

AGENDA

COMMITTEE ON AUDIT

Meeting: 4:35 p.m., Tuesday, March 12, 2002
CSU, Sacramento - University Union Ballroom

Shailesh J. Mehta, Chair
Stanley T. Wang, Vice Chair
Daniel N. Cartwright
Murray L. Galinson
Harold Goldwhite
Ricardo F. Icaza
Frederick W. Pierce IV

Consent Items

Approval of Minutes of Meeting of January 29, 2002

Discussion Items

1. Status Report on Current and Follow-up Internal Audit Assignments,
Information

**MINUTES OF THE MEETING OF
COMMITTEE ON AUDIT**

**Trustees of The California State University
Office of the Chancellor
Glenn S. Dumke Conference Center
401 Golden Shore
Long Beach, California
January 29, 2002**

Members Present

Stanley T. Wang, Vice Chair
Daniel N. Cartwright
Harold Goldwhite
Frederick W. Pierce IV

Other Trustees Present

Laurence K. Gould, Jr., Chair of the Board
William D. Campbell
Martha C. Fallgatter
Debra S. Farar
Robert Foster
William Hauck
Charles B. Reed, Chancellor
Erene S. Thomas
Kyriakos Tsakopoulos

Chancellor's Office Staff

Louis Caldera, Vice Chancellor, University Advancement
Christine Helwick, General Counsel
Larry Mandel, University Auditor
Jackie McClain, Vice Chancellor, Human Resources
David S. Spence, Executive Vice Chancellor and Chief Academic Officer
Richard P. West, Executive Vice Chancellor and Chief Financial Officer

Vice Chair Wang called the meeting to order at 4:12 p.m.

Approval of Minutes

The minutes of the meeting of November 13, 2001, were approved as submitted.

Status Report on Current and Follow-up Internal Audit Assignments

Mr. Mandel presented the item by reporting the status of the following audit assignments and follow-up reviews:

FISMA – Five audits have been completed, report writing is being completed on three campus reviews, while fieldwork is currently taking place at three campuses.

Auxiliary Organizations – Audits have been completed at two campuses/five auxiliaries, three campuses/eleven auxiliaries await a campus response prior to finalization, report writing is being completed on one campus/four auxiliary reviews, while fieldwork is currently taking place at one campus/four auxiliaries.

Delegations of Authority – Three audits have been completed, two audits await a campus response prior to finalization, while report writing is being completed on five campus reviews.

Contracts and Grants – Three audits have been completed, two audits await a campus response prior to finalization, while report writing is being completed on five campus reviews.

Development – Three audits have been completed, two audits await a campus response prior to finalization, while report writing is being completed on five campus reviews.

As per the audit plan, audits will be performed for the subject areas at about ten campuses each this year – approximately 24 auxiliary organizations and 11 FISMA audits.

Follow-up – Currently tracking 40 prior audits (FISMA, Auxiliary Organizations, Continuing Education, Student Health Centers, Hazardous Materials Management, and Public Safety) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

Construction – For fiscal year 2001/02, six construction projects are being reviewed by KPMG with coordination from the Office of the University Auditor. Report writing is being completed on one construction project, while fieldwork continues on two construction projects. For fiscal year 2000/01, follow-ups to recommendations have been completed on two construction projects, while follow-ups are pending on four construction projects.

Mr. Mandel stated that a Special Investigations column was added to the Status Report on Current and Follow-Up Internal Audit Assignments, under the Follow-Up on Past/Current Assignments section, to indicate the two special investigations that were conducted.

Mr. Mandel commended the campuses for their diligence in completing the follow-up process in a timely manner. He noted that only two recommendations still remained outstanding for longer than twelve months and indicated that one would be completed as a result of an item on the agenda of the Committee on Educational Policy.

Trustee Wang thanked the Office of the Chancellor, the Office of the University Auditor, and the campuses for their efforts in completing the outstanding recommendations.

Assignment of Functions to be Reviewed by the Office of the University Auditor for Calendar Year 2002

Trustee Wang noted that the second item to be addressed would be the assignment of functions to be reviewed in calendar year 2002.

Mr. Mandel indicated that at the January meeting of the Board of Trustees, the Committee on Audit selects the three subject area audit assignments for the Office of the University Auditor (OUA) and approves the audit plan for the year. He explained that in addition to the subject area assignments, financial internal control (FISMA) reviews and Auxiliary Organizations reviews are planned for calendar year 2002. Mr. Mandel noted that approximately 75 reviews of campuses/CO/auxiliary organizations are included in the 2002 audit plan.

Mr. Mandel stated that a risk assessment is conducted once every three years. He further stated that calendar year 2002 is the third year in which the results from the 1999 risk assessment were used to assist in the selection of the audit assignments. He explained that Audit Item 2 lists 27 prospective audit topics that represent the top 50 percent of risk and indicates the time last audited by the OUA. He stated that based on the risk assessment, subject areas reviewed in the recent past, and discussion with the Executive Audit Committee, which is represented by four California State University (CSU) presidents and the Executive Vice Chancellor/Chief Financial Officer, the following three subject areas were recommended for consideration for calendar year 2002: Development, which would be continuing from calendar year 2001, Financial Aid, and Disability Support and Accommodations.

Trustee Wang recognized Ms. Kathleen Kaiser as a representative for Academic Senate who wished to address the Committee on Audit.

Ms. Kaiser expressed her concern that a group of campuses are arguing that Title IX has been discriminatory against males and that intercollegiate athletics has never been audited. She inquired as to whether this would be considered a risk.

Mr. Mandel explained that Title IX was reviewed more than ten years ago; however, it was considered separate from an intercollegiate athletics review. He stated that intercollegiate athletics was not recommended for review because there are other NCAA reviews conducted of intercollegiate athletics and it would not be the best use of our resources at this time.

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Chancellor Reed stated that the CSU has a Title IX committee, chaired by President Welty. He further stated that currently, out of the 23 campuses, only 3 are not in compliance. He indicated, however, that of these three, the one large institution still outstanding would be in compliance in the near future.

Trustee Pierce inquired as to whether the prospective audit topics were in any kind of rank order.

Mr. Mandel responded affirmatively that the audit topics are listed in rank order.

As to the selection of audit topics, Trustee Pierce expressed his concern that Employee Relations has never been reviewed; yet it appears to be one of CSU's biggest areas of litigation exposure. He inquired as to whether it would be more beneficial to review Employee Relations rather than Disability Support and Accommodations.

Mr. Mandel explained that due to the Employee Relations area being so interconnected with collective bargaining, it was not an area considered for review at this time.

Trustee Goldwhite inquired as to whether three subject areas would be the limit for calendar year 2002 due to the resources available in the OUA.

Mr. Mandel responded affirmatively.

Trustee Wang asked for a vote on the motion before the Committee on the selection of audit assignments for calendar year 2002.

Trustee Goldwhite moved that Development, Financial Aid, and Disability Support and Accommodations be the three subject areas for review. The motion was approved.

Mr. Mandel stated that in order to accommodate the three subject areas, the FISMA area, the auxiliary area, and to perform as many special investigations as in the past year, it would dictate that the OUA would require an additional auditor position. He further stated that in knowing the current economic conditions, an additional position would not be requested at this time. He indicated, however, that depending on the amount of special investigations conducted by OUA in calendar year 2002, it is conceivable that the entire audit plan would not be completed.

Report of the Systemwide Audit in Accordance with Generally Accepted Accounting Principles Including the Report to Management

Trustee Wang noted that the third item to be addressed would be the systemwide audit report. He then introduced Mr. Richard West and Mr. Mark Thomas, partner in charge, KPMG.

Mr. West introduced Mr. Thomas and indicated that Mark would present the annual report on the financial statements.

Mr. Thomas stated that the Single Audit Report is a review that is required by the federal government, specifically of federal funds. He indicated that the CSU proper, not counting the auxiliary organizations, receives almost a billion dollars in federal funds, over 90 percent of that being student financial aid; the remaining portion of the money relates to sponsored programs, primarily related to San Francisco State University. He explained that the remainder of the research and development is handled primarily through the auxiliary organizations, specifically the foundations of the CSU. He stated that based on KPMG's review, the CSU is in compliance with the requirements of the programs, with the exception of five findings. He explained that the first finding relates to a requirement that a system for verification of payroll costs that are charged to sponsored programs be maintained. He further explained that the second finding relates to the filing of a disclosure statement regarding accounting practices. He stated that because San Francisco State University exceeded the \$25-million threshold, filing a disclosure statement is a new requirement with which they must comply. He further stated that a corrective action plan has been prepared by the CSU that includes two corrective action statements from San Francisco State University, as well as three additional findings related to student financial aid at CSU Los Angeles, San Diego State University, and CSU Long Beach. He stated that KPMG has reviewed the corrective action plan and agrees that the corrective action as stated is appropriate.

Mr. Thomas proceeded to present The Combined Financial Statements of The California State University. He indicated that KPMG's unqualified opinion on the financial statements is located on pages 1 and 2 of the financial statements. He explained that the balance sheet indicates that the CSU as a whole has over \$8-billion in assets, about \$6.7 billion of that in fixed assets, or plant at historical cost; the remaining portion relates to cash and investments. He further explained that the primary area of the liability section is long-term debt related to the facilities in your CSU construction program. He also explained that the Statement of Changes in Fund Balances and Net Assets indicates that the CSU as a whole had approximately a \$400-million increase in revenues, and the auxiliary organizations had an additional \$160-million revenue increase. He noted that there were strong increases both in state appropriations and auxiliary organizations, especially for development and endowment activities. He also noted that expenses increased at about the same rate as the revenues, with the larger increases relating to the educational and general expenses. The majority of the overall increase in fund balances for the CSU of \$384 million relates to the property, plant, and equipment in the buildings that occurred in the year. He mentioned that the footnotes to the financial statements include information regarding the change in plant, the change in debt, and the activity in the year.

Mr. Thomas stated that the format of the financial statements would change with the issuance of the financial statements next year. He further stated that the Governmental Accounting Standards Board (GASB) has rewritten the format, which will be very similar to the model utilized by not-for-profit corporations, and the way the financial operations will be measured for the CSU. He explained that the new format will encompass a whole new basis of accounting, for example, assets will be depreciated differently; there will be additional calculations and fair value assessments; and infrastructure will be included in fixed assets. He indicated that a

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Financial Standards and Advisory Committee has been created by the CSU, where every campus is represented on the committee. He further indicated that the 45-member committee has put forth great effort to convert the CSU financial statements from the legal basis of accounting to the new Generally Accepted Accounting Principles (GAAP). He stated that the adjustments that are booked as part of the preparation for the review are related 98 percent to that conversion process of getting from a legal basis of accounting to a GAAP basis of accounting.

Mr. Thomas commented that if KPMG were to have any disagreements with management about the financial reporting issues and the financial statements, they would be discussed at this time. He further commented that there have been discussions with management about the application of accounting principles and the appropriate application for the CSU, but there have been no disagreements with management.

Trustee Hauck commented that he was happy to hear Mr. Thomas's comments in light of recent national events.

Chancellor Reed thanked the Board of Trustees for their continued commitment to these financial audits. He believes that this is very important to an earlier discussion about debt management and bond rating companies and the fact that we were able to share this information with the rating companies. He referred to the financial statement footnotes that indicate that there are 80 auxiliary organizations that are not reviewed by KPMG. He stated that KPMG accepts the audits conducted by those organizations, but stated his concern that this is probably the CSU's largest risk. He indicated that the OUA will continue to conduct audits of the auxiliary organizations and stated that significant progress has been made this year and the last couple of years. He stated that the CSU and KPMG would continue to focus on the findings included in the Single Audit Report, as well as the corrective action plan. He also stated that as the CSU grows and receives additional federal funds, risks would continue. He stated that he was very satisfied with the corrective action that the institutions have proposed and will follow up on the corrective action statements in a similar way as the OUA follows up on internal audits.

Trustee Wang expressed his concern as to whether the five recommendations in the corrective action plan would be properly closed in a timely manner and inquired as to whether an additional report would be issued stating such.

Mr. West stated that a verbal report would be presented at a future Board meeting indicating that all recommendations have been concluded. He further stated that San Francisco State University has reacted quickly to the closure of their recommendations. He indicated that KPMG has reviewed those two issues and reported that they are now in compliance.

Trustee Wang thanked everyone for a very good report and a job well done.

The meeting was adjourned at 4:40 p.m.

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

Presentation By

Larry Mandel
University Auditor

Summary

This item includes both a status report on the 2002 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Auxiliary Organizations, Development, Financial Aid, Disability Support and Accommodations, Information Systems, and Construction. In addition, follow-up on past assignments (Special Investigations, FISMA, Auxiliary Organizations, Student Health Centers, Hazardous Materials Management, Public Safety, Development, Contracts and Grants, and Delegations of Authority) is currently being conducted on approximately 55 prior campus/auxiliary reviews. Attachment A, summarizing the reviews in tabular form, will be distributed at the committee meeting.

Status Report on Current and Follow-up Internal Audit Assignments

At the January 2002 meeting of the Committee on Audit, an audit plan calling for the review of the following subject areas was approved: FISMA (financial internal controls), Auxiliary Organizations, Development, Financial Aid, Disability Support and Accommodations, Information Systems, and Construction.

FISMA

The audit plan indicated that approximately 136 staff weeks of activity (17 percent of the plan) would be devoted to auditing financial internal controls on 12 campuses. Report writing is being completed on two campus reviews, while fieldwork is currently taking place at four campuses.

Auxiliary Organizations

The audit plan indicated that approximately 261 staff weeks of activity (32 percent of the plan) would be devoted to auditing internal compliance/internal control at 9 campuses/29 auxiliaries. Fieldwork is currently taking place at two campuses/five auxiliaries.

Development

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of 10 campuses on cash contributions and donations of property and services, controls over the analysis of development needs, identification of prospective donors, solicitation and acknowledgment of donations, valuation of nonmonetary donations, recording gifts and posting to accounting records, expending donated funds, and preparation of reports on development activity. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Financial Aid

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of 10 campuses on identification of financial aid resources, establishing student budgets, packaging financial aid awards, coordinating financial aid benefits, managing financial aid funds, complying with federal and state program requirements, securing financial aid applicant information, and preparing financial aid reports. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Disability Support and Accommodations

The audit plan indicated that approximately 97 staff weeks of activity (12 percent of the audit plan) would be devoted to a review of 10 campuses on CSU programs for disabled employees, students and visitors. This would include accessibility of facilities, provision of enabling supportive services and use of adaptive technologies. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

Information Systems

The audit plan indicated that approximately 43 staff weeks of activity (5 percent of the plan) would be devoted to review of systemwide projects such as: Disaster Recovery, Collaborative Management Systems (CMS), and Web Security. In addition, support will be provided in the area of financial internal controls for both campus (FISMA) and auxiliary audits. Review and training are ongoing.

Follow-ups

The audit plan indicated that approximately 26 staff weeks of activity (3 percent of the plan) would be devoted to follow-up on prior audit recommendations. The Office of the University Auditor is currently tracking approximately 55 prior audits (Special Investigations, FISMA, Auxiliary Organizations, Student Health Centers, Hazardous Materials Management, Public Safety, Development, Contracts and Grants, and Delegations of Authority) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

Consultations and Investigations

The audit plan indicated that approximately 43 staff weeks of activity (5 percent of the plan) would be devoted to campus consultations and special requests. The Office of the University Auditor is periodically called upon to provide consultation to the campuses and/or to perform special audit requests made by the Chancellor. Typically, the special requests are investigative in nature and often are the result of alleged defalcations or conflicts of interest.

Construction

The audit plan indicated that approximately 5 staff weeks of activity (1 percent of the plan) would be devoted to coordination of construction auditing. For the 2001/02 fiscal year, six construction projects are being reviewed by KPMG with coordination from the Office of the University Auditor. Areas under review include change orders, project management services, contractor compliance, liquidated damages, close-out documents, and cost verification of major equipment and construction components. Report writing is being completed on three projects, while fieldwork is currently taking place on two projects.

Training

The audit plan indicated that approximately 6 staff weeks of activity (1 percent of the plan) would be devoted to training in control self-assessment. A Management Risk Assessment and Assurance program has been developed and is being implemented at those campuses indicating an interest in such a program during 2002. The proposed program consists of individual workshops where risk assessment/mitigation and internal control training will be provided and a targeted risk assessment profile will be developed. The program has been initiated at three campuses with two more in the planning stage.