

AUXILIARY ORGANIZATIONS

OFFICE OF THE CHANCELLOR

Report Number 04-52

April 8, 2005

Members, Committee on Audit

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BOARD OF TRUSTEES

THE CALIFORNIA STATE UNIVERSITY

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ABBREVIATIONS

CO	Chancellor's Office
CSU	California State University
EO	Executive Order
Foundation	California State University Foundation
Institute	California State University Institute
RFIN	Resolution of the Committee on Finance

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.

Office of the Chancellor 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.

We visited the Office of the Chancellor and its auxiliary organizations from October 4, 2004, through October 27, 2004, and made a study and evaluation of the system of internal compliance/internal control in effect for the period July 2001 to October 2004. This report represents our triennial review.

Our study and evaluation at the *California State University Foundation* 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 October 27, 2004, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at the *California State University Institute* 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 October 27, 2004, 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.

CHANCELLOR'S OFFICE

MANAGEMENT OVERSIGHT AND CONTROL [7]

The functionality provided by the Office of the Chancellor (CO) accounting application was not commensurate with the sophistication and size of both auxiliary's operations.

CALIFORNIA STATE UNIVERSITY FOUNDATION

FISCAL COMPLIANCE [8]

The California State University Foundation (Foundation) did not maintain reserves specifically earmarked for working capital or operating purposes, and the offset of the Foundation's cost reimbursement to the CO for accounting and administrative services was not formally documented.

OPERATIONAL COMPLIANCE [9]

The Foundation had not developed written conflict-of-interest policies and procedures to address the managing of conflict-of-interest situations.

INVESTMENTS [10]

The Foundation's cash management procedures were inadequate. For example, the Foundation checking/operating account included general funds as well as restricted funds, and scholarships funds (restricted) were held, over an extended period of time, in the checking/operating account, rather than an investment account. In addition, the Foundation's investment and endowment policies did not fully document spending criteria and methodology for distribution/allocation of earnings/losses.

PURCHASING AND ACCOUNTS PAYABLE [12]

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

TRUSTS AND OTHER LIABILITIES [13]

Certain Foundation agreements for campus project accounts could not be located by staff, while others required updating to reflect current activity.

CALIFORNIA STATE UNIVERSITY INSTITUTE

FISCAL COMPLIANCE [14]

The California State University Institute (Institute) had not evaluated its compliance with the reserve policy approved by the board in November 2002. In addition, the Institute's fiscal year 2002/03 budget was not approved by the chancellor until November 2002, and fiscal year 2003/04 and 2004/05 budgets were not submitted to the chancellor for approval in a timely manner.

OPERATIONAL COMPLIANCE [15]

The Institute had not developed written conflict-of-interest policies and procedures.

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 *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 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 2001/02, 2002/03 and 2003/04 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 2003 to October 2004. 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:

California State University Foundation

- ▶ Operating and Administrative Agreements
- ▶ Facilities Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Segregation of Duties
- ▶ Cash Receipts and Handling
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable
- ▶ Trusts and Other Liabilities
- ▶ Campus Programs
- ▶ Auxiliary Programs

California State University Institute

- ▶ Operating and Administrative Agreements
- ▶ Facilities Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Segregation of Duties
- ▶ Cash Receipts and Handling
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable
- ▶ Trusts and Other Liabilities
- ▶ Campus Programs
- ▶ Auxiliary Programs

We have not performed any auditing procedures beyond October 2004. 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 MANAGEMENT RESPONSES

CHANCELLOR'S OFFICE

MANAGEMENT OVERSIGHT AND CONTROL

The functionality provided by the accounting application used by the Office of the Chancellor (CO) was not commensurate with the sophistication and size of both auxiliary's operations.

Executive Order (EO) 698, *Board of Trustee Policy for the California State University Auxiliary Organizations*, dated March 3, 1999, states that the review of auxiliary organizations will be used to determine appropriate separation of duties, safeguarding of assets, and reliability and integrity of information.

The senior director/controller of financial services stated that the CO was reviewing other accounting applications in order to move the auxiliary organizations' accounting records to an application that better meets their needs.

The lack of an appropriate accounting application and system access controls increases the risk of unauthorized and inappropriate acts.

Recommendation 1

We recommend that the CO continue to review other accounting applications that better match the sophistication and size of both auxiliary's operations.

Management Response

We concur. The California State University Foundation purchased and implemented Quick Books Premier Nonprofit Edition 2005 as of April 30, 2005. The software matches the size and sophistication of current operations.

CALIFORNIA STATE UNIVERSITY FOUNDATION

FISCAL COMPLIANCE

RESERVES

The California State University Foundation (Foundation) did not maintain reserves specifically earmarked for working capital or operating purposes in accordance with its current policy.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the California State University (CSU) system. Section 8.9.9, *Reserves and Net Assets*, states that the auxiliary should implement financial standards that will assure fiscal viability, including proper provision for professional management, adequate working capital, adequate reserve funds for current operations and capital replacements, and adequate provisions for new business requirements.

The Foundation vice president stated that reserves were maintained for the annuities and the endowments but had not been established for general operations due to the Foundation's low operating costs and the amount of surplus funds held in investment.

Insufficient reserve planning and analysis increase the risk that the auxiliary will be unable to fund future needs.

Recommendation 2

We recommend that the Foundation ensure that reserves for working capital or operating purposes are sufficiently maintained in accordance with its policy.

Management Response

We concur. The finance and investment committee of the board of governors evaluated reserve requirement at their meeting of November 9, 2004, and agreed that the unrestricted funds on balance were sufficient to meet working capital and operational needs. A more specific reserve policy will be presented for approval at the board of governors meeting on June 10, 2005.

COST REIMBURSEMENT

The Foundation had not fully documented its methodology for the offsetting of cost reimbursement to the CO for accounting and administrative services.

EO 753, *Allocation of Costs to Auxiliary Enterprises*, dated July 28, 2000, established the responsibility for auxiliaries to pay allowable direct costs plus an allocable portion of indirect costs associated with facilities, goods, and services provided by the campus and funded by the General Fund.

The Foundation vice president stated that the Foundation's contribution to the university had been in the form of institutional support and student scholarships.

Failure to fully document the methodology for cost reimbursement could result in the General Fund not being properly reimbursed for facilities, goods, or services provided to the auxiliary organization.

Recommendation 3

We recommend that the Foundation coordinate with the executive vice chancellor/chief financial officer to further document the methodology for cost reimbursement under its memorandum of understanding for accounting and administrative services.

Management Response

We concur. The executive vice chancellor/chief financial officer and the associate vice chancellor for financial services approved a memorandum outlining considerations for cost reimbursement on April 15, 2005. This method of reconciling cost reimbursement will be conducted annually.

OPERATIONAL COMPLIANCE

The Foundation had not developed written conflict-of-interest policies and procedures to address the managing of conflict-of-interest conditions.

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.

Education Code §89906 and other similar provisions are established to prevent imprudent or improper decisions by auxiliary board and management members.

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.

The Foundation vice president stated that conflict of interest was addressed in the bylaws and that additional policy in the form of a code of ethics was submitted to the board for approval at the November 2004 meeting.

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

Recommendation 4

We recommend that the Foundation further develop its conflict-of-interest policies and procedures to address the management action required when violations of conflict-of-interest policy are discovered.

Management Response

We concur. The board of governors at their meeting on November 9, 2004, adopted a Code of Ethics to address the management action required when potential conflict-of-interest violations are discovered.

INVESTMENTS

CASH MANAGEMENT

Foundation cash management procedures were inadequate.

We found that:

- ▶ The Foundation checking/operating account included Foundation general funds as well as restricted funds, such as campus project and scholarships monies.
- ▶ Scholarships funds (restricted) were held, over an extended period of time, in the checking/operating account, rather than an investment account.
- ▶ The Foundation checking/operating account for the General Fund had a negative balance of \$256,113 as of June 30, 2004, and had been negative since at least the time of conversion to the current accounting software package in June 2000. The negative balance indicates that the Foundation had been funding operations through the use of restricted and/or temporarily restricted funds (i.e. scholarships, campus projects).

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 management of cash and investment accounts.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.2, *Investments*, states that the auxiliary's business practice objective is to protect and properly account for investments and investment income in accordance with source restrictions and other requirements.

The Foundation vice president stated that the negative balance was due to inadequate cash management. She also stated that the board of directors was aware of the situation and that measures to correct the deficiency were underway.

Insufficient cash management increases the risk that funds will be handled inappropriately and contrary to the expectations of the campus and donors.

Recommendation 5

We recommend that the Foundation:

- a. Implement cash management policies and procedures to ensure appropriate distribution of investment income.
- b. Take appropriate measures to correct the negative balance and, to the extent reasonable, determine the cause for the negative balance.

Management Response

We concur. Appropriate policies and procedures have been implemented to ensure the appropriate distribution of investment income. New mechanisms in regards to cash management were implemented to appropriately balance cash and investment accounting. The negative cash balance has been reconciled as of November 30, 2004.

POLICIES AND PROCEDURES

The Foundation's investment and endowment policies did not sufficiently document spending criteria and methodology for distribution/allocation of earnings/losses.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.2, *Investments*, states that the auxiliary should establish a written governing board investment policy that describes the investment objectives and limitations, and provides for practices to be used to meet its business and fiduciary responsibilities.

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 Foundation vice president stated that the investment and endowment policies were reviewed on a regular basis and that proposed changes were submitted to the board at the November 2004 meeting.

Insufficient investment and endowment policies increase the risk that funds will be handled inappropriately and contrary to the expectations of the campus and donor.

Recommendation 6

We recommend that the Foundation fully document its investment and endowment policies to further define spending criteria and methodology for distribution/allocation of earnings/losses.

Management Response

We concur. The board of governors adopted amendments to the investment policy and approved the spending allocations for 2005/06 at its meeting on November 9, 2004. The finance and investment committee will continue to review on an annual basis the investment policy to ensure the guidelines are appropriate.

PURCHASING AND ACCOUNTS PAYABLE

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

Specifically, our review of 40 disbursements revealed that:

- ▶ In one instance, a consultant arrangement was not supported by a written agreement.
- ▶ In six instances, signature authorization forms were not on file.

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 cash disbursements be fully supported and properly authorized.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.1, *Cash*, states that the auxiliary should disburse cash in a consistent manner utilizing systems that ensure integrity of existing internal controls, with annual management review.

The Foundation vice president stated that the lack of a written agreement was an oversight. She also stated that although signature authorization forms were not on file, approval for the Foundation president and vice president to sign on behalf of the organization was granted by the board of directors.

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

Recommendation 7

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

Management Response

We concur. The Foundation will distribute an updated policy and procedures manual to all project managers by September 1, 2005.

TRUSTS AND OTHER LIABILITIES

Certain Foundation agreements for campus project accounts could not be located by staff, while others required updating to reflect current activity.

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 trust accounts.

The Foundation vice president stated that project account agreements had not been updated due to staffing limitations.

Insufficient administration of custodial funds increases the risk that trust duties and responsibilities will not be met and errors or misappropriations will occur.

Recommendation 8

We recommend that the Foundation ensure that campus project account agreements are maintained and updated to reflect current activity.

Management Response

We concur. Campus project account agreements will be updated by September 1, 2005. Agreements will be reviewed annually to ensure that the agreements reflect current activity.

CALIFORNIA STATE UNIVERSITY INSTITUTE

FISCAL COMPLIANCE

RESERVES

The California State University Institute (Institute) had not evaluated its compliance with the reserve policy approved by the board in November 2002.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.9, *Reserves and Net Assets*, states that an auxiliary should establish a written system of recordkeeping and reporting that properly segregates and accounts for the net assets and reserves of donors, and complies with the legal obligations related to other third parties.

The CO senior director/controller of financial services stated that the accountant responsible for the operations of the Institute was unaware of the requirement to evaluate the reserve policy on an annual basis.

Failure to perform and document sufficient reserve planning and analysis increases the auxiliary's risk to fund future needs.

Recommendation 9

We recommend that the Institute evaluate the adequacy of reserves in accordance with its board-approved reserve policy and CSU guidelines.

Management Response

We concur. All operational staff has reviewed the board-approved reserve policy, and the unrestricted balance on hand is in compliance with the policy.

BUDGET

The Institute did not submit its fiscal year 2003/04 and 2004/05 budgets to the chancellor for approval in a timely manner, and the fiscal year 2002/03 budget had not been approved by the chancellor until November 2002.

Title 5 §42402 states that the president shall require that each auxiliary organization submit its programs and budgets for review at a time and in a manner specified by the president.

The CO senior director/controller of financial services stated that the responsibility for preparing the Institute's budget was not clearly defined.

Untimely budget submission and approval increase the risk of misunderstandings over the allocation of funds.

Recommendation 10

We recommend that the Institute take appropriate measures to ensure that annual budgets are submitted to, and approved by, the chancellor in a timely manner.

Management Response

We concur. The board, at their May 25, 2005, meeting, reviewed and approved the 2005/06 budget.

OPERATIONAL COMPLIANCE

The Institute had not developed written conflict-of-interest policies and procedures.

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.

Education Code §89906 and other similar provisions are established to prevent imprudent or improper decisions by auxiliary board and management members.

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.

The CO senior director/controller of financial services stated that the operational staff assumed the board members were covered under the conflict-of-interest policy required by all chancellor's office employees. Therefore, board members were not required to file a separate conflict-of-interest statement for the Institute.

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

Recommendation 11

We recommend that the Institute develop conflict-of-interest policies and procedures to address, among other things:

- a. Filing of annual statements by board and management personnel.
- b. Determination of whether a conflict of interest exists.
- c. Actions required in association with a conflict.
- d. Actions required when violations of conflict-of-interest policy are discovered.

Management Response

We concur. The board, at their May 25, 2005, meeting, adopted a conflict-of-interest policy.

APPENDIX A: PERSONNEL CONTACTED

Name

Title

CHANCELLOR'S OFFICE

Richard P. West	Executive Vice Chancellor and Chief Financial Officer
Myeshia Armstrong	General Accounting Manager
George Ashkar	Senior Director/Controller, Financial Services
Alex Gibson	Chancellor's Office Desktop Services, Systems Administrator
Robert Schiller	Auxiliary Organization Accountant

CALIFORNIA STATE UNIVERSITY FOUNDATION

Richard P. West	President
Myeshia Armstrong	CO General Accounting Manager
Lori Redfearn	Vice President
Robert Schiller	CO Auxiliary Organization Accountant
Denise Schultz	Foundation Coordinator

CALIFORNIA STATE UNIVERSITY INSTITUTE

Richard P. West	CO Executive Vice Chancellor and Chief Financial Officer
Myeshia Armstrong	CO General Accounting Manager
George Ashkar	CO Senior Director/Controller, Financial Services
Robert Schiller	CO Auxiliary Organization 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 record keeping 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.



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RICHARD P. WEST
 Executive Vice Chancellor
 Chief Financial Officer

MEMORANDUM

RECEIVED
 UNIVERSITY AUDITOR

JUN - 1 2005

THE CALIFORNIA STATE
 UNIVERSITY

DATE: May 16, 2005

TO: Larry Mandel, University Auditor
 The California State University

FROM: Richard P. West
 President
 California State University Foundation

SUBJECT: Campus Responses to Recommendations of Audit Report No. 04-52
 Auxiliary Organizations at the Office of the Chancellor

Attached for your consideration and acceptance are campus responses to the recommendations of the Office of the University Auditor's review of Auxiliary Organizations.

Please contact me at (562) 951-4600 or rwest@calstate.edu if you have any questions.

c: Charles B. Reed, Chancellor

Enclosure

AUXILIARY ORGANIZATIONS
OFFICE OF THE CHANCELLOR
THE CALIFORNIA STATE UNIVERSITY

Report Number 04-52
April 25, 2005

CHANCELLOR'S OFFICE

MANAGEMENT OVERSIGHT AND CONTROL

Recommendation 1

We recommend that the CO continue to review other accounting applications that better match the sophistication and size of both auxiliary's operations.

Management Response

We concur. The California State University Foundation purchased and implemented Quick Books Premier Nonprofit Edition 2005 as of April 30, 2005. The software matches the size and sophistication of current operations.

CALIFORNIA STATE UNIVERSITY FOUNDATION**FISCAL COMPLIANCE****RESERVES**Recommendation 2

We recommend that the Foundation ensure that reserves for working capital or operating purposes are sufficiently maintained in accordance with its policy.

Management Response

We concur. The Finance and Investment Committee of the Board of Governors evaluated reserve requirement at their meeting of November 9, 2004, and agreed that the unrestricted funds on balance were sufficient to meet working capital and operational needs. A more specific reserve policy will be presented for approval at the Board of Governors Meeting on June 10, 2005.

COST REIMBURSEMENTRecommendation 3

We recommend that the Foundation coordinate with the executive vice chancellor/chief financial officer to further document the methodology for cost reimbursement under its memorandum of understanding for accounting and administrative services.

Management Response

We concur. Executive Vice Chancellor/Chief Financial Officer and the Associate Vice Chancellor for Financial Services approved a memorandum outlining considerations for cost reimbursement on April 15, 2005. This method of reconciling cost reimbursement will be conducted annually.

OPERATIONAL COMPLIANCERecommendation 4

We recommend that the Foundation further develop its conflict-of-interest policies and procedures to address the management action required when violations of conflict-of-interest policy are discovered.

Management Response

We concur. The Board of Governors at their meeting on November 9, 2004, adopted a Code of Ethics to address the management action required when potential conflict of interest violations are discovered.

INVESTMENTS

CASH MANAGEMENT

Recommendation 5

We recommend that the Foundation:

- a. Implement cash management policies and procedures to ensure appropriate distribution of investment income.
- b. Take appropriate measures to correct the negative balance and, to the extent reasonable, determine the cause for the negative balance.

Management Response

We concur. Appropriate policies and procedures have been implemented to ensure the appropriate distribution of investment income. New mechanisms in regards to cash management were implemented to appropriately balance cash and investment accounting. The negative cash balance has been reconciled as of November 30, 2004.

POLICIES AND PROCEDURES

Recommendation 6

We recommend that the Foundation fully document its investment and endowment policies to further define spending criteria and methodology for distribution/allocation of earnings/losses.

Management Response

We concur. The Board of Governors adopted amendments to the Investment Policy and approved the spending allocations for 2005 – 2006 at its meeting on November 9, 2004. The Finance and Investment Committee will continue to review on an annual basis the investment policy to ensure the guidelines are appropriate.

PURCHASING AND ACCOUNTS PAYABLE

Recommendation 7

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

Management Response

We concur. The Foundation will distribute an updated Policy and Procedures Manual to all project managers by September 1, 2005.

TRUSTS AND OTHER LIABILITIES

Recommendation 8

We recommend that the Foundation ensure that campus project account agreements are maintained and updated to reflect current activity.

Management Response

We concur. Campus project account agreements will be updated by September 1, 2005. Agreements will be reviewed annually to ensure that the agreements reflect current activity.

CALIFORNIA STATE UNIVERSITY INSTITUTE

FISCAL COMPLIANCE

RESERVES

Recommendation 9

We recommend that the Institute evaluate the adequacy of reserves in accordance with its board-approved reserve policy and CSU guidelines.

Management Response

We concur. All operational staff have reviewed the board-approved reserve policy and the unrestricted balance on hand is in compliance with the policy.

BUDGET

Recommendation 10

We recommend that the Institute take appropriate measures to ensure that annual budgets are submitted to, and approved by, the chancellor in a timely manner.

Management Response

We concur. The board, at their May 25, 2005 meeting, reviewed and approved the 2005/06 budget.

OPERATIONAL COMPLIANCE

Recommendation 11

We recommend that the Institute develop conflict-of-interest policies and procedures to address, among other things:

- a. Filing of annual statements by the board and management personnel.
- b. Determination of whether a conflict of interest exists.
- c. Actions required in association with a conflict.
- d. Actions required when violations of conflict-of-interest policy are discovered.

Management Response

We concur. The board, at their May 25, 2005 meeting, adopted a conflict-of-interest policy.

THE CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR

BAKERSFIELD

June 24, 2005

CHANNEL ISLANDS

FRESNO

MEMORANDUM

DOMINGUEZ HILLS

EAST BAY

TO: Mr. Larry Mandel
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed
Chancellor



HUMBOLDT

SUBJECT: Draft Final Report Number 04-52 on *Auxiliary Organizations*,
Office of the Chancellor

LONG BEACH

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of June 24, 2005, I accept the response as submitted with the draft final report on *Auxiliary Organizations*, Office of the Chancellor.

MONTEREY BAY

NORTHRIDGE

POMONA

CBR/amd

SACRAMENTO

Enclosure

SAN BERNARDINO

cc: Mr. Dennis Hordyk, Assistant Vice Chancellor, Financial Services
Mr. Richard P. West, Executive Vice Chancellor/Chief Financial Officer

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS