

AUXILIARY ORGANIZATIONS
CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR

Audit Report 07-48
January 22, 2008

Members, Committee on Audit

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BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY

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ABBREVIATIONS

CSU	California State University
Foundation	California State University Foundation
Institute	California State University Institute
RFIN	Resolution of the Committee on Finance

EXECUTIVE SUMMARY

In July 1981, the Board of Trustee policy concerning auxiliary organizations was adopted in the Resolution of the Committee on Finance (RFIN) 7-81-4. Executive Order 698, *Board of Trustees Policy for The California State University Auxiliary Organizations*, dated March 3, 1999, required that the Office of the University Auditor conduct internal compliance/internal control reviews of auxiliary organizations, and the Board of Trustees instructed that such reviews be conducted on a triennial basis pursuant to procedures established by the chancellor.

Office of the Chancellor management is responsible for establishing and maintaining an adequate system of internal compliance/internal control and assuring that each of its auxiliary organizations similarly establishes such a system. This responsibility, in accordance with California Code of Regulations, Title 5, Section 42402 et seq. and Executive Order 698, *Board of Trustees Policy for The California State University Auxiliary Organizations et seq.*, includes requiring the documentation of internal control, communicating requirements to employees, and assuring that its system of internal compliance/internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures.

The objectives of a system of internal compliance/internal control are to provide management with reasonable, but not absolute, assurance that:

- ▶ Auxiliary operations are conducted in accordance with policies and procedures established in the State Administrative Manual, Education Code, Title 5, and Trustee policy.
- ▶ Assets are adequately safeguarded against loss from unauthorized use or disposition.
- ▶ Transactions are executed in accordance with management's authorization and recorded properly to permit the timely preparation of reliable financial statements.

We visited the Office of the Chancellor and its auxiliary organizations from October 8, 2007, through November 2, 2007, and made a study and evaluation of the system of internal compliance/internal control in effect as of November 2, 2007. This report represents our triennial review.

Our study and evaluation at *California State University Foundation* did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify another reportable weakness that is described in the executive summary and in the body of the report. In our opinion, the accounting and administrative control in effect as of November 2, 2007, taken as a whole, was sufficient to meet the objectives stated above.

Our study and evaluation at *California State University Institute* did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify other reportable weaknesses that are described in the executive summary and in the body of the report. In our opinion, the accounting and administrative control in effect as of November 2, 2007, taken as a whole, was sufficient to meet the objectives stated above.

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

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

CALIFORNIA STATE UNIVERSITY FOUNDATION

PURCHASING AND ACCOUNTS PAYABLE [6]

The California State University Foundation had not executed three written contracts for the procurement of consulting services.

CALIFORNIA STATE UNIVERSITY INSTITUTE

CORPORATE GOVERNANCE [7]

The California State University Institute (Institute) had neither implemented an audit committee nor established a written charter explaining the roles and responsibilities of the committee's members.

PURCHASING AND ACCOUNTS PAYABLE [7]

The Institute had not updated its bank signature cards to revoke the check signing authority of certain individuals who were no longer associated with the Institute. Also, the certificate of designated representatives for the Institute was outdated. An individual who had retired from California State University service was listed as a designated representative.

INTRODUCTION

BACKGROUND

Education Code §89900 states, in part, that the operation of auxiliary organizations shall be conducted in conformity with regulations established by the Trustees.

Education Code §89904 states, in part, that the Trustees of the California State University (CSU) and the governing boards of the various auxiliary organizations shall:

- ▶ Institute a standard systemwide accounting and reporting system for businesslike management of the operation of such auxiliary organizations.
- ▶ Implement financial standards that will assure the fiscal viability of such various auxiliary organizations. Such standards shall include proper provision for professional management, adequate working capital, adequate reserve funds for current operations and capital replacements, and adequate provisions for new business requirements.
- ▶ Institute procedures to assure that transactions of the auxiliary organizations are within the educational mission of the state colleges.
- ▶ Develop policies for the appropriation of funds derived from indirect cost payments.

The Board of Trustee policy concerning auxiliary organizations was originally adopted in July 1981 in the Resolution of the Committee on Finance (RFIN) 7-81-4. Executive Order 698, *Board of Trustees Policy for The California State University Auxiliary Organizations*, dated March 3, 1999, represents policy of the Trustees addressing CSU auxiliary organization activity and governing the internal management of the system. CSU auxiliary organizations are required to comply with Board of Trustee policy (California Code of Regulations, Title 5, Section 42402 and Education Code, Section 89900).

This executive order requires that the Office of the University Auditor will perform an internal compliance/internal control review of auxiliary organizations. The review will be used to determine compliance with law, including statutes in the Education Code and rules and regulations of Title 5, and compliance with policy of the Board of Trustees and of the campus, including appropriate separation of duties, safeguarding of assets, and reliability and integrity of information. According to Board of Trustee instruction, each auxiliary organization shall be examined on a triennial basis pursuant to procedures established by the chancellor.

PURPOSE

The principal audit objectives were to determine compliance with the Education Code, Title 5, and directives of the Board of Trustees and the Office of the Chancellor and to assess the adequacy of controls and systems. Specifically, we sought assurances that:

- ▶ Legal and regulatory requirements are complied with.
- ▶ Accounting data is provided in an accurate, timely, complete, or otherwise reliable manner.
- ▶ Assets are adequately safeguarded from loss, damage, or misappropriation.
- ▶ Duties are appropriately segregated consistent with appropriate control objectives.
- ▶ Transactions, accounting entries, or systems output is reviewed and approved.
- ▶ Management does not intentionally override internal controls to the detriment of control objectives.
- ▶ Accounting and fiscal tasks, such as reconciliations, are prepared properly and completed timely.
- ▶ Deficiencies in internal controls previously identified were corrected satisfactorily and timely.
- ▶ Management seeks to prevent or detect erroneous recordkeeping, inappropriate accounting, fraudulent financial reporting, financial loss, and exposure.

SCOPE AND METHODOLOGY

Our study and evaluation were conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, and included the audit tests we considered necessary in determining that accounting and administrative controls are in place and operative. The management review emphasized, but was not limited to, compliance with state and federal laws, Board of Trustee policies, and Office of the Chancellor policies, letters, and directives. For those audit tests that required annualized data, fiscal years 2005/06 and 2006/07 were the primary periods reviewed. In certain instances, we were concerned with representations of the most current data; in such cases, the test period was July 1, 2006, to November 2, 2007. Our primary focus was on internal compliance/internal control.

Specifically, we reviewed and tested:

- ▶ Formation of the auxiliary.
- ▶ Functions the auxiliary performs on the campus.
- ▶ Creation and operation of the auxiliary's board.
- ▶ Establishment of policies and procedures based upon sound business practices.
- ▶ Maintenance of "arms-length" in business transactions between the auxiliary and the campus.
- ▶ Campus oversight of auxiliary operations.

Additionally, for the period reviewed, we examined other aspects of compliance of the chancellor's office and each auxiliary with the Education Code and Title 5 as they relate to the operation of CSU auxiliary organizations. Individual codes and regulations added to the scope of our review were identified through an assessment of risk. Similarly, internal controls were included within our scope based upon risk. Therefore, the scope of our review varied from auxiliary to auxiliary.

A preliminary survey of CSU auxiliaries at each campus was used to identify risks. Risk was defined as the probability that an event or action would adversely affect the auxiliary and/or the campus. Our assessment of risk was based upon a systematic process, using professional judgments on probable adverse conditions and/or events that became the basis for development of our final scope. We sought to assign higher review priorities to activities with higher risks. As a result, not all risks identified were included within the scope of our review.

Based upon this assessment of risks, we specifically included within the scope of our review the following:

California State University Foundation

- ▶ Operating and Administrative Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Cash Receipts and Handling
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable
- ▶ Endowment Administration
- ▶ Trusts and Other Liabilities

California State University Institute

- ▶ Operating and Administrative Agreements
- ▶ Corporate Governance
- ▶ Fiscal Compliance
- ▶ Operational Compliance
- ▶ Program Compliance
- ▶ Cash Receipts and Handling
- ▶ Investments
- ▶ Fees, Revenues, and Receivables
- ▶ Purchasing and Accounts Payable

We have not performed any auditing procedures beyond November 2, 2007. Accordingly, our comments are based on our knowledge as of that date. Since the purpose of our comments is to suggest areas for improvement, comments on favorable matters are not addressed.

OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

CALIFORNIA STATE UNIVERSITY FOUNDATION

PURCHASING AND ACCOUNTS PAYABLE

The California State University Foundation (Foundation) had not executed three written contracts for the procurement of consulting services.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the California State University (CSU) system. Section 8.9.5, *Procurement*, states, in part, that the auxiliary should establish a written system that provides for purchases and service contracts to be made within governing board policies, source restrictions, funds availability, and other applicable requirements.

The Foundation vice president stated that failure to execute written contracts was due to oversight.

Operating in the absence of written contracts increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

Recommendation 1

We recommend that the Foundation execute written contracts for the procurement of all current and future services.

Management Response

We concur. The Foundation has already provided additional training regarding procurement procedures and updated its procedures to reflect exceptions to the written contract requirements related to honorariums for training sessions and workshops.

CALIFORNIA STATE UNIVERSITY INSTITUTE

CORPORATE GOVERNANCE

The California State University Institute (Institute) had neither implemented an audit committee nor established a written charter explaining the roles and responsibilities of the committee's members.

Government Code 12586(e) states, in part, that every charitable corporation that receives or accrues in any fiscal year gross revenue of \$2 million or more shall have an audit committee appointed by the board of directors.

The general accounting manager stated that although informal discussions had occurred regarding this issue, no action had been taken by the board to formally establish an audit committee.

Failure to implement an audit committee in accordance with legal mandates increases the risk of misunderstandings and may increase legal liability.

Recommendation 2

We recommend that the Institute implement an audit committee and establish a written charter explaining the roles and responsibilities of the committee's members.

Management Response

We concur. The Institute will appoint an audit committee and establish a written charter defining the roles and responsibilities of the committee's members at its next meeting on March 25, 2008.

PURCHASING AND ACCOUNTS PAYABLE

SIGNATURE AUTHORITY

The Institute had not updated its bank signature cards to revoke the check signing authority of certain individuals who were no longer associated with the Institute.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.1, *Cash*, states that the auxiliary should adopt and annually review governing board policy that identifies signature authority and provides practices for the receipt and disbursement of cash.

The general accounting manager stated that failure to update bank signature cards in a timely manner was due to oversight.

The absence of current bank signature cards increases the risk of misunderstandings and may increase legal liability.

Recommendation 3

We recommend that the Institute ensure current bank signature cards are maintained for all accounts.

Management Response

We concur. The bank signature cards were updated as of December 12, 2007.

AUTHORIZATION OF DISBURSEMENTS

The certificate of designated representatives (those who can act on behalf of the Institute) was outdated.

We found that an individual who had retired from CSU service still had the ability to act on behalf of the Institute, including the authorization of disbursements, execution of contracts, and the approval of all financial transactions.

The *Compilation of Policies and Procedures for California State University Auxiliary Organizations* sets sound business practice guidelines for auxiliary organizations operating within the CSU system. Section 8.9.1, *Cash*, states that the auxiliary should adopt and annually review governing board policy that identifies signature authority and provides practices for the receipt and disbursement of cash.

The general accounting manager stated that failure to update the certificate of designated representatives was due to oversight.

Failure to maintain a current certificate of designated representatives increases the risk of errors, irregularities, and misappropriation of funds.

Recommendation 4

We recommend that the Institute maintain a current certificate of designated representatives.

Management Response

We concur. The certificate of designated representatives for the Institute has been updated as of February 18, 2008.

APPENDIX A: PERSONNEL CONTACTED

Name

Title

OFFICE OF THE CHANCELLOR

Richard P. West	Executive Vice Chancellor and Chief Financial Officer
George Ashkar	Senior Director and Controller, Financial Services
Emil Bautista	Accounts Payable Technician
Robert Eaton	Director of Financing and Treasury
Syrus En	Financial Manager
Terry Hamilton	Accounts Payable Manager
Colleen Nickles	Assistant Vice Chancellor, Financial Services
Sylvia Olivas	General Accounting Manager
Lori Redfearn	Assistant Vice Chancellor, Systemwide Advancement
Lisa Tran	Financial Analyst

CALIFORNIA STATE UNIVERSITY FOUNDATION

Richard P. West	President
Anne Brown	Director of Programs and Services
Lori Redfearn	Vice President
Robert Schiller	Auxiliary Operations Accountant

CALIFORNIA STATE UNIVERSITY INSTITUTE

Richard P. West	Chief Financial Officer
Robert Schiller	Auxiliary Operations Accountant

STATEMENT OF INTERNAL CONTROLS

A. INTRODUCTION

Internal accounting and related operational controls established by the State of California, the California State University Board of Trustees, and the Office of the Chancellor are evaluated by the University Auditor, in compliance with professional standards for the conduct of internal audits, to determine if an adequate system of internal control exists and is effective for the purposes intended. Any deficiencies observed are brought to the attention of appropriate management for corrective action.

B. INTERNAL CONTROL DEFINITION

Internal control, in the broad sense, includes controls that may be characterized as either accounting or operational as follows:

1. Internal Accounting Controls

Internal accounting controls comprise the plan of organization and all methods and procedures that are concerned mainly with, and relate directly to, the safeguarding of assets and the reliability of financial records. They generally include such controls as the systems of authorization and approval, separation of duties concerned with recordkeeping and accounting reports from those concerned with operations or asset custody, physical controls over assets, and personnel of a quality commensurate with responsibilities.

2. Operational Controls

Operational controls comprise the plan of organization and all methods and procedures that are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records.

C. INTERNAL CONTROL OBJECTIVES

The objective of internal accounting and related operational control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting and operational control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgment by management.

D. INTERNAL CONTROL SYSTEMS LIMITATIONS

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting and related operational control. In the performance of most control procedures, errors can result from misunderstanding of instruction, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect to the executing and recording of transactions. Moreover, projection of any evaluation of internal accounting and operational control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate. It is with these understandings that internal audit reports are presented to management for review and use.



Business & Finance Division
401 Golden Shore, 5th Floor
Long Beach, CA 90802-4210

www.calstate.edu

Richard P. West
Executive Vice Chancellor/CFO

562-951-4000
Fax 562-951-4970
rwest@calstate.edu

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FEB 21 2008

THE CALIFORNIA STATE
UNIVERSITY

Date: February 21, 2008
To: Larry Mandel
University Auditor
From: Richard P. West
Executive Vice Chancellor and Chief Financial Officer

Subject: Management Response to Recommendations for Audit Report Number 07-48,
Auxiliary Organizations at Office of the Chancellor

Enclosed are the management responses to the four outstanding audit recommendations pertaining to Audit Report 07-48. Should you have any questions, please feel free to contact Colleen Nickles, Lori Redfearn, or me.

RW:cn

Enclosures

Cc: Colleen Nickles, Assistant Vice Chancellor, Financial Services
Lori Redfearn, Vice President, CSU Foundation

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



Management Response to Recommendations for Audit Report 07-48,
Auxiliary Organizations at Office of the Chancellor

CALIFORNIA STATE UNIVERSITY FOUNDATION

PURCHASING AND ACCOUNTS PAYABLE

Recommendation 1

We recommend that the Foundation execute written contracts for the procurement of all current and future services.

Management Response

We concur. The CSU Foundation has already provided additional training regarding procurement procedures and updated its procedures to reflect exceptions to the written contract requirements related to honorariums for training sessions and workshops.

CALIFORNIA STATE UNIVERSITY INSTITUTE**CORPORATE GOVERNANCE****Recommendation 2**

We recommend that the Institute implement an audit committee and establish a written charter explaining the roles and responsibilities of the committee's members.

Management Response

We concur. The Institute will appoint an Audit Committee and establish a written charter, defining the roles and responsibilities of the committee's members, at its next meeting on March 25, 2008.

PURCHASING AND ACCOUNTS PAYABLE**SIGNATURE AUTHORITY****Recommendation 3**

We recommend that the Institute ensure current bank signature cards are maintained for all accounts.

Management Response

We concur. The bank signature cards were updated as of December 12, 2007.

AUTHORIZATION OF DISBURSEMENTS**Recommendation 4**

We recommend that the Institute maintain a current certificate of designated representatives.

Management Response

We concur. The certificate of designated representatives for the Institute has been updated as of February 18, 2008.



THE CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR

BAKERSFIELD

March 13, 2008

CHANNEL ISLANDS

CHICO

MEMORANDUM

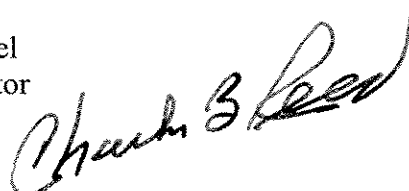
DOMINGUEZ HILLS

EAST BAY

TO: Mr. Larry Mandel
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed 
Chancellor

HUMBOLDT

LONG BEACH

SUBJECT: Draft Final Audit Report 07-48 on *Auxiliary Organizations*,
California State University Office of the Chancellor

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of March 13, 2008, I accept the response as submitted with the draft final report on *Auxiliary Organizations*, California State University Office of the Chancellor.

MONTEREY BAY

NORTHRIDGE

POMONA

CBR/jt

SACRAMENTO

Enclosure

SAN BERNARDINO

cc: Ms. Colleen Nickles, Assistant Vice Chancellor, Financial Services
Ms. Lori Redfearn, Assistant Vice Chancellor, Systemwide Advancement
Mr. Richard P. West, Executive Vice Chancellor and Chief Financial Officer

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS