

**AUXILIARY ORGANIZATIONS**  
**CALIFORNIA POLYTECHNIC STATE UNIVERSITY,**  
**SAN LUIS OBISPO**

**Report Number 05-52**  
**May 31, 2006**

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**BOARD OF TRUSTEES**  
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## ABBREVIATIONS

ASI	Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo
CFO	Chief Financial Officer
CSU	California State University
EO	Executive Order
Foundation	California Polytechnic State University Foundation (Renamed Cal Poly Corporation on February 1, 2006)
Housing	Cal Poly Housing Corporation
IRS	Internal Revenue Service
RFIN	Resolution of the Committee on Finance
UBI	Unrelated Business Income

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## 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.

California Polytechnic State University, San Luis Obispo 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 California Polytechnic State University, San Luis Obispo campus and its auxiliary organizations from December 5, 2005, through January 13, 2006, and made a study and evaluation of the system of internal compliance/internal control in effect for the period April 2003 to January 2006. This report represents our triennial review.

Our study and evaluation at the *California Polytechnic State University Foundation (renamed Cal Poly Corporation on February 1, 2006)* 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 January 2006, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at the *Cal Poly Housing Corporation* 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 January 2006, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at the *Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo* 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 January 2006, 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 changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

The following summary provides management with an overview of conditions requiring 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**

### **OPERATING AND ADMINISTRATIVE AGREEMENTS [8]**

A business arrangement between the campus and the California Polytechnic State University Foundation (Foundation) regarding services and related reimbursements of certain campus employees working at the Conference Coordinating Center was not supported by a written agreement.

## **CALIFORNIA POLYTECHNIC STATE UNIVERSITY FOUNDATION**

### **PETTY CASH AND CHANGE FUNDS [9]**

Administration of California Polytechnic State University Foundation (Foundation) petty cash and change funds was insufficient. Independent, unannounced counts of petty cash and change funds were not conducted in fiscal year 2004/05, nor were counts documented for fiscal year 2003/04.

### **PROPERTY AND EQUIPMENT [10]**

Administration of Foundation property and equipment was deficient, as fixed assets were not consistently tagged and the inventory listing did not consistently reflect current assets.

### **INFORMATION TECHNOLOGY [11]**

Security parameters for the Foundation bookstore computer system hosting the financial application were not set to provide effective access. Further, backup tapes were inappropriately stored at a bookstore employee's residence.

## **CAL POLY HOUSING CORPORATION**

### **OPERATING AND ADMINISTRATIVE AGREEMENTS [13]**

A business arrangement between the Cal Poly Housing Corporation (Housing) and an outside entity was not supported by a current, written agreement. Specifically, Housing paid an invoice a year after the contract expired. A contract extension was not approved by the board, nor was an amendment made to the contract.

### **OPERATIONAL COMPLIANCE [14]**

Housing had not officially adopted a conflict-of-interest policy. In addition, annual conflict-of-interest statements had not been consistently obtained from all board members and/or management.

### **CAMPUS OVERSIGHT AND CONTROL [15]**

Housing budgets for fiscal years 2003/04, 2004/05, and 2005/06 were not approved in a timely manner.

## **ASSOCIATED STUDENTS, INCORPORATED OF CALIFORNIA POLYTECHNIC STATE UNIVERSITY AT SAN LUIS OBISPO**

### **CORPORATE GOVERNANCE [16]**

The Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo (ASI) board and subcommittee minutes were not signed and approved by an appropriate official.

### **FISCAL COMPLIANCE [16]**

The ASI had not accounted for or tracked unrelated business income for childcare services, summer recreational programs, and club programs provided to community members.

### **CASH RECEIPTS AND HANDLING [17]**

The ASI did not maintain a record of individuals with safe access or dates of combination changes.

### **INFORMATION TECHNOLOGY [18]**

The ASI had not installed an after-hours intrusion detection alarm in the computer room and the computer backup tapes were stored in the same building as the computer equipment.

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## 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 2003/2004 and 2004/05 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 2005 to January 2006. 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 Polytechnic State University Foundation

- ▶ Operating and Administrative Agreements
- ▶ Facilities Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Campus Oversight and Control
- ▶ Segregation of Duties
- ▶ Cash Receipts and Handling
- ▶ Petty Cash and Change Funds
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable
- ▶ Personnel and Payroll
- ▶ Property and Equipment
- ▶ Trusts and Other Liabilities
- ▶ Auxiliary Programs
- ▶ Information Technology

Cal Poly Housing Corporation

- ▶ Operating and Administrative Agreements
- ▶ Facilities Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Campus Oversight and Control

Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo

- ▶ Operating and Administrative Agreements
- ▶ Facilities Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance

Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo (cont.)

- ▶ Campus Oversight and Control
- ▶ Segregation of Duties
- ▶ Cash Receipts and Handling
- ▶ Petty Cash and Change Funds
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable
- ▶ Personnel and Payroll
- ▶ Property and Equipment
- ▶ Trusts and Other Liabilities
- ▶ Auxiliary Programs
- ▶ Information Technology

Campus

- ▶ Campus Oversight and Control

We have not performed any auditing procedures beyond January 2006. 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.

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## **OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES**

### **CAMPUS**

#### **OPERATING AND ADMINISTRATIVE AGREEMENTS**

A business arrangement between the campus and the California Polytechnic State University Foundation (Foundation) regarding services and related reimbursements of certain campus employees working at the Conference Coordinating Center was not supported by a written 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 business arrangements be supported by written agreements.

The associate vice president of finance stated that the campus had not established a written agreement regarding services and related reimbursements of certain campus employees working at the Conference Coordinating Center due to oversight.

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

#### **Recommendation 1**

We recommend that the campus establish a written agreement with the Foundation for services and related reimbursements of certain campus employees working at the Conference Coordinating Center.

#### **Campus Response**

We concur with this recommendation. The campus will establish a written agreement with the Cal Poly Corporation (formerly Foundation) for services and related reimbursements of certain campus employees working at the Conference Coordinating Center.

Anticipated Date of Completion: December 31, 2006

## **CALIFORNIA POLYTECHNIC STATE UNIVERSITY FOUNDATION**

### **PETTY CASH AND CHANGE FUNDS**

Administration of California Polytechnic State University Foundation (Foundation) petty cash and change funds was insufficient.

We found that:

- ▶ Independent, unannounced cash counts of petty cash and change funds were not conducted in fiscal year ended June 30, 2005.
- ▶ Independent cash counts of petty cash and change funds were not documented for fiscal year ended June 30, 2004.

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 sufficient administration of petty cash and change funds.

The Foundation chief financial officer (CFO) stated that although surprise cash counts were normally conducted as part of the year-end audit and closing process, the Foundation did not conduct cash counts during fiscal year 2004/05 due to extensive staff turnover in the accounting manager/controller position. He further stated that surprise counts were conducted in fiscal year 2003/04, but he was unable to locate documentation evidencing these counts.

Inadequate administration of petty cash and change funds increases the risk of a loss or misappropriation of funds.

#### **Recommendation 2**

We recommend that the Foundation:

- a. Ensure that independent, unannounced cash counts of petty cash and change funds are performed on a regular basis.
- b. Document independent cash counts of petty cash and change funds.

#### **Campus Response**

We concur with this recommendation. The Cal Poly Corporation (formerly Foundation) has incorporated into its annual “Year-End Audit and Closing” guide procedures, tasks for completing petty cash and change funds counting/verification. These mandated tasks will be conducted throughout the fiscal year and completion is to be verified prior to closing the fiscal year. A new

permanent file entitled "AUDIT – Cash Counts," will hold cash count verification forms and other related documentation. The file will be kept in the Cal Poly Corporation's executive office master file.

Anticipated Date of Completion: December 31, 2006

## PROPERTY AND EQUIPMENT

Administration of Foundation property and equipment was deficient.

We found that:

- ▶ Fixed assets were not consistently tagged.
- ▶ The inventory listing did not consistently reflect current assets.

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 sufficient administration of property and equipment.

*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 8.9.7, *Property and Equipment*, states, in part, that the auxiliary should establish a written system that ensures proper recording of property and equipment when received and for labeling of equipment.

The Foundation CFO stated that it was the Foundation's policy to tag equipment upon acquisition if the equipment design and materials allowed tagging. He further stated that the Foundation annually requested that departments conduct a physical inventory of their respective fixed assets; however, some departments were not always responsive or timely in submitting the updated inventory listing. He added that the Foundation property clerk updated the fixed assets system upon receipt of the current inventory listing from departments.

Insufficient administration of property and equipment increases the risk that property may be lost or stolen.

### Recommendation 3

We recommend that the Foundation:

- a. Ensure that fixed assets are consistently tagged.

- b. Develop and implement procedures to ensure that all Foundation departments submit updated fixed assets inventory listings on a timely and regular basis.

### **Campus Response**

We concur with this recommendation. The Cal Poly Corporation (formerly Foundation) property clerk has updated existing property tagging procedures and will conduct training sessions with staff responsible for tagging property. In addition, we will conduct periodic, random testing and inspection of property to ensure it is tagged in accordance with procedures. Updated procedures include a process of verifying departments have updated fixed assets inventories and a written report will be generated.

Anticipated Date of Completion: December 31, 2006

## **INFORMATION TECHNOLOGY**

### **OPERATING SYSTEM SECURITY – BOOKSTORE APPLICATION**

Security parameters for the Foundation bookstore computer system hosting the financial application were not set to provide effective access.

Executive Order (EO) 698, *Board of Trustees 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 Foundation associate director of the El Corral Bookstore stated that although the system had been installed several years ago, a formal security assessment had never been performed.

Without adequate settings of security parameters, there is no assurance that controls are operating as intended by management or that the system and its associated controls cannot be compromised.

### **Recommendation 4**

We recommend that the Foundation perform a detailed evaluation of operating system security and implement appropriate security parameters for the bookstore computer system hosting the financial application.

### **Campus Response**

We concur with this recommendation. The CSU audit discovered a lapse in the AS/400 password security that originated in the MBS Internet implementation. When informed of that lapse, the El Corral Bookstore's associate director of operations immediately reinstated the AS/400 password security:

MBS Text-Aid passwords will be changed quarterly for all textbook buyback operators. Those passwords will also be changed quarterly for all MBS Text-Aid operators. Authorization lists for access to all MBS retail menus and menu options as well as AS/400 user profiles will be given a complete review in August 2006. Procedures will also be established for “disabling” and deletion of user profiles, for scheduled reviews, and for access controls.

Anticipated Date of Completion: August 31, 2006

## **DATA STORAGE**

Foundation backup tapes were inappropriately stored at a bookstore employee’s residence.

EO 698, *Board of Trustees 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 Foundation associate director of the El Corral Bookstore stated that personal retention of backup tapes was the most cost-effective solution to off-site storage.

Personal retention of off-site media could inadvertently expose the financial information to theft or accidental disclosure, or possibly render it inaccessible.

### **Recommendation 5**

We recommend that the Foundation improve the security and availability of off-site storage of backup tapes.

### **Campus Response**

We concur with this recommendation. By July 30, 2006, IBM AS/400 backup processes will be incorporated into the policies and procedures that apply to the storage of the Cal Poly Corporation’s (formerly Foundation) other system backup media.

Anticipated Date of Completion: July 30, 2006

## **CAL POLY HOUSING CORPORATION**

### **OPERATING AND ADMINISTRATIVE AGREEMENTS**

A business arrangement between the Cal Poly Housing Corporation (Housing) and an outside entity was not supported by a current, written agreement.

Specifically, Housing paid an invoice a year after the contract expired. A contract extension was not approved by the board, nor was an amendment made to the contract.

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 business arrangements be supported by current, written agreements.

The Housing managing director stated that he was unaware of the exact details of what occurred because he was appointed managing director of Housing after the invoice was paid. However, he added that it appeared that a new purchase order was prepared when the project was changed from “rental housing” to “for sale housing” in August 2003. He also stated that a contract amendment was not prepared even though work was performed subsequent to the expiration of the contract.

The absence of a current, written agreement increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

#### **Recommendation 6**

We recommend that Housing establish a current, written agreement for business arrangements with an outside entity to ensure that invoice payments and other transactions are related to the proper contract.

#### **Campus Response**

We concur with this recommendation. Housing has implemented procedures to monitor contract expiration dates and extend them if necessary. A log of active contracts has been established and applicable payments will be reviewed to ensure contract compliance.

Anticipated Date of Completion: Completed

## **OPERATIONAL COMPLIANCE**

Housing had not officially adopted a conflict-of-interest policy. In addition, annual conflict-of-interest statements had not been consistently obtained from all board members and/or management.

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 and compliance with existing policies and procedures.

The Housing managing director stated that it was management's belief that a conflict-of-interest policy was not required. He also stated that conflict-of-interest forms were obtained for the current fiscal year, but were not consistently obtained due to staff turnover.

Failure to formally establish conflict-of-interest policies and procedures and obtain conflict-of-interest statements from all auxiliary board members and/or management increases liability for acts contrary to the code.

### **Recommendation 7**

We recommend that Housing formally adopt a conflict-of-interest policy and obtain annual conflict-of-interest statements from all board members and/or management.

### **Campus Response**

We concur with this recommendation. Housing annually distributes an *Acknowledgment and Declaration on Standards of Conduct and Conflict-of-Interest* form to all board members and executive employees. A checklist was developed in connection with the June 2005 distribution of forms to monitor the acknowledgment and return of the forms to Housing. All forms were returned for the current fiscal year. Housing adopted a formal conflict-of-interest policy at its May 12, 2006, board meeting.

Anticipated Date of Completion: Completed

## **CAMPUS OVERSIGHT AND CONTROL**

Housing budgets for fiscal years 2003/04, 2004/05, and 2005/06 were not approved in a timely manner.

Title 5 §42402 requires the auxiliary to submit its programs and budgets for review in a timely manner as specified by the president (or designee).

The Housing managing director stated that its annual budgets had not been approved in a timely manner because traditionally board approvals are scheduled for the first meeting of each new fiscal year. He further stated that although Housing had submitted its fiscal year 2005/06 budget to the campus vice president of administration and finance in June 2005, it had not been forwarded to the campus president since it lacked approval by the board.

The lack of timely budget approval increases the risk of misunderstandings over the allocation of funds.

### **Recommendation 8**

We recommend that Housing ensure that its annual budgets are approved by its board and submitted to the campus president for approval prior to the beginning of the fiscal year.

### **Campus Response**

We concur with this recommendation. The fiscal year 2006/07 budget was approved by the Housing board of directors at its May 12, 2006, meeting, and has been submitted to the campus president for his approval prior to June 30, 2006.

Anticipated Date of Completion: Completed

**ASSOCIATED STUDENTS, INCORPORATED OF**  
**CALIFORNIA POLYTECHNIC STATE UNIVERSITY AT SAN LUIS OBISPO**

**CORPORATE GOVERNANCE**

The Associated Students, Incorporated of California Polytechnic State University at San Luis Obispo (ASI) board and subcommittee minutes were not 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 ASI executive director stated that all minutes are properly approved by the membership of the appropriate committee and accepted into the formal records. He further stated that physically affixing a signature to approved minutes was not part of the standard operating procedure.

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

**Recommendation 9**

We recommend that the ASI take appropriate measures to ensure that its board and subcommittee minutes are signed and approved by an appropriate official.

**Campus Response**

We concur with the recommendation. The ASI will implement procedures by which all minutes will be properly approved and signed by the appropriate officials.

Anticipated Date of Completion: July 31, 2006

**FISCAL COMPLIANCE**

The ASI had not accounted for or tracked unrelated business income (UBI) for childcare services, summer recreational programs, and club programs provided to community members.

Internal Revenue Code §512 through §514 define an unrelated trade or business of an exempt organization as any trade or business, the conduct of which is not substantially related to the exercise or performance of its tax-exempt purpose. UBI in excess of \$1,000 must be reported to the Internal Revenue Service (IRS), whether or not a tax liability is incurred.

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 establishment of a system to track and account for UBI.

The ASI executive director stated that the ASI had determined that UBI did not apply due to the nature and magnitude of services provided outside the scope of related business activities.

Failure to properly analyze, document, and report UBI increases the auxiliary's exposure to potential penalties and actions by the IRS.

### **Recommendation 10**

We recommend that the ASI account for and track UBI for childcare services, summer recreational programs, and club programs provided to community members, and file federal income tax returns as appropriate.

### **Campus Response**

We concur with the recommendation. The ASI will work with its external auditors on a plan to accurately identify and track UBI. If it is determined that UBI exists, then the ASI will appropriately report it to the proper authority.

Anticipated Date of Completion: October 31, 2006

## **CASH RECEIPTS AND HANDLING**

The ASI did not maintain a record of individuals with safe access or dates of combination changes.

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 sufficient controls over cash receipts and handling.

The ASI executive director stated that the ASI was in the process of finalizing safe documentation procedures.

Failure to maintain documentation over safe combinations increases the risk of errors, irregularities, and misappropriations.

**Recommendation 11**

We recommend that the ASI maintain a record of individuals with safe access and dates of combination changes.

**Campus Response**

We concur with the recommendation. The ASI will implement procedures to appropriately maintain records of individuals with safe access and dates of combination changes.

Anticipated Date of Completion: December 31, 2006

**INFORMATION TECHNOLOGY**

**COMPUTER ROOM SECURITY**

The ASI had not installed an after-hours intrusion detection alarm in the computer room.

EO 698, *Board of Trustees 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 ASI information technology coordinator stated that the existing conditions were the result of space limitations; however, computer room improvements were being considered as a part of the new facility design.

Without appropriate physical safeguards over the facilities housing the computer equipment, there is an increased risk of unauthorized access and disruption of data processing services.

**Recommendation 12**

We recommend that the ASI install after-hours intrusion detection equipment in the computer room.

**Campus Response**

We concur with the recommendation. The ASI will install after-hours intrusion detection equipment in the computer room.

Anticipated Date of Completion: December 31, 2006

## **DATA STORAGE**

The ASI backup tapes were stored in the same building as the computer equipment.

EO 698, *Board of Trustees 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 ASI information technology coordinator stated that the retention of backup tapes in the same building as the computer equipment was due to oversight.

Failure to store backup tapes at an off-site location could expose the data to theft, accidental disclosure, or destruction in the case of a disaster.

### **Recommendation 13**

We recommend that the ASI store backup tapes at an off-site location.

### **Campus Response**

We concur with the recommendation. In coordination with the campus, the ASI will implement a program of storing backup tapes at an off-site location.

Anticipated Date of Completion: December 31, 2006

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## **APPENDIX A: PERSONNEL CONTACTED**

### **Name**

### **Title**

#### **CAMPUS**

Warren J. Baker	President
Lawrence Kelley	Vice President, Administration and Finance
Dario Luis	Business Manager, Continuing Education
Rick Ramirez	Associate Vice President, Finance
Vicki Stover	Associate Vice President, Administration

