SPECIAL INVESTIGATION

CALIFORNIA STATE UNIVERSITY,
FULLERTON

Report Number 04-91
October 11, 2006

Members, Committee on Audit

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BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY
October 11, 2006

Dr. Charles B. Reed
Chancellor
The California State University
401 Golden Shore
Long Beach, CA 90802

Dear Dr. Reed:

Pursuant to a request from your office on September 16, 2004, the Office of the University Auditor has conducted an investigation in response to allegations made by certain members of the California State University (CSU), Fullerton campus of improper governmental activities, disregard for regulations and CSU policy, allowance of abuse of authority, continuous improper suppression of irregularities, and acts of retaliation.

To investigate the allegations, we considered the campus' fiscal operations for the period from July 1995 through September 2005. Our primary focus was on activities and financial transactions that occurred between January 2001 and December 2004. We examined available financial and non-financial records and documents as deemed appropriate. Additionally, we interviewed current and previous employees of the campus and its auxiliaries.

Included within the report are the results of the investigation of the allegations and specific recommendations which, we believe, would benefit the campus' fiscal and operational management.

The President and certain key administrators had knowledge of many of the allegations and claims prior to the start of our investigation. As a result, various organizational and operational changes coincided with the investigation.

Sincerely,

Larry Mandel
University Auditor

LM:amd

CSU Campuses
Bakersfield
Channel Islands
Chico
Dominguez Hills
East Bay
Fresno
Fullerton
Humboldt
Long Beach
Los Angeles
Maritime Academy
Monterey Bay
Northridge
Pomona
Sacramento
San Bernardino
San Diego
San Francisco
San José
San Luis Obispo
San Marcos
Sonoma
Stanislaus
CONTENTS

SEC  Securities and Exchange Commission
UAF  University Advancement Foundation
     (Currently the Cal State Fullerton Philanthropic Foundation)
UAM  Unified Application Manager
VP   Vice President
EXECUTIVE SUMMARY

ALLEGATIONS

- The control environment within Business and Financial Affairs (BFA) discouraged the reporting of instances of fraud, waste, and abuse.
- Waste, abuse, and fraud occurred within Enterprise Computing (EC) activities.
- Full and complete budget information was withheld from senior administrators by BFA management.
- Certain non-General Funds were inappropriately administered by BFA management.
- A conflict of interest resulted when an auxiliary organization executive director was granted the right to be a voting member of the board.
- Waste, abuse, and fraud occurred within the activities overseen by BFA management.

INVESTIGATION RESULTS – ALLEGATIONS

CONTROL ENVIRONMENT

The control environment within BFA resulted in unsatisfactory oversight and continuation of past inappropriate activities, and discouraged the reporting of instances of waste, fraud, and abuse.

Unsatisfactory Oversight

- Irregular work hours of certain BFA managers resulted in unsatisfactory oversight of financial operations.

Failure to Modify Underlying Operating Culture

- Certain control weaknesses and inappropriate activities noted in the past regarding the operations of BFA continued unchecked.

Non-Supportive Workplace Environment

- The workplace environment within BFA did not support and encourage employees to freely report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation.
ENTERPRISE COMPUTING

Waste, abuse, and potential fraud occurred within EC activities.

**Insufficient Oversight of Enterprise Computing**
- The campus failed to establish necessary and appropriate controls over EC contracting activities.
- EC failed to successfully complete and implement most of its application development projects.

**Inappropriate Information Technology Expenditures**
- Funds allocated for use on readiness for the Common Management Systems (CMS) implementation, including a fit-gap analysis, were instead diverted to the development of web content management and workflow application development projects.
- BFA failed to appropriately capitalize EC software development expenditures.
- The campus paid for certain software user licenses and maintenance fees in excess of need.

**Inappropriate Software Endorsements**
- The Director of EC and the prior Chief Financial Officer inappropriately provided endorsements to software companies, both in violation of policy and inconsistent with the campus’ experience.

**Conflict of Interest**
- Information system projects administered by the Director of EC were evaluated and tested by his spouse, the Director of BFA Systems.
- The Director of BFA Systems purchased web content management software from a company in which her spouse, the Director of EC, had a financial interest.
- The campus did not adequately address and implement campus conflict-of-interest code policies and procedures.

**Incompatible Activities**
- The Director of EC was actively involved in the administration of a software company doing business with the campus.


EXECUTIVE SUMMARY

CAMPUS BUDGETS

Full and complete budget information was withheld from senior administrators by BFA management.

Insufficient Management Oversight

- The President’s Administrative Board and the Planning, Resource and Budget Committee were unable to provide an effective financial advisory function to the President because they were not given complete and comprehensive budget documentation by BFA management.

- BFA management had not established standards for reporting budgetary information and failed to produce regular and consistent budgetary documents for use by the campus community.

- In certain instances, BFA management was unable to satisfactorily respond to requests for complete budgetary information from administrators and members of the campus community.

- BFA management was unable to reconcile the current financial position of the campus to budgetary and accounting ledgers in a timely manner.

Inappropriate Budget Transfers

- BFA management made transfers without maintaining the identity of the year funds were appropriated by the state.

- BFA management inadequately managed and controlled budgetary fund transfers.

- BFA management did not clearly establish responsibility for accounts maintained to facilitate interfund transfers.

Inappropriate Management of Cash Flows and Deficits

- BFA management oversaw accounting and budgeting practices that caused large balances of unexpended funds to accumulate, unknown to other members of the campus management team.

- BFA management did not appropriately control deficits in individual budgetary accounts, nor did it sufficiently consider the effects of the deficits in annual budget planning.

- BFA management used certain estimates and reserves for budget planning purposes that were not appropriately recorded in budget or accounting ledgers.

Insufficient Administrative Controls

- BFA management failed to appropriately grant/limit access to budget data it maintained.

- BFA management did not maintain a single reliable budget ledger.
EXECUTIVE SUMMARY

**NON-GENERAL FUNDS**

Certain non-General Funds were inappropriately administered by BFA management.

**Non-Reimbursement of the General Fund**

- Funds intended to reimburse the General Fund for continuing education-related activities were inappropriately maintained in non-General Fund accounts.

**Inappropriate Administration of Continuing Education Funds**

- BFA did not deposit or otherwise record reimbursements for facilities, goods, or services provided to Continuing Education by the General Fund, and vice versa.

**Inappropriate Administration of Lottery Funds**

- The use of lottery funds to facilitate a construction project was not properly recorded.

**UNIVERSITY ADVANCEMENT FOUNDATION (UAF)**

A conflict of interest was not found to exist when the Vice President of University Advancement (UAF Executive Director) was granted the right to be a voting member of the board. However, certain UAF revenues were found to be improperly classified.

**Conflict of Interest**

- A revision to the UAF’s bylaws did not create a conflict of interest.

**Inappropriate Classification of Revenues**

- Fundraising for campus scholarship programs inappropriately included transfers from other campus funds as revenue, thereby inflating revenues actually earned.

**BUSINESS AND FINANCIAL AFFAIRS**

Waste and abuse occurred within the activities overseen by BFA management.

**Procurement Process Control Weaknesses**

- BFA management allowed contracts to be expanded essentially without limit based upon a single signature and split transactions to avoid limits.
  - BFA management’s implementation of an online e-commerce process was flawed.
EXECUTIVE SUMMARY

- In certain instances, managers circumvented required bidding processes.

**Improper Handling of Travel Advances**

- A BFA administrator failed to promptly clear travel advances.

**Inappropriate Personnel Appointments**

- BFA’s management staffing process failed to provide the campus with needed financial experience and leadership skills.
- Controls within BFA were significantly weakened because several key management positions remained vacant for a long period of time.

**Payroll Abuse**

- A BFA administrator was inappropriately granted additional leave benefits.

**Inaccurate Financial Information**

- Regular reconciliations of subsidiary accounting ledgers and information maintained in a data warehouse were not regularly performed.
- Regular reconciliations of scanned document inventory were not performed, and data was not maintained in an unalterable format.
INTRODUCTION

ALLEGATIONS

Certain members of the California State University (CSU), Fullerton campus made allegations of improper governmental activities, disregard for regulations and CSU policy, allowance of abuse of authority, continuous improper suppression of irregularities, and acts of retaliation. Those allegations were forwarded to the Chair of the CSU Board of Trustees’ Committee on Audit.

In September 2004, the Chancellor requested that the University Auditor review the allegations. After meeting with campus administrators and managers, and obtaining certain corroborating documentation, we determined that sufficient predication existed to warrant further investigation.

Complaints presented to us alleged that: fraud, waste, and abuse had occurred within both Enterprise Computing (EC) activities and the activities overseen by Business and Financial Affairs (BFA); full and complete budget information was withheld from senior administrators by BFA management; certain non-General Funds were inappropriately administered by BFA management; a conflict of interest resulted when an auxiliary organization executive director was granted the right to be a voting member of the board; and the control environment within BFA discouraged the reporting of instances of waste, fraud, and abuse.

BACKGROUND

Over the past ten years, CSU, Fullerton has experienced tremendous growth in students, facilities, and academic accomplishment. Currently, its General Fund budget exceeds $230 million dollars, making it one of the largest of the 23 CSU campuses. During this same period, the campus has been impacted by systemwide pressures affecting the CSU, including: past inconsistencies in state funding; requirements to reduce the state’s share of costs through private fundraising efforts; new financial reporting requirements; changing demands and requirements for information systems; and the state’s student demographic, which called for increased enrollment.

In addition, the demands and requirements placed on campus financial and administrative management personnel and internal control systems have also grown. Transition during this period has proven difficult and at times problematic for the campus’ financial operations. Most notably, the period was marked by an investigation conducted by the Bureau of State Audits in 1999. The State Auditor cited mismanagement issues relating to the administration of financial affairs. In response to this investigation, the campus sought outside expertise to evaluate and improve affected fiscal control systems.

In the fall of 2003, the President designated the campus Internal Auditor to be the recipient of whistleblower complaints. The Internal Auditor stated that shortly thereafter, numerous issues and concerns were brought forward regarding the administration of BFA and the management of certain information systems projects overseen by EC. Further, he believed that certain transactions and activities approved by BFA management seemed inappropriate. In January 2004, the Internal Auditor summarized and discussed these issues and other concerns with the President who suggested that he discuss them with the prior Chief Financial Officer (CFO)
In March 2004, the President formed a BFA Review Committee (Committee) consisting of members of his executive team. In light of the information brought forth by the Internal Auditor and others, the Committee interviewed BFA management and staff and other key campus personnel. According to Committee members, staff indicated that BFA lacked leadership, direction, communication, and teamwork. In addition, the Committee heard concerns about staffing at BFA, including the knowledge and abilities of certain managers and staffing equity issues.

After the Committee’s findings and based upon other factors, the President chose to combine BFA and Administration into one campus division under a single executive who would oversee administration and finance. At the direction of the President, the role of CFO transitioned to this executive to be known as the Vice President for Administration and Finance/CFO. This transition became effective April 2005.

During this period, management also questioned the sufficiency of controls over EC projects. Prior to the completion of our investigation of EC, its Director left CSU employment. In late 2003, the Chief Information Technology Officer (CITO) began a review of the return on investment associated with the various EC projects. The results of his review were unfavorable. He presented his findings to the President and once our investigation began, he presented them to us. Approximately one month after presenting his findings to us, the CITO announced his retirement. An interim CITO was appointed immediately and an ongoing CITO appointment was made several months later. Finally, the Director of BFA Systems also left employment during the course of our investigation.

Throughout our investigation, we found management and staff to be cooperative and supportive of our efforts and noted that administration was working to improve known deficiencies.

**SCOPE AND METHOD OF INVESTIGATION**

To investigate the allegations, we considered the campus’ fiscal operations for the period from July 1995 through September 2005. Our primary focus was on activities and financial transactions that occurred between January 2001 and December 2004. We examined available financial and non-financial records and documents as deemed appropriate. Additionally, we interviewed current and previous employees of the campus and its auxiliaries.
RESULTS OF INVESTIGATION

INVESTIGATION RESULTS - ALLEGATIONS

CONTROL ENVIRONMENT

The control environment within Business and Financial Affairs (BFA) resulted in unsatisfactory oversight and continuation of past inappropriate activities, and discouraged the reporting of instances of waste, fraud, and abuse.

Unsatisfactory Oversight

Irregular Work Hours

Irregular work hours of certain BFA managers resulted in unsatisfactory oversight of financial operations.

We found that key BFA managers often were not present during normal business hours. BFA staff indicated that day-to-day management decisions had to be delayed or were left to individuals with unclear authority, sometimes leading to improper decisions.

Specifically, a key manager typically was absent in the mornings and worked late in the evenings. As a result, this individual was not available to manage staff during regular business hours. In another instance, a key BFA employee regularly worked three days in the office and two days at home. We were provided no evidence that these practices were approved or officially sanctioned and controlled by Human Resources procedures. These practices were, however, approved by the prior Chief Financial Officer (CFO).

Not requiring key personnel, including managers, to be present during normal business hours may have contributed to BFA’s lack of service to campus departments and diminished internal communication between BFA managers. Further, the ability of staff to obtain ad hoc/day-to-day interaction with BFA administration was also diminished.

Government Code §13402 states that state agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

When necessary and appropriate oversight of employees is not maintained, the risk that fraud, waste, and abuse could occur and not be detected timely is increased.
Failure to Modify Underlying Operating Culture

Control Weaknesses

Certain control weaknesses and inappropriate activities noted in the past regarding the operations of BFA continued unchecked.

In 1999, the campus was subjected to an audit by the State Auditor. He concluded that the campus acted without statutory authority when it established an all-purpose trust account, used funds in that account to pay for many types of improper expenditures not authorized by state laws, and diverted surplus funds to the account. He also substantiated that the prior CFO improperly spent her division’s fee revenues, circumvented official contracting policies, and engaged in questionable personnel practices.

Some of the same weaknesses were found during our investigation and indicate that some of the underlying causes for the State Auditor’s findings have not yet been fully addressed.

The State Auditor noted that “although many of the problems we identified may not seem significant in isolation, collectively they demonstrate serious mismanagement at the campus.” We found that many of these same problems continued to exist at the time of our investigation.

Government Code §13402 states that agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

When appropriate corrective measures are not taken as a result of past audits and organizational reviews, the risk that state assets and funds are inadequately safeguarded is significantly increased.

Non-Supportive Workplace Environment

Fear of Retaliation

The workplace environment within BFA did not support and encourage employees to freely report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation.

Based on their interviews with BFA staff, campus executives determined that BFA lacked leadership, direction, and teamwork, and found that communication among BFA managers was poor. We agree with the campus’ conclusions.

In addition, since 1999, employees who brought forward allegations of waste, fraud, and abuse made claims that BFA leadership retaliated against them. Several employees interviewed during this investigation explained that they feared retaliation from the prior CFO. During the course of our investigation, one BFA employee filed a formal claim of retaliation.
While perceptions are necessarily subjective, and therefore unique to each individual, the similarities of perceptions among several departmental staff indicate that the BFA workplace environment has not supported the reporting of waste, fraud, abuse of authority, or other problems by staff. Further, this problem has not been erased or sufficiently mitigated by the existing campus policies, procedures, and practices.

Government Code §8547.1 states that employees should be free to report waste, fraud, abuse of authority, violation of law, or threat to public health without fear of retributon.

When employees cannot be candid and honest in reporting issues, there is an increased risk of waste, fraud, and abuse of authority.

ENTERPRISE COMPUTING

Waste, abuse, and potential fraud occurred within Enterprise Computing (EC) activities.

Insufficient Oversight of Enterprise Computing

Contract Administration

The campus failed to establish necessary and appropriate controls over EC contracting activities.

The Director of EC oversaw the expenditure of over $5 million for equipment, software, and consulting services without a clear mandate from campus leadership as to what the group was to accomplish. In addition, EC maintained minimal documentation to show how it expended these resources. We found that EC activities and projects were funded through movements of funds in the control of the prior CFO rather than through the campus-wide budgetary process (including the President’s Administrative Board and the Planning, Resource and Budget Committee).

EC contracts were increased beyond their original amount through multiple change orders with little or no management control. Further, oversight by the contracts and procurement office was minimized by EC’s overuse of sole source contracts. In addition, general purchasing of services, supplies, and equipment occurred with only limited management oversight.

EC hired consultants to manage projects and to staff computer programming needs. However, only the Director of EC knew specifically what these consultants were working on. Deliverables were unclear and, in certain instances, not made a part of the contracts and invoices; the only supporting documentation are time sheets and a few status reports.

Campus employees indicated that EC administration of contracts did not follow basic principles of project management. For example, checks and balances on project scope, time frames, costs, or business justification were not implemented.
Executive Order (EO) 648, *Delegations of Fiscal Authority and Responsibility*, dated January 1, 1996, states that the campus president is delegated authority to approve the expenditure from and transfer between appropriations, funds, programs, allotments, and projects except when prohibited by applicable statutes including Education Code §89750 to §89761, the annual Budget Act regulations, bond indentures, and policies of the Board of Trustees. Additionally, the campus president is responsible for ensuring that appropriate internal controls are in place to protect funds from misuse.

When necessary and appropriate controls over contracting activities are not properly established, the risk of inappropriate expenditures/benefits is increased.

**Application Development Projects**

EC failed to successfully complete and implement most of its application development projects.

Since 2001, EC attempted various workflow engineering projects seeking to manage travel, human resources, timekeeping, and other accounting functions. Additionally, it attempted to establish an in-house web portal that could unify access to the various applications operated by the campus. Extensive time and effort was put into these projects by both campus employees and hired consultants.

These projects were being developed to replace outdated systems used by the campus, and to eliminate much of the cost associated with implementing the Common Management Systems (CMS). The applications under development were created using workflow software¹ with the objective of interfacing with CMS system software. Based upon our review, it appears that many of the projects undertaken were experimental and only one of the applications, timekeeping, was put into limited operation.

In 2004, the campus abandoned a majority of the experimental projects. The human resources package was abandoned largely because it had been developed without input from Campus Human Resources; the timekeeping program was later deemed unsuccessfully implemented based upon the results of testing by a pilot sample of employees.

The CSU Policy Manual for Contracting and Procurement, Section 500, *Information Technology Resources (ITR) Procurement Policy* [Reference: Public Contract Code §12100 et seq.; EO 667 and 775; Education Code §89036, Government Code §11702 (e)] states that each campus shall employ sound and appropriate business practices to guide and control the planning, acquisition, development, operation, maintenance, and evaluation of all ITR-related applications.

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¹ Integrated document management software products designed to manage information and enhance enterprise productivity by automating and streamlining their business processes, and providing connectivity needed to simplify decision-making.
Failure to successfully complete and implement application development projects increases the risk that succeeding projects will be handled similarly and result in a waste of valuable resources.

**Inappropriate Information Technology Expenditures**

**Readiness for CMS Implementation**

Funds allocated for use on readiness for the CMS implementation, including a fit-gap analysis, were instead diverted to the development of web content management and workflow application development projects.

EC was responsible for ensuring the campus’ readiness to implement CMS, including completing needed fit-gap analysis. Instead, the Director of EC utilized contract programmers and campus-assigned CMS project team members to develop web content management and workflow application development projects that were unrelated to required readiness efforts. The effect of this diversion was twofold: an inappropriate use of targeted funds and a delay of the analysis far beyond the normal period required.

Government Code §13403 (a) states that internal accounting and administrative controls are the methods through which reasonable assurances can be given that measures adopted by state agency heads to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies are being followed.

Failure to use targeted funds appropriately increases the risk that project objectives and timetables will not be achieved.

**Capitalization of Software Development Costs**

BFA failed to appropriately capitalize EC software development expenditures.

Approximately $6 million in EC and BFA systems software expenditures were never capitalized. The practice of the campus was to expense development costs in the year incurred. We noted one instance where this was done for a $500,000 expenditure. During the course of our fieldwork, these facts and circumstances were discussed with the campus’ external auditor, who adjusted financial statements accordingly.

American Institute of Certified Public Accountants’ Statement of Position Number 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, provides guidelines to ensure that entities properly determine the types of internal-use software to report as assets subject to amortization or classify as current period expenses.

When financial statements do not properly reflect purchases of assets, the risk of misunderstandings with respect to the results of operations is increased.
Software Licenses and Maintenance Fees

The campus paid for certain software user licenses and maintenance fees in excess of need.

Licenses and maintenance fees were paid for certain document scanning software that was never fully utilized. BFA purchased 1,000 licenses at an initial cost of nearly a million dollars with annual maintenance costs over $150,000. We were unable to establish that even 10% of these licenses were in use.

In addition, excessive licenses and fees were paid for certain database query software. During the course of our investigation, Information Technology (IT) reduced by 50% the number of licensed campus servers for this software. The original cost associated with the purchase of four CPU software suites was over $200,000 in December 2003. In addition, thousands of dollars were required in annual maintenance fees. Finally, at the time of our investigation, even the two software suites the campus retained had not been put into service.

Government Code §13401 (b) (3) states that all levels of management of state agencies must be involved in assessing and strengthening systems of internal accounting and administrative control to minimize the waste of government funds.

When there is a failure to conduct detailed and sufficient planning for licenses and maintenance fees, the risk of inefficiency, waste, and abuse is significantly increased.

Inappropriate Software Endorsements

Director of Enterprise Computing and Prior Chief Financial Officer

The Director of EC and the prior CFO inappropriately provided endorsements to software companies, both in violation of policy and inconsistent with the campus’ experience.

The Director of EC made an erroneous endorsement regarding the campus’ implementation of workflow software. The endorsement was posted on the workflow software’s website. It overstated the campus’ use and integration of the software. Specifically, the endorsement indicated software helped the campus “make the transition to the new [CMS] application easily and with no major impact on day-to-day efficiency and productivity.” In fact, EC had only implemented a limited timekeeping function on a test basis.

The workflow vendor, on an annual basis, competitively awards recognition to organizations that have implemented leading edge applications using its software. We found that the Director of EC had submitted a false application overstating the campus’ implementation of a workflow application to the vendor. This was discovered by the current manager in charge of campus IT when the vendor contacted the campus suggesting it reapply. The vendor at that time was notified that the campus’ previously reported success was overstated by the Director of EC.
In another instance, the prior CFO incorrectly endorsed an e-commerce software solution that campus users were generally dissatisfied with. In fact, dissatisfaction with the software culminated with the dissolution of the agreement with the service provider. Nevertheless, we found that the home page for the software included the campus logo and a quote from the prior CFO promulgating the benefits of the campus e-commerce software. In addition, we found that the prior CFO had co-presented a demonstration of the e-commerce services provided by the vendor to a California State University (CSU) systemwide group of procurement officers. Not only was it a violation of policy for the prior CFO to make any endorsement of the software solution, according to campus managers and staff we interviewed, the endorsement both overstated the benefits of the software and understated the associated costs of its operation.

The CSU Policy Manual for Contracting and Procurement, Section 210.05, Commercial Endorsements of Products or Services [Education Code §89005.5 (a) (2) and (3); Trustees' Resolution 63-16, July 1963], states that officers and employees of the CSU, in their official capacities, are prohibited from endorsing any commercial product or service.

Allowing administrators to make endorsements for products and service increases the risk of lawsuits resulting from implied warranty for the effectiveness of such products.

**Conflict of Interest**

**Marital Status**

*Information system projects administered by the Director of EC were evaluated and tested by his spouse, the Director of BFA Systems.*

Based upon the recommendation of the prior chief information technology officer (CITO), the campus hired the Director of EC. Subsequent to the hiring of the Director of EC, projects he administered were evaluated and tested by the Director of BFA Systems, an individual who, some time later, was revealed to be his spouse. We found that the prior CFO knew of the marital status at the time of hiring, did not inform appropriate administrators (including the President), and did not institute satisfactory mitigating controls to address weaknesses inherent when such a potential conflict exists.

The State Administrative Manual, §8080, Separation of Duties, states that a key element in a system of internal control is separation of duties. For purposes of evaluating the adequacy of the separation of duties, members of the same family (husband, wife, brother, or sister) are considered one person.

Inadequate segregation of duties increases the risk that errors and irregularities will not be detected in a timely manner.

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2 The problems with web-based e-commerce software are discussed in more detail later in this report.
Web Content Management Software

The Director of BFA Systems purchased web content management software from a company in which her spouse, the Director of EC, had a financial interest.

The Director of BFA Systems purchased a software product that focuses on web content management, e-commerce, and workflow integration. (See Table 1 – Related Party Payments – Web Content Software.) It was relatively untested in the university environment, and the company selling it was not in a strong financial condition. This company was affiliated with the corporation the Director of EC was known to work for before his employment with the campus. Our audit disclosed that the Director of EC had a continuing relationship with that corporation after he was hired by the campus. This is discussed in detail below included within our discussion of the Director of EC’s incompatible duties. We found that a conflict of interest resulted in the purchase because of the business relationship as well as the Director of EC’s active facilitation of the purchase and related payment transactions.

Table 1 – Related Party Payments – Web Content Software

<table>
<thead>
<tr>
<th>Date</th>
<th>Goods/Services Purchased</th>
<th>Amount Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 25, 2001</td>
<td>Professional Services and Travel</td>
<td>$ 1,310</td>
</tr>
<tr>
<td>July 20, 2001</td>
<td>Software, Professional Services and Travel</td>
<td>70,513</td>
</tr>
<tr>
<td>October 26, 2001</td>
<td>Progress Professional Services</td>
<td>4,000</td>
</tr>
<tr>
<td>December 19, 2001</td>
<td>Progress Professional Services</td>
<td>5,000</td>
</tr>
<tr>
<td>January 9, 2002</td>
<td>Progress Professional Services</td>
<td>5,000</td>
</tr>
<tr>
<td>June 19, 2002</td>
<td>Progress Professional Services</td>
<td>1,000</td>
</tr>
<tr>
<td>June 21, 2002</td>
<td>Maintenance</td>
<td>11,250</td>
</tr>
<tr>
<td>December 22, 2004</td>
<td>Maintenance</td>
<td>9,000</td>
</tr>
<tr>
<td>February 18, 2005</td>
<td>Maintenance</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$116,073</strong></td>
</tr>
</tbody>
</table>

We found that the web content software was being run in a limited capacity on campus. It provided a means of collecting employee reimbursements due to the campus (i.e., reimbursements for personal phone calls and personal use of the state procurement card). This limited functionality was administered by staff in BFA Systems. Even though amounts collected were not substantial, we considered it unusual for systems analysts, rather than accounting personnel, to administer an accounting and cash receipting function like this. The software required a hole in the campus firewall in order to operate, and it did not work with standard campus software protocols, thus compromising the security of the data used in conjunction with the software.

Considerable effort was being expended by EC toward creating the Unified Application Manager (UAM) for the campus. EC and BFA Systems were working together to create such an application utilizing capabilities of the software. Efforts toward creating the UAM for the campus also benefited the company selling it because enhancements to the software resulted from EC’s establishing
connectivity to other popular software such as the workflow software discussed above and the software utilized for CMS.

The Director of BFA Systems indicated that her relationship with the company marketing the software was purely a vendor-client relationship. She stated that up until last fiscal year, she signed the invoice for the annual maintenance to verify that the software was still in use. Although the Director of BFA Systems approved nearly $30,000 in maintenance costs, the campus could provide us with no evidence of any software maintenance updates associated with the software.

The Director of BFA Systems stated her belief that there was “no impropriety in the purchase of the software” as neither she nor any of her family members received any income as a result of this purchase. However, Securities and Exchange Commission (SEC) filings prepared by the company indicate the Director of EC’s association with the company and his financial interest. The Director of BFA Systems indicated to us that she and her spouse were not even aware of some of the filings until we brought them to her attention. She further indicated that both she and her spouse question the accuracy of the filings both in terms of content and dates (indicating that no stocks had been issued to her spouse from the parent company or its subsidiaries during his employment at CSU, Fullerton or since his retirement).

Government Code §87100 states that no public official at any level of state or local government shall make, participate in making, or in any way attempt to use, his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest. A financial interest exists if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, or a member of his or her immediate family.

Failure to adequately address potential or actual conflicts increases liability for acts contrary to the code.

*Campus Conflict-of-Interest Policies and Procedures*

The campus did not adequately address and implement campus conflict-of-interest code policies and procedures.

There was not a clear process in place to ensure that all required conflict-of-interest forms were actually submitted. For example, we noted that a senior BFA manager held a reportable amount of stock in the company that sold the workflow software to the campus, and no formal follow-up occurred with the manager. Further, neither the Director of EC nor the Director of BFA Systems disclosed their interest in the company that sold the web content software to the campus.

Government Code §81000 et seq., designated The Political Reform Act of 1974, is California’s principal conflict-of-interest law. The Act contains a general prohibition against conflicts of interest as well as provisions for the adoption of a conflict-of-interest code by the CSU. Under the CSU code, if a conflict of interest exists, an employee must publicly announce the financial interest creating the conflict and should disqualify himself or herself from involvement in the decision-making process.
Failure to adequately address and implement campus conflict-of-interest code policies and procedures increases the risk of acts contrary to the code.

**Incompatible Activities**

**Outside Business Interests**

*The Director of EC was actively involved in the administration of a software company doing business with the campus.*

Based upon an undisclosed financial interest in web content software as described above, the Director of EC’s association with this product and the vendor that sells it represented activities incompatible with his campus employment.

During the period of time that the Director of EC was employed by the campus, we found that he:

- Directed the expenditure of over $3 million of state money to consultants who spent time integrating the product with both the workflow and other software currently used by the campus, thus enhancing the value of the web content software for the vendor. Over $2.4 million was paid to a consulting firm who provided computer programmers.

- Hired consultants whom he had worked with previously. SEC records indicated at least four of these consultants would receive shares of stock in the vendor company along with the Director of EC.

- Utilized a personnel outsourcing company that would later obtain a business interest in the web content software noted above.

- Allowed vendor to promote the campus’ use of the software (use cited in SEC documentation was beyond what was actually implemented by the campus).

- Falsely represented to the web content software’s customers that his campus e-mail account related to his employment as a professor at the campus.

We also found e-mails and other information to and from the Director of EC which:

- Indicated that he was transacting business (i.e., contacting customers) on behalf of the vendor noted above.

- Indicated he made trips to Japan where he was actively marketing the web content software.

- Show that he guided web content software vendor representatives toward a sole-source purchase and facilitated payments.

Currently, this same vendor has a marketing agreement with a corporation owned by the Director of EC. The corporation is marketing functionality similar to that attempted by EC at the campus.
Government Code §8314 states that officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members. The code continues and states that it is unlawful for any state or local appointee, employee, or consultant to use or permit others to use public resources for personal or other purposes which are not authorized by law. "Personal purpose" means those activities the purpose of which is for personal enjoyment, private gain or advantage, or an outside endeavor not related to state business.

Failure to adequately address potential or actual conflicts increases liability for acts contrary to the code.

**CAMPUS BUDGETS**

*Full and complete budget information was withheld from senior administrators by BFA management.*

**Insufficient Management Oversight**

**Advisory Groups**

_The President's Administrative Board (PAB) and the Planning, Resource and Budget Committee (PRBC) were unable to provide an effective financial advisory function to the President because they were not given complete and comprehensive budget documentation by BFA management._

The campus was unable to provide us with a written copy of a current budget. In fact, for years BFA had not prepared a comprehensive budget document for use by the PAB, the PRBC, and the campus community. The last time a detailed budget was publicly presented was in 1998.

We interviewed a faculty member on the PRBC. The faculty member stated that he and others had asked for a detailed, comprehensive campus-wide budget document for years but never received one. The faculty member indicated that years ago when he was on this same committee, such a document was the basis for the PRBC’s recommendations to the President. PAB members indicated that they, too, had unsuccessfully requested a single comprehensive budget.

Government Code §13401 (a) (3) states that effective systems of internal accounting and administrative control are necessary to assure that state assets and funds are adequately safeguarded, as well as to produce reliable financial information for the agency.

The prior CFO indicated that she recognized that improvements were needed in the campus budget process, but believed BFA was providing campus executives with the information they needed to accomplish their work.

Limiting the oversight of administrative committees with insufficient budgetary documentation increases the risk that errors, irregularities, and misappropriation of funds could occur and not be detected in a timely manner.
Standard Budgetary Reporting

BFA management had not established standards for reporting budgetary information and failed to produce regular and consistent budgetary documents for use by the campus community.

We found that budget documents were not regularly and consistently prepared and reported by the budget office for use by management and staff. Managers responsible for divisional budgets indicated that duplicative or “shadow” records and reports were created because BFA did not provide timely and accurate information. These shadow systems were incomplete and insufficient to provide managers with all information needed to make decisions.

Specifically, reports were needed for position management, tracking part-time faculty numbers, encumbrances, and available balances.

Government Code §13401 (b) (2) states that effective systems of internal accounting and administrative control are necessary to assure that state assets and funds are adequately safeguarded, as well as to produce reliable financial information for the agency.

Failure to prepare timely and consistent reporting on campus budgets increases the risk of errors, irregularities, and misappropriation of funds and creates inefficiencies for members of the campus community.

Requests for Records

In certain instances, BFA management was unable to satisfactorily respond to requests for complete budgetary information from administrators and members of the campus community.

In June 2003, a public records request was made for campus budget records. This request could not be fulfilled in a timely manner by the BFA budget office because they had not established standard forms for presenting campus-wide budgetary data.

That same year, the PRBC requested more detailed budget reports. We found that these reports were incomplete (did not include all funds) and contained numerical errors, i.e., columns did not all add up. Campus managers assigned oversight of department budgets consistently stated that information and support from the BFA budget office was typically untimely and often incomplete or inaccurate.

Government Code §13401 (a) (2) states that effective systems of internal accounting and administrative control provide the basic foundation upon which a structure of public accountability must be built.

Failure to satisfactorily respond to requests for information increases the risk of improper decision-making due to a lack of pertinent data.
Current Financial Position

BFA management was unable to reconcile the current financial position of the campus to budgetary and accounting ledgers in a timely manner.

The President allowed several months for the duties of the prior CFO to be transferred over to the Vice President for Administration (now the Vice President for Administration and Finance). Over those months, the Vice President for Administration asked that a detailed accounting of the current financial position of the campus be provided to him prior to becoming campus CFO. Several days after the transition became official on April 1, 2005, the prior CFO provided a one-page worksheet that was used to explain the current financial status of the campus. This spreadsheet was marked “draft” and was not reconciled to budgetary or accounting ledgers or reports. In May 2005, we requested that the prior CFO provide us with documentation of the current financial position of the campus reconciled to accounting and budgetary records. The requested reconciliation was not completed until the end of June 2005.

The results of the requested reconciliation were difficult to interpret. However, it did confirm the need to encumber or set aside millions of dollars of non-General Funds in order to cover General Funds that had been allocated to departments. Data and reporting infrastructure for this type of information was not readily available in standard reports; most standard reports that were prepared by BFA related to determining year-end cash flows only. These reports provided only a narrow and incomplete picture of the campus’ finances and did not disclose deficits in individual funds, nor did they provide details of the prior year’s experience.

Government Code §13401 (a) (3) states that effective systems of internal accounting and administrative control are necessary to assure that state assets and funds are adequately safeguarded, as well as to produce reliable financial information for the agency.

When administrators do not have a sufficiently detailed understanding of the financial position of the campus, errors in judgment detrimental to the best interest of the campus could result.

Inappropriate Budget Transfers

Integrity of State Appropriations

BFA management made transfers without maintaining the identity of the year funds were appropriated by the state.

The Governor's budget, by constitutional requirement, must be accompanied by a budget bill itemizing recommended expenditures. This budget bill establishes time limited appropriations. We found that the prior CFO did not appropriately track these limitations and, in fact, disassociated millions of dollars in appropriations through misleading accounting entries.

The Department of Finance defines appropriations as an authorization for a specific agency to make expenditures or incur liabilities from a specific fund for a specific purpose. It is usually limited in amount and period of time during which the expenditure is to be incurred. For example, under the
budget bill, CSU encumbrances must be liquidated within two years of the expiration date of the period of availability, at which time the undisbursed balance of the appropriation is reverted back to the state.

Over the past several years, BFA management inappropriately carried forward funds, commingling General Funds from different year’s appropriation. First, via accounting entry, the state was informed that all remaining appropriations given to the campus had been liquidated by expenditure. In fact, expenditures had not been made. Next, BFA represented through accounting entries that it paid expenses chargeable to the prior year’s appropriation from current year appropriations. In fact, expenditures had not been made. As a result, cash was moved between periods and disassociated from its original appropriations. Once the funds were moved forward and disconnected from the prior year appropriation, they were, in effect, available for use in the current year. We found that most of this cash remained unspent and rolled year after year. (See Table 2 – Carryforward below.)

Failure to maintain legislatively mandated accountability for appropriations increases the risk that future appropriations will be modified.

Table 2 – Carryforward

<table>
<thead>
<tr>
<th>Carryforward (CFWD) Funds by Fiscal Year</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Division</td>
<td>BAL CFWD</td>
<td>BAL CFWD</td>
<td>BAL CFWD</td>
<td>BAL CFWD</td>
</tr>
<tr>
<td>VP Academic Affairs</td>
<td>10,224,945</td>
<td>16,869,083</td>
<td>22,853,189</td>
<td>26,146,835</td>
</tr>
<tr>
<td>Information Technology</td>
<td>387</td>
<td>-1,536,073</td>
<td>361,569</td>
<td>2,240,078</td>
</tr>
<tr>
<td>Executive VP</td>
<td>1,326,660</td>
<td>1,575,429</td>
<td>1,978,100</td>
<td>2,053,342</td>
</tr>
<tr>
<td>VP Student Affairs</td>
<td>575,930</td>
<td>1,565,579</td>
<td>1,660,744</td>
<td>1,419,588</td>
</tr>
<tr>
<td>VP Administration</td>
<td>23,302</td>
<td>121,591</td>
<td>263,477</td>
<td>898,817</td>
</tr>
<tr>
<td>VP University Advancement</td>
<td>409,665</td>
<td>360,502</td>
<td>415,726</td>
<td>211,534</td>
</tr>
<tr>
<td>Office of the President</td>
<td>195,242</td>
<td>297,759</td>
<td>330,322</td>
<td>204,840</td>
</tr>
<tr>
<td>Total</td>
<td>$13,177,636</td>
<td>$19,780,226</td>
<td>$28,184,301</td>
<td>$33,955,196</td>
</tr>
</tbody>
</table>

Table Source – Administration and Finance

Budgetary Fund Transfers

BFA management inadequately managed and controlled budgetary fund transfers.

We found that support for budgetary fund transfers was often insufficient. We looked at transfers and found that supporting documentation, in many instances, did not clearly describe the basis for transactions nor did it always evidence management’s oversight or approval of the transactions. This was true for both small transfers and those involving millions of dollars.
For example, transfers done in 2003 and 2004 included the following:

- A transfer of $100,000 in Continuing Education Revenue Funds (CERF), which was supported by an e-mail between two budget office staff persons and a transfer request form that had left blank (1) Cost Center Approval, (2) Division Approval, and (3) Presidential Approval.

- $4 million related to Year Round Operations Summer Faculty was transferred based upon an unsigned and otherwise unsupported spreadsheet, i.e., detailed documentation evidencing the basis for the entry.

- A transfer of $781,000 of funds set aside for utilities was moved to support the completion of a campus facilities project, supported by an otherwise blank transfer form much like the one described above, and an e-mail which indicates the amount comes from a budget number that is not adequately sourced or otherwise verified.

- A $300 transfer for tickets to a campus fundraising event supported by an invoice that states “Departments using General Funds to Pay: Please submit a completed and signed Budget Transfer Request form to the President’s office.”

- Multiple transfers ranging from $5,000 to $16,000 where the justification states “Host” or “Purchase” table(s) for a concert event and otherwise unsupported except by an invoice payable to the University Advancement Foundation.

Government Code §13401 (b) (1) states that each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices.

Insufficient supporting documentation increases the risk that errors or irregularities will occur and not be detected timely.

**Accountability for Funds**

*BFA management did not clearly establish responsibility for accounts maintained to facilitate interfund transfers.*

Millions of dollars were placed in accounts noted as either “Global” or “All University,” and used to administer university-wide expenses and unallocated budgets. BFA staff indicated that these accounts were used to offset and track interfund transfers. We noted that a process to regularly reconcile these accounts was not in place. Further, we found that responsibility/signature authority for many of these accounts was not clearly established. In several instances, signature authority was assigned to a BFA manager or staff member even though the basis for delegation was unclear.

The activity in many of these accounts occurred without the knowledge of the President’s advisors including the PAB, the PRBC, and even campus departments.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping
procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Inadequate accountability/responsibility for funds increases the risk of loss or misuse.

**Inappropriate Management of Cash Flows and Deficits**

**Cash Flows**

*BFA management oversaw accounting and budgeting practices that caused large balances of unexpended funds to accumulate, unknown to other members of the campus management team.*

General Fund carryforward balances for the campus grew over each of the last four years. The campus’ newly organized Administration and Finance budget office determined that approximately $40 million in General Funds was to be carried forward as of June 30, 2005. BFA management was unable to provide evidence that the details of this growth, or the method to account for it, were explained to the PAB or the PRBC.

One campus executive indicated that the failure to communicate specifics regarding carryforward funds to the PAB left several campus priorities unaddressed, including student/faculty ratios, deferred maintenance of facilities, faculty salaries, and the augmentation of the satellite campus.

The following table (Table 3) identifies the General Fund amounts BFA carried forward from fiscal year 2004/05 to fiscal year 2005/06.

**Table 3 – Carryforward**

<table>
<thead>
<tr>
<th>General Fund Carryforward from 2004/05 to 2005/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carryforward Budget&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>All University-Divisions</td>
</tr>
<tr>
<td>Division&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Total Carryforward Budget Balance Available</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Encumbrances and Obligations&lt;sup&gt;c&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Divisions (Purchase Orders, Travel, Utilities, etc.)</td>
</tr>
<tr>
<td>Less Prepaid (Various)</td>
</tr>
<tr>
<td>Total Carryforward and Encumbrances&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Funds Available for Carryforward</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004/05 Funds Carried Forward - General Fund&lt;sup&gt;e&lt;/sup&gt;</td>
</tr>
<tr>
<td>Total Carryforward Fund Balance&lt;sup&gt;f&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

*Table Source – Administration and Finance*
a Carryforward Budget is the Revised Budget less expenses paid and encumbrances at year end; it can also be called unexpended balance or Budget Balance Available.
b Each division consists of one or more departments.
c Encumbrances are for purchase orders, procurement card transactions, invoices, travel authorizations and claims etc., identified as commitments at year end, but that have not yet been processed for payment. Prepaids are items identified as commitments and are budgeted in 2005/06.
d Total Carryforward and Encumbrances of $41.5 million will require an equal amount to be re-budgeted in 2005/06 in order to allow divisions to spend out of the General Fund.
e Funds Available for Carryforward General Fund is the unexpended budget balance available supported by State Appropriation or revenue as reported on State Controller’s Office records.
f Total Carryforward Fund Balance amount should be zero. At year end, there should be an equal budget balance available to cover the amounts to be re-budgeted for carryforward and encumbrances in the subsequent year. The General Fund does not allow for "reserves" at year end; all funds need to be identified as commitments.

Not only was there a large carryforward, but certain of its components were cause for concern. First, the $30 million noted in Table 3 as Encumbrances and Obligations (Purchase Orders, Travel, Utilities, etc.) is likely overstated based upon discussions with campus accounting staff. Second, the campus did not have a good understanding of what comprised this balance, and there was no formal process for reviewing old encumbrances. Third, certain items classified as encumbrances and obligations within state accounting records should not have been classified as such. For example, the campus identified over a million dollars of state university grant funds for prepayment. While it is shown as a use of state funds in the encumbrance calculation, the annual financial audit of the campus shows the transaction reversed because a commitment to specific students in the next year did not exist.

Government Code §13401 (b) (1) states that each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices.

When administrators do not have a sufficiently detailed understanding of the financial position of the campus, errors in judgment detrimental to the best interest of the campus could result.

**Account Deficits**

*BFA management did not appropriately control deficits in individual budgetary accounts, nor did it sufficiently consider the effects of the deficits in annual budget planning.*

BFA did not regularly monitor individual department funds to determine the appropriateness or reasonableness of accounts that had deficit balances. Additionally, an analysis was not made to determine whether year-end carryforward amounts and encumbrances exceeded General Funds available. As a result, BFA erroneously allocated more funds to departments than had been allocated by the state. If departments had expended all that they had been granted authority by the prior CFO to expend, a $12-million deficit would have resulted.
EO 648, *Delegations of Fiscal Authority and Responsibility*, dated January 1, 1996, states that the campus president is responsible for ensuring that expenditure commitments do not exceed available resources and request for allocation orders are completed as necessary to adjust budgeted revenue, reimbursements, and expenditures to reflect actual experience.

Inadequate accountability for funds increases the risk of loss or misappropriation not being detected timely.

**Estimates and Reserves**

*BFA management used certain estimates and reserves for budget planning purposes that were not appropriately recorded in budget or accounting ledgers.*

The prior CFO indicated that lottery funds and CERF were being held in reserve to offset deficits in the General Fund. Records indicated over $16 million in lottery funds were unencumbered and could be available for this purpose. However, we found no entry in the budgetary or accounting ledgers to reserve these funds, nor was this planning discussed by the PAB and the PRBC.

Finally, we discussed the prior CFO’s practices with an expert in CSU budgeting. He stated that there seemed to be a hiding and shifting of budget funds where an over expenditure in the General Fund was only prevented because of the campus department’s conservative spending practices. He further stated that while apparently there was availability of large balances in CERF and lottery funds which could offset deficits, this practice of allowing the over allocation of General Fund budgets puts the campus at risk if campus departments were to spend all funds made available to them.

Government Code §13401 (b) (3) states that all levels of management of state agencies must be involved in assessing and strengthening the systems of internal accounting and administrative control to minimize the waste of government funds.

When administrators do not have a sufficiently detailed understanding of the financial position of the campus, errors in judgment detrimental to the best interest of the campus could result.

**Insufficient Administrative Controls**

**Access to Budget Data**

*BFA management failed to appropriately grant/limit access to budget data it maintained.*

Access to accounts by individuals with a legitimate need to know was strictly limited by BFA management. For example, the prior CITO regularly questioned transactions, but access to necessary account data for funds he was responsible for was not granted to him. Similarly, the Financial Manager of Continuing Education (CE) could not access data from accounts for which she was responsible. Specifically, millions of dollars in CE retained earnings were in accounts that only certain individuals could access. BFA Systems had implemented role-based security for information maintained in the campus data warehouse. This access was configured in a manner that limited...
campus account managers’ ability to retrieve needed information, i.e., query reports with periodic totals and subtotals were not possible.

At the opposite end of the spectrum, key BFA managers and staff, including staff from BFA Systems, had unlimited access to budget ledgers and records. We found that, both BFA and BFA Systems staff made changes in records with little or no oversight. Essentially, records were changed with little or no audit trail to be able to determine what changes were made or by whom. As a result, it would not be possible to identify all changed or altered records.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

When appropriate levels of systems access are either not granted or limited appropriately, the risk is increased that data will be inappropriately accessed or unavailable to valid users of the data.

**Budget Ledgers**

*BFA management did not maintain a single reliable budget ledger.*

As noted earlier, campus departments were maintaining duplicative or shadow systems to track budgets. We found that the BFA budget office essentially did the same thing.

BFA’s shadow budget system was maintained in a master spreadsheet. A one-page budget summary spreadsheet was presented by the prior CFO to the Vice President for Administration and Finance. It was essentially drawn from these shadow records. The shadow system was controlled by budget office staff with oversight by the prior CFO and contained detail not included in the one-page spreadsheet. Maintaining such a system, in addition to the official budget ledger, was likely a contributing factor to delays discussed earlier.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Controls over the appropriateness and accuracy of budget balances are weakened when shadow systems are utilized because transactional oversight and documentation requirements are less stringent than that required of official campus budget ledgers.
NON-GENERAL FUNDS

Certain non-General Funds were inappropriately administered by Business and Financial Affairs management.

Non-Reimbursement of the General Fund

Non-General Fund Accounts

Funds intended to reimburse the General Fund for continuing education-related activities were inappropriately maintained in non-General Fund accounts.

BFA management allocated significant portions of CE reimbursements, which were due to the General Fund, to accounts under the control of various academic departments.

Further, nearly a million dollars owed to the General Fund from CE had been set aside by BFA at least two years earlier but never deposited. Only BFA could access the funds; neither Academic Affairs nor CE management knew BFA held these funds. In addition, none of the CE and other self-support activity on campus was being processed in the reimbursed activities account; doing so would allow for charges and costs to be more clearly identifiable.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

When the General Fund is not properly reimbursed for facilities, goods, and services provided to non-General Fund activities, there is an increased perception that a gift of public funds has occurred.

Inappropriate Administration of Continuing Education Funds

Non-Recorded Reimbursements

BFA did not deposit or otherwise record reimbursements for facilities, goods, or services provided to CE by the General Fund, and vice versa.

Funds that should have been used to reimburse the General Fund were, instead, maintained in state trust accounts under the control of academic departments. Conversely, we found instances where CERF monies were used for campus construction.

Campus records indicate that over $4 million in CERF were set aside in state trust accounts. Once funds were transferred to these accounts, however, CE stopped its oversight even though it reported them as CE funds for systemwide reporting purposes. In addition, the campus could provide no evidence that CE reimbursed the General Fund for annual rent for space in the College Park building.
since 2001. This building was rented by the campus and housed various state-supported campus programs. A large portion of the rent paid benefited CE rather than the General Fund.

The use of CERF monies for campus construction, which was not seen to be of benefit to CE programs, appears to be a violation of restrictions on CERF expenditures.

Education Code §89704 (b) states that all CERF revenues are to be appropriated for the support and development of self-supporting instructional programs of the CSU.

Government Code §11259 states that all money received by any state agency, other than the Regents of the University of California, for charges for work, services, materials, or equipment shall be deposited in the State Treasury and, except advances or transfers under Sections 11257 and 11258, credited by the State Controller to the fund or appropriation from which the cost of such work, services, materials, or equipment was or will be paid.

Government Code §16301 states that except as otherwise provided by law, all money belonging to the state received from any source whatever by any state agency shall be accounted for to the State Controller’s Office at the close of each month, or more frequently if required by the Controller or the Department of Finance, in such form as he prescribes, and on the order of the Controller be paid into the Treasury and credited to the General Fund, provided that amounts received as partial or full reimbursement for services furnished shall be credited to the applicable appropriation.

Misplacement/misuse of CE funds increases the risk of errors or irregularities occurring and not being detected timely.

**Inappropriate Administration of Lottery Funds**

**Improper Recording**

*The use of lottery funds to facilitate a construction project was not properly recorded.*

Lottery funds totaling $5 million were set aside to facilitate the completion of the construction of the performing arts center. Purchasing documents and a written loan agreement signed by the prior CFO indicated that lottery funds would be used to purchase equipment essential to the completion of the project. However, we did not find these transactions appropriately reflected in accounting or budgetary records. We also did not find the prior CFO’s plan to utilize lottery funds to balance budgetary deficits recorded in official ledgers.

The California State Lottery Act of 1984 is contained in the California Government Code beginning with §8880. Section 8880.1 states that lottery revenues should not be used as substitute funds but rather shall supplement the total amount of money allocated for public education in California. Further, Government Code §8880.5 states, in part, that all lottery funds shall be used exclusively for the education of pupils and students and no funds shall be spent for acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.
When financial and budgetary transactions are not clearly and appropriately recorded, the risk of non-compliance with associated legal requirements is increased.

**UNIVERSITY ADVANCEMENT FOUNDATION (UAF)**

*A conflict of interest was not found to exist when the Vice President of University Advancement (UAF Executive Director) was granted the right to be a voting member of the board. However, certain UAF revenues were found to be improperly classified.*

**Conflict of Interest**

**Change in Bylaws**

*A revision to the UAF’s bylaws did not create a conflict of interest.*

It was alleged that a conflict of interest resulted when an individual who was the Vice President for University Advancement (UAF Executive Director) was made, by a change of bylaws, a voting member of the UAF board.

We concluded that the UAF Executive Director did not have a conflict of interest. However, based upon our discussion with her, written procedures were not in place to preclude her from board discussions related to the evaluation of her performance as Executive Director.

The California Corporations Code anticipates this situation. Specifically, Corporations Code §5213 states that a corporation shall have a chairman of the board or a president or both, a secretary, a chief financial officer and such other officers with such titles and duties as shall be stated in the bylaws or determined by the board and as may be necessary to enable it to sign instruments. The president, or if there is no president the chairman of the board, is the general manager and chief executive officer of the corporation, unless otherwise provided in the articles or bylaws. Any number of offices may be held by the same person unless the articles or bylaws provide otherwise, except that neither the secretary nor the chief financial officer may serve concurrently as the president or chairman of the board.

The absence of specific written procedures increases the risk of misunderstandings and miscommunication regarding the Executive Director’s rights and responsibilities.

**Inappropriate Classification of Revenues**

**Inflated Revenues**

*Fundraising for campus scholarship programs inappropriately included transfers from other campus funds as revenue, thereby inflating revenues actually earned.*
While campus non-General Funds could properly be used to support scholarship, the campus improperly classified these transactions and did not complete a consistent accounting of both direct and indirect costs associated with fundraising events.

We found that departments transferred budget balances to the UAF to “purchase” tables at events.

Although the UAF viewed this as revenue, the transactions were simply transfers of campus funds, and it was therefore inappropriate to classify them as revenues. Overstated revenue leads to overstated profits, which is the amount that should be available to the President’s Scholars program. At the time of our investigation, Advancement was considering reporting such activities as public relations expenditures by departments.

EO 648, Delegations of Fiscal Authority and Responsibility, dated January 1, 1996, states that campus financial practices should adhere to uniform accounting standards in accordance with Generally Accepted Accounting Principles (GAAP) for institutions of higher education [Education Code §89761(a)].

When revenues are not properly classified, the risk of misunderstandings with respect to the results of fundraising events is increased.

**BUSINESS AND FINANCIAL AFFAIRS**

**Waste and abuse occurred within the activities overseen by BFA management.**

**Procurement Process Control Weaknesses**

**Expenditure Authority**

*BFA management allowed contracts to be expanded essentially without limit based upon a single signature and split transactions to avoid limits.*

As discussed previously, contracts with certain vendors had been expanded in excess of a million dollars. We found that BFA procedures allowed campus managers with fund signature authority the ability to approve contracts under $50,000. Contracts above this amount required additional approvals, but BFA allowed existing contracts to be expanded based upon that same signature authority. The result was that contracts could be expanded limited only by available budgeted funds.

This ability encouraged individual managers to write contracts under $50,000, easily opening the opportunity to spend more. Alternately, managers could split projects into multiple contracts under $50,000. We observed an instance where documentation indicated the prior CFO was involved in contract splitting. Specifically, four individual contracts (purchase orders) of $30,000 each were issued on the same day. The contract numbers were nearly consecutive, the vendor numbers were consecutive, and two of the vendors had the same mailing address. Supporting documents indicated the prior CFO’s interest in, and support for, the processing of these contracts in such a manner and further indicated these contracts were for the same project.
The CSU Policy Manual for Contracting and Procurement (Manual), Section 301, *Bid Thresholds for Personal Property*, indicates that competition is not required for goods or services on transactions of an amount less than $50,000 unless the campus determines that competition is necessary to develop sources, validate prices, or for other sound business reasons. Acquisitions that are estimated to be greater than $50,000 and less than $100,000 may be awarded to a Certified Small Business, as long as price quotations have been obtained from two or more Certified Small Businesses.

Section 301 further states that, except in cases when it has been determined that only one source or that only one brand or trade name of an article is the only one which will properly meet the needs of the CSU and as provided for in Section 301B of the Manual, all contracts for the acquisition of goods in the amount of $50,000 or more shall be formally bid and awarded by written contract to the lowest responsible bidder meeting specifications.

Section 401 of the Manual, *Bid Thresholds for Services*, states that, except in cases where valid sole source justification exists, all written contracts for the acquisition of services in the amount of $50,000 or more or as provided for in Section 401B of the Manual and all contracts for services in the amount of $50,000 or more shall be formally bid and awarded to the lowest responsible bidder(s) meeting the Invitation For Bid specifications or the bidder(s) whose proposal is given the highest score by the evaluation committee.

When necessary and appropriate controls over contracting activities are not properly established, inappropriate expenditures could result and inappropriate benefits could be conferred.

**E-commerce Process**

*BFA management’s implementation of an online e-commerce process was flawed.*

In 2002, BFA put into service an e-procurement system. BFA sought an on-demand technology with low cost, the ability to handle multiple purchasing cards, and strong reporting capabilities. BFA selected a local software vendor and entered into a contract to purchase the web-based e-commerce software product. Although there was no direct cost for the software, there was a caveat in the contract that the campus include this same vendor as a competing supplies vendor among the others utilized by the campus. One of the functions of the e-commerce software was to serve as a database showing office supplies and other products, along with the associated costs, available for purchase by the campus from different vendors. In addition to selling the web-based solution and other software, the vendor also sold office supplies.

Implementation of the e-commerce product involved the establishment of a database of products available from the various campus supply vendors (e.g., office supplies, laboratory equipment, and paper products). Over several years of use, the campus experienced numerous difficulties with the web-based e-commerce solution, including the following:

- Administrators did not have access to make changes other than to reset passwords.
- Software placed limitations on purchase card accounts (i.e., it could not handle multiple accounts on one purchasing card).
Problems existed with missing or incorrect shipments when account users could not follow up on questioned orders themselves.

Account users were not notified when vendors denied orders.

Integration with other BFA financial systems was difficult because necessary detail was not available from the system.

Account users could not ascertain which orders were charged by month.

While the software was installed under the premise that it would save time and money, at least eight employees had roles and responsibilities related to the software product.

When the e-commerce solution was implemented, the CSU systemwide office supply vendor cooperated with BFA’s implementation even though they would be only one of several vendors included in the database. Shortly thereafter, it became apparent that the software vendor was using the CSU office supply vendor’s price list to allow it to underbid them for office supply sales by one cent.

Knowledge of other vendors’ bids or pricing is generally confidential information in order to assure fair competition. Once it became clear to the CSU office supply vendor that the software was consistently allowing the e-commerce software vendor to underbid them, it discontinued sharing its price list with the campus for input into the e-commerce database, thereby eliminating much of the benefits of the “on demand” process.

When a competitor is in charge of comparing catalog costs or bids, and also competes for the same sale, a conflict of interest exists. During the course of our investigation, the campus decided to stop using the e-commerce software.

Government Code §13403 states that internal accounting and administrative controls are the methods through which reasonable assurances can be given that measures adopted by state agency heads to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies are being followed.

When necessary and appropriate controls over contracting activities are not properly established, there is an increased risk that inappropriate expenditures will result and inappropriate benefits could accrue to vendors.

\[3\] To reduce costs, the CSU entered into a Master Agreement with a large office supply retailer. These agreements support the strategic sourcing efforts of two or more campuses by combining common requirements for specified goods and services, avoiding redundant bid solicitations and contracts, maximizing volume discounts, and reducing administrative costs.
**Bidding Processes**

*In certain instances, managers circumvented required bidding processes.*

Circumvention of required bidding processes occurred with EC contracts, a BFA Systems software contract, and BFA’s acquisition of an e-commerce/office supply software package. In each case, management simply included a short paragraph which merely stated that the service or the product was unique rather than clearly documenting how it was unique in order to justify sole-source procurement.

The CSU Policy Manual for Contracting and Procurement, Section 402, *Formal Solicitation for Services*, requires that public notice of the intent to formally request services from the open market shall be posted in a location easily accessible to any bidder who may wish to participate. Further, to promote fair and open competition, each formal solicitation for services must attempt to secure at least three competitive bids or proposals. The policy also states that any solicitation that has received less than three bids or proposals shall document, in a manner prescribed by the procedures of the campus, the firms or individuals it solicited for bids or proposals, and contracts for services may be awarded under a procedure which makes use of a request for proposal or invitation for bid. The sole-source justifications noted above did not include this information.

When necessary and appropriate controls over contracting activities are not properly established, there is an increased risk that inappropriate expenditures will result and inappropriate benefits could be conferred.

**Improper Handling of Travel Advances**

**Advance Clearance and Reporting**

*A BFA administrator failed to promptly clear travel advances.*

Despite requests from accounting staff for her to submit travel expense claims, the prior CFO left two of her own travel authorization and advance request forms outstanding for more than two years. These items were finally cleared during the course of this investigation. We also found that required tax reporting for these advances was not done.

According to CSU travel policy, a travel expense claim must be submitted to substantiate travel expenses within a reasonable period of time not to exceed 60 days. If the advance exceeds the substantiated expenses, the employee must submit a check or money order with the claim to return the excess advance no more than 120 days after the expense is paid or incurred. If an employee does not substantiate and return any excess advances, if applicable, that amount will be deducted from the next payroll warrant.

Failure to clear advances in a timely manner increases the risk of loss or misappropriation of advanced funds.
**Inappropriate Personnel Appointments**

**Selection Process**

*BFA’s management staffing process failed to provide the campus with needed financial experience and leadership skills.*

A BFA review committee concluded in early 2004 that the prior CFO did not post certain positions or use the campus search process, but instead placed managers she selected in positions at the pay rate she chose. Specifically questioned were the qualifications of many of the individuals selected by the prior CFO as well as the rates of pay she desired for them. Based upon our review of documentation considered by the review committee, and information we obtained from Human Resources, the prior CFO did not technically violate any laws or regulations. However, it was clear that many key leadership positions in BFA were held by people moved from clerical or analytical positions to senior management level positions over a short time frame.

Government Code §13403 (a) (5) states that the elements of a satisfactory system of internal accounting and administrative control shall include personnel of a quality commensurate with their responsibilities.

The prior CFO’s hiring decisions left the campus with a financial leadership that lacked necessary and appropriate experience as high-level administrators for a large campus.

When an appropriate management structure is not established, the risk that state assets and funds are inadequately safeguarded is significantly increased.

**Key Positions**

*Controls within BFA were significantly weakened because several key management positions remained vacant for a long period of time.*

BFA’s responsibilities include creating and maintaining budgets, contracts and procurement, payroll, accounting, and other related financial services. Management positions responsible for these functions went unfilled for long periods of time or were headed by individuals temporarily put in charge. The campus has gone years without a controller and a director of procurement. During this same period of time, BFA did not actively recruit for these and other key positions.

Because BFA did not fill these key leadership positions, campus administrators and BFA employees looked to the prior CFO for direction and approval of transactions. This fact created functional bottlenecks and minimized control benefits offered when functions are appropriately segregated. One noteworthy example was the lengthy delay in the completion of the fiscal year 2004/05 audited financial statements due to the absence of a campus controller. Additionally, we found that the campus had operated without a director of procurement for over three years.
Government Code §13403 (a) (5) states that the elements of a satisfactory system of internal accounting and administrative control shall include personnel of a quality commensurate with their responsibilities.

When an appropriate management structure is not established, the risk that state assets and funds are inadequately safeguarded is significantly increased.

**Payroll Abuse**

**Employee Leave**

A BFA administrator was inappropriately granted additional leave benefits.

Prior to the start of our investigation, the campus evaluated a potential abuse of employee leave benefits which started in the fall of 2002. That investigation found that an unusual means for accruing vacation and sick leave had been applied to the benefit of a BFA administrator and to the detriment of the campus. Further, the investigation found family sick days were also granted to her in excess of the five permitted by policy, and holiday and bereavement absences were inappropriately paid.\(^4\) The facts and circumstances surrounding this administrator’s receipt of paid leave benefits were confused by weak systems of internal control over leave accounting.

We found that the BFA administrator, whose duties included oversight of the campus’ payroll function, extended her approximately four months of leave over eight months, ignoring costs incurred by the campus and other specific limitations on leave benefits. Documentation reflects that the BFA administrator attempted to justify her improper use of leave after the fact by rewriting in an accounting spreadsheet the days and hours she claimed to have worked. The spreadsheet, which combined unpaid leave and work at home with vacation and sick leave, was prepared on behalf of the BFA administrator with the assistance of the prior CFO and staff who reported to the BFA administrator. The campus’ willingness to have someone outside of BFA investigate and evaluate the allegations led to an agreement between the campus and the BFA administrator and facilitated her release from employment with the campus. The BFA administrator agreed to repay approximately $24,000 that was improperly paid to her.

Government Code §13402 states that state agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

When controls over employee leave are not properly established, the risk of inappropriate benefits is increased.

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\(^4\) The BFA administrator’s spouse was ill.
Inaccurate Financial Information

Data Reconciliations

Regular reconciliations of subsidiary accounting ledgers and information maintained in a data warehouse were not regularly performed.

In the past five years, the campus initiated a stand-alone data warehouse. The purpose of the warehouse was to centralize reports of accounting data. BFA did not regularly and consistently reconcile accounting data to the warehouse. As such, we evaluated certain controls in place over accounting data in order to assess its accuracy and completeness. We found that accounting records were maintained in several different electronic data systems. The general ledger was in the Financial Reporting System (FRS). This data is audited by the campus’ external auditors and reported to the state. However, neither these FRS records nor information in other subsidiary accounting systems (i.e., accounts payable) was regularly reconciled to the data warehouse records. Information in the data warehouse was utilized by campus managers; but without regular reconciliations between the systems, the reliability of the data was diminished.

At our request, campus accountants initiated a reconciliation of the FRS data to the data warehouse for a limited sample of accounts. This process was difficult and time-consuming and disclosed numerous unexplained differences. Based upon the work done by campus accountants, the differences were likely exceptions or errors in the information included within the data warehouse rather than in the FRS data.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

Failure to regularly reconcile accounting ledgers increases the risk that errors or irregularities like those found in the data warehouse will occur and not be detected timely.

Scanned Documents

Regular reconciliations of scanned document inventory were not performed, and data was not maintained in an unalterable format.

BFA scanned, in a retrievable format, supporting documentation for accounts payable transactions. This data was neither reconciled regularly to control records, nor was it stored in a format that prevented records from being altered.

Government Code §13403 (a) (3) states that the elements of a satisfactory system of internal accounting and administrative control shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.
Failure to perform reconciliations of scanned documents to control records increases the risk that errors or irregularities may go undetected. Further, the accuracy and completeness of records could be questioned when documents are not stored in an unalterable format.
INVESTIGATION RESULTS – CONCLUSION

We investigated allegations of fraud, waste, and abuse within EC activities and substantiated waste and abuse. We also found that the campus did not maintain appropriate and sufficient budgetary records. In addition, certain non-General Funds were mismanaged. We did not find that a conflict of interest resulted when an auxiliary organization executive director was granted the right to be a voting member of the board. We did find, however, that risk-mitigating controls needed to be documented. As to allegations of fraud, waste, and abuse within the activities of the BFA division, we substantiated waste and abuse. Although we did not substantiate fraud, we found that the potential was high within EC activities. Finally, we found that the control environment within the BFA division discouraged the reporting of instances of waste, fraud, and abuse.

The President and certain key administrators had knowledge of many of the allegations and claims prior to the start of our investigation. As a result, various organizational and operational changes coincided with the investigation. These efforts have initially been met positively by most affected managers, and our preliminary assessment of their effects is similarly positive.
RECOMMENDATIONS AND CAMPUS RESPONSES

Our investigation was administrative in nature. Conclusions drawn were made within that context. Recommendations, which would mitigate the recurrence of similar findings in the future, are presented below along with recommendations to effect specific corrective actions:

CONTROL ENVIRONMENT

Unsatisfactory Oversight

We recommend that the campus:

1. Establish training for campus management regarding work hours for managers.

Campus Response

We concur. The campus will implement additional communication and training regarding work hours for managers by November 2006.

Failure to Modify Underlying Operating Culture

We recommend that the campus:

2. Call for an independent study of the operating culture within Business and Financial Affairs (BFA) to determine the underlying causes for the failure to make substantial improvements since the 1999 State Auditor review.

Campus Response

We concur. A number of actions addressing this recommendation have been implemented. In particular, in March 2004, the President appointed a BFA Review Committee consisting of the Vice Presidents for Academic Affairs, Administration, and Student Affairs, and the Executive Vice President to study the climate of BFA. This committee identified insufficient leadership, direction, communication, teamwork, and in certain cases insufficient qualifications of some managers and other human resource issues as fundamental issues of concern affecting the BFA operating culture. Based upon recommendations provided by this committee, along with other factors, the President determined that a management and organizational change was in order. In August 2004, the President announced management responsibility for BFA would be transferred to the Vice President for Administration, who would also serve as the campus Chief Financial Officer (CFO). Following a transition period, responsibility for overseeing former BFA operations formally occurred on April 1, 2005. Since that time, a number of significant operating and personnel changes have occurred, and the Vice President for Administration and Finance/CFO has filled the following key positions: Associate Vice President for Finance; Director of Contracts and Procurement; Director of Internal Controls; and Director of Student Financial Services. National searches for an Assistant Vice President of Budget and a Controller are currently underway, and the university is continuing to explore a variety of recruitment strategies to attract highly qualified candidates. In order to ensure university budget issues were addressed immediately, an experienced manager was appointed to
oversee budget operations on an acting basis until a comprehensive search could be completed and the position filled on a permanent basis. Filling these important positions with experienced senior managers allows for additional oversight of all activities within the finance area and throughout the campus. A number of additional operating changes have also occurred, many of which are outlined in the response to the recommendations in this report. The President will reconvene the former BFA Review Committee, absent the current Vice President for Administration and Finance/CFO, to assess progress in addressing issues identified by the committee in 2004. This will be completed by December 2006.

Non-Supportive Workplace Environment

We recommend that the campus:

3. Continue efforts to change the workplace environment within BFA to support and encourage employees to freely report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation.

Campus Response

We concur. Beginning in August 2004, the Vice President for Administration and Finance/CFO initiated a number of actions to foster an environment of open communication, including filling a number of key senior manager positions as referenced in the campus response to recommendation 2. Filling these key positions with experienced senior managers who support and encourage employees to report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation contributes to an environment of open communication. The Vice President for Administration and Finance/CFO also initiated group and individual one-on-one meetings with finance managers and staff to solicit their thoughts and ideas on ways to improve the operation; formed an Ad Hoc Financial Advisory Committee consisting of the financial officers from each division, extended education, and each auxiliary to advise the CFO and Associate Vice President of Finance on financial and other matters from the division and auxiliary perspective; and initiated a strategic planning process for the division that provides staff with numerous opportunities to provide input. In addition, the Risk Management web site includes a frequently asked questions section and links to information regarding how to report waste, fraud, etc. To further enhance these efforts, the Vice President for Administration and Finance/CFO will launch a University Business Institute in January 2007 that, among other topics, will include additional training for financial managers and staff regarding workplace ethics, internal controls, and processes and procedures for reporting waste, fraud, etc. In addition, a Business Principles document focusing on expectations regarding integrity, accountability, stewardship of university resources, respect and collaboration, quality and efficiency, and safety will be finalized and distributed to Administration and Finance staff by December 2006.
ENTERPRISE COMPUTING

Insufficient Oversight of Enterprise Computing

We recommend that the campus:

4. Establish necessary and appropriate controls over Enterprise Computing (EC) contracting activities, considering the need to sufficiently plan, organize, direct, and control such projects.

Campus Response

We concur and the following steps addressing this recommendation have occurred:  
a) in November 2003, management oversight of campus EC functions was transferred by the President to the Chief Information Technology Officer (CITO) and the CITO now has responsibility and accountability for managing EC budgets and funds, which had not previously been the case;  
b) following an assessment by the CITO, the former EC department was disbanded in February 2004 and EC functions were folded into two units: Document Management that has the responsibility for supporting campus-wide document management and imaging applications (e.g., Admissions and Records, Financial Aid, Finance), and Common Management Systems (CMS) that has the responsibility for implementing the three modules of the CMS (Human Resources, Finance, and Student Administration). Since that time, the university’s CMS implementation approach has been to minimize consulting services, and the CMS department has been exceeding all California State University (CSU) standards and policies to sufficiently plan, organize, direct, and control contracting activities, and has received superior ratings for readiness assessment for all three modules from the CSU CMS readiness consultants;  
c) following a national search, in October 2005, the campus filled the Director of Contracts and Procurement position, which had been vacant for approximately three years, providing additional management oversight of all campus contracting and purchasing activities;  
d) in April 2006, the university implemented additional internal controls for all IT purchases, including services and consulting contracts, requiring CITO approval of all IT expenditures with a cumulative total above $100,000 and the approval of both the CITO and the CFO for all IT expenditures with a cumulative total above $250,000. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

5. Determine the salvage value of past EC application development projects by:
   
a. Determining the usefulness, if any, of systems processes or subsystems begun.

b. Performing a cost/benefit analysis as to the value of completing any unfinished development projects.

Campus Response

We concur. Following the reorganization of EC activities described in the campus response to recommendation 4, EC application development projects were evaluated by the CITO. Document and imaging applications have been salvaged and are currently being utilized by a number of campus departments. Based on a cost/benefit analysis, all other EC development projects are on hold, or, as
recommended by the CSU CMS Executive Committee, have been integrated, or are in the process of being integrated, into CMS. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Inappropriate Information Technology Expenditures**

We recommend that the campus:

6. Continue efforts to improve the usefulness and accuracy of CSU CMS implementation reporting.

**Campus Response**

We concur. Following the reorganization of EC activities described in the campus response to recommendation 4, and evaluation of EC development projects described in the campus response to recommendation 5, in June 2004, the university established a CMS project implementation structure, including a CMS Steering Committee, currently chaired by the Vice President of Student Affairs, with broadly based campus representation, and a CMS Reporting Subcommittee to oversee implementation reporting. In addition, the CITO provides regular reports regarding the status of CMS implementation efforts to the President’s Administrative Board (PAB), Academic Senate, and the Planning, Resource and Budget Committee (PRBC). The university also continues to provide ongoing reports to the chancellor’s office regarding the status of implementation efforts and is currently on track to fully implement CMS reporting. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

7. Appropriately capitalize EC software development expenditures by:

   a. Continuing evaluation of past costs and the appropriateness of capitalization.

   b. Making appropriate adjustments to accounting records.

   c. Evaluating the appropriateness of current account code structure as it relates to the accounting and control of equipment and other fixed assets.

**Campus Response**

We concur. In December 2005, all past EC software development costs were evaluated, appropriately capitalized, and depreciated for the 2004/05 financial reports per the CSU Capital Assets Guidelines. The current account code structure has been evaluated as part of our CMS conversion activities and is appropriate as it relates to the accounting and control of equipment and other fixed assets. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
8. Establish policies and procedures to assist in the control of software user licenses and maintenance contracts by:

   a. Ensuring that needs assessments are performed and documented for existing software licenses and maintenance fees and before future purchases are made.

   b. Implementing administrative ledgers to track user licenses and maintenance contracts.

**Campus Response**

We concur. As indicated in the campus response to recommendation 4, in April 2006, the university implemented additional internal controls for all IT purchases, including procedures to track all software user licenses and maintenance contracts by requiring CITO approval of all IT expenditures with a cumulative total above $100,000 and the approval of both the CITO and the CFO for all IT expenditures with a cumulative total above $250,000, including software user licenses and maintenance contracts. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Inappropriate Software Endorsements**

We recommend that the campus:

9. Clarify for management the implications of CSU policy on product endorsements by:

   a. Communicating CSU policy to managers whose responsibilities put them in a position where they may be asked to recommend vendors’ products.

   b. Drafting campus procedures to ensure compliance with CSU policies.

**Campus Response**

We concur. In August 2006, all university managers received an email from the Vice President for Administration and Finance/CFO reminding them that CSU employees are prohibited from implying, indicating, or otherwise suggesting that any procedure, service, or organization is connected or affiliated with, or is endorsed, favored, or supported by, or is opposed by the university and attaching the relevant Education Code [Education Code §89005.5 (a) (2)]. This email also instructed managers to share this information with others in their departments as appropriate. This information will be included in university orientation packets provided to new managers beginning in September 2006.

**Conflict of Interest**

We recommend that the campus:

10. Establish training for, and reiterate policies to, campus management and staff regarding conflicts of interest established by The Political Reform Act of 1974, Title V, and CSU policy that specifically address:
a. Spouses evaluating each other’s work products.
b. Purchases from related parties.
c. Financial interest in companies doing business with the campus.
d. Submission/collection of required forms.

Campus Response

We concur. Beginning in June 2004, the university implemented a comprehensive two-hour online ethics regulations and conflict-of-interest code training program that includes spouses evaluating other’s work products, purchases from related parties, financial interest in companies doing business with the campus, submission/collection of required forms, and incompatible activities. The training is mandatory for all employees in designated positions and must be completed within six months of appointment in a designated position and at least once during each consecutive two-year period. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

Incompatible Activities

We recommend that the campus:

11. Reiterate CSU policies and procedures relating to incompatible activities for campus managers.

Campus Response

This recommendation has been addressed as described in the campus response to recommendation 10 above.

12. Establish training for management regarding incompatible activities.

Campus Response

This recommendation has been addressed as described in the campus response to recommendation 10 above.

CAMPUSS BUDGETS

Insufficient Management Oversight

We recommend that the campus:

13. Ensure that the PAB and the PRBC are provided complete and comprehensive budget documentation in order to perform an effective advisory function to the President.
Campus Response

We concur. During fiscal year (FY) 2005/06, a series of new comprehensive university budget and financial reports were developed and presented at numerous PAB and PRBC meetings throughout the fiscal year. Additional reports are in development. In addition, the Vice President for Administration/CFO meets with the Chair of the Academic Senate and the Chair of the PRBC on a regular basis to review university budget and fiscal information. In addition, the CFO and Associate Vice President of Finance will conduct budget workshops for the PAB, the PRBC, and the Senate Executive Committee during September and October 2006 and will provide these groups with copies of the publication *College and University Budgeting: An Introduction for Faculty and Academic Administrators*, authored by the National Association of College and University Business Officers, to further assist these groups in performing an effective advisory function for the President.

14. Establish standards for reporting budgetary information and produce regular and consistent budgetary documents for use by the campus community.

Campus Response

We concur. During FY 2005/06, budget operations standards for recording budgetary transactions, supporting regular and consistent budgetary documents for the campus community, were established. Further enhancements to campus budget documents will occur by March 2007 as part of the campus CMS Finance implementation.

15. Improve the campus’ ability to satisfactorily respond to requests for budgetary information from administrators and members of the campus community.

Campus Response

We concur. In addition to hiring new financial management staff beginning in May 2004, as referenced in the campus response to recommendation 2, additional budget analysts were also hired beginning in July 2005 to assist in responding to requests for budgetary information from administrators and members of the campus community. In addition, together the series of new university budget and financial reports developed in FY 2005/06 referenced in the campus response to recommendation 13, along with the budget operations standards in recording budgetary transactions implemented in FY 2005/06 referenced in the campus response to recommendation 14, have dramatically improved the university’s ability to satisfactorily respond to all requests for budgetary information. Further enhancements will occur by March 2007.

16. Regularly reconcile subsidiary data supporting reports on the current financial position of the campus to budgetary and accounting ledgers.

Campus Response

We concur. Effective June 2005, the process of recording budgetary and accounting transactions is now current, and the budgetary and accounting ledgers are complete and up to date and are now the sources of data used in designing, developing, and generating all reports (including subsidiary data
supporting reports) on the current financial position of the campus. Standardized financial reports are reconciled and tie back to the budgetary and accounting ledgers. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Inappropriate Budget Transfers**

We recommend that the campus:

17. Maintain the identity of the year funds were appropriated by the state when making transfers.

**Campus Response**

We concur. As a result of fully implementing the CSU Fee Revenue Management Program established effective July 1, 2006 throughout FY 2006/07, all of the university’s General Fund appropriations (including FY 2006/07) will be fully expended before the end of the current fiscal year. Any budget balance available at the end of this fiscal year carried forward into the next fiscal year will reside in the State University Trust Fund, which has no funding expiration date. Thus, this recommendation will be completed when the university’s FY 2006/07 General Fund appropriation is fully expended, which we anticipate will occur by March 2007.

18. Follow policies and procedures regarding budgetary fund transfers to ensure they are adequately managed and controlled.

**Campus Response**

We concur. Beginning in FY 2005/06, the campus now requires sufficient supporting documentation and appropriate approvals from authorized individuals with regards to recording budgetary fund transfers on a standardized form. Requests for budgetary fund transfers are reviewed by appropriate university officials prior to processing to ensure such requests are managed and controlled appropriately. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

19. Establish clear responsibility for accounts maintained to facilitate interfund transfers of campus funds.

**Campus Response**

We concur. Beginning in May 2006, accounts maintained to facilitate interfund transfers were assigned to the Director of Budget Operations to clearly establish responsibility and signature authority for the accounts. Furthermore, the activity in these accounts was included in the various new budgetary and financial reports presented to the President, the PAB, and the PRBC during FY 2005/06. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
**Inappropriate Management of Cash Flows and Deficits**

We recommend that the campus:

20. Establish accounting and budgeting practices that afford transparency regarding large balances of unexpended funds.

**Campus Response**

We concur. In addition to actions identified in the campus response to recommendations 13, 14, 15, 16, 17, 18, and 19, beginning in FY 2005/06, accounting, budgetary, and reporting practices were implemented to provide university management with full details regarding unexpended fund balances. Specifically with regards to General Fund carry forward, a new annual report designed and developed during FY 2005/06 showing departmental and university-wide budgets, including carry forward balances over the past five years, was presented to the President, the PAB and the PRBC. The university will provide documentation to demonstrate compliance with this recommendation by March 2007.

21. Appropriately control deficits in individual budgetary accounts and ensure their effects are sufficiently considered in annual budget planning.

**Campus Response**

We concur. Beginning in FY 2005/06, operation of individual budgetary accounts, including deficits, encumbrances, and carry forward balances, are now analyzed and factored into the university’s annual budget planning. Encumbrances and carry forward balances are no longer automatically added to the following year’s appropriation; budget centers must request and provide support for such reallocations. Of the university’s total General Fund carry forward at the end of FY 2004/05, only approximately one third of the total carry forward was reallocated back to the individual departments. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

22. Appropriately record estimates and reserves used for budget planning purposes in both budget and accounting ledgers.

**Campus Response**

We concur. With the departure of the former Chief of Budget Planning and Strategy (also the former CFO), the Vice President for Administration and Finance/CFO was assigned responsibility for budget planning in August 2006. Estimates and reserves for budget planning purposes were included in budget documents presented to the President and the PAB in August 2006 and will subsequently be presented to PRBC. Estimates and reserves will be recorded in the budgetary, accounting, or encumbrance ledgers by October 2006.
**Insufficient Administrative Controls**

We recommend that the campus:

23. Appropriately grant and limit access to budget data.

**Campus Response**

We concur and have initiated a process to recertify and control access to budget data as appropriate to ensure access is granted and/or limited based upon authorized fund and account responsibilities. This process will be completed by November 2006.

24. Maintain a single reliable budget ledger.

**Campus Response**

We concur. As indicated in the campus response to recommendation 16, beginning in FY 2005/06, the official Financial Reporting System (FRS) budgetary ledger used for State Controller’s Office and chancellor’s office reporting is also now the single budgetary ledger used for campus budget office reporting. Financial services no longer utilizes a shadow system. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**NON-GENERAL FUNDS**

**Non-Reimbursement of the General Fund**

We recommend that the campus:

25. Ensure that funds advanced to self-supporting operations are appropriately accounted for.

**Campus Response**

We concur. All self-supporting financial operations will be appropriately accounted for, and transactions will be processed by March 2007.

26. Update and execute cost allocation plans on a timely basis.

**Campus Response**

We concur. In June 2006, the university developed a prospective cost allocation plan for the fund referenced in this report, and appropriate fund transfers occurred at this time. The university will fine tune and modify this plan on an ongoing basis as appropriate. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
27. Calculate reimbursements to the General Fund for the use of facilities, goods, and services and support those calculations with current and valid assertions and assumptions.

**Campus Response**

We concur. As indicated in the campus response to recommendation 26, in June 2006, the university developed a prospective cost allocation plan for the fund referenced in this report and appropriate fund transfers occurred at this time. Reimbursements to the General Fund for the use of facilities, goods, and services were calculated and addressed in this plan. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

28. Repay amounts due to the General Fund.

**Campus Response**

We concur. As indicated in the campus response to recommendation 26, in June 2006, the university developed a prospective cost allocation plan for the fund referenced in this report and appropriate fund transfers occurred at this time. Resolution of past indirect costs due to the General Fund occurred in conjunction with this plan. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

29. Ensure that access to, and responsibility for, funds are clearly and appropriately established.

**Campus Response**

We concur. Access to, and responsibility for, funds referenced in this report are assigned to the Vice President for Academic Affairs and the Dean of Extended Education, and a financial plan to fully spend funds in specific accounts was developed in February 2006.

30. Ensure that all self-support activity on campus is consistently processed in the reimbursed activities accounts to ensure that charges and costs are more clearly identifiable.

**Campus Response**

We concur. The university is developing standards for processing self-support activities and will ensure charges and costs are more clearly identified by March 2007.

31. Analyze the million dollars identified relating to continuing education (CE) and determine the appropriate disposition and accounting for these funds.

**Campus Response**

We concur. Analysis of the identified funds was completed in June 2006, and appropriate disposition and accounting of these funds will occur by December 2006.
Inappropriate Administration of Continuing Education Funds

We recommend that the campus:

32. Appropriately record reimbursements for facilities, goods, and services provided to CE in the General Fund.

Campus Response

We concur. In June 2006, CE reimbursements to the General Fund for the use of facilities, goods, and services were calculated and included in the prospective cost allocation plan referenced in the campus response to recommendation 26 and have been appropriately recorded. This plan will be reviewed and modified on an annual basis, and appropriate reimbursements will occur on an ongoing basis as necessary. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

33. Close state trust accounts established to hold CE General Fund reimbursements.

Campus Response

We concur. In June 2006, the state trust accounts identified in this report, which are established and funded annually (per various Memoranda of Understanding), were included in the campus cost allocation plan referenced in the campus response to recommendation 26, and appropriate fund transfers occurred at this time. These accounts have not been established to develop reserves, but to fully spend the available funds on programs and activities in support of the General Fund. Rather than close the accounts, a financial plan to fully spend Academic Affairs specific accounts was developed in February 2006.

34. Establish controls to ensure that compliance with CE fund expenditure restrictions are consistently adhered to.

Campus Response

We concur. Beginning in FY 2005/06, budget operations staff review and approve material CE expenditure requests to ensure consistent compliance with fund expenditure restrictions. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

35. Clearly document evidence that CE reimbursed the General Fund for annual rent for space in the College Park building since initial occupancy.

Campus Response

We concur. In February 2006, documentation to support CE reimbursement of all costs, including the College Park building rent, was approved by the CFO and appropriate fund transfers occurred at this
time. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Inappropriate Administration of Lottery Funds**

We recommend that the campus:

36. Appropriately reflect in accounting or budgetary records (recorded in official ledgers) pledge or loan transactions such as those relating to the utilization of lottery funds to balance budgetary deficits.

**Campus Response**

We concur. Pledge or loan transactions for budget planning purposes will be recorded in budgetary, accounting, or encumbrance ledgers by October 2006.

37. Establish controls to ensure that compliance with lottery fund expenditure restrictions are consistently adhered to.

**Campus Response**

We concur. Beginning in FY 2005/06, budget operations staff review and approve material lottery fund expenditure requests to ensure consistent compliance with fund expenditure restrictions. In addition, lottery fund revenues, uses, and balances will be included in the overall university budgeting process effective FY 2006/07 and will be included separately in university budget reports. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**UNIVERSITY ADVANCEMENT FOUNDATION (UAF)**

**Conflict of Interest**

We recommend that the campus:

38. Ensure that policies and procedures for the evaluation of the performance of the Executive Director appropriately consider the change in voting rights established by the recent revision of the UAF’s bylaws.

**Campus Response**

We concur. An amendment to the CSF Philanthropic Foundation (CSFPF), previously known as the University Advancement Foundation, bylaws, explicitly stating that “the Executive Director may not participate in any discussion or vote which pertains to the evaluation of his/her performance” will be presented to the CSFPF board at the next regularly scheduled meeting in September 2006.
Inappropriate Classification of Revenues

We recommend that the campus:

39. Establish policies and procedures that ensure revenues from fundraising events are properly classified.

Campus Response

We concur. General Fund dollars coming to the CSFPF through fundraising events are deposited in the CSFPF as non-gift revenue. CSFPF annual audited financial reporting is submitted to the university for the purposes of consolidating financial information, and an adjusting GAAP entry to eliminate double accounting of revenues (and expenses) is recorded. CSFPF will develop policies and procedures to assure General Fund non-gift revenue is not directly or indirectly stated as fundraising profit and/or directed to scholarships by November 2006.

BUSINESS AND FINANCIAL AFFAIRS

Procurement Process Control Weaknesses

We recommend that the campus:

40. Establish procedures which prevent contracts from being inappropriately expanded, ensuring that:

   a. CSU limits are adhered to.
   b. Authorization for the expansion of contracts is sufficiently documented.
   c. Split contracts are identified and appropriate corrective measures are taken.

Campus Response

We concur and action addressing this recommendation has occurred. Following a national search, the university appointed a Director of Contracts and Procurement in October 2005. This position, which had previously been vacant for approximately three years, provides additional management oversight of all campus contracting and purchasing activities. In addition, contract procedures to ensure CSU limits are adhered to, authorization for the expansion of contracts is sufficiently documented, and split contracts are identified have been implemented. Contract approval limits have been clearly identified, and the Contracts and Procurement department has been reorganized to further increase administrative review of all contracts. The incidents in the narrative regarding contract splitting were isolated occurrences in which a former employee, charged with ensuring the controls, bypassed the controls. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
41. Eliminate the outsourced online e-commerce process as planned.

**Campus Response**

We concur. The contract with the online e-commerce vendor was terminated effective December 2005.

42. Establish sufficient oversight of campus bidding practices to ensure that requirements are not circumvented.

**Campus Response**

We concur. As indicated in the campus response to recommendation 40, following a national search, the campus appointed a Director of Contracts and Procurement, providing additional management oversight of all campus contracting and purchasing activities. The university also filled other Contracts and Procurement vacancies to enhance oversight of contract bidding practice requirements, including the submission of required documentation when justifying sole-source procurements, and has initiated Certified Purchasing Manager training for Contracts and Procurement staff with a goal of having all staff certified. In addition, the university implemented additional internal controls for IT purchases as indicated in the campus response to recommendation 8, including a requirement for vendors to sign conflict-of-interest agreements. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Improper Handling of Travel Advances**

We recommend that the campus:

43. Ensure that all travel advances are cleared timely.

**Campus Response**

We concur. In July 2006, the university implemented practices and procedures to ensure travel advances are cleared in a timely manner, including reducing the number of travel advances and tracking individual advances and initiating follow-up contact to clear these balances. The incident cited in the report was an isolated occurrence involving the former CFO. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

44. Establish procedures to report to the Internal Revenue Service any advances uncleared at year-end.

**Campus Response**

We concur. In July 2006, procedures to report unsubstantiated uncleared travel advances at year-end to the Internal Revenue Service were developed as indicated in the campus response to recommendation 43. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
Inappropriate Personnel Appointments

We recommend that the campus:

45. Continue to reevaluate its administration of personnel appointments.

Campus Response

We concur. The campus has implemented a new procedure and form requiring the Executive Director of Human Resources to review all management appointments to confirm appropriate policies and procedures have been utilized before recommendations for appointment are forwarded to the President for approval. Any issues of concern are brought to the attention of the Vice President for Administration and Finance/CFO to resolve with the respective division head or to bring to the attention of the President if necessary. This procedure has been communicated to the division heads and the university is continuing to utilize this procedure and form in its administration of management appointments. The university will reevaluate use of this procedure and form by October 2006.

46. Continue its reorganization plan for Business and Financial Affairs.

Campus Response

We concur. Since assuming responsibility for financial services, the Vice President for Administration and Finance/CFO has reorganized the former BFA operation, including taking the following steps to provide additional management oversight: establishing financial services as a separate operating unit within the Division of Administration and Finance and creating and adding a new position of Associate Vice President of Finance to oversee this unit; creating and adding a new position of Director of Internal Controls within the Division of Administration and Finance; reinstituting the Controller position; filling the Director of Contracts and Procurement position and Director of Budget position that had previously been held vacant for a number of years; restructuring reporting lines to have Student Financial Services, Accounting Services, and Accounts Payable report to the Controller; merging Payroll with Human Resources; and merging the financial IT unit with the administration IT unit.

Following the reassignment by the Vice President for Administration and Finance/CFO of two interim Senior Directors in BFA, reassignment of a former Senior Director due to illness, and the resignation of the Senior Director of Financial Systems, none of the former BFA Senior Directors are currently employed in financial services. In addition, in August 2006, the President launched a search to refill the university’s Director of Internal Audit position and has also approved a job description to add a second auditor position to the university’s internal audit staff in early 2007. Furthermore, the Division of Administration and Finance has launched a strategic planning process. Senior managers and a divisional strategic planning steering committee have evaluated feedback from division staff and the campus community regarding divisional strengths, weaknesses, opportunities, and threats. The Vice President for Administration and Finance/CFO will establish task forces to begin addressing strategic goals and developing operational objectives and action plans in November 2006.
47. Continue to aggressively recruit experienced professionals for all key management positions that remain vacant.

**Campus Response**

We concur. Beginning in May 2004 through September 2006, following national searches, the Associate Vice President for Finance and Directors of Internal Controls, Contracts and Procurement, and Student Financial Services positions have all been filled with experienced senior managers. National searches for an Assistant Vice President of Budget and a Controller are currently underway and the university is continuing to explore a variety of recruitment strategies, including exploring utilization of a search firm, to attract highly qualified candidates. In order to ensure university budget issues were addressed immediately, an experienced manager was appointed to oversee budget operations on an acting basis until a comprehensive search could be completed and the position is filled on a permanent basis. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Payroll Abuse**

We recommend that the campus:

48. Improve its administration of leave accounting processes, including clear documentation of standards and practices.

**Campus Response**

We concur. Effective March 2005, the Payroll function now reports to the Executive Director of Human Resources, who in turn reports to the Vice President of Administration and Finance/CFO. Having both Human Resources and Payroll report to the same individual enhances information sharing and reporting of potential leave accounting irregularities. Both the Payroll and Human Resources Benefits staff utilize Technical Letter HR/Leaves 2005-01 to administer leave accounting. The incident in the narrative was an isolated occurrence in which a former employee charged with overseeing administration of leave accounting bypassed the controls. Human Resources will develop a training session regarding leave accounting processes, including clear documentation of standards and practices, for staff in Payroll and Benefits, as well as the Human Resource Coordinators in each division by November 2006. Additional training will be provided as changes occur and/or new staff are hired.
49. Re-train payroll staff responsible for upholding campus leave policies and procedures.

**Campus Response**

We concur. Following the March 2005 Human Resources/Payroll merger, a Human Resource Benefits specialist and an experienced Payroll staff member have been assigned responsibility for leave accounting. Human Resources Benefits and Payroll staff now meet regularly for training, utilizing Technical Letter HR/Leaves 2005-01 as reference, and to discuss operational issues. As indicated in the campus response to recommendation 48, Human Resources will develop a training session regarding leave accounting processes, including clear documentation of standards and practices, for staff in Payroll and Benefits, as well as the Human Resource Coordinators in each division by November 2006. Additional training will be provided as changes occur and/or new staff are hired.

50. Establish training for campus management regarding appropriate and inappropriate uses of employee leave.

**Campus Response**

We concur. To enhance its current training developed in November 2003, the university will develop online training regarding employee leaves for campus managers by December 2006.

51. Ensure that matters involving employee leaves be formally documented, keeping in mind the substance of the requirements.

**Campus Response**

We concur. As indicated in the campus response to recommendations 48, 49, and 50, the Payroll and Human Resources Benefits staff utilize Technical Letter HR/Leaves 2005-01 to administer leave accounting and will provide additional training to staff in Payroll and Benefits, divisional Human Resource Coordinators, and campus managers.

**Inaccurate Financial Information**

We recommend that the campus:

52. Establish procedures to ensure the accuracy of subsidiary accounting data and evaluate the impact of past discrepancies on future operations.

**Campus Response**

We concur. Procedures have been established to ensure all general and subsidiary ledger transactions are current and accurate and have been utilized to evaluate the impact of past discrepancies. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
53. Establish procedures to ensure the accuracy of vendor data records and evaluate the impact of past discrepancies on future operations.

**Campus Response**

We concur. Procedures to ensure the accuracy of vendor data records have been developed and will be utilized to evaluate the impact of past discrepancies. Analysis and reevaluation of the vendor data records is occurring as part of the university’s CMS Finance implementation and vendor data cleanup, and conversion will occur by March 2007.

54. Perform regular reconciliations of subsidiary ledgers and data maintained in the campus data warehouse to related control records.

**Campus Response**

We concur. Beginning in July 2006, reconciliations of subsidiary ledgers and data maintained in the campus data warehouse to related control records now occur on a monthly basis. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

55. Perform regular reconciliations of the inventory of scanned documents to control ledgers and maintain this data in an unalterable format.

**Campus Response**

We concur. Beginning in July 2006, an audit sample of scanned documents is retrieved and checked on a monthly basis. In addition a “Write Group” security access profile allows authorized users to correct logistical scanning errors without permitting alterations of core scanned data. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
DATE: August 25, 2006

TO: Larry Mandel
    University Auditor

FROM: Milton A. Gordon
      President

SUBJECT: Campus Response to Recommendations of Investigation Report Number 04-91, Special Investigation at California State University, Fullerton

I want to express my appreciation to you and your staff for the professional job in conducting a special investigation at California State University, Fullerton. Attached are campus responses to the recommendations outlined in this report. In addition to responses to specific recommendations, I also appreciate the opportunity you provided to summarize actions the campus initiated prior to and during the course of this investigation.

Again, I appreciate the time and effort put into this report. As always, please do not hesitate to contact me if you have questions or concerns.

cc: Willie Hagan, Vice President, Administration & Finance/CFO
    Amir Dabirian, Chief Information Technology Officer
    Bill Barrett, Associate Vice President, Administration
    Brian Jenkins, Associate Vice President, Finance
    Norma Morris, Staff Assistant to the President
    Naomi Goodwin, Assistant Vice President, Administration & Finance
RECOMMENDATIONS AND CAMPUS RESPONSES

This investigation began in December 2004 in response to allegations regarding events prior to that time. It is important to note that a number of self-initiated corrective actions were taken prior to December 2004, as is more fully described below. These actions were based on information and recommendations provided by university staff and information obtained during the Business and Financial Affairs (BFA) Review initiated by the President in March 2004 (described below). In addition, based on information received during the course of this investigation, the university took additional corrective action from December 2004 to present and continues to do so.

Business & Financial Affairs Oversight
In March 2004, a President-appointed Review Committee consisting of four Vice Presidents was established to study the BFA division. Based upon that review, which included some of the subjects noted in this investigation, and recommendations provided by this committee, along with other factors, President Gordon decided to make an organizational change. In August 2004, approximately four months before the start of this investigation, President Gordon announced management responsibility for BFA would be transferred to the Vice President for Administration, who also would serve as the campus CFO. Following a transition period, responsibility for overseeing former BFA operations formally occurred on April 1, 2005.

During the transition period, the Vice President for Administration studied the University's financial picture and division operations; met with BFA managers and staff; created an Ad Hoc Financial Advisory Committee consisting of divisional and auxiliary finance managers; presented a BFA reorganization and merger plan to Administration and BFA staff; and launched national searches to fill key senior management vacancies.

Since the April 1, 2005 organizational change, following national searches, the Vice President for Administration and Finance/CFO has filled the following key positions: Associate Vice President for Finance; Director of Contracts and Procurement; Director of Internal Controls; and Director of Student Financial Services. National searches for an Assistant Vice President of Budget and a Controller are currently underway and the university is continuing to explore a variety of recruitment strategies to attract highly qualified candidates. In order to ensure university budget issues were addressed immediately, an experienced manager was appointed to oversee budget operations on an acting basis until a comprehensive search could be completed and the position filled on a permanent basis. Filling these important positions with experienced senior managers allows for additional oversight of all activities within the finance area and throughout the campus. A number of additional operating changes have also occurred, many of which are outlined in the responses to the recommendations in this report, which follow below.

Enterprise Computing/Common Management System Implementation & Oversight
In November 2003, Enterprise Computing responsibilities were transferred by the President from the former CFO to the Chief Information Technology Officer (CITO). The CITO subsequently initiated a review of the return on investment associated with the enterprise computing projects and presented these findings to President Gordon. In February 2004, the former Director of Enterprise Computing left the University. Reorganization within the Information Technology division followed immediately thereafter and the Enterprise Computing department ceased to exist. All enterprise computing technology that could be utilized was integrated into the CMS project and an experienced senior campus IT Director assumed CMS Director responsibilities.

Campus Action Between 1999 & 2003
As indicated in this investigation report, in December 1999 the California State Auditor issued an investigation report concerning Cal State Fullerton. In August 1999, prior to the December 1999 State Audit report being issued, the campus sought outside expertise to evaluate and improve campus fiscal control
systems. In addition, a broadly based task force consisting of Chancellor's Office, campus, and community representatives was established to ensure recommendations from the external evaluation and the State Audit report were implemented. In September 2000, this task force reported to the President that all of the recommendations had been addressed and indicated they believed “the overall financial organization and systems at Cal State Fullerton have been significantly strengthened.” As a result of these and additional efforts, including subsequent audits, the President felt a solid fiscal control environment was in place.

Nevertheless, when concerns regarding fiscal oversight were raised in late 2003, President Gordon initiated a review and subsequent reorganization of the BFA division and reassigned enterprise computing/CMS responsibilities as previously described.

Additional information regarding specific action the campus has taken, or is in the process of implementing, is described below:

**CONTROL ENVIRONMENT**

**Unsatisfactory Oversight**

We recommend that the campus:

1. Establish training for campus management regarding work hours for managers.

**Campus Response**

We concur. The campus will implement additional communication and training regarding work hours for managers by November 2006.

**Failure to Modify Underlying Operating Culture**

We recommend that the campus:

2. Call for an independent study of the operating culture within Business and Financial Affairs to determine the underlying causes for the failure to make substantial improvements since the 1999 State Auditor review.

**Campus Response**

We concur. A number of actions addressing this recommendation have been implemented. In particular, in March 2004 President Gordon appointed a BFA Review committee consisting of the Vice Presidents for Academic Affairs, Administration, Student Affairs, and the Executive Vice President to study the climate of Business and Financial Affairs. This committee identified insufficient leadership, direction, communication, teamwork, and in certain cases insufficient qualifications of some managers and other human resource issues as fundamental issues of concern affecting the BFA operating culture. Based upon recommendations provided by this committee, along with other factors, President Gordon determined that a management and organizational change was in order. In August 2004 President Gordon announced management responsibility for Business and Financial Affairs would be transferred to the Vice President for Administration who would also serve as the campus CFO. Following a transition period, responsibility for overseeing former Business and Financial Affairs operations formally occurred on April 1, 2005. Since that time, a number of significant operating and personnel changes have occurred, and the Vice President for Administration and Finance/CFO has filled the following key positions:
Associate Vice President for Finance; Director of Contracts and Procurement; Director of Internal Controls; and Director of Student Financial Services. National searches for an Assistant Vice President of Budget and a Controller are currently underway and the university is continuing to explore a variety of recruitment strategies to attract highly qualified candidates. In order to ensure university budget issues were addressed immediately, an experienced manager was appointed to oversee budget operations on an acting basis until a comprehensive search could be completed and the position filled on a permanent basis. Filling these important positions with experienced senior managers allows for additional oversight of all activities within the finance area and throughout the campus. A number of additional operating changes have also occurred, many of which are outlined in the response to the recommendations in this report. President Gordon will reconvene the former BFA Review Committee, absent the current Vice President for Administration and Finance/CFO, to assess progress in addressing issues identified by the committee in 2004. This will be completed by December 2006.

**Non-Supportive Workplace Environment**

We recommend that the campus:

3. Continue efforts to change the workplace environment within BFA to support and encourage employees to freely report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation.

**Campus Response**

We concur. Beginning in August 2004, the Vice President for Administration and Finance/CFO initiated a number of actions to foster an environment of open communication, including filling a number of key senior manager positions as referenced in the campus response to recommendation number two. Filling these key positions with experienced senior managers who support and encourage employees to report waste, fraud, abuse of authority, violation of law, or failures to comply with state rules and regulations without fear of retaliation contributes to an environment of open communication. The Vice President for Administration and Finance/CFO also initiated group and individual one-on-one meetings with finance managers and staff to solicit their thoughts and ideas on ways to improve the operation; formed an Ad Hoc Financial Advisory Committee consisting of the financial officers from each division, extended education, and each auxiliary to advise the CFO and Associate Vice President of Finance on financial and other matters from the division and auxiliary perspective; and initiated a strategic planning process for the division that provides staff with numerous opportunities to provide input. In addition, the Risk Management web site includes a frequently asked questions section and links to information regarding how to report waste, fraud, etc. To further enhance these efforts, the Vice President for Administration and Finance/CFO will launch a University Business Institute in January 2007 that, among other topics, will include additional training for financial managers and staff regarding workplace ethics, internal controls, and processes and procedures for reporting waste, fraud, etc. In addition, a Business Principles document focusing on expectations regarding integrity, accountability, stewardship of university resources, respect and collaboration, quality and efficiency, and safety will be finalized and distributed to Administration and Finance staff by December 2006.
RECOMMENDATIONS AND CAMPUS RESPONSES

ENTERPRISE COMPUTING

Insufficient Oversight of Enterprise Computing

We recommend that the campus:

4. Establish necessary and appropriate controls over Enterprise Computing (EC) contracting activities, considering the need to sufficiently plan, organize, direct, and control such projects.

Campus Response

We concur and the following steps addressing this recommendation have occurred: a) in November 2003 management oversight of campus enterprise computing functions was transferred by the President to the Chief Information Technology Officer (CITO) and the CITO now has responsibility and accountability for managing enterprise computing budgets and funds, which had not previously been the case; b) Following an assessment by the CITO, the former Enterprise Computing Department was disbanded in February 2004 and enterprise computing functions were folded into two units: Document Management that has the responsibility for supporting campus wide document management and imaging applications (e.g., Admissions and Records, Financial Aid, Finance), and CMS that has the responsibility responsible for implementing the three modules of the Common Management System (Human Resources, Finance and Student Administration). Since that time, the university’s CMS implementation approach has been to minimize consulting services and the CMS department has been exceeding all CSU standards and policies to sufficiently plan, organize, direct, and control contracting activities, and has received superior ratings for readiness assessment for all three modules from the CSU CMS readiness consultants; c) following a national search, in October 2005 the campus filled the Director of Contracts and Procurement position, which had been vacant for approximately three years, providing additional management oversight of all campus contracting and purchasing activities; d) in April 2006 the university implemented additional internal controls for all information technology purchases, including services and consulting contracts, requiring CITO approval of all IT expenditures with a cumulative total above $100,000 and the approval of both the CITO and the CFO for all IT expenditures with a cumulative total above $250,000. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

5. Determine the salvage value of past EC application development projects by:

   a. Determining the usefulness, if any, of systems processes or subsystems begun.

   b. Performing a cost/benefit analysis as to the value of completing any unfinished development projects.

Campus Response

We concur. Following the reorganization of enterprise computing activities described in the campus response to recommendation number four, enterprise computing application development projects were evaluated by the CITO. Document and imaging applications have been salvaged and are currently being utilized by a number of campus departments. Based on a cost/benefit analysis, all other enterprise computing development projects are on hold, or, as recommended by the CSU CMS Executive Committee, have been integrated, or are in the process of being integrated, into CMS. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
Inappropriate Information Technology Expenditures

We recommend that the campus:

6. Continue efforts to improve the usefulness and accuracy of California State University (CSU) Common Management Systems implementation reporting.

Campus Response

We concur. Following the reorganization of enterprise computing activities described in the campus response to recommendation number four, and evaluation of enterprise computing development projects described in the campus response to recommendation number five, in June 2004 the university established a CMS project implementation structure, including a CMS Steering Committee, currently chaired by the Vice President of Student Affairs, with broadly-based campus representation, and a CMS Reporting Subcommittee to oversee implementation reporting. In addition, the Chief Information Technology Officer provides regular reports regarding the status of CMS implementation efforts to the President’s Administrative Board, Academic Senate, and the Planning, Resource and Budget Committee. The university also continues to provide ongoing reports to the Chancellor’s Office (CO) regarding the status of implementation efforts and is currently on track to fully implement CMS reporting. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

7. Appropriately capitalize EC software development expenditures by:
   
   a. Continuing evaluation of past costs and the appropriateness of capitalization.
   
   b. Making appropriate adjustments to accounting records.
   
   c. Evaluating the appropriateness of current account code structure as it relates to the accounting and control of equipment and other fixed assets.

Campus Response

We concur. In December 2005 all past EC software development costs were evaluated, appropriately capitalized, and depreciated for the 2004-05 financial reports per the CSU Capital Assets Guidelines. The current account code structure has been evaluated as part of our CMS conversion activities and is appropriate as it relates to the accounting and control of equipment and other fixed assets. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

8. Establish policies and procedures to assist in the control of software user licenses and maintenance contracts by:

   a. Ensuring that needs assessments are performed and documented for existing software licenses and maintenance fees and before future purchases are made.
   
   b. Implementing administrative ledgers to track use licenses and maintenance contracts.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. As indicated in the campus response to recommendation four, in April 2006 the university implemented additional internal controls for all information technology purchases, including procedures to track all software user licenses and maintenance contracts by requiring CITO approval of all IT expenditures with a cumulative total above $100,000 and the approval of both the CITO and the CFO for all IT expenditures with a cumulative total above $250,000, including software user licenses and maintenance contracts. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

Inappropriate Software Endorsements

We recommend that the campus:

9. Clarify for management the implications of CSU policy on product endorsements by:
   a. Communicating CSU policy to managers whose responsibilities put them in a position where they may be asked to recommend vendors' products.
   b. Drafting campus procedures to ensure compliance with CSU policies.

Campus Response

We concur. In August 2006 all university managers received an email from the Vice President for Administration and Finance/CFO reminding them that CSU employees are prohibited from implying, indicating, or otherwise suggesting that any procedure, service, or organization is connected or affiliated with, or is endorsed, favored, or supported by, or is opposed by the University and attaching the relevant Education Code (Education Code 89005.5 (a) (2)). This email also instructed managers to share this information with others in their departments as appropriate. This information will be included in University orientation packets provided to new managers beginning in September 2006.

Conflict of Interest

We recommend that the campus:

10. Establish training for, and reiterate policies to, campus management and staff regarding conflicts of interest established by The Political Reform Act of 1974, Title V, and CSU Policy that specifically address:
   a. Spouses evaluating each other's work products.
   b. Purchases from related parties.
   c. Financial interest in companies doing business with the campus.
   d. Submission/collection of required forms.

Campus Response

We concur. Beginning in June 2004 the university implemented a comprehensive two-hour online ethics regulations and conflict of interest code training program that includes spouses evaluating other’s work products, purchases from related parties, financial interest in companies doing business with the campus, submission/collection of required forms, and incompatible activities. The training is mandatory for all
employees in designated positions and must be completed within six months of appointment in a designated position and at least once during each consecutive two year period. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Incompatible Activities**

We recommend that the campus:

11. Reiterate CSU policies and procedures relating to incompatible activities for campus managers.

**Campus Response**

This recommendation has been addressed as described in the campus response to recommendation 10 above.

12. Establish training for management regarding incompatible activities.

**Campus Response**

This recommendation has been addressed as described in the campus response to recommendation 10 above.

**CAMPUS BUDGETS**

**Insufficient Management Oversight**

We recommend that the campus:

13. Ensure that the President's Administrative Board and the Planning, Resource and Budget Committee are provided complete and comprehensive budget documentation in order to perform an effective advisory function for the President.

**Campus Response**

We concur. During FY 2005-06 a series of new comprehensive university budget and financial reports were developed and presented at numerous PAB and PRBC meetings throughout the fiscal year. Additional reports are in development. In addition, the Vice President for Administration/CFO meets with the Chair of the Academic Senate and the Chair of the Planning Resource and Budget Committee on a regular basis to review university budget and fiscal information. In addition, the CFO and Associate Vice President of Finance will conduct budget workshops for PAB, PRBC and the Senate Executive Committee during September and October 2006 and will provide these groups with copies of the publication *College and University Budgeting: An Introduction for Faculty and Academic Administrators*, authored by the National Association of College and University Business Officers, to further assist these groups in performing an effective advisory function for the President.

14. Establish standards for reporting budgetary information and produce regular and consistent budgetary documents for use by the campus community.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. During FY 2005-06 budget operations standards for recording budgetary transactions, supporting regular and consistent budgetary documents for the campus community, were established. Further enhancements to campus budget documents will occur by March 2007 as part of the campus CMS Finance implementation.

15. Improve the campus’ ability to satisfactorily respond to requests for budgetary information from administrators and members of the campus community.

Campus Response

We concur. In addition to hiring new financial management staff beginning in May 2004, as referenced in the campus response to recommendation number two, additional budget analysts were also hired beginning in July 2005 to assist in responding to requests for budgetary information from administrators and members of the campus community. In addition, together the series of new university budget and financial reports developed in FY 2005-06 referenced in the campus response to recommendation 13, along with the budget operations standards in recording budgetary transactions implemented in FY 2005-06 referenced in the campus response to recommendation 14, have dramatically improved the university’s ability to satisfactorily respond to all requests for budgetary information. Further enhancements will occur by March 2007.

16. Regularly reconcile subsidiary data supporting reports on the current financial position of the campus to budgetary and accounting ledgers.

Campus Response

We concur. Effective June 2005 the process of recording budgetary and accounting transactions is now current, the budgetary and accounting ledgers are complete and up to date, and are now the sources of data used in designing, developing, and generating all reports (including subsidiary data supporting reports) on the current financial position of the campus. Standardized financial reports are reconciled and tie back to the budgetary and accounting ledgers. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

Inappropriate Budget Transfers

We recommend that the campus:

17. Maintain the identity of the year funds were appropriated by the state when making transfers.

Campus Response

We concur. As a result of fully implementing the CSU Fee Revenue Management Program established effective July 1, 2006 throughout FY 2006–2007, all of the university’s General Fund Appropriations (including the FY 2006-2007) will be fully expended before the end of the current fiscal year. Any budget balance available at the end of this fiscal year carried forward into the next fiscal year will reside in the State University Trust Fund, which has no funding expiration date. Thus, this recommendation will be completed when the university’s FY 2006–2007 General Fund appropriation is fully expended, which we anticipate will occur by March 2007.
RECOMMENDATIONS AND CAMPUS RESPONSES

18. Follow policies and procedures regarding budgetary fund transfers to ensure they are adequately managed and controlled.

Campus Response

We concur. Beginning in FY 2005-06 the campus now requires sufficient supporting documentation and appropriate approvals from authorized individuals with regards to recording budgetary fund transfers on a standardized form. Requests for budgetary fund transfers are reviewed by appropriate university officials prior to processing to ensure such requests are managed and controlled appropriately. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

19. Establish clear responsibility for accounts maintained to facilitate interfund transfers of campus funds.

Campus Response

We concur. Beginning in May 2006 accounts maintained to facilitate inter-fund transfers were assigned to the Director of Budget Operations to clearly establish responsibility and signature authority for the accounts. Furthermore, the activity in these accounts was included in the various new budgetary and financial reports presented to the President, PAB and PRBC during FY 2005-06. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

Inappropriate Management of Cash Flows and Deficits

We recommend that the campus:

20. Establish accounting and budgeting practices that afford transparency regarding large balances of unexpended funds.

Campus Response

We concur. In addition to actions identified in the campus response to recommendations 13, 14, 15, 16, 17, 18, and 19, beginning in FY 2005-06 accounting, budgetary, and reporting practices were implemented to provide university management with full details regarding unexpended fund balances. Specifically with regards to General Fund carry forward, a new annual report designed and developed during FY 2005-06 showing departmental and university-wide budgets, including carry forward balances over the past five years, was presented to the President, PAB and PRBC. The university will provide documentation to demonstrate compliance with this recommendation by March 2007.

21. Appropriately control deficits in individual budgetary accounts and ensure their effects are sufficiently considered in annual budget planning.

Campus Response

We concur. Beginning in FY 2005-06 operation of individual budgetary accounts, including deficits, encumbrances, and carry forward balances, are now analyzed and factored into the university’s annual budget planning. Encumbrances and carry forward balances are no longer automatically added to the following year’s appropriation; budget centers must request and provide support for such reallocations. Of the university’s total General Fund carry forward at the end of FY 2004–2005, only approximately
RECOMMENDATIONS AND CAMPUS RESPONSES

one third of the total carry forward was reallocated back to the individual departments. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

22. Appropriately record estimates and reserves used for budget planning purposes in both budget and accounting ledgers.

Campus Response

We concur. With the departure of the former Chief of Budget Planning and Strategy (also the former CFO), the Vice President for Administration and Finance/CFO was assigned responsibility for budget planning in August 2006. Estimates and reserves for budget planning purposes were included in budget documents presented to the President and PAB in August 2006 and will subsequently be presented to PRBC. Estimates and reserves will be recorded in the budgetary, accounting, or encumbrance ledgers by October 2006.

Insufficient Administrative Controls

We recommend that the campus:

23. Appropriately grant and limit access to budget data.

Campus Response

We concur and have initiated a process to recertify and control access to budget data as appropriate to ensure access is granted and/or limited based upon authorized fund and account responsibilities. This process will be completed by November 2006.

24. Maintain a single reliable budget ledger.

Campus Response

We concur. As indicated in the campus response to recommendation number 16, beginning in FY 2005-06 the official FRS budgetary ledger used for State Controller Office and CO reporting is also now the single budgetary ledger used for campus budget office reporting. Financial services no longer utilizes a shadow system. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

NON-GENERAL FUNDS

Non-Reimbursement of the General Fund

We recommend that the campus:

25. Ensure that funds advanced to self supporting operations are appropriately accounted for.

Campus Response

We concur. All self-supporting financial operations will be appropriately accounted for and transactions will be processed by March 2007.
26. Update and execute cost allocation plans on a timely basis.

**Campus Response**

We concur. In June 2006 the university developed a prospective cost allocation plan for the fund referenced in this report and appropriate fund transfers occurred at this time. The university will fine tune and modify this plan on an ongoing basis as appropriate. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

27. Calculate reimbursements to the General Fund for the use of facilities, goods, and services and support those calculations with current and valid assertions and assumptions.

**Campus Response**

We concur. As indicated in the campus response to recommendation number 26, in June 2006 the university developed a prospective cost allocation plan for the fund referenced in this report and appropriate fund transfers occurred at this time. Reimbursements to the General Fund for the use of facilities, goods, and services were calculated and addressed in this plan. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

28. Repay amounts due to the General Fund.

**Campus Response**

We concur. As indicated in the campus response to recommendation number 26, in June 2006 the university developed a prospective cost allocation plan for the fund referenced in this report and appropriate fund transfers occurred at this time. Resolution of past indirect costs due to the General Fund occurred in conjunction with this plan. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

29. Ensure that access to, and responsibility for, funds is clearly and appropriately established.

**Campus Response**

We concur. Access to, and responsibility for, funds referenced in this report are assigned to the Vice President for Academic Affairs and the Dean of Extended Education and a financial plan to fully spend funds in specific accounts was developed in February 2006.

30. Ensure that all self-support activity on campus is consistently processed in the reimbursed activities accounts to ensure that charges and costs are more clearly identifiable.

**Campus Response**

We concur. The university is developing standards for processing self-support activities and will ensure charges and costs are more clearly identified by March 2007.

31. Analyze the million dollars identified relating to continuing education (CE) and determine the appropriate disposition and accounting for these funds.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. Analysis of the identified funds was completed in June 2006 and appropriate disposition and accounting of these funds will occur by December 2006.

Inappropriate Administration of Continuing Education Funds

We recommend that the campus:

32. Appropriately record reimbursements for facilities, goods, and services provided to CE in the General Fund.

Campus Response

We concur. In June 2006 CE reimbursements to the General Fund for the use of facilities, goods, and services were calculated and included in the prospective cost allocation plan referenced in the campus response to recommendation number 26 and have been appropriately recorded. This plan will be reviewed and modified on an annual basis and appropriate reimbursements will occur on an ongoing basis as necessary. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

33. Close state trust accounts established to hold CE General Fund reimbursements.

Campus Response

We concur. In June 2006 the state trust accounts identified in this report, which are established and funded annually (per various Memoranda of Understandings), were included in the campus cost allocation plan referenced in the campus response to recommendation number 26 and appropriate fund transfers occurred at this time. These accounts have not been established to develop reserves, but to fully spend the available funds on programs and activities in support of the General Fund. Rather than close the accounts, a financial plan to fully spend Academic Affairs specific accounts was developed in February 2006.

34. Establish controls to ensure that compliance with CE fund expenditure restrictions are consistently adhered to.

Campus Response

We concur. Beginning in FY 2005-06 budget operations staff review and approve material CE expenditure requests to ensure consistent compliance with fund expenditure restrictions. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

35. Clearly document evidence that CE reimbursed the General Fund for annual rent for space in the College Park building since initial occupancy.

Campus Response

We concur. In February 2006 documentation to support CE reimbursement of all costs, including the College Park building rent, was approved by the CFO and appropriate fund transfers occurred at this time. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
RECOMMENDATIONS AND CAMPUS RESPONSES

Inappropriate Administration of Lottery Funds

We recommend that the campus:

36. Appropriately reflect in accounting or budgetary records (recorded in official ledgers) pledge or loan transactions such as those relating to the utilization of lottery funds to balance budgetary deficits.

Campus Response

We concur. Pledge or loan transactions for budget planning purposes will be recorded in budgetary, accounting, or encumbrance ledgers by October 2006.

37. Establish controls to ensure that compliance with lottery fund expenditure restrictions are consistently adhered to.

Campus Response

We concur. Beginning in FY 2005-06 budget operations staff review and approve material lottery fund expenditure requests to ensure consistent compliance with fund expenditure restrictions. In addition, lottery fund revenues, uses, and balances will be included in the overall university budgeting process effective 2006-07 and will be included separately in university budget reports. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

UNIVERSITY ADVANCEMENT FOUNDATION (UAF)

Conflict of Interest

We recommend that the campus:

38. Ensure that policies and procedures for the evaluation of the performance of the Executive Director appropriately consider the change in voting rights established by the recent revision of the UAF's bylaws.

Campus Response

We concur. An amendment to the CSF Philanthropic Foundation (CSFPF), previously known as the University Advancement Foundation, bylaws, explicitly stating that “the Executive Director may not participate in any discussion or vote which pertains to the evaluation of his/her performance” will be presented to the CSFPF Board at the next regularly scheduled meeting in September 2006.

Inappropriate Classification of Revenues

We recommend that the campus:

39. Establish policies and procedures that ensure revenues from fundraising events are properly classified.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. General Fund dollars coming to the CSFPF through fundraising events are deposited in the CSFPF as non-gift revenue. CSFPF annual audited financial reporting is submitted to the university for the purposes of consolidating financial information and an adjusting GAAP entry to eliminate double accounting of revenues (and expenses) is recorded. CSFPF will develop policies and procedures to assure General Fund non-gift revenue is not directly or indirectly stated as fundraising profit and/or directed to scholarships by November 2006.

BUSINESS AND FINANCIAL AFFAIRS

Procurement Process Control Weaknesses

We recommend that the campus:

40. Establish procedures which prevent contracts from being inappropriately expanded, ensuring that:

   a. CSU limits are adhered to.
   b. Authorization for the expansion of contracts is sufficiently documented.
   c. Split contracts are identified and appropriate corrective measures are taken.

Campus Response

We concur and action addressing this recommendation has occurred. Following a national search, the university appointed a Director of Contracts and Procurement in October 2005. This position, which had previously been vacant for approximately three years, provides additional management oversight of all campus contracting and purchasing activities. In addition, contract procedures to ensure CSU limits are adhered to, authorization for the expansion of contracts is sufficiently documented, and split contracts are identified have been implemented. Contract approval limits have been clearly identified, and the Contracts and Procurement department has been reorganized to further increase administrative review of all contracts. The incidents in the narrative regarding contract splitting were isolated occurrences in which a former employee charged with ensuring the controls, by-passed the controls. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

41. Eliminate the outsourced online e-commerce process as planned.

Campus Response

We concur. The contract with the online e-commerce vendor was terminated effective December 2005.

42. Establish sufficient oversight of campus bidding practices to ensure that requirements are not circumvented.

Campus Response

We concur. As indicated in the campus response to recommendation number 40, following a national search the campus appointed a Director of Contracts and Procurement, providing additional management oversight of all campus contracting and purchasing activities. The university also filled other Contracts and Procurement vacancies to enhance oversight of contract bidding practice requirements, including the submission of required documentation when justifying sole-source procurements, and has initiated
RECOMMENDATIONS AND CAMPUS RESPONSES

Certified Purchasing Manager training for Contracts and Procurement staff with a goal of having all staff certified. In addition, the university implemented additional internal controls for information technology purchases as indicated in the campus response to recommendation number eight, including a requirement for vendors to sign conflict of interest agreements. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Improper Handling of Travel Advances**

We recommend that the campus:

43. Ensure that all travel advances are cleared timely.

**Campus Response**

We concur. In July 2006 the university implemented practices and procedures to ensure travel advances are cleared in a timely manner, including reducing the number of travel advances and tracking individual advances and initiating follow-up contact to clear these balances. The incident cited in the report was an isolated occurrence involving the former CFO. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

44. Establish procedures to report to the Internal Revenue Service any advances uncleared at year-end.

**Campus Response**

We concur. In July 2006 procedures to report unsubstantiated uncleared travel advances at year-end to the Internal Revenue Service were developed as indicated in the campus response to recommendation number 43. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

**Inappropriate Personnel Appointments**

We recommend that the campus:

45. Continue to reevaluate its administration of personnel appointments.

**Campus Response**

We concur. The campus has implemented a new procedure and form requiring the Executive Director of Human Resources to review all management appointments to confirm appropriate policies and procedures have been utilized before recommendations for appointment are forwarded to the President for approval. Any issues of concern are brought to the attention of the Vice President for Administration and Finance to resolve with the respective division head or to bring to the attention of the President if necessary. This procedure has been communicated to the division heads and the university is continuing to utilize this procedure and form in its administration of management appointments. The university will reevaluate use of this procedure and form by October 2006.

46. Continue its reorganization plan for Business and Financial Affairs.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. Since assuming responsibility for financial services, the Vice President for Administration and Finance/CFO has reorganized the former BFA operation, including taking the following steps to provide additional management oversight: Establishing financial services as a separate operating unit within the Division of Administration and Finance and creating and adding a new position of Associate Vice President of Finance to oversee this unit; creating and adding a new position of Director of Internal Controls within the Division of Administration and Finance; re-instituting the Controller position; filling the Director of Contracts and Procurement position and Director of Budget position that had previously been held vacant for a number of years; restructuring reporting lines to have Student Financial Services, Accounting Services and Accounts Payable report to the Controller; merging Payroll with Human Resources; and merging the financial information technology unit with the administration information technology unit.

Following the reassignment by the Vice President for Administration and Finance of two interim Senior Directors in BFA, reassignment of a former Senior Director due to illness, and the resignation of the Senior Director of Financial Systems, none of the former BFA Senior Directors are currently employed in financial services. In addition, in August 2006, the President launched a search to refill the university’s Director of Internal Audit position and has also approved a job description to add a second auditor position to the university’s internal audit staff in early 2007. Furthermore, the Division of Administration and Finance has launched a strategic planning process. Senior managers and a divisional strategic planning steering committee have evaluated feedback from division staff and the campus community regarding divisional strengths, weaknesses, opportunities and threats. The Vice President for Administration and Finance/CFO will establish task forces to begin addressing strategic goals and developing operational objectives and action plans in November 2006.

47. Continue to aggressively recruit experienced professionals for all key management positions that remain vacant.

Campus Response

We concur. Beginning in May 2004 through September 2006, following national searches, the Associate Vice President for Finance, Directors of Internal Controls, Contracts and Procurement, and Student Financial Services positions have all been filled with experienced senior managers. National searches for an Assistant Vice President of Budget and a Controller are currently underway and the university is continuing to explore a variety of recruitment strategies, including exploring utilization of a search firm, to attract highly qualified candidates. In order to ensure university budget issues were addressed immediately, an experienced manager was appointed to oversee budget operations on an acting basis until a comprehensive search could be completed and the position is filled on a permanent basis. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

Payroll Abuse

We recommend that the campus:

48. Improve its administration of leave accounting processes, including clear documentation of standards and practices.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. Effective March 2005 the Payroll function now reports to the Executive Director of Human Resources, who in turn reports to the Vice President of Administration and Finance/CFO. Having both Human Resources and Payroll report to the same individual enhances information sharing and reporting of potential leave accounting irregularities. Both the Payroll and Human Resources Benefits staff utilize Technical Letter HR/Leaves 2005-01 to administer leave accounting. The incident in the narrative was an isolated occurrence in which a former employee charged with overseeing administration of leave accounting by-passed the controls. Human Resources will develop a training session regarding leave accounting processes, including clear documentation of standards and practices, for staff in Payroll and Benefits, as well as the Human Resource Coordinators in each division by November 2006. Additional training will be provided as changes occur and/or new staff are hired.

49. Re-train payroll staff responsible for upholding campus leave policies and procedures.

Campus Response

We concur. Following the March 2005 Human Resources/Payroll merger, a Human Resource Benefits specialist and an experienced Payroll staff member have been assigned responsibility for leave accounting. Human Resources Benefits and Payroll staff now meet regularly for training, utilizing Technical Letter HR/Leaves 2005-01 as reference, and to discuss operational issues. As indicated in the campus response to recommendation number 48, Human Resources will develop a training session regarding leave accounting processes, including clear documentation of standards and practices, for staff in Payroll and Benefits, as well as the Human Resource Coordinators in each division by November 2006. Additional training will be provided as changes occur and/or new staff are hired.

50. Establish training for campus management regarding appropriate and inappropriate uses of employee leave.

Campus Response

We concur. To enhance its current training, developed in November 2003, the university will develop online training regarding employee leaves for campus managers by December 2006.

51. Ensure that matters involving employee leaves be formally documented, keeping in mind the substance of the requirements.

Campus Response

We concur. As indicated in the campus response to number 48, 49, and 50, the Payroll and Human Resources Benefits staff utilize Technical Letter HR/Leaves 2005-01 to administer leave accounting and will provide additional training to staff in Payroll, Benefit, divisional Human Resource Coordinators, and campus managers.

Inaccurate Financial Information

We recommend that the campus:

52. Establish procedures to ensure the accuracy of subsidiary accounting data and evaluate the impact of past discrepancies on future operations.
RECOMMENDATIONS AND CAMPUS RESPONSES

Campus Response

We concur. Procedures have been established to ensure all general and subsidiary ledger transactions are current and accurate and have been utilized to evaluate the impact of past discrepancies. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

53. Establish procedures to ensure the accuracy of vendor data records and evaluate the impact of past discrepancies on future operations.

Campus Response

We concur. Procedures to ensure the accuracy of vendor data records have been developed and will be utilized to evaluate the impact of past discrepancies. Analysis and reevaluation of the vendor data records is occurring as part of the university’s CMS Finance implementation and vendor data cleanup and conversion will occur by March 2007.

54. Perform regular reconciliations of subsidiary ledgers and data maintained in the campus data warehouse to related control records.

Campus Response

We concur. Beginning in July 2006 reconciliations of subsidiary ledgers and data maintained in the campus data warehouse to related control records now occur on a monthly basis. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.

55. Perform regular reconciliations of the inventory of scanned documents to control ledgers and maintain this data in an unalterable format.

Campus Response

We concur. Beginning in July 2006 an audit sample of scanned documents is retrieved and checked on a monthly basis. In addition a “Write Group” security access profile allows authorized users to correct logistical scanning errors without permitting alterations of core scanned data. The university will provide documentation to demonstrate compliance with this recommendation by October 2006.
October 11, 2006

MEMORANDUM

TO: Mr. Larry Mandel  
University Auditor

FROM: Charles B. Reed  
Chancellor

SUBJECT: Draft Final Report Number 04-91, Special Investigation, California State University, Fullerton

In response to your memorandum of October 11, 2006, I accept the response as submitted with the draft final report on Special Investigation, California State University, Fullerton.

CBR/amd

Enclosure

cc: Dr. Milton A. Gordon, President  
Mr. Willie Hagan, Vice President for Administration and Finance/Chief Financial Officer