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ABBREVIATIONS

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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CA</td>
<td>Cost Allocation</td>
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<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
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<td>CSU</td>
<td>California State University</td>
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<tr>
<td>FISMA</td>
<td>Financial Integrity and State Manager’s Accountability Act</td>
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<td>MOU</td>
<td>Memorandum of Understanding</td>
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<td>OUA</td>
<td>Office of the University Auditor</td>
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EXECUTIVE SUMMARY

As a result of a systemwide risk assessment conducted by the Office of the University Auditor (OUA) during the last quarter of 2011, the Board of Trustees, at its January 2012 meeting, directed that Cost Allocation (CA) be reviewed. The OUA had previously reviewed CA in the biennial Financial Integrity and State Manager’s Accountability Act (FISMA) audits, the last of which was performed on campus in 2008. Aspects of CA are also reviewed by the OUA in the triennial audits of auxiliary organization.

We visited the California State University, Northridge campus from January 23, 2012, through February 3, 2012, and audited the procedures in effect at that time.

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on CA activities. However, we did identify other reportable weaknesses that are described in the executive summary and body of this report. In our opinion, the operational and administrative controls for CA activities in effect as of February 3, 2012, taken as a whole, were sufficient to meet the objectives stated in the “Purpose” section of this report.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

The following summary provides management with an overview of conditions requiring attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [ ] refer to page numbers in the report.

GENERAL ENVIRONMENT [5]

The campus cost allocation plan needed improvement. Specifically, the plan was not reviewed and approved annually, and the associate vice president of financial services reviewed and approved allocations of indirect costs without a written delegation of authority from the chief financial officer.

PLAN FORMATION [6]

Memorandums of understanding for the recovery of costs from auxiliary enterprises were not always signed and dated prior to the beginning of the service period.
INTRODUCTION

BACKGROUND

Executive Order 1000, Delegation of Fiscal Authority and Responsibility, dated July 1, 2007, states that each campus must develop a cost allocation plan to ensure that costs incurred by the California State University (CSU) Operating Fund for services, products, and facilities provided to other CSU funds and to auxiliary organizations are properly and consistently recovered with cash and/or a documented exchange of value. The campus chief financial officer, or designee, shall annually approve and implement this plan.

Integrated California State University Administrative Manual §3552.01, Cost Allocation/Reimbursement Plans for the CSU Operating Fund, revised October 6, 2011, provides additional details on the required elements of the cost allocation plan and the recovery of the allocated costs.

Historically, management of the cost allocation function was reviewed by the CSU Office of the University Auditor (OUA) as part of cyclical audits based on the Financial Integrity and State Manager’s Accountability Act (FISMA) of 1983, passed by the California Legislature and detailed in Government Code §13400 through §13407. Aspects of the cost allocation function are also reviewed in the triennial Auxiliary Organization audits.

Beginning in calendar year 2010, cyclical FISMA audits were reevaluated and discontinued due to a change in the OUA audit risk assessment methodology. Using the new procedure, the OUA worked with CSU campus executive management to identify high-risk areas on each campus. In addition to these high-risk areas, the OUA audit plan considered high-profile areas and core financial areas to assure comprehensive audit coverage. Cost allocation was selected as the core financial area to review in 2012.
OUR OVERALL AUDIT OBJECTIVE WAS TO ASCERTAIN THE EFFECTIVENESS OF EXISTING POLICIES AND PROCEDURES RELATED TO COST ALLOCATION FOR THE CSU OPERATING FUND AND TO DETERMINE THE ADEQUACY OF CONTROLS OVER RELATED PROCESSES TO ENSURE COMPLIANCE WITH TRUSTEE POLICY, OFFICE OF THE CHANCELLOR DIRECTIVES, AND CAMPUS PROCEDURES.

Within the overall audit objective, specific goals included determining whether:

- Management and oversight over campus cost allocation plans provides an effective control environment.
- Policies and procedures surrounding campus cost allocation plans are current and comprehensive.
- The methodology used to create cost allocation plans is reasonable and adheres to CSU policy and guidelines.
- Allocated costs are valid, timely, and accurately invoiced and recovered.
SCOPE AND METHODOLOGY

The proposed scope of the audit as presented in Attachment A, Audit Agenda Item 2 of the January 24 and 25, 2012, meeting of the Committee on Audit stated that Cost Allocation (CA) includes the processes for recovering all costs incurred by the CSU Operating Fund for services provided to ancillary organizations. Proposed audit scope would include, but was not limited to, review of compliance with Trustee policy, systemwide directives, and campus policies and procedures; development, approval, and maintenance of campus CA plans; indirect rate formation; direct cost capture; and billing and collection processes.

Our study and evaluation were conducted in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors and included the audit tests we considered necessary in determining whether operational and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with Board of Trustee policies and Office of the Chancellor and campus policies, letters, and directives. The audit focused on procedures in effect from January 1, 2010, through December 31, 2011.

We focused primarily on the internal administrative, compliance, and operations controls over CA activities. Specifically, we reviewed and tested:

- Timely completion and proper approval of the campus cost allocation plan.
- Methodology used for direct cost recovery and indirect cost rate formation.
- Documentation of in-kind or exchange-of-value reimbursements.
- Billing and collection processes.
OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

GENERAL ENVIRONMENT

The campus cost allocation plan needed improvement.

We found that:

- The campus cost allocation plan was not reviewed and approved on an annual basis.

- The associate vice president of financial services reviewed and approved allocations of indirect costs without a written delegation of authority from the chief financial officer (CFO).

Executive Order 1000, *Delegation of Fiscal Authority and Responsibility*, dated July 1, 2007, states that each campus must develop a cost allocation plan to ensure that costs incurred by the CSU Operating Fund for services, products, and facilities provided to other CSU funds and to auxiliary organizations are properly and consistently recovered with cash and/or a documented exchange of value. The campus CFO, or designee, shall annually approve and implement this plan.

The associate vice president of financial services stated that the campus cost allocation plan was not reviewed and approved annually due to oversight.

Failure to review and approve the cost allocation plan annually and properly delegate authority for approval of the allocation of indirect costs increases the risk that the campus operating fund will not be fully compensated for support provided to auxiliary enterprises.

**Recommendation 1**

We recommend that the campus:

a. Review and approve the cost allocation plan on an annual basis.

b. Document any delegation of authority from the CFO for the review and approval of allocations of indirect costs.

**Campus Response**

We concur.

a. The campus has updated the process to ensure an annual review of memorandums of understanding (MOU). The associate vice president, financial services verifies and signs that all MOUs are in keeping with university and state policies. Procedures have been updated and cost recovery worksheets have been developed and posted to the office of financial services website to assist the campus in calculating costs and categorizing any reimbursements. This information is managed in a database and an annual summary created for review and approval by the CFO.
b. The campus has developed a process for the CFO to annually review and approve a summary of the MOUs. Therefore, a delegation of authority from the CFO is not necessary for the review and approval of allocation of indirect costs.

**PLAN FORMATION**

MOUs for the recovery of costs from auxiliary enterprises were not always signed and dated prior to the beginning of the service period.

We reviewed 26 MOUs for fiscal years 2010/11 and 2011/12, and we found that eight were signed after the MOU’s effective date, and three were not dated.

Government Code §13402 and §13403 state, in part, that state agencies are responsible for the establishment and maintenance of a system of internal accounting and administrative control that includes an established system of practices to be followed and an effective system of internal review.

The associate vice president of financial services stated that MOUs were not always implemented in a timely manner because the system in place to monitor MOU renewal dates did not always allow sufficient lead time to complete the MOU prior to the beginning of the service period. She further stated that the failure to include an execution date on some MOUs was due to oversight.

The absence of fully executed MOUs in support of the campus cost allocation plan increases the risk that the campus operating fund will not be fully compensated for support provided to auxiliary enterprises.

**Recommendation 2**

We recommend that the campus sign and date MOUs for the recovery of costs from auxiliary enterprises prior to the beginning of the service period.

**Campus Response**

We concur. The campus has updated the MOU procedures to indicate, “An MOU or contract of services must be approved before services are performed. MOUs will be processed annually.”
<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>Harold Hellenbrand</td>
<td>Interim President</td>
</tr>
<tr>
<td>Robert Barker</td>
<td>Accounting Professor</td>
</tr>
<tr>
<td>Margo Dutton</td>
<td>Assistant Director of Financial Accounting</td>
</tr>
<tr>
<td>Mary Hanson</td>
<td>Assistant Director of Logistical Services, Physical Plant Management</td>
</tr>
<tr>
<td>Howard Lutwak</td>
<td>Director of Internal Audit</td>
</tr>
<tr>
<td>Tom McCarron</td>
<td>Vice President of Administration and Finance and Chief Financial Officer</td>
</tr>
<tr>
<td>Cindy Mitchell</td>
<td>Administrative Assistant to the Associate Vice President of Human Resources</td>
</tr>
<tr>
<td>Travis Thomas</td>
<td>Materials Manager, Physical Plant Management</td>
</tr>
<tr>
<td>John Veatch</td>
<td>Manager, Finance and Trust Accounting</td>
</tr>
<tr>
<td>Jim Villar</td>
<td>Financial Analyst, Department of Police Services</td>
</tr>
<tr>
<td>Deborah Wallace</td>
<td>Associate Vice President of Financial Services</td>
</tr>
<tr>
<td>Janice Xanthos</td>
<td>Manager of Financial Services Resource Management</td>
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March 29, 2012

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

Subject: Campus Response to Recommendations of Audit Report Number 12-25, Cost Allocation at California State University, Northridge

Dear Larry:

Enclosed please find the California State University, Northridge (CSUN) response to the recommendations of the audit, as requested in your email of March, 21, 2012.

We have read the report including the observations and recommendations, and agree with them. Corrective action to implement all of the recommendations has occurred. By separate correspondence, the applicable documents evidencing completion of our implementation process and corrective action for each recommendation will be provided.

Should there be questions regarding the contents of the response, they may be addressed to Howard Lutwak, CSUN Internal Audit Director at (818) 677-2333.

We appreciate the recommendations to improve CSUN’s systems of internal control.

Sincerely,

Tom McCarron
Vice President Administration and Finance and CFO

TM: mh

Enclosures

cc: Dr. Harry Hellenbrand, Interim President
    Howard Lutwak, Director, Internal Audit
COST ALLOCATION

CALIFORNIA STATE UNIVERSITY,
NORTH RIDGE

Audit Report 12-25

GENERAL ENVIRONMENT

Recommendation 1

We recommend that the campus:

a. Review and approve the cost allocation plan on an annual basis.

b. Document any delegation of authority from the CFO for the review and approval of allocations of indirect costs.

Campus Response

We concur.

a. The campus has updated the process to ensure an annual review of Memorandums of Understanding (MOUs). The Associate Vice President, Financial Services verifies and signs that all MOUs are in keeping with University and state policies. Procedures have been updated and cost recovery worksheets have been developed and posted to the Office of Financial Services website to assist the campus in calculating costs and categorizing any reimbursements. This information is managed in a database and an annual summary created for review and approval by the CFO.

b. The campus has developed a process for the CFO to annually review and approve a summary of the MOUs. Therefore, a delegation of authority from the CFO is not necessary for the review and approval of allocation of indirect costs.

PLAN FORMATION

Recommendation 2

We recommend that the campus sign and date MOUs for the recovery of costs from auxiliary enterprises prior to the beginning of the service period.
Campus Response

We concur.

The campus has updated the Memorandum of Understanding (MOU) Procedures to indicate “An MOU or contract of services must be approved before services are performed. MOUs will be processed annually...”
April 5, 2012

MEMORANDUM

TO: Mr. Larry Mandel
    University Auditor

FROM: Charles B. Reed
      Chancellor

SUBJECT: Draft Final Report 12-25 on Cost Allocation,
         California State University, Northridge

In response to your memorandum of April 5, 2012, I accept the response as submitted with the draft final report on Cost Allocation, California State University, Northridge.

CBR/amd