibited by state legislation or systemwide guidelines; expenses were not always approved by an individual authorized by the corresponding trust agreement; and trust fund agreements did not always include sufficient information to describe the purpose of the fund, the types of appropriate expenditures, or the relevant restrictions.
INTRODUCTION

BACKGROUND

The California State Lottery Act (Act) of 1984 directed the lottery administration to provide supplemental funding for the state’s public schools and colleges. The Act states that all lottery funds allocated to public education must be considered supplemental to other funds allotted to public education, and that no educational program shall receive less financial support from the state because it receives lottery proceeds.

Most of the lottery funds allocated to public education are given to K-12 and community college districts. In fiscal year (FY) 2012/13, K-12 education received 81 percent of the lottery fund allocation for public education. Community college districts received 13 percent, and the California State University (CSU) received less than four percent.

The CSU’s allotment, based on units of full-time-equivalent student enrollment, is given directly to the Board of Trustees (BOT). Since the passage of the Act in 1984, the CSU has received nearly $1 billion in lottery funds. The annual amount has generally increased each year, and the CSU allocation for FY 2012/13 was $43.9 million. Some of the funds are retained by the chancellor’s office (CO) for use in systemwide programs, but the majority are distributed to the individual campuses for use in enhancing instruction. More than $30 million was allocated to campuses in FY 2012/13.

The Act has been codified in Government Code §8880. In addition to outlining terms for the administration of lottery games, the legislation addresses the Act’s intent to ensure that lottery funds are considered supplemental to state education funding. It also mandates that lottery funds be managed separately from state appropriations and deposited in and expended from the California State Lottery Education Fund. Further, it emphasizes the intent that lottery fund allocations to educational institutions are to be used exclusively for the education of students and specifically prohibits the use of the funds for the acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.

The CO Budget Office provides the following written guidance for campus lottery fund allocations:

- **Lottery Budgeting and Allocation Process** outlines the principles of the Act, including the provisions stating that the funds are supplemental to state appropriations and are intended to be used for instructional purposes. It also provides guidelines for both appropriate and prohibited expenditures; states that lottery funds are to be administered separately from state-appropriated funds; and outlines campus and systemwide reporting requirements for the annual report to the BOT, governor and Legislature. Sections discuss in detail the proper use of lottery funds in campus-based programs and in systemwide programs administered by the CO.

- **General Guidelines for Expenditures**, dated September 3, 2008, provides more detailed guidelines regarding appropriate lottery fund expenditures, including specific discussion about the use of lottery funds for faculty compensation. The guidelines prohibit using lottery funds to pay faculty for classroom instruction, to fund faculty overloads, or to increase the compensation rate for any staff, but do allow lottery funds to be used for faculty development, in certain circumstances.


- **Carry-Forward Fund Policy**, dated August 28, 2007, states, in part, that lottery fund allocations should be spent in the year they are allotted, and that excess funds may be subject to de-allocation by the CO. It further states that campuses may carry forward no more than 80 percent of the fiscal year allocation, and that campuses with carry-forward balances will be required to provide to the CO, as part of the financial reporting package, an annual supplemental report addressing the balance.

- **Process for Reporting Expenditure Plan for Amounts that Exceed Carry-Forward Policy**, dated April 21, 2008, provides campuses with more specific instructions on the treatment and reporting of lottery fund carry-forward balances.

The CSU also has policies for the fiscal management of funding sources, including lottery funds. Executive Order (EO) 1000, *Delegation of Fiscal Authority and Responsibility*, dated July 1, 2007, provides the authority and responsibility for effective oversight of all state funds held by the campuses and all funds held in a fiduciary capacity. Lottery funds are one of the many funding sources for CSU campuses and are, as such, subject to the budget and accounting requirements as outlined in the EO.
PURPOSE

Our overall audit objective was to ascertain the effectiveness of existing policies and procedures related to lottery funds and to determine the adequacy of controls that ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, and campus procedures.

Within the overall audit objective, specific goals included determining whether:

- Administration of the lottery fund program is well-defined and includes clear lines of organizational authority and responsibility and documented delegations of authority.
- Policies and procedures related to lottery funds are current, comprehensive, and effectively distributed.
- The campus is providing accurate and timely lottery fund expenditure information to the CO for annual BOT and state reporting.
- The allocation process for lottery funds is well-documented and includes appropriate review and approval.
- The campus is appropriately budgeting and accounting for lottery fund allocations.
- The campus is properly administering and maintaining appropriate reserves of lottery fund allocations.
- The campus is complying with programmatic restrictions for funds received for specific CO lottery fund programs.
- Lottery funds expended in campus-based programs are in compliance with state and CSU requirements and restrictions.
SCOPE AND METHODOLOGY

The proposed scope of the audit as presented in Audit Agenda Item 4 of the January 28 and 29, 2014, meeting of the Committee on Audit stated that Lottery Funds includes activities for the budgeting, receipt, accounting, and expenditures of lottery fund proceeds allocated to the campuses. Proposed audit scope could include, but was not limited to, review of campus lottery fund allocation and expenditure policies and procedures to ensure compliance with CSU and state requirements; review of internal campus processes for monitoring, reviewing, and approving campus discretionary allocations to specific programs; and examination of specific programs receiving lottery funding to confirm the expenditures are in conformance with state and CSU restrictions.

Our study and evaluation were conducted in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors and included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with federal and state regulations and guidance, Board of Trustee policies, and Office of the Chancellor and campus policies, letters, and directives. The audit focused on procedures in effect from July 1, 2011, through February 28, 2014.

We focused primarily on the internal administrative, compliance, and operational controls over Lottery Funds activities. Specifically, we reviewed and tested:

- Administration of lottery fund allocations, including defined responsibilities and current policies and procedures.
- Processes to identify appropriate programs or areas for receipt of campus lottery fund allocations.
- Budgeting and accounting processes.
- Administration and reporting of carry-forward balances.
- Use of lottery fund allocations for administrative expenses.
- Expenditures from lottery fund allocations.
OBSERVATIONS, RECOMMENDATIONS, 
AND CAMPUS RESPONSES

CAMPUS PROGRAM EXPENDITURES

Campus administration of lottery fund expenditures needed improvement.

We reviewed 50 expenditures from various lottery trust fund accounts, and we noted that:

- In five instances, expenditures were prohibited by state legislation or systemwide guidelines. Specifically, lottery funds were used in two instances to pay for faculty overload performed during the academic instructional period, and in three instances to pay salaries for support staff and management/supervisory positions that had previously been state-supported.

- In six instances, expenses had not been approved by an individual authorized by the corresponding trust agreement.

- Trust fund agreements did not always include sufficient information to describe the purpose of the fund, the types of appropriate expenditures, or the relevant restrictions.

The General Guidelines for Expenditures, dated September 3, 2008, states that lottery funds may not be used to finance increases in the rate of compensation paid to existing staff and thus, stipends and honoraria are not permissible. It further states that lottery funds may not be used for faculty overloads unless the existing faculty member was working a summer period under a personal services contract.

The Lottery Budgeting and Allocation Process states under “program expenditures” that funds should be allocated to a select group of instructional activities to achieve maximum impact on enhancing instruction. It further states that this means that lottery revenue should be used to supplement instruction beyond the expected level of state support and should not be used to replace state funding of the budget.

Government Code §8880.4 (b) states that funds allocated for the benefit of public education are in addition to other funds appropriated or required for educational purposes and that no program shall have the amount appropriated to support that program reduced as a result of funds. §8880.5 (m) states that all funds allocated from the California State Lottery Education Fund shall be used exclusively for the education of students, and no funds shall be spent for acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.

State Administrative Manual §19440.1 states that each trust account established shall be supported by documentation as to the type of trust, donor, or source of trust monies, purpose of the trust, time constraints, persons authorized to withdraw or expend funds, specimen signatures, reporting requirements, instructions for closing the account, disposition of any unexpended balance, and restrictions on the use of monies for administrative or overhead costs.

Executive Order (EO) 1000, Delegation of Fiscal Authority and Responsibility, dated July 1, 2001, states that it is the responsibility of the president to ensure that accounting processes are established to
maintain appropriate records of financial transactions and balances, in accordance with CSU policies, standards, and definitions, and that appropriate internal controls are in place for the safeguarding of assets and the reliability of financial reporting.

The director of budget for academic and student affairs stated that due to oversight, lottery fund payments for faculty professional development were not always verified to ensure full compliance with the guidelines. The senior director for university budget stated that lottery funds were used for management and support salaries on a multi-year, temporary basis, as the intent was to enhance the instructional technology area and not supplant the operating fund support. The police chief and executive director for risk management, internal control, and information security stated that the campus was unaware that the campus could not use lottery funds for faculty workstations and related support staff. The director of budget for academic and student affairs further stated that the process for employee sign-ups and payroll transactions, as well as other transactions, required signature approval, but validation of the correct signature authority was sometimes overlooked due to staff changes. The deputy controller stated that the campus recognized the need to strengthen certain sections of the trust agreements and had begun, but not completed, an update.

Using lottery funds in a manner prohibited by state and systemwide guidelines exposes the university to potential legal liabilities and negative public scrutiny, and inadequate administration of authorization for expenditures increases the potential for errors and misuse of funds.

**Recommendation 1**

We recommend that the campus:

a. Expend lottery funds in accordance with state legislation and systemwide guidelines.

b. Obtain approvals for lottery fund expenditures from individuals authorized by corresponding trust agreements.

c. Update trust fund agreements for lottery funds to include sufficient information to describe the purpose of the fund, the types of appropriate expenditures, and the relevant restrictions.

**Campus Response**

We concur.

a. To ensure compliance with state legislation and systemwide guidelines for lottery fund expenditures, the senior director of university budget and the director of budget for academic and student affairs will require appropriate administrators and other key staff with signature authority to review state legislation and CSU regulations pertaining to the purpose of the funds and expenditure guidelines.

b. Lottery program administrators will review EO 1000, *Delegation of Fiscal Authority and Responsibility*, related to lottery funds. Program administrators will receive and review copies of the updated trust agreements and verify the names and signatures of those with delegation of
expenditure authority on the fund. The program administrators and authorized signers will be responsible for approving all lottery fund expenses.

c. Lottery trust fund agreements will be updated to include specific information on the purpose of the fund, the types of appropriate expenditures, and the relevant restrictions.

Anticipated completion date: August 15, 2014
## APPENDIX A: PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ruben Armiñana</td>
<td>President</td>
</tr>
<tr>
<td>David Crozier</td>
<td>Deputy Controller</td>
</tr>
<tr>
<td>Christopher Dinno</td>
<td>Associate Vice President, Facilities Administration</td>
</tr>
<tr>
<td>Veronica Duarte</td>
<td>Teacher Diversity Project Coordinator</td>
</tr>
<tr>
<td>Laurence Furukawa-Schlereth</td>
<td>Vice President, Administration and Finance</td>
</tr>
<tr>
<td>Gayle Graff</td>
<td>Administrative Manager, Office of the Dean of Education</td>
</tr>
<tr>
<td>Nate Johnson</td>
<td>Police Chief and Executive Director for Risk Management,</td>
</tr>
<tr>
<td></td>
<td>Internal Control and Information Security</td>
</tr>
<tr>
<td>Shawn Kilat</td>
<td>Director of Budget, Academic and Student Affairs</td>
</tr>
<tr>
<td>Mike Kiraly</td>
<td>Director of Operations, University Library</td>
</tr>
<tr>
<td>Kurt Koehle</td>
<td>Director, Internal Operations</td>
</tr>
<tr>
<td>John Kornfeld</td>
<td>Associate Vice President for Undergraduate Studies</td>
</tr>
<tr>
<td>Laura Lupei</td>
<td>Senior Director of University Budget</td>
</tr>
<tr>
<td>Scott Miller</td>
<td>Director, Writing Center</td>
</tr>
<tr>
<td>Loriann Negri</td>
<td>Coordinator, Writing Center</td>
</tr>
<tr>
<td>Katie Robinson</td>
<td>Budget Manager, Budget and Treasury</td>
</tr>
<tr>
<td>Tai Russotti</td>
<td>Administrative Manager, Office of the Dean - Arts and Humanities</td>
</tr>
<tr>
<td>Elaine Sundberg</td>
<td>Associate Vice President for Academic Programs</td>
</tr>
</tbody>
</table>
June 12, 2014

