

AGENDA

COMMITTEE ON AUDIT

Meeting: 8:00 a.m., Wednesday, July 20, 2005
Glenn S. Dumke Auditorium

Raymond W. Holdsworth, Chair
Herbert L. Carter, Vice Chair
Roberta Achtenberg
Debra Farar
Bob Foster
George G. Gowgani
William Hauck

Consent Items

Approval of Minutes of Meeting of May 11, 2005

Discussion Items

1. Status Report on Current and Follow-up Internal Audit Assignments, *Information*
2. Selection of the External Auditor for the California State University System, *Action*

**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**

May 11, 2005

Members Present

Roberta Achtenberg, Chair
Herbert L. Carter
Debra S. Farar
Bob Foster
William Hauck
Raymond W. Holdsworth

Trustee Achtenberg called the meeting to order.

Approval of Minutes

The minutes of the meeting of March 15, 2005, were approved as submitted.

Status Report on Current and Follow-up Internal Audit Assignments

Mr. Larry Mandel, university auditor, presented the Status Report on Current and Follow-up Internal Audit Assignments, Agenda Item 1 of the May 10-11, 2005, Board of Trustees agenda.

Mr. Mandel reported that most of the campuses have completed the outstanding recommendations in a timely manner. He noted that documentation demonstrating the completion of the remaining outstanding recommendation pertaining to Auxiliary Organizations at California State University, Chico had been recently submitted and was currently being reviewed by Office of the University Auditor management.

Trustee Kaiser commended the campus presidents and their staffs for the tremendous effort in the completion of the outstanding recommendations, and noted appreciation for the leadership provided by the university auditor.

Due to vacant positions, together with recruitment challenges, Mr. Mandel requested an amendment to the 2005 audit plan, deleting Student Records and Registration as one of the three subjects areas for review. He explained that a three-year risk assessment would be completed at the end of this year to determine the areas of highest risk to the system. At that time, Student

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Records and Registration would once again be evaluated on its level of risk in relation to other prospective topics for the selection of audit assignments.

Mr. Mandel further explained the necessity for the amendment to the audit plan. He stated that there are several vacant positions currently on the audit staff, including changes in audit managers. He noted that one audit manager transferred to a different position within the chancellor's office and the other would be retiring at the end of the month. Two candidates were offered the audit manager position; however, after researching the California real estate market, each regrettably had to decline the offer, delaying the recruitment process. In order to assist with the recruitment of the audit managers, the possibility of retaining an executive search firm is being considered.

Mr. Mandel commented that due to Sarbanes Oxley, recruitment of field auditors has also proven challenging and time-consuming. He noted that corporations are offering higher salaries with no travel commitment, making it very difficult to compete with given the travel requirement at the California State University (CSU). Mr. Mandel assured the Committee that efforts would continue in the recruitment of audit staff.

Chancellor Reed noted that he and Mr. Mandel had discussed the recruitment challenges and the possibility of deleting Student Records and Registration from the 2005 audit plan. He reiterated Mr. Mandel's concerns regarding Sarbanes Oxley and the CSU's travel requirement for field auditors, noting that further discussions would take place regarding the management of travel time. Chancellor Reed then suggested that a motion be made to amend the 2005 audit plan to exclude Student Records and Registration.

Both Trustee Galinson and Trustee Holdsworth suggested that retired, semi-retired, or local auditors specific to a campus area be considered on a temporary basis to help with the travel issue.

Trustee Guzman Moore commented on the importance of reflecting on the record that an executive search firm would be used to assist in the recruitment of two audit managers.

The Committee on Audit voted unanimously to amend the 2005 audit plan to delete Student Records and Registration as one of the three subject areas for review.

Trustee Achtenberg adjourned the meeting.

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 2005 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, Continuing Education, Housing/Residential Services, Information Systems, and Construction. In addition, follow-up on past assignments (FISMA, Auxiliary Organizations, Admissions, Human Resources, and Student Activities) is currently being conducted on approximately 25 prior campus/auxiliary reviews. Attachment A summarizes the reviews in tabular form. An up-to-date Attachment A will be distributed at the Committee meeting.

Status Report on Current and Follow-up Internal Audit Assignments

At the January 2005 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, Continuing Education, Housing/Residential Services, Student Records and Registration, Information Systems, and Construction. At the May 2005 meeting of the Committee on Audit, Student Records and Registration was deleted from the audit plan due to difficulties in recruiting the necessary staff.

