LOTTERY FUNDS

CALIFORNIA STATE UNIVERSITY,
BAKERSFIELD

Audit Report 14-25
April 23, 2014

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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 California State University, Bakersfield campus from February 24, 2014, through March 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 March 28, 2014, taken as a whole, were sufficient to meet the objectives stated in the “Purpose” section of this report. Areas of concern include: budgeting and allocation and 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.

BUDGETING AND ALLOCATION [6]

The campus exceeded lottery fund allocation carry-forward limitations. Specifically, the campus had lottery fund carry-forward balances in excess of 80 percent of the annual lottery fund allocation for fiscal years 2011/12 and 2012/13.

CAMPUS PROGRAM EXPENDITURES [6]

Campus administration of lottery-funded expenditures needed improvement. Specifically, lottery funds were used to pay for faculty overload performed during the academic instructional period.
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.
INTRODUCTION

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 March 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

BUDGETING AND ALLOCATION

The campus exceeded lottery fund allocation carry-forward limitations.

Specifically, we found that the campus had lottery fund carry-forward balances in excess of 80 percent of the annual lottery fund allocation for fiscal years 2011/12 and 2012/13.

California State University (CSU) Carry-Forward Fund Policy, dated August 28, 2007, states that campuses are expected to spend all lottery funds during the fiscal year in which they are allocated. It further states that if a campus does carry forward lottery funds from one fiscal year to the next, the carry-forward amount is limited to no more than 80 percent of that fiscal year’s allocation, and that excess funds are subject to de-allocation by the chancellor’s office.

The vice president of business and administrative services stated that the president and provost deemed the amount of funds carried forward judicious.

Excessive carry-forward balances increase the risk that lottery funds are not being used appropriately and expose the campus to the possibility of de-allocation by the chancellor’s office.

Recommendation 1

We recommend that the campus comply with carry-forward limitations for lottery fund allocations.

Campus Response

The campus will comply with carry-forward limitations for lottery fund allocations. Carry-forward amounts will not exceed 80 percent of the prior year’s lottery fund campus allocation.

Expected implementation date is August 31, 2014.

CAMPUS PROGRAM EXPENDITURES

Campus administration of lottery-fund expenditures needed improvement.

We reviewed 50 lottery-fund expenditures and found seven instances in which lottery funds were used to pay for faculty overload performed during the academic instructional period.

CSU General Guidelines for Expenditures, dated September 3, 2008, states that lottery funds may not be used to pay faculty salaries for classroom instruction. 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.
Government Code 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.

The provost and vice president of academic affairs stated that six of the seven faculty members noted had provided instruction and/or services related to a presidential-approved lottery-funded program, and one faculty member had provided online course instruction in response to a chancellor’s office initiative, and therefore, the use of lottery funds was deemed appropriate.

Using lottery funds in a matter prohibited by state and systemwide guidelines exposes the university to potential legal liabilities and negative public scrutiny.

Recommendation 2

We recommend that the campus discontinue using lottery funds to pay for faculty overload during the academic year.

Campus Response

The campus will discontinue using lottery funds to pay faculty overload during the academic year.

Expected implementation date is June 30, 2014.
**APPENDIX A:**
**PERSONNEL CONTACTED**

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>Horace Mitchell</td>
<td>President</td>
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<tr>
<td>Soraya Coley</td>
<td>Provost and Vice President, Academic Affairs</td>
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<tr>
<td>Jackie Collins</td>
<td>Budget Coordinator, Academic Affairs</td>
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<tr>
<td>Lizeth Gamez</td>
<td>Accounting Supervisor</td>
</tr>
<tr>
<td>Kamel Haddad</td>
<td>Associate Dean, Natural Sciences, Mathematics, and Engineering</td>
</tr>
<tr>
<td>Eva Hebebrand</td>
<td>Manager, Student Financial Services</td>
</tr>
<tr>
<td>Carl Kemnitz</td>
<td>Associate Vice President, Academic Programs</td>
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<td>Wanda Lacava</td>
<td>Budget and Special Projects Coordinator, Enrollment Management</td>
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<td>Tanae McCall</td>
<td>Scholarship Coordinator, Financial Aid</td>
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<tr>
<td>Andrea Medina</td>
<td>Program Director, Math and Science Teacher Initiative</td>
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<tr>
<td>Michelle Mills</td>
<td>Director, University Budget</td>
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<tr>
<td>Jacqueline Minms</td>
<td>Associate Vice President, Enrollment Management</td>
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<td>Michael Neal</td>
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<td>Ron Radney</td>
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<td>Director, First-Year Experience Center</td>
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<td>Douglas Wade</td>
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<tr>
<td>Karla Young</td>
<td>Outreach Counselor, Outreach Services</td>
</tr>
</tbody>
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May 19, 2014

Mr. Larry Mandel  
University Auditor  
Office of the Chancellor  
California State University  
401 Golden Shore 4th Floor  
Long Beach, CA 90802-4210

Re: University Response to Recommendations Contained in Report Number 14-25, Lottery Funds, CSU Bakersfield

Dear Mr. Mandel:

Attached are the University’s responses to the recommendations contained in Report Number 14-25, Lottery Funds Audit.

If you have any questions or concerns, please contact my office at (661) 654-2287.

Sincerely,

Michael A. Neal  
Vice President for Business and Administrative Services

c: Horace Mitchell, CSUB President
BUDGETING AND ALLOCATION

Recommendation 1
We recommend that the campus comply with carry-forward limitations for lottery fund allocations.

Campus Response
The campus will comply with carry-forward limitations for lottery fund allocations. Carry-forward amounts will not exceed 80 percent of the prior year’s lottery fund campus allocation.

Expected implementation date is August 31, 2014.

CAMPUS PROGRAM EXPENDITURES

Recommendation 2
We recommend that the campus discontinue using lottery funds to pay for faculty overload during the academic year.

Campus Response
The campus will discontinue using lottery funds to pay faculty overload during the academic year.

Expected implementation date is June 30, 2014.
May 30, 2014

MEMORANDUM

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

FROM: Timothy P. White  
      Chancellor

SUBJECT: Draft Final Report 14-25 on Lottery Funds,  
          California State University, Bakersfield

In response to your memorandum of May 30, 2014, I accept the response as submitted with the draft final report on Lottery Funds, California State University, Bakersfield.

TPW/amd