#### **CALIFORNIA POLYTECHNIC STATE UNIVERSITY FOUNDATION**

Sheri Bliss	Campus Market Manager
Jodi Block	Grant Analyst I
Karen Brown	Accounting Manager
Jaime Bustos	Assistant Director, Campus Dining
Janet Carlstrom	Customer Service Manager, El Corral Bookstore
Frank Cawley	Director, El Corral Bookstore
Lori Cordova	Accounting Manager
Alan Cushman	Associate Director, Campus Dining
Philip Davis	Associate Director, Finance and Operations, El Corral Bookstore
Tammy Farrell	Financial Account Coordinator, El Corral Bookstore
Cathy Ferreira	Payroll Supervisor
Cindy Giambalvo	Courseware Division Manager, El Corral Bookstore
Maurie Higginbotham	Accounting Specialist
Jill Keezer	Director, Sponsor Programs
Diana Kinunen	Administrative Projects Manager
Debbie Kirschenmann	General Accounting Clerk I
Starr Lee	General Counsel
Frank Mumford	Executive Director
Gayle Nakano	Grant Analyst III
Nancy Osorio	Customer Service Manager, Campus Dining
Jim Reinhart	Associate Executive Director
Lisa Rockwell-Harpster	Trust Administrator
Colleen Slocum	Customer Services Supervisor
Melissa Swanson	Procurement Manager, Campus Dining
Rosa Taliaferro	Accounts Receivable Supervisor
Dale Texter	Chief Financial Officer
Debbie Tuson	Campus Programs Analyst
Ron Weaver	Investment Administrator
Joanne Williams	Director, Human Resources
Nancy Williams	Director, Campus Dining
Laura Wunsch	Accounting Analyst

#### **CAL POLY HOUSING CORPORATION**

Jim Reinhart	Managing Director
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**ASSOCIATED STUDENTS, INCORPORATED OF  
CALIFORNIA POLYTECHNIC STATE UNIVERSITY AT SAN LUIS OBISPO**

Dawn Annoni	Human Resources Technician
Carol Brizendine	Human Resources Coordinator
Dwayne Brummett	Director, Business Services
Cecilia Chen	Cash Control Assistant
Anthony Colvard	Information Technology Coordinator
Daren Connor	Assistant Director, Programs
Michelle Curro	Assistant Program Coordinator
Tonya Iversen	Director, Children's Program
Rick Johnson	Executive Director
Marcy Maloney	Director, University Union/Recreation Sports
Tyler Middlestandt	President
Gina Murtha	Accounting Technician II
Nancy Owen	Accounting Assistant
Kay Pasillas	Administrative Assistant I
Jan Stiles	Accountant
Jennifer Von der Lohe	Accounting Technician

## **STATEMENT OF INTERNAL CONTROLS**

### **A. INTRODUCTION**

Internal accounting and related operational controls established by the State of California, the California State University 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.

# CAL POLY

California Polytechnic State University  
San Luis Obispo, CA 93407

Administration & Finance Division  
(805) 756-2171 • Fax (805) 756-7560

July 6, 2006

Mr. Larry Mandel  
University Auditor  
Office of the University Auditor  
The California State University  
401 Golden Shore  
Long Beach, CA 90802-4275

RECEIVED  
UNIVERSITY AUDITOR

JUL 14 2006

THE CALIFORNIA STATE  
UNIVERSITY

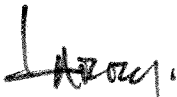
Subject: Audit Report Number 05-52, *Auxiliary Organizations*, at California Polytechnic State University, San Luis Obispo

Dear Larry:

Attached is the campus response to recommendations of Audit Report Number 05-52, *Auxiliary Organizations*, as well as a computer disk with this information. It is anticipated that documentation supporting audit findings that are specified as complete will be forwarded to you within the next few weeks.

If you have questions regarding this document, please contact Vicki Stover, Associate Vice President for Administration, at 805-756-2171 or [VStover@calpoly.edu](mailto:VStover@calpoly.edu).

Sincerely,



Lawrence Kelley  
Vice President for Administration & Finance

cc: W. Baker  
R. Detweiler  
K. Ikeda  
F. Mumford  
D. Kinunen  
J. Reinhart  
R. Johnson  
D. Brummett

**AUXILIARY ORGANIZATIONS**

**CALIFORNIA POLYTECHNIC STATE UNIVERSITY,  
SAN LUIS OBISPO**

**Report Number 05-52  
May 31, 2006**

**CAMPUS**

**OPERATING AND ADMINISTRATIVE AGREEMENTS**

**Recommendation 1**

We recommend that the campus establish a written agreement with the Foundation for services and related reimbursements of certain campus employees working at the Conference Coordinating Center.