FISMA

The initial audit plan indicated that approximately 132 staff weeks of activity (17 percent of the plan) would be devoted to auditing financial internal controls on 12 campuses. One audit has been completed, while report writing is being completed on four campus reviews.

Auxiliary Organizations

The initial audit plan indicated that approximately 241 staff weeks of activity (29 percent of the plan) would be devoted to auditing internal compliance/internal control at 8 campuses/27 auxiliaries. One campus/three auxiliaries await a response prior to finalization, while report writing is currently being completed for two campuses/nine auxiliaries.

Continuing Education

The initial audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of ten campuses to ensure proper management of the processes for administration of continuing education and extended learning operations as self-supporting entities; budgeting procedures, fee authorizations, and selection and management of courses; faculty workloads and payments to faculty and other instructors; enrollment procedures and maintenance of student records; and reporting of continuing education activity and maintenance of CERF contingency reserves. Report writing is being completed on one campus review, and fieldwork is taking place at one campus.

Housing/Residential Services

The initial audit plan indicated that approximately 97 staff weeks of activity (12 percent of the plan) would be devoted to a review of ten campuses to ensure proper management of on-campus residence halls and the programming of activities for residential students; support of activities afforded students in locating suitable housing; review of Dormitory Revenue Fund Operations and residence hall costs; processes for establishing housing fees; and maintenance of residence halls. Report writing is being completed on two campus reviews, and fieldwork is currently taking place at two campuses.

Student Records/Registration

The initial audit plan indicated that approximately 97 staff weeks of activity (12 percent of the audit plan) would be devoted to a review of ten campuses to ensure proper administration of database recordkeeping and registration systems; procedures for creating and changing records; and security measures protecting against unauthorized or inadvertent modification, removal or destruction of records. Vacant positions, together with recruitment challenges, have necessitated the deletion of this subject from the audit plan.

Information Systems

The initial 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, Common 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 28 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 25 prior audits (FISMA, Auxiliary Organizations, Admissions, Human Resources, and Student Activities) 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 76 staff weeks of activity (9 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. In addition, whistleblower investigations will now be performed on an ongoing basis, both by referral from the State Auditor, and directly from the chancellor's office.

Construction

The audit plan indicated that approximately five staff weeks of activity (1 percent of the plan) would be devoted to coordination of construction auditing. For the 2004/05 fiscal year, six construction projects are being reviewed by KPMG with coordination from the Office of the University Auditor. Areas under review include construction bid process, change orders, project management services, contractor compliance, liquidated damages, and cost verification of major equipment and construction components. Two audits await a response prior to completion, and four audits are in the report writing stage.

Status Report on Current and Follow-Up Internal Audit Assignments
(as of 7/21/2005)

	2005 ASSIGNMENTS				FOLLOW-UP ON PAST/CURRENT ASSIGNMENTS										
	FISMA	Aux Orgs	Cont Educ	Housing/ Res Svcs	FISMA		Auxiliary Organizations		Admissions		Human Resources		Student Activities		
					*Recs	**Mo.	•No.	*Recs	**Mo.	*Recs	**Mo.	*Recs	**Mo.	*Recs	**Mo.
BAK		RW			13/13	-	3							8/9	5
CHI			RW		6/6	-	3	32/32	-			6/7	5		
CI		AI			23/23	-	2								
DH	RW						3	36/36	-	6/6	-	1/5	4		
EB					17/17	-	4	65/65	-						
FRE		RW			8/8	-	6							3/6	5
FUL					6/6	-	4	32/32	-	4/4	-			5/5	-
HUM				RW	4/4	-	3	53/53	-						
LB				RW	7/7	-	3	27/27	-			5/5	-	5/5	-
LA					7/7	-	4	42/42	-						
MA					0/7	2	2	21/21	-	5/6	7				
MB					25/25	-	2	40/40	-			7/9	7		
NOR					11/11	-	5	46/46	-	2/2	-				
POM			FW		0/11	2	3	24/24	-						
SAC					13/13	-	5	65/65	-			7/7	-		
SB					8/8	-	3	33/33	-	3/3	-	5/5	-		
SD	RW			FW			4	20/21	8	6/6	-				
SF	RW						4	48/48	-			3/3	-	7/8	6
SJ					9/9	-	4	93/93	-	5/5	-				
SLO				FW	10/14	8	2	29/29	-						
SM					12/12	-	3	34/34	-						
SON	RW						4	21/21	-					7/7	-
STA	RW						4	50/50	-					11/11	-
CO					10/10	-	2	10/11	4			2/2	-		
SYS												2/11	2		

FW = Field Work In Progress
RW = Report Writing in Progress
AI = Audit Incomplete (awaiting formal exit conference and/or campus response)
AC = Audit Complete

* The number of recommendations satisfactorily addressed followed by the number of recommendations in the original report.
A "0" in a column is used as a place holder until such time as documentation is provided to the OUA evidencing that a recommendation has been satisfactorily addressed; significant progress may have been made prior to that time.
Numbers/letters in red are updates since the agenda mailout.
**The number of months recommendations have been outstanding (since the formal campus exit conference).
• The number of auxiliary organizations reviewed.

COMMITTEE ON AUDIT

Selection of the External Auditor for the California State University System

Presentation by

Richard P. West
Executive Vice Chancellor and
Chief Financial Officer

Dennis Hordyk
Assistant Vice Chancellor
Financial Services

Summary

The Chancellor's Office issued a request for proposal in April 2005 to solicit proposals from qualified independent public accounting firms for the purposes of establishing a CSU master service contract for the performance of a variety of audit services for the three fiscal years ending June 30, 2006, 2007, and 2008. The proposal includes optional one-year extensions for up to three additional years. The audit services, as set forth in the Scope of Work, include systemwide financial statements, revenue bond audits, campus financial statement audits, federal OMB Circular A-133 audit of federal funds, audit of special entities, and certain other tasks.

In spite of efforts to encourage submissions from as many CPA firms as possible, KPMG was the only bidder. This result appears to be attributable to several factors, including audit market structure and condition, and the complexity of the CSU audit. The lack of viable competition has been a continuing problem over the years, even in the previous RFP process in 2001.

Requirements for Audited Financial Statements

Issuance of audited financial statements for the CSU system is mandatory by statutory requirements including the following:

- California Government Code Section 12440.1 (AB 2613 of 1996)
- Federal OMB Circular A-133 audit of federal funds
- California Government Code Section 12586(e) (Non-Profit Integrity Act of 2004)
- Revenue bond covenants
- Reporting requirements of special entities (CSURMA, Channel Islands Authorities, etc.)

Limiting Factors in the Selection Process

Flexibility in the selection of an audit firm for the CSU system is significantly diminished for the following reasons:

- Need for a single signature on the overall financial statements because of accountability and associated liability
- Experience in higher education with unique rules and issues
- Complexity and size of the CSU system
- Sufficient resources needed to handle the workload, and extensive coordination and communication required
- Oligarchic structure of audit industry and a significant increase in demand for audit services resulting from the Sarbanes-Oxley Act

Background History

Prior to July 1, 1993:

CSU did not issue audited financial statements of its own. The CSU's financial statements were subject only to audit procedures performed in conjunction with the state's financial statements audit.

For fiscal years 1993/94 through 1995/96:

Five campuses were audited initially in 1993/94 and subsequently ten campuses were audited. However, the audit did not include the CSU system as a whole. Coopers & Lybrand was selected as the auditor during this period.

For fiscal years 1996/97 to present:

As a result of the enactment of Chapter 934, Statutes of 1996 (AB 2613), the audit includes the financial statements of the CSU system as a whole, as well as at least ten individual campus stand-alone financial statements each year. Every campus must issue audited stand-alone financial statements at least once every two years.

- For fiscal years 1996/97 through 1999/2000, KPMG was selected over Coopers & Lybrand based on lower cost.
- For fiscal years 2000/01 through 2004/05 (including two one-year optional extensions exercised by the CSU), KPMG was selected again through a new RFP process. KPMG was the only national CPA firm that submitted a proposal. The two small firms also submitted proposals that did not meet the bid requirements and were eliminated from consideration.

Plan for the Future

University staff will seek ways to bring in more competition, including investigation of the possibility of encouraging mid-tier firms to compete for the contract. In the next several years as more corporations in private industry complete implementation of the Sarbanes-Oxley Act, demand for audit services may decline. In discussions with several major and mid-sized audit firms, some indicated that they may be interested in competing for the business at that time.

Adoption of the following resolution is recommended:

RESOLVED, By the Board of Trustees of the California State University, that KPMG LLP be selected as the external audit firm for the University for the three fiscal years ending June 30, 2006, 2007, and 2008 with an option for three one year renewals.