COST ALLOCATION

HUMBOLDT STATE UNIVERSITY

Audit Report 12-26
April 30, 2012

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BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY
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ABBREVIATIONS

CA Cost Allocation
CFO Chief Financial Officer
CSU California State University
FISMA Financial Integrity and State Manager’s Accountability Act
MOU Memorandum of Understanding
OUA Office of the University Auditor
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 Humboldt State University campus from February 20, 2012, through March 9, 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 March 9, 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. For example, the director of contracts reviewed and approved allocations of indirect costs without a written delegation of authority, and certain indirect rates and indirect rate methodologies were not documented in the plan.

PLAN FORMATION [6]

Memorandums of understanding for the recovery of costs from auxiliary organizations and 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.
INTRODUCTION

PURPOSE

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.

Specifically, we found that:

- Certain elements of the cost allocation plan had not been reviewed or approved by the vice president of administrative affairs/chief financial officer (CFO). We reviewed 35 memorandums of understanding (MOU) included in the plan and found that 13 were signed by the director of contracts and procurement, without a written delegation of authority.

- The campus had not documented the review and approval of the indirect rates and rate methodology used for indirect costs charged for information technology services and liability insurance.

- The campus did not recover indirect costs for public safety from auxiliary organizations and enterprises other than parking and housing, and it had not documented an exchange of value to show that cost recovery was not necessary from other auxiliary enterprises.

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 CFO, or designee, shall annually approve and implement this plan.

The director of financial services stated that the director of contracts and procurement had been delegated the authority to approve the MOUs; however, as these MOUs included an element of cost recovery, they should have additionally been approved by the vice president of administrative affairs, but were not due to oversight. She further stated that the campus had reviewed and appropriately charged for indirect costs related to information technology and liability insurance, but had not documented these charges in MOUs because there was a long-standing agreement about the charges. She also stated that the documented exchange of value for public safety services to auxiliary organizations and enterprises other than housing and parking had not been completed due to oversight.

Failure to properly review and approve all elements of the cost allocation plan and document indirect costs and exchange of value 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. Ensure that MOUs included in the cost allocation plan are reviewed and approved by the vice president of administrative affairs/CFO or designee with written delegation of authority.

b. Document the review and approval of all indirect rates and rate methodologies used in the cost allocation plan, including information technology services and liability insurance, on an annual basis.

c. Recover indirect costs for public safety from auxiliary organizations and enterprises other than parking and housing, or document an exchange of value, as applicable.

Campus Response

We concur.

a. The campus will ensure that MOUs included in the cost allocation plan are reviewed and approved by the vice president of administrative affairs or designee.

b. The campus will document the review and approval of all indirect rates and rate methodologies used in the cost allocation plan, including information technology services and liability insurance, on an annual basis.

c. The campus will either recover indirect costs or document an exchange of value for public safety services provided to auxiliary organizations and enterprises.

Expected Implementation Date: June 29, 2012

PLAN FORMATION

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

We reviewed 33 MOUs for fiscal years 2010/11 and 2011/12, and we found that 27 were signed after the MOU’s effective date, and six 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 director of financial services stated that MOUs may not be signed prior to the service period because they require careful review from many parties; however, the recovery of the costs established in these MOUs was timely and generally accomplished in the same fiscal year. In addition, she stated
her belief that the risk of not recovering the costs from auxiliary organizations and enterprises due to contracts being established during the service period is minimal, as the campus and auxiliaries are related parties and the campus president has ultimate control over the propriety of all auxiliary expenditures.

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 organizations and enterprises.

**Recommendation 2**

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

**Campus Response**

We concur. The campus will modify and update the cost allocation plan to include appropriate timelines for execution of MOUs with auxiliary organizations and enterprises to ensure timely recovery of costs expended on non-state activities based on the most current systemwide authority.

Expected Implementation Date: June 29, 2012
### APPENDIX A:
### PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
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<tbody>
<tr>
<td>Rollin C. Richmond</td>
<td>President</td>
</tr>
<tr>
<td>Dave Bugbee</td>
<td>Director of Contracts and Procurement</td>
</tr>
<tr>
<td>Carlos Diaz</td>
<td>Buyer II</td>
</tr>
<tr>
<td>Emily Kupec</td>
<td>Financial Analyst, Reporting Analysis</td>
</tr>
<tr>
<td>Mary Ann McCulloch</td>
<td>Director, ITS Administrative Support</td>
</tr>
<tr>
<td>Burt Nordstrom</td>
<td>Vice President, Administrative Affairs and Chief Financial Officer</td>
</tr>
<tr>
<td>Lynne Sandstrom</td>
<td>Director, Financial Services</td>
</tr>
<tr>
<td>Carol Terry</td>
<td>Associate Vice President for Business Services</td>
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May 31, 2012

Larry Mandel
University Auditor
The California State University
401 Golden Shore
Long Beach, CA 90802-4210

Audit Report 12-26 Cost Allocation

Dear Mr. Mandel:

Please find enclosed Humboldt State University’s response to Audit Report 12-26 Cost Allocation, findings #1 and #2.

Please review the information and let us know if there are any questions, or if we can provide additional information. We appreciate the effort you and your staff have made to indicate areas where our procedures could be strengthened.

Please direct questions regarding the responses to Lynne Sandstrom, CPA, Financial Services at (707) 826-4031 or lss37@humboldt.edu.

Sincerely,

Carol Terry, Associate Vice President of Business Services

Cc: Rollin C. Richmond, President (w/o enclosures)
    Burt Nordstrom, Vice President Administrative Affairs (w/o enclosures)
COST ALLOCATION
HUMBOLDT STATE UNIVERSITY
Audit Report 12-26

GENERAL ENVIRONMENT

Recommendation 1

We recommend that the campus:

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b. Document the review and approval of all indirect rates and rate methodologies used in the cost allocation plan, including information technology services and liability insurance, on an annual basis.

c. Recover indirect costs for public safety from auxiliary organizations and enterprises other than parking and housing, or document an exchange of value, as applicable.

Campus Response

We concur.

a. The campus will ensure that MOUs included in the cost allocation plan are reviewed and approved by the vice president of administrative affairs or designee.

b. The campus will document the review and approval of all indirect rates and rate methodologies used in the cost allocation plan, including information technology services and liability insurance, on an annual basis.

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Expected Implementation Date: June 29, 2012
PLAN FORMATION

Recommendation 2

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

Campus Response

We concur. The campus will modify and update the cost allocation plan to include appropriate timelines for execution of MOU’s with auxiliary organizations and enterprises to ensure timely recovery of costs expended on non-state activities based on the most current system-wide authority.

Expected Implementation Date: June 29, 2012
June 8, 2012

MEMORANDUM

TO: Mr. Larry Mandel
    University Auditor

FROM: Charles B. Reed
      Chancellor

SUBJECT: Draft Final Report 12-26 on Cost Allocation,
         Humboldt State University

In response to your memorandum of June 8, 2012, I accept the response as submitted with the draft final report on Cost Allocation, Humboldt State University.

CBR/amd