MEMORANDUM

TO: Larry Mandel
   Vice Chancellor and Chief University Auditor
   California State University
   401 Golden Shore, 4th Floor
   Long Beach, California 90802-4200

FROM: Laurence Furukawa-Schloth
      Chief Financial Officer and
      Vice President for Administration and Finance

SUBJECT: Lottery Funds, Preliminary Draft Audit Report #14-24
         Campus Response

On behalf of President Armiñana, I am submitting the Campus Response to the recommendations of the Preliminary Draft Audit Report # 14-24, Lottery Fund. Upon acceptance of this response, we will provide documentation to demonstrate the completion of corrective actions for each recommendation.

A pdf copy of this memorandum and the Campus Response will be sent via email to OAAS@calstate.edu.

Attachment

c: Ruben Armiñana, President
   Andrew Rogerson, Provost and Vice President
   Nathan Johnson, Chief of Police and Executive Director
   John Kornfeld, Associate Vice President, Undergraduate Studies
   Elaine Sundberg, Associate Vice President, Academic Programs
   David Crozier, Senior Director, University Financial Services
   Laura Lupei, Senior Director, University Budget
   Shawn Kilat, Director of Budget, Academic and Student Affairs
   Kurt Koeble, Director, Internal Operations
LOTTERY FUNDS
SONOMA STATE UNIVERSITY
Audit Report 14-24

CAMPUS PROGRAM EXPENDITURES

Recommendation 1

We recommend that the campus:

a. Expend lottery funds in accordance with state legislation and systemwide guidelines.

b. Obtain approvals for lottery fund expenditures from individuals authorized by corresponding trust agreements.

c. Update trust fund agreements for lottery funds to include sufficient information to describe the purpose of the fund, the types of appropriate expenditures, and the relevant restrictions.

Campus Response

We concur.

a. To ensure compliance with state legislation and systemwide guidelines for lottery fund expenditures, the Senior Director of University Budget and the Director of Budget for Academic and Student Affairs will require appropriate administrators and other key staff with signature authority to review state legislation and CSU regulations pertaining to the purpose of the funds and expenditure guidelines.

b. Lottery Program administrators will review Executive Order 1000, Delegation of Fiscal Authority and Responsibility, related to lottery funds. Program administrators will receive and review copies of the updated trust agreements and verify the names and signatures of those with delegation of expenditure authority on the fund. The program administrators and authorized signers will be responsible for approving all lottery fund expenses.

c. Lottery trust fund agreements will be updated to include specific information on the purpose of the fund, the types of appropriate expenditures, and the relevant restrictions.

Anticipated completion date: August 15, 2014
June 25, 2014

MEMORANDUM

TO: Mr. Larry Mandel
Vice Chancellor and Chief Audit Officer

FROM: Timothy P. White
Chancellor

SUBJECT: Draft Final Report 14-24 on Lottery Funds,
Sonoma State University

In response to your memorandum of June 25, 2014, I accept the response as submitted with the draft final report on Lottery Funds, Sonoma State University.

TPW/amd