

**AUXILIARY ORGANIZATIONS**  
**CALIFORNIA STATE UNIVERSITY,**  
**OFFICE OF THE CHANCELLOR**

**Audit Report 10-07**  
**January 25, 2011**

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**BOARD OF TRUSTEES**  
**THE CALIFORNIA STATE UNIVERSITY**

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## CONTENTS

Executive Summary .....	1
Introduction.....	2
Background .....	2
Purpose.....	3
Scope and Methodology .....	3

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## APPENDICES

APPENDIX A:	Personnel Contacted
APPENDIX B:	Statement of Internal Controls
APPENDIX C:	Chancellor's Acceptance

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## ABBREVIATIONS

CSU	California State University
EO	Executive Order
Institute	California State University Institute
RFIN	Resolution of the Committee on Finance

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## 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 (EO) 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 EO 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 the California State University Institute from November 15, 2010, through December 10, 2010, and made a study and evaluation of the system of internal compliance/internal control in effect as of December 10, 2010. This report represents our triennial review.

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. There were no major findings revealed during our review. In our opinion, the accounting and administrative control in effect as of December 10, 2010, taken as a whole, was sufficient to meet the objectives stated above.

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## 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.

The California State University Institute (Institute) was established as a non-profit benefit corporation in 1993 to assist the CSU with the administration of various educationally related functions, special programs, and other activities. The Institute's main function is to issue commercial paper and facilitate lease revenue bonds on behalf of the CSU's 23 campuses, thus raising capital and expediting major projects throughout the university system. The Institute is governed by a board of directors comprised of the chancellor, the executive vice chancellor and chief financial officer, and the executive vice chancellor and chief academic officer. The Institute does not have employees and relies on personnel from the chancellor's office for administrative and accounting support services.

## **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 2008/09 and 2009/10 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, 2010, to December 10, 2010. Our primary focus was on internal compliance/internal control.

Specifically, we reviewed and tested:

- ▶ Formation of the auxiliary.
- ▶ Functions the auxiliary performs at the chancellor's office.
- ▶ 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 chancellor's office.
- ▶ Chancellor's office oversight of auxiliary operations.

Additionally, for the period reviewed, we examined other aspects of compliance of the chancellor's office and the 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.

A preliminary survey of the Institute was used to identify risks. Risk was defined as the probability that an event or action would adversely affect the auxiliary and/or the chancellor's office. 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:

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

We have not performed any auditing procedures beyond December 10, 2010. 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.

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**APPENDIX A:  
PERSONNEL CONTACTED**

**Name**

**Title**

**OFFICE OF THE CHANCELLOR**

Benjamin F. Quillian	Executive Vice Chancellor and Chief Financial Officer
George Ashkar	Assistant Vice Chancellor/Controller, Financial Services
Emil Bautista	Accounts Payable Technician
Robert Eaton	Director of Financing and Treasury
Syrus En	Financial Manager
Jean Gill	Assistant Controller
Sylvia Olivas	General Accounting Manager
Lauri Reilly	Accounts Payable Manager
Lisa Tran	Financial Analyst

**CALIFORNIA STATE UNIVERSITY INSTITUTE**

Benjamin F. Quillian	Chief Financial Officer
Kelly Cox	Senior Accounting Manager
Cindy Gong	Systemwide Accountant
Alice Kim	Enterprise Accounting Supervisor
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.

THE CALIFORNIA STATE UNIVERSITY  
OFFICE OF THE CHANCELLOR

BAKERSFIELD

CHANNEL ISLANDS

January 31, 2011

CHICO

DOMINGUEZ HILLS

**MEMORANDUM**

EAST BAY

TO: Mr. Larry Mandel  
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed  
Chancellor



HUMBOLDT

SUBJECT: Draft Final Report 10-07 on *Auxiliary Organizations*,  
California State University, Office of the Chancellor

LONG BEACH

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of January 31, 2011, I accept the draft final report on *Auxiliary Organizations*, California State University, Office of the Chancellor.

MONTEREY BAY

NORTHRIDGE

POMONA

CBR/amd

SACRAMENTO

SAN BERNARDINO

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS