

**FISMA**

**CALIFORNIA STATE UNIVERSITY  
OFFICE OF THE CHANCELLOR**

**Audit Report 07-10  
April 15, 2008**

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## **ABBREVIATIONS**

CSU	California State University
FISMA	Financial Integrity and State Manager's Accountability Act
GC	Government Code
SAM	State Administrative Manual

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## EXECUTIVE SUMMARY

The California Legislature passed the Financial Integrity and State Manager's Accountability Act (FISMA) of 1983, Government Code (GC) Sections 13400 through 13407. This act requires state agencies to establish and maintain a system of internal accounting and administrative control. To ensure that the requirements of this act are fully complied with, state entities with internal audit units are to complete biennial internal control audits (covering accounting and fiscal compliance practices) in accordance with the *International Standards for the Professional Practice of Internal Auditing* (Institute of Internal Auditors) as required by GC, Section 1236. The Office of the University Auditor of the California State University (CSU) is currently responsible for conducting such audits within the CSU.

Office of the Chancellor management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with GC, Sections 13402 et seq., includes documenting internal control, communicating requirements to employees, and assuring that 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 accounting and administrative control are to provide management with reasonable, but not absolute, assurance that:

- ▶ Assets are safeguarded against loss from unauthorized use or disposition.
- ▶ Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- ▶ Established controls are not only effective but also promote operational efficiency.
- ▶ Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual, Education Code, Title 5, and Trustee policy.

We visited the Office of the Chancellor from November 26, 2007, through January 18, 2008, and made a study and evaluation of the accounting and administrative control in effect as of January 18, 2008. This report represents our biennial review.

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on accounting and administrative controls. However, we did identify other reportable weaknesses that are described in the executive summary and body of this report.

In our opinion, the Office of the Chancellor's accounting and administrative control in effect as of January 18, 2008, 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.

### **PURCHASING [6]**

The Office of the Chancellor's procurement card policy needed strengthening. Specifically, the policy did not clearly define all categories of prohibited or unauthorized purchases such as Human Resources' regular payment of a three-year service contract for temporary employee services.

### **FIXED ASSETS [7]**

Lost items were not reported correctly on property survey reports. A review of the May 2006 equipment inventory disclosed that 110 of 118 unlocated items were surveyed as obsolete rather than as lost. Fifty-six items of these items were considered sensitive items and included laptop computers.

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## INTRODUCTION

### **STATEMENT OF INTERNAL CONTROLS**

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. The ultimate responsibility for good internal control rests with management.

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, personnel of a quality commensurate with responsibilities, and an effective system of internal review.

#### 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.

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.

Experience indicates that the existence of certain danger signals will usually be indicative of a poorly maintained or vulnerable control system. These symptoms may apply to the organization as a whole or to individual units or activities, and generally include any of the following danger signals:

- ▶ Policy and procedural or operational manuals are either not currently maintained or are non-existent.
- ▶ Lines of organizational authority and responsibility are not clearly articulated or are non-existent.
- ▶ Financial and operational reporting is not timely and is not used as an effective management tool.
- ▶ Line supervisors ignore or do not adequately monitor control compliance.
- ▶ No procedures are established to assure that controls in all areas of operation are evaluated on a reasonable and timely basis.

- ▶ Internal control weaknesses detected are not acted upon in a timely fashion.
- ▶ Controls and/or control evaluations bear little relationship to organizational exposure to risk of loss or resources.

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.

### **PURPOSE**

The principal audit objective was to assess the adequacy of controls and systems to ensure that:

- ▶ Cash receipts are processed in accordance with laws, regulations, and management policies.
- ▶ Receivables are promptly recognized and balances are periodically evaluated.
- ▶ Purchases are made in accordance with laws, regulations, and management policies.
- ▶ Operating fund disbursements are authorized and processed in accordance with laws, regulations, and management policies.
- ▶ Cash disbursements are properly authorized and made in accordance with established procedures, and adequate segregation of duties exists.
- ▶ Payroll/personnel criteria for hiring employees, establishing compensation rates, and authorizing disbursements are controlled and access to personnel and payroll records and processing areas are restricted.
- ▶ Purchase and disposition of fixed assets are controlled and assets are promptly recorded in the subsidiary records.
- ▶ Fiscal information systems are adequately controlled and safeguarded, and adequate segregation of duties exists.
- ▶ Investments are adequately controlled and securities are safeguarded.
- ▶ Trust funds are established in accordance with State University Administrative Manual guidelines.

## **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 year 2006/07 was the primary period 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 September 30, 2007. Our primary focus was on internal controls. Specifically, we reviewed and tested:

- ▶ Procedures for receipting and storing cash, segregation of duties involving cash receipting, and recording of cash receipts.
- ▶ Establishment of receivables and adequate segregation of duties regarding billing and payment of receivables.
- ▶ Approval of purchases, receiving procedures, and reconciliation of expenditures to State Controller's balances.
- ▶ Limitations on the size and types of operating fund disbursements.
- ▶ Use of petty cash funds, periodic cash counts, and reconciliation of bank accounts.
- ▶ Authorization of personnel/payroll transactions and accumulation of leave credits in compliance with state policies.
- ▶ Posting of the property ledger, monthly reconciliation of the property to the general ledger, and physical inventories.
- ▶ Access restrictions to accounting systems and related computer facilities/equipment, and administration of information technology operations.
- ▶ Procedures for initiating, evaluating, and accounting for investments.
- ▶ Establishment of trust funds, separate accounting, adequate agreements, and annual budgets.

We have not performed any auditing procedures beyond January 18, 2008. 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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## **OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES**

### **PURCHASING**

The Office of the Chancellor's procurement card policy needed strengthening.

Specifically, the policy did not clearly define all categories of prohibited or unauthorized purchases such as Human Resources' regular payment of a three-year service contract for temporary employee services.

The chancellor's office *Procurement Card Manual*, dated February 20, 2007, states that the procurement card is strictly prohibited for service agreements (no annual maintenance) or ongoing contracts.

Executive Order 760, *Procurement Cards*, dated October 16, 2000, states that the chief financial officer of each campus is responsible for developing and maintaining policies and procedures governing the use of the procurement card and that campus practices should ensure strong internal controls that mitigate procurement card abuses, comply with Trustee policy, ensure observance of good business practices, and provide appropriate checks and balances.

The assistant director of purchasing stated that temporary work and the payment of related charges with the procurement card were not considered an ongoing service that was automatically renewed by the merchant.

Failure to maintain comprehensive policies and procedures compromises internal controls and increases the risk of inappropriate expenditures and losses.

#### **Recommendation 1**

We recommend that the chancellor's office strengthen existing policies and procedures for procurement cards and more clearly define the categories of prohibited or unauthorized purchases.

#### **Management Response**

We concur. The chancellor's office will review its existing policies and procedures for procurement cards and strengthen them, where needed, and more clearly define the categories of prohibited or unauthorized purchases. This will be completed no later than July 31, 2008.

## **FIXED ASSETS**

Lost items were not reported correctly on property survey reports.

Our review of the May 2006 equipment inventory disclosed that 110 of 118 unlocated items were surveyed as obsolete rather than as lost. Fifty-six of these items were considered sensitive and included laptop computers.

State Administrative Manual (SAM) §8643 states that whenever property is lost, stolen, or destroyed, the department will adjust its property accounting records and retain the property survey report as documentation.

SAM §8600 states that property accounting procedures are designed to maintain uniform accountability for state property. These standard procedures are used to provide accurate records for the acquisition, maintenance, control, and disposition of property. The combination of accurate accounting records and strong internal controls must be in place to protect against and detect the unauthorized use of state property.

The budget director stated that many of the items held a zero value at the time of the physical inventory and it was believed that the items could be surveyed as obsolete.

Failure to accurately account for lost items reduces accountability over state property and increases the risk of theft and/or loss of state property.

### **Recommendation 2**

We recommend that the chancellor's office ensure that property survey reports are properly completed and lost items are accurately reflected.

### **Management Response**

We concur. To strengthen our property policies in the recording of lost items, the property manual has been revised to include a new Lost/Stolen California State University (CSU) Asset form. To reinforce the importance of the proper handling of CSU assets, the manual is being distributed to all chancellor's office staff. In addition, the employee's responsibility in the reporting of lost/stolen assets will be discussed at the upcoming property inventory coordinators' meeting. This will be completed no later than July 31, 2008.

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## APPENDIX A: PERSONNEL CONTACTED

<u>Name</u>	<u>Title</u>
Richard P. West	Executive Vice Chancellor and Chief Financial Officer
Amy Ahearn	Financial Information Systems Administrator
George Ashkar	Senior Director and Controller, Financial Services
Lillian Audet	Revenue Management Program Accounting Supervisor
Robert Boyhan	Director of Operations
Sean Boylan	Cash Management Operations Officer
Ben Cheng	Manager of Financial Systems, Internal Control and Compliance
Jolene Colman	International Programs Secretary
Kelly Cox	Enterprise Accounting Manager
Mark Crase	Senior Director, Technical Infrastructure
Joyce Cury	Student Fund Coordinator, International Programs
Tracy Daniels	Administrative Assistant, Financial Services
Robert Eaton	Financial Manager, Finance and Treasury
David Ernst	Assistant Vice Chancellor, Information Technology Services (At time of review)
Ellyce Gordon	Property Clerk
Martha Guiditta	Administrative Support Specialist, Operations
Terry Hamilton	Accounts Payable Manager (At time of review)
Sedong John	Associate Director, Systemwide Financial Reporting
Alice Kim	Enterprise Accounting Supervisor
Thoa Le	Budget Director
Lorena Martinez	Administrative Assistant, Financial Services
Linda Masterton	Assistant Director, Purchasing
Mike McLean	Information Technology Services, Chief of Staff
Colleen Nickles	Assistant Vice Chancellor, Financial Services
Sharon Okashima	Assistant Director of Finance, International Programs
Sylvia Olivas	General Accounting Manager
Sherry Pickering	General Accounting Manager
Pat Ritchie	Payroll and Data Manager
Jason Solis	Associate Director, Network Support Services
Jason Stanton	Program Coordinator, CalState TEACH Program
Jan Terborg	Campus Relations Administrator
Joselyn Zamora	Human Resources Assistant



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

[www.calstate.edu](http://www.calstate.edu)

**Richard P. West**  
Executive Vice Chancellor/CFO

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

**Date:** May 1, 2008

**To:** Larry Mandel  
University Auditor

**From:** Richard R. West  
Executive Vice Chancellor and Chief Financial Officer

**Subject:** Management Response to Recommendations for Audit Report Number 07-10,  
*FISMA at the Office of the Chancellor*

Enclosed are the management responses to the two outstanding audit recommendations pertaining to Audit Report 07-10. Should you have any questions, please feel free to contact Colleen Nickles or me.

RW:cn

Enclosures

Cc: Colleen Nickles, Assistant Vice Chancellor, Financial Services

RECEIVED  
UNIVERSITY AUDITOR

JUL - 8 2008

THE CALIFORNIA STATE  
UNIVERSITY

**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 Number 07-10,  
*FISMA at Office of the Chancellor***

**PURCHASING**

**Recommendation 1**

We recommend that the chancellor's office strengthen existing policies and procedures for procurement cards and more clearly define the categories of prohibited or unauthorized purchases.

**Management Response**

We concur. The CO will review its existing policies and procedures for procurement cards and strengthen them, where needed, and more clearly define the categories of prohibited or unauthorized purchases. This will be completed no later than July 31, 2008.

**FIXED ASSETS**

**Recommendation 2**

We recommend that the chancellor's office ensure that property survey reports are properly completed and lost items are accurately reflected.

**Management Response**

We concur. To strengthen our property policies in the recording of lost items, the property manual has been revised to include a new Lost/Stolen CSU Asset form. To reinforce the importance of the proper handling of CSU assets, the manual is being distributed to all Chancellor's Office staff. In addition, the employee's responsibility in the reporting of lost/stolen assets will be discussed at the upcoming property inventory coordinators' meeting. This will be completed no later than July 31, 2008.

  
**THE CALIFORNIA STATE UNIVERSITY**  
 OFFICE OF THE CHANCELLOR

BAKERSFIELD

July 24, 2008

CHANNEL ISLANDS

CHICO

**MEMORANDUM**

DOMINGUEZ HILLS

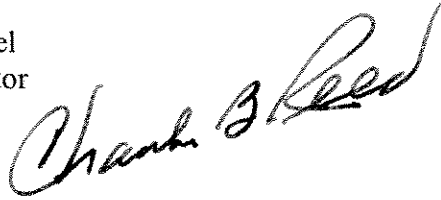
EAST BAY

FRESNO

TO: Mr. Larry Mandel  
University Auditor

FULLERTON

FROM: Charles B. Reed  
Chancellor



HUMBOLDT

LONG BEACH

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

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of July 24, 2008, I accept the response as submitted with the draft final report on *FISMA*, 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  
Mr. Richard P. West, Executive Vice Chancellor and Chief Financial Officer

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS