COST ALLOCATION
CALIFORNIA POLYTECHNIC STATE UNIVERSITY,
SAN LUIS OBISPO

Audit Report 12-28
April 19, 2012

Members, Committee on Audit

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BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY
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ABBREVIATIONS

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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>BABS</td>
<td>Budget and Analytic Business Services</td>
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<td>CA</td>
<td>Cost Allocation</td>
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<tr>
<td>Cal Poly</td>
<td>California Polytechnic State University, San Luis Obispo</td>
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<td>CE</td>
<td>Continuing Education</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>ITS</td>
<td>Information Technology Services</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 organizations.

We visited the California Polytechnic State University, San Luis Obispo campus from March 5, 2012, through March 16, 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 16, 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.

PLAN FORMATION [5]

Certain indirect cost information in the campus cost allocation plan was outdated or incomplete.

COST RECOVERY [6]

The campus did not always maintain sufficient documentation for the recovery of direct costs incurred by the campus operating fund.
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.
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.
INTRODUCTION

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

PLAN FORMATION

Certain indirect cost information in the campus cost allocation plan was outdated or incomplete.

We found that indirect costs charged to continuing education (CE) for library usage, academic records, and information technology services (ITS) had not been updated for more than ten years. In addition, the methodology for calculating ITS indirect costs was not included in the cost allocation plan.

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. Allowable and allocable indirect costs shall be allocated and recovered according to a cost allocation plan that utilizes a documented and consistent methodology, including identification of indirect costs and basis for allocation.

California Polytechnic University, San Luis Obispo (Cal Poly) Memorandum of Understanding, Services Provided by the Library to Extended Education, dated February 4, 2000, states that the library and extended/continuing education will agree to the following: The library will forward monthly copies of its statistics report “Number of Patrons with Library Privileges” to budget and analytic business services (BABS), and the library will ensure that the number of patrons will be accurately maintained; the BABS office will notify extended/continuing education annually of the cost of library services; and the BABS office, on behalf of the library, will be responsible for facilitating the documentation necessary to ensure that the transactions are recorded.

The director of BABS stated that CE and the library had not been providing BABS with regular statistical reports to support CE use of state facilities and services. He also stated that the failure to include ITS cost recovery methodology in the cost allocation plan was due to oversight.

The lack of a complete and updated cost allocation plan 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 update its cost allocation plan to ensure that all indirect cost amounts are current and to include the methodology for calculating all such costs.

Campus Response

We concur. We will review the indirect costs allocated to the continuing education revenue fund for library usage, academic records, and information technology services and will update the cost allocation plan including the methodology for calculating these costs. The updated methodology will be utilized in the subsequent annual cost allocation plan.
Completion date: October 19, 2012

**COST RECOVERY**

The campus did not always maintain sufficient documentation for the recovery of direct costs incurred by the campus operating fund.

We reviewed four direct costs incurred by the campus operating fund, and we found that in one case, the campus lacked documentation to support the amount charged and to show that follow-up actions were taken to recover the cost, which remained outstanding for 238 days.

Cal Poly *Accounts Receivable Collections and Write Offs* policy, dated March 3, 2008, states that the following general guidelines should be followed: Review the accounts receivable aging reports each month; research any credits and note why the customer has a credit balance. Review the nature of all outstanding balances to determine if follow-up action is needed; some customers, such as government payers or university auxiliaries, may require substantial time after billing to verify and approve charges as billed and to go through the necessary processes in order to generate payment to the university. At 60-90, 90-120, and 120-365 days outstanding, a first, second, and third letter should be sent respectively requesting payment. The third and final letter should state that the account will be sent for collection if no contact on the part of the customer is made within 30 days of the date of the letter.

State Administrative Manual §8776 states that the accounting office will send a sequence of three collection letters at 30-day intervals. If a reply or payment is not received within 30 days after sending the first letter, the accounting office will send a second letter. This follow-up letter will reference the original request-for-payment letter and will be stated in a stronger tone. If a response is still not received from the debtor, a third letter will be sent 30 days later. This last letter will include references to prior letters and will state what further actions may be taken in the collection process.

The assistant director of general accounting and financial reporting stated that the lack of appropriate documentation and methodology to support the direct cost and the failure to document follow-up on the delinquent outstanding receivable occurred because one CE course was different from normal CE program activities and did not fit within established systems. She further stated that CE staff failed to inquire about proper alternatives for this exception.

Failure to obtain appropriate documentation to support direct costs increases the risk of inappropriate or wasteful spending, and failure to document follow-up actions taken on delinquent receivables increases the risk that campus funds will not be recovered in a timely manner.

**Recommendation 2**

We recommend that the campus:

a. Maintain documentation to support the amount charged for direct costs incurred by the campus operating fund.
b. Maintain documentation of follow-up actions taken to recover delinquent outstanding receivables.

**Campus Response**

We concur.

a. We will ensure that documentation is maintained to support the direct costs incurred by the CSU operating fund.

b. We will maintain documentation of the routine collection actions performed to recover delinquent outstanding receivables.

Completion date: August 31, 2012
## APPENDIX A:
### PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td>Jeffrey D. Armstrong</td>
<td>President</td>
</tr>
<tr>
<td>Victor Brancart</td>
<td>Director, Budget and Analytic Business Services (BABS)</td>
</tr>
<tr>
<td>Denise Gibbons</td>
<td>Lead Business Analyst, BABS</td>
</tr>
<tr>
<td>Larry Kelley</td>
<td>Vice President, Administration and Finance</td>
</tr>
<tr>
<td>Lorlie Leetham</td>
<td>Director, Fiscal Services</td>
</tr>
<tr>
<td>Jeanette Elizabeth Paolucci</td>
<td>Administrative Support Coordinator, Contracts, Procurement and Risk Management</td>
</tr>
<tr>
<td>Kimberly Perez</td>
<td>Assistant Director, General Accounting and Finance Reporting, Fiscal Services</td>
</tr>
<tr>
<td>Rick Ramirez</td>
<td>Associate Vice President for Finance, Administration and Finance</td>
</tr>
</tbody>
</table>
21 May 2012

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

Subject: Campus Responses to Recommendations of Incomplete Draft Audit Report
Number 12-28, Cost Allocation, California Polytechnic State University, San Luis Obispo

Dear Larry:

Enclosed are responses to the recommendations in the incomplete draft of the Cost Allocation audit report (Audit Report No. 12-28). The responses are submitted to you for review and for acceptance by the Chancellor. The responses include a corrective action plan and time frame for completion.

Please direct questions to Rick Ramírez, Associate Vice President for Finance, at 805-756-2091 (ramirez@calpoly.edu).

Sincerely,

[Signature]

Lawrence Kelley
Vice President for Administration and Finance

cc: J. Armstrong, R. Ramírez
**PLAN FORMATION**

**Recommendation 1**

We recommend that the campus update its cost allocation plan to ensure that all indirect cost amounts are current and to include the methodology for calculating all such costs.

**Campus Response**

Concur. We will review the indirect costs allocated to the Continuing Education Revenue Fund for library usage, academic records, and information technology services and will update the cost allocation plan including the methodology for calculating these costs. The updated methodology will be utilized in the subsequent annual cost allocation plan.

Completion Date: October 19, 2012

**COST RECOVERY**

**Recommendation 2**

We recommend that the campus:

a. Maintain documentation to support the amount charged for direct costs incurred by the campus operating fund.

b. Maintain documentation of follow-up actions taken to recover delinquent outstanding receivables.

**Campus Response**

Concur.

a. We will ensure that documentation is maintained to support the direct costs incurred by the CSU Operating Fund.

b. We will maintain documentation of the routine collection actions performed to recover delinquent outstanding receivables.

Completion Date: August 31, 2012
May 25, 2012

MEMORANDUM

TO: Mr. Larry Mandel
   University Auditor

FROM: Charles B. Reed
      Chancellor

SUBJECT: Draft Final Report 12-28 on Cost Allocation,
         California Polytechnic State University, San Luis Obispo

In response to your memorandum of May 25, 2012, I accept the response as
submitted with the draft final report on Cost Allocation, California Polytechnic
State University, San Luis Obispo.

CBR/amd