**Campus Response**

We concur with this recommendation. The campus will establish a written agreement with the Cal Poly Corporation (formerly Foundation) for services and related reimbursements of certain campus employees working at the Conference Coordinating Center.

Anticipated Date of Completion: December 31, 2006

**CALIFORNIA POLYTECHNIC STATE UNIVERSITY FOUNDATION****PETTY CASH AND CHANGE FUNDS****Recommendation 2**

We recommend that the Foundation:

- a. Ensure that independent, unannounced cash counts of petty cash and change funds are performed on a regular basis.
- b. Document independent cash counts of petty cash and change funds.

**Campus Response**

We concur with this recommendation. The Cal Poly Corporation (formerly Foundation), has incorporated into its annual “Year-End Audit & Closing” guide procedures, tasks for completing petty cash and change funds counting/verification. These mandated tasks will be conducted throughout the fiscal year and completion is to be verified prior to closing the fiscal year. A new permanent file entitled “AUDIT - Cash Counts,” will hold cash count verification forms and other related documentation. The file will be kept in the Cal Poly Corporation’s Executive Office master file.

Anticipated Date of Completion: December 31, 2006

**PROPERTY AND EQUIPMENT****Recommendation 3**

We recommend that the Foundation:

- a. Ensure that fixed assets are consistently tagged.
- b. Develop and implement procedures to ensure that all Foundation departments submit updated fixed assets inventory listings on a timely and regular basis.

**Campus Response**

We concur with this recommendation. The Cal Poly Corporation’s Property Clerk has updated existing property tagging procedures and will conduct training sessions with staff responsible for tagging property. In addition, we will conduct periodic, random testing and inspection of property, to ensure it is tagged in accordance with procedures. Updated procedures include a process of verifying departments have updated fixed assets inventories and a written report will be generated.

Anticipated Date of Completion: December 31, 2006

## INFORMATION TECHNOLOGY

### OPERATING SYSTEM SECURITY – BOOKSTORE APPLICATION

#### Recommendation 4

We recommend that the Foundation perform a detailed evaluation of operating system security and implement appropriate security parameters for the bookstore computer system hosting the financial application.

#### Campus Response

We concur with this recommendation. The CSU audit discovered a lapse in AS/400 Password Security that originated in the MBS Internet implementation. When informed of that lapse, El Corral Bookstore's Associate Director of Operations immediately reinstated AS/400 Password Security:

MBS Text-Aid passwords will be changed quarterly for all textbook buyback operators. Those passwords will also be changed quarterly for all MBS Text-Aid operators. Authorization lists for access to all MBS Retail menus and menu options as well as AS/400 User Profiles will be given a complete review in August 2006. Procedures will be also be established for "disabling" and deletion of user profiles, for scheduled reviews and access controls.

Anticipated Date of Completion: August 31, 2006

### DATA STORAGE

#### Recommendation 5

We recommend that the Foundation improve the security and availability of off-site storage of backup tapes.

#### Campus Response

We concur with this recommendation. By July 30, 2006, IBM AS/400 back-up processes will be incorporated into the policies and procedures that apply to the storage of the Corporation's other system back-up media.

Anticipated Date of Completion: July 30, 2006

## **CAL POLY HOUSING CORPORATION**

### **OPERATING AND ADMINISTRATIVE AGREEMENTS**

#### **Recommendation 6**

We recommend that Housing establish a current, written agreement for business arrangements with an outside entity to ensure that invoice payments and other transactions are related to the proper contract.

#### **Campus Response**

We concur with this recommendation. The CPHC has implemented procedures to monitor contract expiration dates and extend them if necessary. A log of active contracts has been established and applicable payments will be reviewed to ensure contract compliance.

Anticipated Date of Completion: Completed

### **OPERATIONAL COMPLIANCE**

#### **Recommendation 7**

We recommend that Housing formally adopt a conflict-of-interest policy and obtain annual conflict-of-interest statements from all board members and/or management.

#### **Campus Response**

We concur with this recommendation. CPHC annually distributes an “Acknowledgment and Declaration on Standards of Conduct and Conflict-of-Interest” form to all board members and executive employees. A checklist has been developed in connection with the June 2005 distribution of forms to monitor the acknowledgment and return of the forms to CPHC. All forms were returned for the current fiscal year. CPHC adopted a formal Conflict-of-Interest Policy at its May 12, 2006 board meeting.

Anticipated Date of Completion: Completed

### **CAMPUS OVERSIGHT AND CONTROL**

#### **Recommendation 8**

We recommend that Housing ensure that its annual budgets are approved by its board and submitted to the campus president for approval prior to the beginning of the fiscal year.

**Campus Response**

We concur with this recommendation. The FY 2006-2007 budget was approved by the CPHC Board of Directors at its May 12, 2006 meeting, and has been submitted to the campus President for his approval prior to June 30, 2006.

Anticipated Date of Completion: Completed

**ASSOCIATED STUDENTS, INCORPORATED OF**  
**CALIFORNIA POLYTECHNIC STATE UNIVERSITY AT SAN LUIS OBISPO**

**CORPORATE GOVERNANCE**

**Recommendation 9**

We recommend that the ASI take appropriate measures to ensure that its board and subcommittee minutes are signed and approved by an appropriate official.

**Campus Response**

We concur with the recommendation. ASI will implement procedures by which all minutes will be properly approved and signed by the appropriate officials.

Anticipated Date of Completion: July 31, 2006

**FISCAL COMPLIANCE**

**Recommendation 10**

We recommend that the ASI account for and track UBI for childcare services, summer recreational programs, and club programs provided to community members, and file federal income tax returns as appropriate.

**Campus Response**

We concur with the recommendation. ASI will work with its external auditors on a plan to accurately identify and track UBI. If it is determined that UBI exists, then ASI will appropriately report it to the proper authority.

Anticipated Date of Completion: October 31, 2006

**CASH RECEIPTS AND HANDLING**

**Recommendation 11**

We recommend that the ASI maintain a record of individuals with safe access and dates of combination changes.

**Campus Response**

We concur with the recommendation. ASI will implement procedures to appropriately maintain records of individuals with safe access and dates of combination changes.

Anticipated Date of Completion: December 31, 2006

## INFORMATION TECHNOLOGY

### COMPUTER ROOM SECURITY

#### Recommendation 12

We recommend that the ASI install after-hours intrusion detection equipment in the computer room.

#### Campus Response

We concur with the recommendation. ASI will install after hours intrusion detection equipment in the computer room.

Anticipated Date of Completion: December 31, 2006

### DATA STORAGE

#### Recommendation 13

We recommend that the ASI store backup tapes at an off-site location.

#### Campus Response

We concur with the recommendation. In coordination with the campus, ASI will implement a program of storing backup tapes at an off-site location.

Anticipated Date of Completion: December 31, 2006

  
**THE CALIFORNIA STATE UNIVERSITY**  
 OFFICE OF THE CHANCELLOR

BAKERSFIELD

August 8, 2006

CHANNEL ISLANDS

CHICO

**MEMORANDUM**

DOMINGUEZ HILLS

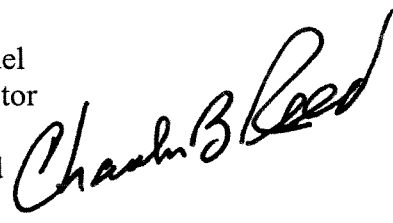
EAST BAY

TO: Mr. Larry Mandel  
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed  
Chancellor



HUMBOLDT

LONG BEACH

SUBJECT: Draft Final Report Number 05-52 on *Auxiliary Organizations*,  
California Polytechnic State University, San Luis Obispo

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of August 8, 2006, I accept the response as submitted with the draft final report on *Auxiliary Organizations*, California Polytechnic State University, San Luis Obispo.

MONTEREY BAY

NORTHRIDGE

POMONA

SACRAMENTO

CBR/jt

SAN BERNARDINO

Enclosure

SAN DIEGO

cc: Dr. Warren J. Baker, President  
Mr. Lawrence R. Kelley, Vice President for Administration and Finance

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS