

AUXILIARY ORGANIZATIONS

SONOMA STATE UNIVERSITY

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ABBREVIATIONS

ASI	Associated Students of Sonoma State University
CSU	California State University
IRC	Internal Revenue Code
IRS	Internal Revenue Service
RFIN	Resolution of the Committee on Finance
SSE	Sonoma State Enterprises, Inc.
SSU	Sonoma State University
SSUAF	Sonoma State University Academic Foundation Inc.
SSUC	Sonoma Student Union Corporation

EXECUTIVE SUMMARY

In July 1981, the Board of Trustee policy concerning auxiliary organizations was adopted in the Resolution of the Committee on Finance (RFIN) 7-81-4. Executive Order 698, *Board of Trustees Policy for the California State University Auxiliary Organizations*, dated March 3, 1999, required that the Office of the University Auditor conduct internal compliance/internal control reviews of auxiliary organizations, and the Board of Trustees instructed that such reviews be conducted on a triennial basis pursuant to procedures established by the chancellor.

We visited the Sonoma State University (SSU) campus and its auxiliary organizations from October 6, 2003, through November 7, 2003, and made a study and evaluation of the system of internal compliance/internal control in effect for the period July 2000 to November 2003. This report represents our triennial review.

SSU's management is responsible for establishing and maintaining an adequate system of internal compliance/internal control and assuring that each of its auxiliary organizations similarly establishes such a system. This responsibility, in accordance with California Code of Regulations, Title 5, Section 42402 et seq. and Executive Order 698, *Board of Trustees Policy for the California State University Auxiliary Organizations et seq.*, includes requiring the documentation of internal control, communicating requirements to employees, and assuring that its system of internal compliance/internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures.

The objectives of a system of internal compliance/internal control are to provide management with reasonable, but not absolute, assurance that:

- ▶ Auxiliary operations are conducted in accordance with policies and procedures established in the State Administrative Manual, Education Code, Title 5, and Trustee policy.
- ▶ Assets are adequately safeguarded against loss from unauthorized use or disposition.
- ▶ Transactions are executed in accordance with management's authorization and recorded properly to permit the timely preparation of reliable financial statements.

Our study and evaluation at *Sonoma State University Academic Foundation Inc.* revealed certain conditions, which, in our opinion, could result in errors and irregularities if not corrected. Specifically, the auxiliary did not maintain adequate control over the following areas: investments; fees, revenues, and receivables; and purchasing and accounts payable. These conditions, along with other weaknesses, are described in the executive summary and in the body of the report. In our opinion, except for the effect of the weaknesses described above, accounting and administrative control in effect as of November 7, 2003, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at *Sonoma State Enterprises, Inc.* did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify other reportable weaknesses that are described in the executive summary and in the body of the report. In our opinion, the accounting and administrative

control in effect as of November 7, 2003, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at *Sonoma Student Union Corporation* revealed certain conditions, which, in our opinion, could result in errors and irregularities if not corrected. Specifically, the auxiliary did not maintain adequate control over the following area: purchasing and accounts payable. These conditions, along with other weaknesses, are described in the executive summary and in the body of the report. In our opinion, except for the effect of the weaknesses described above, accounting and administrative control in effect as of November 7, 2003, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at *Associated Students of Sonoma State University* revealed certain conditions, which, in our opinion, could result in errors and irregularities if not corrected. Specifically, the auxiliary did not maintain adequate control over the following area: personnel and payroll. These conditions, along with other weaknesses, are described in the executive summary and in the body of the report. In our opinion, except for the effect of the weaknesses described above, accounting and administrative control in effect as of November 7, 2003, taken as a whole, was sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls change 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 their 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

LEGAL AND REGULATORY COMPLIANCE [9]

The campus improperly loaned \$110,000 in health center trust funds to the Sonoma Student Union Corporation. In addition, board minutes for three of the four campus auxiliary organizations were not consistently signed and approved by an appropriate official, and the campus had not established a process to ensure that all conflict-of-interest statements were executed annually. Further, administrative service agreements between the campus and two auxiliaries for personnel services had not been established.

PERSONNEL AND PAYROLL [12]

The campus' administration of Children's School employee personnel files and certain employment standards was deficient. Campus personnel did not maintain complete personnel files in a central location containing all required documents, did not ensure that Children's School employees were

properly screened and classified, and did not ensure that background checks were conducted and appropriately documented for all Children's School employees.

AUXILIARY PROGRAMS [13]

Funds provided by Sonoma State Enterprises, Inc. to the campus for use in renovation of a campus facility were financially treated as a prepayment for 20 years of administrative costs.

SONOMA STATE UNIVERSITY ACADEMIC FOUNDATION INC.

INVESTMENTS [15]

The Sonoma State University Academic Foundation Inc. (SSUAF) investment policies and procedures did not sufficiently address the management of market losses.

PURCHASING AND ACCOUNTS PAYABLE [16]

Certain SSUAF cash disbursements were not supported by sufficient and appropriate documentation and/or appropriate authorization. Numerous processing exceptions were noted indicating that existing cash disbursement policies and procedures required reiteration.

SONOMA STATE ENTERPRISES, INC.

LEGAL AND REGULATORY COMPLIANCE [18]

Sonoma State Enterprises, Inc. (SSE) reserves were not maintained in compliance with its reserve policy.

CASH RECEIPTS AND HANDLING [18]

Controls over SSE's concession receipts were in need of improvement, as procedures over the administration of concession receipts were not documented, documentation of cash counts was not maintained, and independent revenue reconciliations had not been performed.

PURCHASING AND ACCOUNTS PAYABLE [19]

Certain SSE cash disbursements were not supported by sufficient and appropriate documentation and/or appropriate authorization. Various processing exceptions were noted indicating that existing cash disbursement policies and procedures required reiteration.

SONOMA STUDENT UNION CORPORATION

LEGAL AND REGULATORY COMPLIANCE [21]

The Sonoma State Union Corporation (SSUC) had not established procedures to ensure that confirmation of appropriate university admission was obtained prior to the awarding of a scholarship or other related payment (e.g., stipend); awarded stipends were not appropriately reported to the financial aid office; and board member stipends were not reported to the Internal Revenue Service. In addition, documentation evidencing presidential approval of bylaws was not retained.

PURCHASING AND ACCOUNTS PAYABLE [23]

The SSUC did not follow campus purchasing and accounts payable policies and procedures as required. For example, a purchase of an electric car, made by the executive director on his personal credit card, was not processed through campus procurement and did not receive prior approval. In addition, certain SSUC cash disbursements were not supported by sufficient and appropriate documentation. Specifically, disbursements for student events did not include appropriate supporting documentation, such as an announcement to the students, an attendee listing, or record of the number of students attending the event; and numerous processing exceptions were noted indicating that existing cash disbursement policies and procedures required reiteration.

FIXED ASSETS [26]

The SSUC did not adhere to campus fixed assets policies and procedures regarding the use of equipment off campus and control over property susceptible to theft.

ASSOCIATED STUDENTS OF SONOMA STATE UNIVERSITY

LEGAL AND REGULATORY COMPLIANCE [28]

The Associated Students of Sonoma State University (ASI) operating agreement with the campus did not sufficiently address all aspects of ASI operations on the campus. Functions not articulated in the operating agreement included ASI's operation of a children's center program; provision of loans, scholarships, grants-in-aids, stipends, or related financial assistance; and maintenance of trusts and similar funds. The ASI had not established procedures to ensure that confirmation of continued enrollment in the university was obtained prior to the awarding of a scholarship or other related payment (e.g., stipend). In addition, documentation evidencing presidential approval of bylaws was not retained.

PURCHASING AND ACCOUNTS PAYABLE [30]

Certain ASI cash disbursements were not supported by sufficient and appropriate documentation. Specifically, expenditures for a hospitality event did not provide the names of participating individuals, and numerous processing exceptions were noted indicating that existing cash disbursement policies and procedures required reiteration.

PERSONNEL AND PAYROLL [31]

The ASI could not provide appropriate documentation of the referendum establishing current payments to student officers for service to the student government. In addition, the ASI bylaws defined payments to board members as compensation. However, these payments were not reported to the Internal Revenue Service as income.

INTRODUCTION

BACKGROUND

Education Code §89900 states, in part, that the operation of auxiliary organizations shall be conducted in conformity with regulations established by the Trustees.

Education Code §89904 states, in part, that the Trustees of the California State University (CSU) and the governing boards of the various auxiliary organizations shall:

- ▶ Institute a standard systemwide accounting and reporting system for businesslike management of the operation of such auxiliary organizations.
- ▶ Implement financial standards that will assure the fiscal viability of such various auxiliary organizations. Such standards shall include proper provision for professional management, adequate working capital, adequate reserve funds for current operations and capital replacements, and adequate provisions for new business requirements.
- ▶ Institute procedures to assure that transactions of the auxiliary organizations are within the educational mission of the state colleges.
- ▶ Develop policies for the appropriation of funds derived from indirect cost payments.

The Board of Trustee policy concerning auxiliary organizations was originally adopted in July 1981 in the Resolution of the Committee on Finance (RFIN) 7-81-4. Executive Order 698, *Board of Trustees Policy for the California State University Auxiliary Organizations*, dated March 3, 1999, represents policy of the Trustees addressing CSU auxiliary organization activity and governing the internal management of the system. CSU auxiliary organizations are required to comply with Board of Trustee policy (California Code of Regulations, Title 5, Section 42402 and Education Code, Section 89900).

This executive order requires that the Office of the University Auditor will perform an internal compliance/internal control review of auxiliary organizations. The review will be used to determine compliance with law, including statutes in the Education Code and rules and regulations of Title 5, and compliance with policy of the Board of Trustees and of the campus, including appropriate separation of duties, safeguarding of assets, and reliability and integrity of information. According to Board of Trustee instruction, each auxiliary organization shall be examined on a triennial basis pursuant to procedures established by the chancellor.

PURPOSE

The principal audit objectives were to determine compliance with the Education Code, Title 5, and directives of the Board of Trustees and the Office of the Chancellor and to assess the adequacy of controls and systems. Specifically, we sought assurances that:

- ▶ Legal and regulatory requirements are complied with.
- ▶ Accounting data is provided in an accurate, timely, complete, or otherwise reliable manner.
- ▶ Assets are adequately safeguarded from loss, damage, or misappropriation.
- ▶ Duties are appropriately segregated consistent with appropriate control objectives.
- ▶ Transactions, accounting entries, or systems output is reviewed and approved.
- ▶ Management does not intentionally override internal controls to the detriment of control objectives.
- ▶ Accounting and fiscal tasks, such as reconciliations, are prepared properly and completed timely.
- ▶ Deficiencies in internal controls previously identified were corrected satisfactorily and timely.
- ▶ Management seeks to prevent or detect erroneous recordkeeping, inappropriate accounting, fraudulent financial reporting, financial loss, and exposure.

SCOPE AND METHODOLOGY

Our study and evaluation were conducted in accordance with the *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 that accounting and administrative controls are in place and operative. The management review emphasized, but was not limited to, compliance with state and federal laws, Board of Trustee policies, and Office of the Chancellor policies, letters, and directives. For those audit tests that required annualized data, fiscal years 2000/01, 2001/02, and 2002/03 were the primary periods reviewed. In certain instances, we were concerned with representations of the most current data; in such cases, the test period was July 2002 to June 2003. Our primary focus was on internal compliance/internal control.

Specifically, we reviewed and tested:

- ▶ Formation of the auxiliary.
- ▶ Functions the auxiliary performs on the campus.
- ▶ Creation and operation of the auxiliary's board.
- ▶ Establishment of policies and procedures based upon sound business practices.
- ▶ Maintenance of "arms-length" in business transactions between the auxiliary and the campus.
- ▶ Campus oversight of auxiliary operations.

Additionally, for the period reviewed, we examined other aspects of compliance of the campus and each auxiliary with the Education Code and Title 5 as they relate to the operation of CSU auxiliary organizations. Individual codes and regulations added to the scope of our review were identified through an assessment of risk. Similarly, internal controls were included within our scope based upon risk. Therefore, the scope of our review varied from auxiliary to auxiliary.

A preliminary survey of CSU auxiliaries at each campus was used to identify risks. Risk was defined as the probability that an event or action would adversely affect the auxiliary and/or the campus. Our assessment of risk was based upon a systematic process, using professional judgments on probable adverse conditions and/or events that became the basis for development of our final scope. We sought to assign higher review priorities to activities with higher risks. As a result, not all risks identified were included within the scope of our review.

Based upon this assessment of risks, we specifically included within the scope of our review the following:

Sonoma State University Academic Foundation, Inc.

- ▶ Legal and Regulatory Compliance
- ▶ Cash Receipts and Handling
- ▶ Investments
- ▶ Endowments
- ▶ Fees, Revenues, and Receivables
- ▶ Trusts and Other Liabilities
- ▶ Auxiliary Programs — Sponsored Programs

Sonoma State Enterprises, Inc.

- ▶ Legal and Regulatory Compliance
- ▶ Cash Receipts and Handling
- ▶ Petty Cash and Change Funds
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable

Sonoma Student Union Corporation

- ▶ Legal and Regulatory Compliance
- ▶ Cash Receipts and Handling
- ▶ Petty Cash and Change Funds
- ▶ Fees, Revenues, and Receivables
- ▶ Personnel and Payroll
- ▶ Fixed Assets

Associated Students of Sonoma State University

- ▶ Legal and Regulatory Compliance
- ▶ Cash Receipts and Handling
- ▶ Petty Cash and Change Funds
- ▶ Personnel and Payroll
- ▶ Fixed Assets
- ▶ Trusts and other Liabilities

We have not performed any auditing procedures beyond the date of our report. Accordingly, our comments are based on our knowledge as of that date. Since the purpose of our comments is to suggest areas for improvement, comments on favorable matters are not addressed.

OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

CAMPUS

LEGAL AND REGULATORY COMPLIANCE

WRITTEN AGREEMENTS

The campus improperly loaned \$110,000 in health center trust funds to the Sonoma Student Union Corporation (SSUC).

Education Code §89721 states, in part, that a health center fund shall be legally established using monies received in connection with fees and charges for services, materials, and facilities authorized by Section 89700 where these fees or charges are required of those persons who, at their option, use the services or facilities or are provided the material for which the fees or charges are made. Fees and charges so received and deposited shall be used solely to meet the costs of providing these services, materials, and facilities.

The university controller stated that it was the campus' intent for funds to be appropriately loaned between the SSUC trust fund and the campus health center trust fund in accordance with related requirements.

Incorrectly drafting written agreements increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

Recommendation 1

We recommend that the original agreement be voided and that all funds loaned from the health center trust fund to the SSUC be returned.

Campus Response

We concur. The agreement has been cancelled, and the funds, including interest, have been repaid on June 25, 2004.

Corrective action has been completed.

BOARD MINUTES

Board minutes for three of the four campus auxiliary organizations were not consistently signed and approved by an appropriate official.

Corporations Code §5215 states that the original or a copy of the bylaws or of the minutes of any incorporators', members', directors', committee or other meeting or of any resolution adopted by the board or a committee thereof, or members, certified to be a true copy by a person purporting to be the

secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of such bylaws or resolution or of the due holding of such meeting and of the matters stated therein.

The vice president of finance and administration stated that board minutes were not signed due to oversight.

Failure to maintain signed and approved board minutes increases the risk of misunderstandings and may increase legal liability.

Recommendation 2

We recommend that the campus take appropriate measures to ensure that minutes of auxiliary governing boards are signed and approved by an appropriate official.

Campus Response

We agree. Instructions will be issued to all the auxiliaries to ensure that the minutes of the governing boards are signed and approved by an appropriate official.

Expected completion date: July 31, 2004

CONFLICT OF INTEREST

The campus had not established a process to ensure that all conflict-of-interest statements were executed annually.

Education Code §89906 states that no member of the governing board of an auxiliary organization shall be financially interested in any contract or other transaction entered into by the board of which he is a member, and any contract or transaction entered into in violation of this section is void.

Title 5 §42401, §42402, §42500 and Education Code §89900 establish a responsibility to operate in accordance with sound business practices in the interest of the campus. Sound business practice mandates establishing conflict-of-interest policies and procedures to implement Education Code §89906 and other similar provisions to prevent imprudent or improper decisions by auxiliary board and management members.

The vice president of administration and finance stated his belief that current policies and procedures were adequate.

Failure to adequately address and implement conflict-of-interest code policies and procedures increases liability for acts contrary to the code.

Recommendation 3

We recommend that the campus provide additional guidance for its auxiliaries to strengthen and further document conflict-of-interest policies and procedures.

Campus Response

We concur. The campus will issue additional guidance to its auxiliaries to strengthen conflict-of-interest procedures and retain the appropriate records to document annual conflict-of-interest statements by board members.

Expected completion date: August 13, 2004

ADMINISTRATIVE SERVICE AGREEMENTS

Administrative service agreements between the campus and two auxiliaries for personnel services had not been established.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that written agreements that fully define the expectations, rights, and responsibilities of the parties involved be executed.

The vice president of administration and finance stated that the failure to establish written administrative service agreements with auxiliaries for personnel services was due to oversight.

The absence of written agreements increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

Recommendation 4

We recommend that the campus establish written administrative service agreements with auxiliaries for personnel services.

Campus Response

We agree. The university will set up service agreements with the Associated Students of Sonoma State University (ASI) and the SSUC to provide for personnel services.

Expected completion date: July 31, 2004

PERSONNEL AND PAYROLL

The campus' administration of Children's School employee personnel files and certain employment standards was deficient.

In 2002, when the Children's School personnel became campus employees, campus personnel services did not review existing personnel files containing background checks, licensing, and applications prior to converting these individuals to campus employees.

We found that the campus did not:

- ▶ Maintain complete personnel files in a central location containing all required documents. Personnel files were missing documents such as verification of fingerprints, completed background checks, or Notice of Employee Rights forms.
- ▶ Ensure that Children's School employees were properly screened and classified. A nutritionist was mistakenly classified as an early childhood instructor.
- ▶ Ensure that background checks were conducted and appropriately documented for all Children's School employees.

Title 22 §101170 and §101216 indicate that the child-care center must submit fingerprints to the California Department of Justice to conduct a criminal record clearance prior to the individual's employment and that proof of clearance must be kept in personnel files. Furthermore, a copy of the signed Notice of Employee Rights shall be kept in the employee's personnel record.

Title 22 §101217 (d) states that all personnel records are to be maintained at the child-care center or at a central administrative location provided that they are readily available upon request.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that employees be properly classified as to position duties and requirements.

The director of employee services stated that all aspects were not concluded regarding the transitioning of personnel responsibilities for the ASI Children's School employees to the campus.

Failure to properly administer personnel files and employment standards increases the risk of misunderstandings and legal liability.

Recommendation 5

We recommend that the campus, on behalf of the ASI Children's School:

- a. Maintain complete personnel files in a central location containing all required documents.
- b. Ensure that Children's School employees are properly screened and classified.
- c. Ensure that background checks are conducted and appropriately documented for all Children's School employees.

Campus Response

We concur. The university has addressed each of the above-specific recommendations. Effective December 5, 2003, total personnel administration responsibilities were assumed by the Sonoma State University Human Services Cluster.

Corrective action has been completed.

AUXILIARY PROGRAMS

Funds provided by Sonoma State Enterprises, Inc. (SSE) to the campus for use in renovation of a campus facility were financially treated as a prepayment for 20 years of administrative costs.

SSE's partial funding (\$6.1 million) of the Salazar Hall remodel project (\$19.3 million) was characterized as a 20-year prepayment for campus services to be provided to SSE for human resources, fiscal, and logistical services. The campus had based the characterization of this event on similarly approved transactions. The CSU associate general counsel, upon further review of Government Code §11259 and Education Code §89046, concluded that the initial characterization of the transaction was not correct. Rather, it should have been characterized as a capital leasehold improvement.

Government Code §11259 states, in part, that all monies received by any state agency for charges for work, services, materials, or equipment shall be deposited in the State Treasury and credited by the State Controller to the fund or appropriation from which the cost of such work, services, materials, or equipment was or will be paid.

Education Code §89046 states, in part, that any rental received by the trustees under this or other leasing sections shall be deposited in the State Treasury and credited to the support appropriation of the California State University (CSU) current during the period of occupancy.

When the General Fund is not properly reimbursed for facilities, goods, and services provided to auxiliary organizations, there is a risk that a "gift of public funds" claim could be asserted against the campus.

Recommendation 6

We recommend that the campus characterize the SSE financial event as a capital leasehold transaction and refrain from using the initial method of financing in the future.

Campus Response

We concur. The SSE Salazar transaction has been characterized as a capital leasehold improvement. Appropriate contractual documents have been developed and executed between SSE and the university effective July 1, 2003.

Corrective action has been completed.

SONOMA STATE UNIVERSITY ACADEMIC FOUNDATION, INC.

INVESTMENTS

The Sonoma State University Academic Foundation (SSUAF) investment policies and procedures did not sufficiently address the management of market losses.

SSUAF holds funds for the benefit of the campus, including endowments, scholarships, gifts, and other campus funds.

- ▶ During two of the last three years, realized losses were not distributed within the general ledger to the individual accounts that comprised the pool.
- ▶ SSUAF had not reassessed its spending policy to consider the effect of realized losses on the pool and its individual accounts.
- ▶ Fund expenditures were only restricted to the book value of the account rather than to the lower of account book or market value.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates strong controls over the administration and management of investment accounts.

The SSUAF president stated that the condition generally occurred as a result of the significant and prolonged decline in the investment markets during the three-year period from 1999 through 2002, and the inability to rapidly adjust earnings distribution to address the decline.

When investment policies and procedures do not fully consider the possibility of significant financial market fluctuations, the risk is increased that funding levels for scholarships and other campus projects will be inconsistent between periods.

Recommendation 7

We recommend that the SSUAF amend its investment policies and procedures to address:

- a. The distribution of realized losses to the individual accounts that comprise the pool.
- b. The reassessment of its spending policy to consider the effect of realized losses on the pool and its individual accounts.
- c. Expenditure of funds at the lower of account book or market value.

Campus Response

We concur. Each specific recommendation is addressed in the SSUAF investment policy, as revised by board action.

Corrective action has been completed as proposed.

PURCHASING AND ACCOUNTS PAYABLE

Certain SSUAF cash disbursements were not supported by sufficient and appropriate documentation and/or appropriate authorization.

Our review of 40 cash disbursements disclosed the following:

Processing Exceptions

- ▶ In seven instances, a facsimile or photocopied invoice was accepted for payment without certification that records were checked to prevent duplicate payments.
- ▶ In seven instances, disbursements were missing pertinent supporting documentation, such as supporting receipts or invoices.
- ▶ In seven instances, invoices, requisitions, and a travel expense claim lacked approval by an authorized individual.
- ▶ In seven instances, invoices were not paid in a timely manner.
- ▶ In two instances, travel authorization forms and/or travel expense claims did not support travel disbursements. In both instances, the regular employee was reimbursed for a volunteer employee's travel expenses with gift funds.
- ▶ In one instance, documentation indicating competitive bidding practices in support of the purchase did not exist.
- ▶ In one instance, an employee was reimbursed for a laptop that was purchased without a price quote and without the assistance of the contracts and procurement office.
- ▶ In one instance, payment was made without proof of receipt of goods.
- ▶ In one instance, a list of attendees was not obtained as part of the supporting documentation.
- ▶ In one instance, a disbursement was not made in accordance with terms of the trust agreement.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the

objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that all cash disbursements be fully supported and properly authorized.

The university controller stated that policies and procedures existed to ensure that proper documentation and authorization was obtained before disbursements were processed; however, exceptions occurred due to oversight.

Insufficient supporting documentation and/or lack of appropriate authorization increase the risk of errors, irregularities, and misappropriation of funds.

Recommendation 8

We recommend that the SSUAF reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation and appropriate authorization.

Campus Response

We concur. The campus will issue a letter of instruction to remind staff of existing cash disbursement policies and procedures in respect to appropriate documentation and authorization.

Expected completion date: August 13, 2004

SONOMA STATE ENTERPRISES, INC.

LEGAL AND REGULATORY COMPLIANCE

The Sonoma State Enterprises, Inc. (SSE) was not in compliance with its reserve policy.

SSE's board-approved reserve policy addressed reserve requirements and the methodology to be used for the calculation and recording of reserves; however, the policy was not followed.

Education Code §89904(b), §89904.5, and §89905 indicate that reserve planning is necessary.

The SSE senior director of entrepreneurial services stated that variance from stated policy was due to oversight.

Insufficient reserve planning and analysis increase the auxiliary's risk to fund future needs.

Recommendation 9

We recommend that SSE ensure that reserves are maintained in compliance with its reserve policy.

Campus Response

We concur. A new reserve policy and procedure is being developed for approval by the SSE board of directors.

Expected completion date: October 31, 2004

CASH RECEIPTS AND HANDLING

Controls over SSE's concession cash receipts were in need of improvement.

We noted that:

- ▶ Procedures for the administration of concession receipts were not documented.
- ▶ Documentation of cashier counts was not maintained.
- ▶ An independent reconciliation of receipts and deposits was not performed.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that sufficient internal controls be maintained over cashiering duties and cash receipts processing.

The SSE director of university dining services stated her belief that all counts and reconciliations were being performed.

Inadequate controls over cashiering duties and cash receipts processing increase the risk of loss or misappropriation of funds.

Recommendation 10

We recommend that SSE:

- a. Document procedures for the administration of concession receipts.
- b. Maintain evidence of cashier counts.
- c. Perform independent reconciliations of receipts and deposits.

Campus Response

We agree. Each of the above recommendations has been addressed in the Cash Handling Guidelines and Procedures updated on May 28, 2004.

Corrective action has been completed.

PURCHASING AND ACCOUNTS PAYABLE

Certain SSE cash disbursements were not supported by sufficient and appropriate documentation and/or appropriate authorization.

Our review of 25 cash disbursements disclosed the following:

Processing Exceptions

- ▶ In three instances, a facsimile or photocopied invoice was accepted for payment without certification that records were checked to prevent duplicate payment.
- ▶ In three instances, payments were made without sufficient supporting documentation, such as receipts or proof of receipt of goods.
- ▶ In two instances, a specimen signature was not on file for the fund from which a disbursement was made.
- ▶ In one instance, the quantity billed and paid exceeded the quantity received.
- ▶ In one instance, a check request was altered without explanation or initials approving the change.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the

objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that all cash disbursements be fully supported and properly authorized.

The university controller stated that disbursements made without appropriate supporting documentation and appropriate authorization were due to oversight.

Insufficient supporting documentation and/or lack of appropriate authorization increase the risk of errors, irregularities, and misappropriation of funds.

Recommendation 11

We recommend that SSE reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation and appropriate authorization.

Campus Response

We concur. The university controller will issue a letter of instruction to remind staff of existing cash disbursement policies and procedures in respect to appropriate documentation and authorization.

Expected completion date: July 31, 2004

SONOMA STUDENT UNION CORPORATION

LEGAL AND REGULATORY COMPLIANCE

BYLAWS

The Sonoma State Union Corporation (SSUC) did not retain documentation evidencing the campus president's approval of its bylaws.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates the retention of approved bylaws.

The SSUC executive director stated that the bylaws had been submitted to the campus president, but approval documentation could not be located.

Failure to retain presidential approval of bylaws increases the risk of misunderstandings regarding rights and responsibilities.

Recommendation 12

We recommend that the SSUC retain documentation evidencing the campus president's approval of its bylaws.

Campus Response

We concur.

Corrective action has been completed.

EDUCATIONAL SUPPORT

Controls over SSUC stipends were deficient in certain areas.

We found that:

- ▶ The SSUC had not established procedures to ensure that confirmation of appropriate university admission was obtained prior to the awarding of a scholarship or other related payment (e.g., stipend).
- ▶ The SSUC did not report awarded stipends to the financial aid office.

- ▶ The SSUC did not appropriately report board member stipends to the Internal Revenue Service (IRS).

Title 5 §42500(d) states that student loans, scholarships, stipends, and grants-in-aid shall only be given to currently admitted students. Additionally, a record of financial assistance, such as student loans, scholarships, stipends, and grants-in-aid shall be forwarded on a timely basis to the campus financial aid office and shall be documented on student financial aid recipient records in that office.

IRS Publication 15-A, *Employer's Supplemental Tax Guide*, indicates that an employee-employer relationship exists if the employer can control what work will be done and how it will be done. Publication 15-A further indicates that in order to establish an individual as an employee, an employer must demonstrate behavioral and financial control over the employee. Additionally, Publication 15-A states that a director of a corporation is not an employee with respect to services performed as a director.

According to the IRS, in order to establish that all or part of a scholarship or fellowship grant is received tax-free, the following must be documented:

- ▶ They are a candidate for a degree at an educational institution.
- ▶ Amounts they receive as a scholarship or fellowship are used for tuition and fees required for enrollment or attendance at the educational institution, or for books, supplies, and equipment required for courses of instruction.
- ▶ Amounts received are not a payment for services.

Further, the IRS notes that the following income would be reportable:

- ▶ Amounts used for incidental expenses, such as room and board, travel, and optional equipment.
- ▶ Amounts received as payments for teaching, research, or other services required as a condition for receiving the scholarship or fellowship grant.

Internal Revenue Code (IRC) §6050S requires entities to report specified information returns with the IRS and to provide a corresponding statement to individuals on the information return, indicating that the information has been reported. These leadership scholarships are reportable as 1099 miscellaneous income because they represent reimbursement for incidental expenses. In order to be a tax-free scholarship (per IRS Publication 520), the stipend would have to be used under the terms of the grant for tuition and fees required for enrollment, and for fees, books, supplies, and equipment required for all students enrolled in a given course.

The SSUC executive director stated that although student status was verified, documentation was not maintained. He further stated that when the SSUC performed its own accounting, 1099's were issued for stipends paid to board members; however, due to oversight, this practice did not continue when the campus took responsibility for such payments.

Insufficient controls over the awarding of stipends increase the risk that erroneous payments will be made and could result in a tax liability.

Recommendation 13

We recommend that the SSUC:

- a. In conjunction with the campus, establish procedures to ensure that a confirmation of appropriate university admission is obtained prior to the awarding of a scholarship or other related payment (e.g., stipend).
- b. Report awarded stipends to financial aid.
- c. Report to the IRS, when required, stipends to board members.

Campus Response

We concur. The campus will issue a letter of instruction to the SSUC to ensure that:

- a. A procedure is established, in cooperation with the university, to confirm that appropriate university admission confirmation is obtained prior to awarding a scholarship or other related payment (e.g. stipend), and that enrollment status is verified after the enrollment drop date.
- b. A report of the award is issued to the financial aid office.
- c. A report to the IRS is made, when required, of stipends made to board members.

Expected completion date: August 13, 2004

PURCHASING AND ACCOUNTS PAYABLE

POLICIES AND PROCEDURES

The SSUC did not follow campus purchasing and accounts payable policies and procedures as required.

We noted that the executive director of the SSUC was reimbursed \$48,000 for SSUC purchases during the period under review. He used personal credit cards in lieu of the campus-approved procurement card, allowing him to earn airline mile rewards. Purchases included an electric cart, which was not processed through campus procurement and did not receive prior approval. Further, the executive director was reimbursed for others' travel.

Education Code §89900 and Title 5 §42403 require that sufficient operating procedures be established by the auxiliary to allow the campus president (or designee) to ascertain that all expenditures are in

accordance with policies of the CSU Trustees, including the propriety of all expenditures, and integrity of financial reporting.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates strict adherence to procurement and accounts payable policies and procedures.

The SSUC executive director stated his belief that SSUC was following campus policy, because claims submitted for payment were not questioned by campus accounting staff. The campus vice president of administration and finance stated that all auxiliaries should be following campus policy.

Failure to define and enforce policies and procedures weakens internal controls and increases the risk that misunderstandings will occur.

Recommendation 14

We recommend that the campus enforce its purchasing and accounts payable policies and procedures applicable to SSUC.

Campus Response

We concur. The campus will issue a letter of instruction to remind SSUC staff that existing university purchasing and accounts payable policies are to be followed.

Expected completion date: July 31, 2004.

SUPPORTING DOCUMENTATION

Certain SSUC cash disbursements were not supported by sufficient and appropriate documentation.

Our review of 40 cash disbursements disclosed the following:

Process Controls

- ▶ In four instances, disbursements for student events did not include appropriate supporting documentation, such as an announcement to the students, an attendee listing (e.g., copy of a sign-up sheet), or record of the number of students attending the event to demonstrate that the event occurred.

Processing Exceptions

- ▶ In seven instances, a facsimile or photocopied invoice was accepted for payment without certification that records were checked to prevent duplicate payment.

- ▶ In six instances, internet printouts and rental contracts, instead of original receipts or invoices, were submitted with the disbursement.
- ▶ In five instances, individuals were reimbursed for other students' travel and conference fees.
- ▶ In three instances, claims for reimbursement were not submitted in a timely manner, sometimes taking up to five months.
- ▶ In two instances, complete supporting documentation, such as agreements or contracts, were not submitted with the disbursement.
- ▶ In two instances, individuals were reimbursed for purchasing computers on their personal credit cards.
- ▶ In two instances, claims for personal reimbursement were submitted without proof of expenditure.
- ▶ In one instance, a stipend authorization dated in 2000 was submitted for a stipend awarded in 2002.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that all cash disbursements be fully supported.

The SSUC executive director stated that failure to submit the appropriate supporting documentation with disbursements was due to oversight.

Insufficient supporting documentation increases the risk of errors, irregularities, and misappropriation of funds.

Recommendation 15

We recommend that the SSUC:

- a. Require student event disbursements to be supported by an accompanying announcement to the students, an attendee listing (e.g., copy of a sign-up sheet), or record of the number of students attending the event to demonstrate that the event occurred.
- b. Reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation.

Campus Response

We concur. The campus will issue a letter of instruction to the SSUC to ensure that:

- a. Student event disbursements are supported by an accompanying announcement to students and an attendee listing or a record of the number of students attending the events to demonstrate that the event occurred.
- b. Existing university cash disbursement policies and procedures are followed in respect to sufficient and appropriate supporting documentation.

Expected completion date: July 31, 2004

FIXED ASSETS

The SSUC did not adhere to campus fixed assets policies and procedures.

We noted that the SSUC:

- ▶ Was not utilizing the university property checkout request, or similar form, for the use of equipment off campus.
- ▶ Did not take proper security precautions for high-risk property.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates strong controls over fixed assets.

The SSUC executive director stated that he was unaware of campus fixed assets policies and procedures.

Inadequate controls over fixed assets increase the risk that property may be lost or stolen.

Recommendation 16

We recommend that the SSUC:

- a. Utilize the university property checkout request, or similar form, for the use of equipment off campus.
- b. Take proper security precautions for high-risk property.

Campus Response

We concur. The campus will issue a letter of instruction to ensure that the SSUC:

- a. Utilize the university property checkout request for off-campus use of equipment.
- b. Properly secure high-risk property through lock down cables, etc.

Expected completion date: July 31, 2004

ASSOCIATED STUDENTS OF SONOMA STATE UNIVERSITY

LEGAL AND REGULATORY COMPLIANCE

AUXILIARY AUTHORIZATION

The Associated Students of Sonoma State University (ASI) operating agreement with the campus did not sufficiently address all aspects of ASI operations on the campus.

Functions not articulated in the operating agreement included ASI's operation of a children's center program; provision of loans, scholarships, grants-in-aids, stipends, or related financial assistance; and maintenance of trusts and similar funds.

Title 5 §42501 states that a written agreement on behalf of the State of California by the Chancellor of The California State University and the auxiliary organization is required for the performance by such auxiliary organization of any of the functions listed in §42500. Title 5 §42502 states that the operating agreement should specify the function or functions which the organization is to manage, operate, or administer.

The ASI executive director stated that the omission of certain functions from the operating agreement was due to oversight.

Operating in the absence of an up-to-date, written agreement increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

Recommendation 17

We recommend that the ASI amend its operating agreement with the campus to specify all functions managed, administered, and operated by the auxiliary.

Campus Response

We concur. The operating agreement effective September 1, 2004, specifies all functions managed, administered, and operated by the ASI.

Corrective action has been completed.

BYLAWS

The ASI did not retain documentation evidencing the campus president's approval of its bylaws.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that

allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates the retention of approved bylaws.

The ASI executive director stated that the ASI bylaws had been submitted to the president and failure to retain documentation evidencing presidential approval of revisions was due to oversight.

Failure to retain presidential approval of bylaws increases the risk of misunderstandings regarding rights and responsibilities.

Recommendation 18

We recommend that the ASI retain documentation evidencing the campus president's approval of its bylaws.

Campus Response

We concur.

Corrective action has been completed.

EDUCATIONAL SUPPORT

The ASI had not established procedures to ensure that confirmation of continued enrollment in the university was obtained prior to awarding a scholarship or other related payment (e.g., stipend).

The ASI confirmed that its board members were admitted to the university prior to the enrollment drop date, but not after. Additionally, the enrollment status of recipients of short-term loans was verified based upon presentation of their campus identification card enrollment sticker, but otherwise was not verified.

Title 5 §42500(d) states that student loans, scholarships, stipends, and grants-in-aid shall only be given to currently admitted students.

The ASI executive director stated his belief that student status was sufficiently verified; however, he had not fully considered all possibilities regarding the potential change in a student's status.

Insufficient controls over the awarding of stipends increase the risk that erroneous payments will be made and could result in a tax liability.

Recommendation 19

We recommend that the ASI develop procedures to confirm and document the:

- a. Eligibility of board members, both before and after the drop date.
- b. Current eligibility of loan recipients at the time the loans are disbursed.

Campus Response

We concur. The campus will issue a letter of instruction to ensure that the ASI:

- a. Establish a procedure to validate eligibility of all board members before and after the enrollment drop date of each semester the student is in office.
- b. Develop a procedure to confirm the eligibility of loan recipients at the time the loan is disbursed.

Expected completion date: August 13, 2004

PURCHASING AND ACCOUNTS PAYABLE

Certain ASI cash disbursements were not supported by sufficient and appropriate documentation.

Our review of 30 cash disbursements disclosed the following:

Process Controls

- ▶ In two instances, the expenditure for a hospitality event did not provide the names of participating individuals.

Processing Exceptions

- ▶ In eight instances, a facsimile or photocopied invoice was accepted for payment without certification that records were checked to prevent duplicate payment.
- ▶ In three instances, complete supporting documentation, such as agreements or contracts, was not submitted with the disbursement.

Title 5 §42401 and §42402 indicate that the campus president shall require that auxiliary organizations operate in conformity with policy of the Board of Trustees and the campus. One of the objectives of the auxiliary organizations is to provide fiscal procedures and management systems that allow effective coordination of the auxiliary activities with the campus in accordance with sound business practices. Sound business practice mandates that all cash disbursements be fully supported.

The ASI executive director stated that the exceptions noted were due to oversight.

Insufficient supporting documentation increases the risk of errors, irregularities, and misappropriation of funds.

Recommendation 20

We recommend that the ASI:

- a. Require that hospitality expenditures include the names of participating individuals.
- b. Reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation.

Campus Response

We concur. The campus will issue a letter of instruction to the ASI to ensure that:

- a. The campus hospitality expenditure guidelines are followed.
- b. Existing university cash disbursement policies and procedures are followed in respect to sufficient and appropriate supporting documentation.

Expected completion date: August 13, 2004.

PERSONNEL AND PAYROLL

Certain controls over ASI stipends paid to student board members were deficient.

We found that:

- ▶ The ASI could not provide appropriate documentation of the referendum establishing current payments to student officers for service to the student government.
- ▶ The ASI bylaws defined payments to board members as compensation. However, these payments were not reported to the IRS as income.

Title 5 §42659(k) indicates that student body organization funds obtained from mandatory fees may be expended for student government-scholarship stipends, grants-in-aid, and reimbursements to student officers for service to student government. Before such scholarship stipends, grants-in-aid, and reimbursements are established by a student body association, the principle of establishing such payments shall be approved by a student referendum.

IRS Publication 15-A, *Employer's Supplemental Tax Guide*, indicates that an employee-employer relationship exists if the employer can control what work will be done and how it will be done. Publication 15-A further indicates that in order to establish an individual as an employee, an employer must demonstrate behavioral and financial control over the employee. Additionally, Publication 15-A states that a director of a corporation is not an employee with respect to services performed as a director.

According to the IRS, in order to establish that all or part of a scholarship or fellowship grant is received tax-free, the following must be documented:

- ▶ They are a candidate for a degree at an educational institution.
- ▶ Amounts they receive as a scholarship or fellowship are used for tuition and fees required for enrollment or attendance at the educational institution, or for books, supplies, and equipment required for courses of instruction.

IRC §6050S requires entities to report specified information returns with the IRS and to provide a corresponding statement to individuals on the information return, indicating that the information has been reported. These leadership scholarships are reportable as 1099 miscellaneous income because they represent reimbursement for incidental expenses. In order to be a tax-free scholarship (per IRS Publication 520), the stipend would have to be used under the terms of the grant for tuition and fees required for enrollment, and for fees, books, supplies, and equipment required for all students enrolled in a given course.

The ASI executive director stated that he was unaware of the tax implications of stipends paid to student officers and considered them scholarships.

The lack of supporting documentation evidencing appropriate use of student fees increases the risk of both inappropriate expenditures and misunderstandings about the use of funds.

Recommendation 21

We recommend that the ASI:

- a. Appropriately document the principles for establishing stipend payments to student officers.
- b. Clearly document its determination that stipends paid to student board members are scholarships.

Campus Response

We concur. The campus will issue a letter of instruction to ensure that the ASI:

- a. Appropriately document the principles for establishing stipend payments to student officers.
- b. Clearly document its determination that stipends paid to student board members are scholarships.

Expected completion date: September 17, 2004.

APPENDIX A: PERSONNEL CONTACTED

<u>Name</u>	<u>Title</u>
CAMPUS	
Ruben Armiñana	President
Trisha Allen	Campus Life Adviser, Clubs and Organizations
John Beckman	Investment Administrator
Marlene Bles	Administrative Assistant, Athletics
Ann Casella	Cashier
Leticia Coate	University Controller
Lawrence Furukawa-Schlereth	Vice President, Administration and Finance
Bill Fusco	Director, Athletics
Janet Hankes	Advancement Support Facilitator
Grace Herrera	Cashier
William Ingels	Associate Controller/Treasurer
Susan Kashack	Director, Communication
Kurt Koehle	Director, Internal Operations
Richard Ludmerer	Senior Director, Risk Management
Sharon Marshall	Vendor Representative-Accounting Technician III
Ruth McDonnell	Director, Contracts and Procurement
Cindy Miller	Accounting Officer, Payments
Tania Montes	Accountant
Jerry Norris	Accountant, Fixed Assets/Property
Linda Norris	Assistant Controller, Auxiliaries
Laurie Ogg	Scholarship Coordinator
Rebecca Olsen	Accountant, General Accounting
Diane Psota	Accountant
Valerie Riffle	Development Database Coordinator
Paul Santini	Director, Receipts, Accounts Receivable and Financial Aid
Nicholas Saschin	Account Administrator, Financial Services
Kathleen Spitzer	Director, Employee Services
Mary Trimble	Accountant, Receipts
Steven Wilson	Associate Vice President, Administration and Finance

SONOMA STATE UNIVERSITY ACADEMIC FOUNDATION, INC.

Letitia Coate	Secretary/Chief Financial Officer
Steven Wilson	President/Vice President/Chief Operating Officer

SONOMA STATE ENTERPRISES, INC.

Lisa Andresen	Director, University Dining Services
Ken Brown	Director, Retail Services
Chris Cammarano	Assistant to the Director, Retail Services
Stephanie Larcher	Assistant Director, University Dining Services
Alan Murray	Senior Director, Entrepreneurial Services
Rhonda Nilsson	Cashier Supervisor, Bookstore
Dan O'Brien	Associate Director, Dining Services

SONOMA STUDENT UNION CORPORATION

Donna Cavin	Administrative Support Assistant
Geoff Cridge	Box Office Manager
Andra Feldman	Copy Corner Manager
Sarah Hellman	Operations Manager
Pamela Su	Recreation Sports Coordinator
Jerry Uhlig	Technical/Operation Coordinator
William Williams	Assistant Director
John Wright	Executive Director

ASSOCIATED STUDENTS OF SONOMA STATE UNIVERSITY

Brittany Davison	Student Assistant
Erik Dickson	Executive Director
Lia Thompson-Clark	Director, Children's School
Linda Williams	Accountant

STATEMENT OF INTERNAL CONTROLS

A. INTRODUCTION

Internal accounting and related operational controls established by the state of California, the CSU Board of Trustees, and the Office of the Chancellor are evaluated by the university auditor, in compliance with professional standards for the conduct of internal audits, to determine if an adequate system of internal control exists and is effective for the purposes intended. Any deficiencies observed are brought to the attention of appropriate management for corrective action.

B. INTERNAL CONTROL DEFINITION

Internal control, in the broad sense, includes controls that may be characterized as either accounting or operational as follows:

1. Internal Accounting Controls

Internal accounting controls comprise the plan of organization and all methods and procedures that are concerned mainly with, and relate directly to, the safeguarding of assets and the reliability of financial records. They generally include such controls as the systems of authorization and approval, separation of duties concerned with recordkeeping and accounting reports from those concerned with operations or asset custody, physical controls over assets, and personnel of a quality commensurate with responsibilities.

2. Operational Controls

Operational controls comprise the plan of organization and all methods and procedures that are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records.

C. INTERNAL CONTROL OBJECTIVES

The objective of internal accounting and related operational control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting and operational control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgment by management

D. INTERNAL CONTROL SYSTEMS LIMITATIONS

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting and related operational control. In the performance of most control procedures, errors can result from misunderstanding of instruction, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect to the executing and recording of transactions. Moreover, projection of any evaluation of internal accounting and operational control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate. It is with these understandings that internal audit reports are presented to management for review and use.



DIVISION OF ADMINISTRATION AND FINANCE
1801 East Cotati Avenue
Rohnert Park, California 94928-3609

July 1, 2004

Larry Mandel
 University Auditor
 401 Golden Shore, 4th Floor
 Long Beach, California 90802-4200

RECEIVED
 UNIVERSITY AUDITOR

JUL - 6 2004

THE CALIFORNIA STATE
 UNIVERSITY

Dear Mr. Mandel: *Larry*

On behalf of President Armiñana, I am submitting the campus response to the recommendations of the University Auditor Report Number 03-51, Auxiliary Organizations at Sonoma State University. This response has also been forwarded via email to lmandel@calstate.edu. Documentation demonstrating implementation of recommendations already completed will be forwarded to you separately.

Please contact Kurt Koehle (kurt.koehle@sonoma.edu) on my staff for additional information and follow up.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry", written over a horizontal line.

Laurence Furukawa-Schlereth
 Chief Financial Officer and
 Vice President for Administration and Finance

Enclosures

Cc: President Ruben Armiñana
 Steve Wilson, Associate Vice President for Administration and Finance
 Letitia Coate, Controller and Senior Director for Financial Services
 Alan Murray, Senior Director, Entrepreneurial Services, SSE
 John Wright, Executive Director, SSUC
 Erik Dickson, Executive Director, ASI
 Kurt Koehle, Director of Internal Operations

THE CALIFORNIA STATE UNIVERSITY

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 Luis Obispo • San Marco • Sonoma • Stanislaus

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

CAMPUS

LEGAL AND REGULATORY COMPLIANCE

WRITTEN AGREEMENTS

Recommendation 1

We recommend that the original agreement be voided and that all funds loaned from the health center trust fund to the SSUC be returned.

Campus Response

We concur. The agreement has been cancelled, and the funds, including interest, have been repaid on June 25, 2004.

Corrective action has been completed.

BOARD MINUTES

Recommendation 2

We recommend that the campus take appropriate measures to ensure that minutes of auxiliary governing boards are signed and approved by an appropriate official.

Campus Response

We agree. Instructions will be issued to all the auxiliaries to ensure that the minutes of the governing boards are signed and approved by an appropriate official.

Expected completion date: July 31, 2004

CONFLICT OF INTEREST

Recommendation 3

We recommend that the campus provide additional guidance for its auxiliaries to strengthen and further document conflict-of-interest policies and procedures.

Campus Response

We concur. The campus will issue additional guidance to its auxiliaries to strengthen conflict-of-interest procedures and retain the appropriate records to document annual conflict-of-interest statements by board members.

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

Expected completion date: August 13, 2004

ADMINISTRATIVE SERVICE AGREEMENTS

Recommendation 4

We recommend that the campus establish written administrative service agreements with auxiliaries for personnel services.

Campus Response

We agree. The University will set up service agreements with the ASI and the SSUC to provide for personnel services.

Expected completion date: July 31, 2004

PERSONNEL AND PAYROLL

Recommendation 5

We recommend that the campus, on behalf of the ASI Children's School:

- a. Maintain complete personnel files in a central location containing all required documents.
- b. Ensure that Children's School employees are properly screened and classified.
- c. Ensure that background checks are conducted and appropriately documented for all Children's School employees.

Campus Response

We concur. The University has addressed each of the above specific recommendations. Effective December 5, 2003, total personnel administration responsibilities were assumed by the SSU Human Services Cluster.

Corrective action has been completed.

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

AUXILIARY PROGRAMS

Recommendation 6

We recommend that the campus characterize the SSE financial event as a capital leasehold transaction and refrain from using the initial method of financing in the future.

Campus Response

We concur. The SSE Salazar transaction has been characterized as a capital leasehold improvement. Appropriate contractual documents have been developed and executed between SSE and the University effective July 1, 2003.

Corrective action has been completed.

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

SONOMA STATE UNIVERSITY ACADEMIC FOUNDATION INC.

INVESTMENTS

Recommendation 7

We recommend that the SSUAF amend its investment policies and procedures to address:

- a. The distribution of realized losses to the individual accounts that comprise the pool.
- b. The reassessment of its spending policy to consider the effect of realized losses on the pool and its individual accounts.
- c. Expenditure of funds at the lower of account book or market value.

Campus Response

We concur. Each specific recommendation is addressed in the SSUAF Investment Policy, as revised by board action.

Corrective action has been completed as proposed.

PURCHASING AND ACCOUNTS PAYABLE

Recommendation 8

We recommend that the SSUAF reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation and appropriate authorization.

Campus Response

We concur. The campus will issue a letter of instruction to remind staff of existing cash disbursement policies and procedures in respect to appropriate documentation and authorization.

Expected completion date: August 13, 2004

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

SONOMA STATE ENTERPRISES, INC.

LEGAL AND REGULATORY COMPLIANCE

Recommendation 9

We recommend that SSE ensure that reserves are maintained in compliance with its reserve policy.

Campus Response

We concur. A new reserve policy and procedure is being developed for approval by the SSE Board of Directors.

Expected completion date: October 31, 2004

CASH RECEIPTS AND HANDLING

Recommendation 10

We recommend that SSE

- a. Document procedures for the administration of concession receipts.
- b. Maintain evidence of cashier counts.
- c. Perform independent reconciliations of receipts and deposits.

Campus Response

We agree. Each of the above recommendations has been addressed in the Cash Handling Guidelines and Procedures updated on May 28, 2004.

Corrective action has been completed.

SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51

PURCHASING AND ACCOUNTS PAYABLE

Recommendation 11

We recommend that SSE reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation and appropriate authorization.

Campus Response

We concur. The University Controller will issue a letter of instruction to remind staff of existing cash disbursement policies and procedures in respect to appropriate documentation and authorization.

Expected completion date: July 31, 2004

**SONOMA STATE UNIVERSITY
Auxiliary Organizations
Audit Report Number 03-51**

SONOMA STUDENT UNION CORPORATION

LEGAL AND REGULATORY COMPLIANCE

BYLAWS

Recommendation 12

We recommend that the SSUC retain documentation evidencing the campus president's approval of its bylaws.

Campus Response

We concur.

Corrective action has been completed.

EDUCATIONAL SUPPORT

Recommendation 13

We recommend that the SSUC:

- a. In conjunction with the campus, establish procedures to ensure that a confirmation of appropriate university admission is obtained prior to the awarding of a scholarship or other related payment (e.g., stipend).
- b. Report awarded stipends to financial aid.
- c. Report to the IRS, when required, stipends to board members.

Campus Response

We concur. The campus will issue a letter of instruction to the SSUC to ensure that:

- a. A procedure is established, in cooperation with the university, to confirm that appropriate university admission confirmation is obtained prior to awarding a scholarship or other related payment (e.g. stipend), and that enrollment status is verified after the enrollment drop date.
- b. A report of the award is issued to the financial aid office.
- c. A report to the IRS is made, when required, of stipends made to board members.

Expected completion date: August 13, 2004

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PURCHASING AND ACCOUNTS PAYABLE**POLICIES AND PROCEDURES****Recommendation 14**

We recommend that the campus enforce its purchasing and accounts payable policies and procedures applicable to SSUC.

Campus Response

We concur. The campus will issue a letter of instruction to remind SSUC staff that existing University purchasing and accounts payable policies are to be followed.

Expected completion date: July 31, 2004

SUPPORTING DOCUMENTATION**Recommendation 15**

We recommend that the SSUC:

- a. Require student event disbursements to be supported by an accompanying announcement to the students, an attendee listing (e.g., copy of a sign-up sheet), or record of the number of students attending the event to demonstrate that the event occurred.
- b. Reiterate to staff existing cash disbursement policies and procedures regarding sufficient and appropriate supporting documentation.

Campus Response

We concur. The campus will issue a letter of instruction to the SSUC to ensure that:

- a. Student event disbursements are supported by an accompanying announcement to students and an attendee listing or a record of the number of students attending the events to demonstrate that the event occurred.
- b. Existing University cash disbursement policies and procedures are followed in respect to sufficient and appropriate supporting documentation.

Expected completion date: July 31, 2004

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FIXED ASSETS**Recommendation 16**

We recommend that the SSUC:

- a. Utilize the university property checkout request, or similar form, for the use of equipment off campus.
- b. Take proper security precautions for high-risk property.

Campus Response

We concur. The campus will issue a letter of instruction to ensure that the SSUC:

- a. Utilize the university property checkout request for off campus use of equipment.
- b. Properly secure high-risk property through lock down cables, etc.

Expected completion date: July 31, 2004

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ASSOCIATED STUDENTS OF SONOMA STATE UNIVERSITY

LEGAL AND REGULATORY COMPLIANCE

AUXILIARY AUTHORIZATION

Recommendation 17

We recommend that the ASI amend its operating agreement with the campus to specify all functions managed, administered, and operated by the auxiliary.

Campus Response

We concur. The operating agreement effective September 1, 2004, specifies all functions managed, administered and operated by the Associated Students, Inc.

Corrective action has been completed.

BYLAWS

Recommendation 18

We recommend that the ASI retain documentation evidencing the campus president's approval of its bylaws.

Campus Response

We concur.

Corrective action has been completed.

EDUCATIONAL SUPPORT

Recommendation 19

We recommend that the ASI develop procedures to confirm and document the:

- a. Eligibility of board members, both before and after the drop date.
- b. Current eligibility of loan recipients at the time the loans are disbursed.

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Campus Response

We concur. The campus will issue a letter of instruction to ensure that the ASI:

- a. Establish a procedure to validate eligibility of all board members before and after the enrollment drop date of each semester the student is in office.
- b. Develop a procedure to confirm the eligibility of loan recipients at the time the loan is disbursed.

Expected completion date: August 13, 2004

PURCHASING AND ACCOUNTS PAYABLE**Recommendation 20**

We recommend that the ASI:

- a. Require that hospitality expenditures include the names of participating individuals.
- b. Reiterate to staff existing cash disbursements policies and procedures regarding sufficient and appropriate supporting documentation.

Campus Response

We concur. The campus will issue a letter of instruction to the ASI to ensure that:

- a. The campus hospitality expenditure guidelines are followed.
- b. Existing University cash disbursement policies and procedures are followed in respect to sufficient and appropriate supporting documentation.

Expected completion date: August 13, 2004

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PERSONNEL AND PAYROLL

Recommendation 21

We recommend that the ASI:

- a. Appropriately document the principles for establishing stipend payments to student officers.
- b. Clearly document its determination that stipends paid to student board members are scholarships.

Campus Response

We concur. The campus will issue a letter of instruction to ensure that the ASI:

- a. Appropriately document the principles for establishing stipend payments to student officers.
- b. Clearly document its determination that stipends paid to student board members are scholarships.

Expected completion date: September 17, 2004

THE CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR

BAKERSFIELD

September 9, 2004

CHANNEL ISLANDS

CHICO

MEMORANDUM

DOMINGUEZ HILLS

FRESNO

FULLERTON

TO: Mr. Larry Mandel
University Auditor

HAYWARD

FROM: Charles B. Reed
Chancellor

HUMBOLDT

LONG BEACH

SUBJECT: Draft Final Report Number 03-51 on *Auxiliary Organizations*,
Sonoma State University

LOS ANGELES

MARITIME ACADEMY

MONTEREY BAY

In response to your memorandum of September 9, 2004, I accept the response as
submitted with the draft final report on *Auxiliary Organizations*, Sonoma State
University.

NORTHRIDGE

POMONA

SACRAMENTO

CBR/amd

SAN BERNARDINO

Enclosure

SAN DIEGO

cc: Dr. Ruben Armifiana, President

SAN FRANCISCO

SAN JOSE

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS