LOTTERY FUNDS

CALIFORNIA STATE UNIVERSITY, FRESNO

Audit Report 14-26
June 16, 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
GC Government Code
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, Fresno campus from April 14, 2014, through May 16, 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 May 16, 2014, taken as a whole, were sufficient to meet the objectives stated in the “Purpose” section of this report. Areas of concern include: general environment, 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.

GENERAL ENVIRONMENT [6]

Unexpended lottery fund balances were not disbursed in accordance with trust fund agreements.

BUDGETING AND ALLOCATION [7]

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 [7]

Campus administration of lottery fund expenditures needed improvement. Specifically, expenditures were not always approved by authorized individuals, supported by sufficient documentation, or utilized according to lottery fund guidelines.
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 (GC) §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.
INTRODUCTION

- **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.
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 May 16, 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

GENERAL ENVIRONMENT

Unexpended lottery fund balances were not disbursed in accordance with trust fund agreements.

We found that in four instances, funds were not closed in accordance with the trust fund agreement when the purpose of the trust fund was completed. Specifically, as of the audit review date:

- Summer Arts had a fund balance of $29,403.
- Library Transition had a fund balance of $10,674.
- Early Assessment Program had a fund balance of $24,523.
- Provost’s Study Abroad Scholarship had a fund balance of $1,875.

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.

Government Code (GC) §8880.5 (m) states that funds shall be used exclusively for the education of pupils and students and no funds shall be spent for the acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.

California State University (CSU) Lottery Budgeting and Allocation Process states that funds should be allocated to a select group of instructional activities to achieve maximum impact in enhancing instruction.

The associate vice president for financial services stated that until recently, lottery fund balances were not disbursed because the campus had not reviewed unspent balances on a regular basis.

Maintaining balances in inactive funds increases the risk that funds will not be utilized for enhancements to student education and may keep the campus from fulfilling the intent of government and systemwide lottery fund guidelines.

Recommendation 1

We recommend that the campus disburse unexpended lottery fund balances in accordance with trust fund agreements.

Campus Response

We concur. The campus will review all unexpended funds at year-end and prepare a spending plan, or the president/cabinet will reallocate unspent funds to other current programs. This step will be added to our year-end procedures by November 28, 2014.
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.

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 associate vice president for financial services stated that the campus had not reviewed unspent balances on a regular basis, but the president had reviewed the unspent balances at fiscal year ended June 30, 2012, and reallocated balances to other programs during fiscal year 2012/13. He further stated that there have been efforts to monitor expenses during fiscal year 2013/14 with the expectation that year-end balances will be reduced.

Excessive carry-forward balances increase the risk that lottery will be used inappropriately and expose the campus to the possibility of de-allocation by the chancellor’s office.

Recommendation 2
We recommend that the campus comply with carry-forward limitations for lottery fund allocations.

Campus Response
We concur. We will work to monitor and eliminate any excess carry-forward balances in all lottery funds by November 28, 2014.

CAMPUS PROGRAM EXPENDITURES

Campus administration of lottery fund expenditures needed improvement.

We reviewed 50 lottery fund expenditures and found that:

- Four expenses were not approved by an individual authorized by the corresponding trust agreement.

- In one instance, sufficient documentation was not available to determine whether lottery funds were used in compliance with applicable guidelines.

- In three instances, lottery funds were used for non-instructional purposes.
In one instance, lottery funds were used to pay a faculty salary for classroom instruction.

Integrated California State University Administrative Manual §3103.01, *Disbursements – General*, effective January 1, 2014, states that the expenditure approver must have delegated authority and ensure that appropriate authority and approval has been acquired to initiate the expenditure; appropriate documentation has been obtained; the expenditure is a CSU allowable business expense; the expenditure is in compliance with any funding designations and/or guidelines; and the expenditure is in compliance with appropriate university policies and procedures.

CSU Fresno *Trust Accounting Policy and Procedures Manual* states that the trust administrator will comply with all regulations and procedures for deposit and withdrawals of trust funds and execution of required documents authorizing purchase of and payment for required supplies, services, and equipment.

GC §8880.5 (m) states that all funds allocated from the California State Lottery Education Fund shall be used exclusively for the education of pupils and students, and no funds shall be spent for the acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.

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

The associate vice president for financial services stated that authorized signers did not always match the authorization on the trust agreement because departments did not always update the trust agreements with the appropriate authorized signers after personnel changes. He further stated that the campus has not held regular training on lottery-eligible expenses in the past because most allocations have been for similar types of expenditures; therefore, some non-qualifying expenditures may have been paid.

Inadequate administration over lottery fund expenditures increases the risk of unallowable expenditures and exposes the university to negative public scrutiny.

**Recommendation 3**

We recommend that the campus:

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

b. Obtain sufficient documentation to determine whether lottery funds are being used in compliance with applicable guidelines.

c. Require that all lottery funds are used for instructional purposes that contribute to the education of students.
d. Discontinue the practice of using lottery funds to pay for faculty salaries for classroom instruction.

**Campus Response**

We concur. The campus will continue to monitor that authorized signatures for lottery expenses are matching our trust agreements. The campus will provide appropriate lottery expenditure guideline training to all recipients of a lottery allocation effective November 28, 2014.
## APPENDIX A:
### PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>Joseph I. Castro</td>
<td>President</td>
</tr>
<tr>
<td>Rita Bocchinfuso-Cohen</td>
<td>Director, Career Services</td>
</tr>
<tr>
<td>Carol Fry Bohlin</td>
<td>Director, Mathematics and Science Teacher Initiative (MSTI)</td>
</tr>
<tr>
<td>Robert Boyd</td>
<td>Associate Vice President, Facilities Management</td>
</tr>
<tr>
<td>Lilia De La Cerda</td>
<td>Director, Louise Stokes Alliance for Minority Participation</td>
</tr>
<tr>
<td>Anthony Forestiere</td>
<td>University Controller</td>
</tr>
<tr>
<td>Glenda Harada</td>
<td>Director, Library – Administrative Offices</td>
</tr>
<tr>
<td>Vikki Hensel</td>
<td>Event Coordinator, University Outreach Services</td>
</tr>
<tr>
<td>Lora Kutka</td>
<td>Associate Controller</td>
</tr>
<tr>
<td>Linda Landucci</td>
<td>Administrative Analyst, Academic Programs and Resources</td>
</tr>
<tr>
<td>May Lee</td>
<td>Administrative Assistant and Career Counselor, MSTI</td>
</tr>
<tr>
<td>Arleen Leischner</td>
<td>Director, Kremen School of Education and Human Development</td>
</tr>
<tr>
<td>Pamela Lewis</td>
<td>Manager, Budget and Resource Planning</td>
</tr>
<tr>
<td>Clinton Moffitt</td>
<td>Associate Vice President, Financial Services</td>
</tr>
<tr>
<td>Rachel Lee Nardo</td>
<td>Director, California State University (CSU) Summer Arts, Chancellor’s Office (CO)</td>
</tr>
<tr>
<td>Louise Neal</td>
<td>Coordinator, Pre-Doctoral Program</td>
</tr>
<tr>
<td>Dennis Nef</td>
<td>Associate Vice President, Academic Programs and Resources and Dean, Undergraduate Studies</td>
</tr>
<tr>
<td>Bernard Ogden</td>
<td>Director, Financial Aid</td>
</tr>
<tr>
<td>Frances Pena-Olgin</td>
<td>Director, University Outreach Services</td>
</tr>
<tr>
<td>Kara Perkins</td>
<td>Associate Director, Initiatives and Resource Management, CO</td>
</tr>
<tr>
<td>Kimberley Robles-Smith</td>
<td>Librarian, Library – Collection Management</td>
</tr>
<tr>
<td>Laura Schultz</td>
<td>Business Manager, CSU Summer Arts, CO</td>
</tr>
<tr>
<td>Joanne Sharp</td>
<td>Assistant Director, CSU Summer Arts, CO</td>
</tr>
<tr>
<td>Cynthia Teniente-Matson</td>
<td>Vice President, Administration and Chief Financial Officer</td>
</tr>
<tr>
<td>Christine Thibodeaux</td>
<td>Administrative Analyst, College of Science and Mathematics</td>
</tr>
<tr>
<td>Leo Van Cleve</td>
<td>State University Dean, International Programs and Summer Arts, CO</td>
</tr>
<tr>
<td>Sandra Witte</td>
<td>Interim Dean, Graduate Studies and Associate Dean, Jordan College of Agricultural Sciences and Technology</td>
</tr>
<tr>
<td>Aleta Wolfe</td>
<td>Career Counselor, Career Services</td>
</tr>
</tbody>
</table>
July 18, 2014

MEMORANDUM

To: Larry Mandel
Vice Chancellor and Chief Audit Officer, California State University

From: Cynthia Teniente-Matson
Vice President for Administration and Chief Financial Officer

Subject: Response to the Lottery Funds Incomplete Draft Audit Report 14-26

The university has reviewed the incomplete draft report for the Lottery Funds Audit 14-26. Attached is Fresno State’s response to the recommendations. Please let me know if you have any questions. Thank you.

Attachment

c: Dr. Joseph I. Castro
Mr. Clinton Moffitt
Ms. Michelle Schlack
Ms. Ann Hough
Ms. Carolyn Phu
LOTTERY FUNDS

CALIFORNIA STATE UNIVERSITY,
FRESNO

Audit Report 14-26

GENERAL ENVIRONMENT

Recommendation 1

We recommend that the campus disburse unexpended lottery fund balances in accordance with trust fund agreements.

Campus Response

We concur. The campus will review all unexpended funds at year-end and prepare a spending plan or the President/Cabinet will reallocate unspent funds to other current programs. This step will be added to our year-end procedures by November 28, 2014.

BUDGETING AND ALLOCATION

Recommendation 2

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

Campus Response

We concur. We will work to monitor and eliminate any excess carry-forward balances in all lottery funds by November 28, 2014.

CAMPUS PROGRAM EXPENDITURES

Recommendation 3

We recommend that the campus:

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

b. Obtain sufficient documentation to determine whether lottery funds are being used in compliance with applicable guidelines.

c. Require that all lottery funds are used for instructional purposes that contribute to the education of students.
d. Discontinue the practice of using lottery funds to pay for faculty salaries for classroom instruction.

Campus Response

We concur. The campus will continue to monitor that authorized signatures for lottery expenses are matching our trust agreements. The campus will provide appropriate lottery expenditure guideline training to all recipients of a lottery allocation effective November 28, 2014.
August 4, 2014

MEMORANDUM

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

FROM: Timothy P. White
      Chancellor

SUBJECT: Draft Final Report 14-26 on Lottery Funds,
         California State University, Fresno

In response to your memorandum of August 4, 2014, I accept the response as submitted with the draft final report on Lottery Funds, California State University, Fresno.

TPW/amd