

**LOTTERY FUNDS**  
**CALIFORNIA STATE UNIVERSITY,**  
**EAST BAY**

**Audit Report 14-23**  
**April 22, 2014**

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

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## **ABBREVIATIONS**

Act	The California State Lottery Act of 1984
BOT	Board of Trustees
CFO	Chief Financial Officer
CO	Chancellor's Office
CSU	California State University
EO	Executive Order
FY	Fiscal Year
LF	Lottery Funds
OAAS	Office of Audit and Advisory Services

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## **EXECUTIVE SUMMARY**

As a result of a systemwide risk assessment conducted by the Office of Audit and Advisory Services (OAAS) during the last quarter of 2013, the Board of Trustees, at its January 2014 meeting, directed that *Lottery Funds* (LF) be reviewed. The OAAS has never reviewed lottery funds as a stand-alone audit.

We visited the California State University, East Bay campus from January 27, 2014, through February 28, 2014, and audited the procedures in effect at that time.

In our opinion, except for the effect of the weaknesses described below, the fiscal, operational, and administrative controls for LF activities as of February 28, 2014, taken as a whole, were sufficient to meet the objectives stated in the “Purpose” section of this report. Areas of concern include: budgeting and allocation and campus program expenditures.

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 attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [ ] refer to page numbers in the report.

### **BUDGETING AND ALLOCATION [6]**

The campus was exceeding lottery fund allocation carry-forward limitations. Specifically, the campus had lottery fund carry-forward balances in excess of 80 percent of the annual lottery fund allocation for fiscal years (FY) 2011/12 and 2012/13.

### **CAMPUS PROGRAM EXPENDITURES [6]**

Campus administration of lottery-funded expenditures needed improvement. For example, in FY 2011/12, the campus used lottery funds for special consultant payments and for health benefit costs related to overload compensation for a faculty member. In addition, sales tax on instructional equipment purchases was over-accrued in the lottery fund, and a subsequent credit was not made to properly reflect the actual expense incurred. Also, some expenses had not been approved by an individual authorized by the delegation of fiscal authority. Further, the associate director of financial aid did not have delegation of fiscal authority to authorize lottery-funded scholarship disbursements for the future scholars program.

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## INTRODUCTION

### **BACKGROUND**

The California State Lottery Act (Act) of 1984 directed the lottery administration to provide supplemental funding for the state's public schools and colleges. The Act states that all lottery funds allocated to public education must be considered supplemental to other funds allotted to public education, and that no educational program shall receive less financial support from the state because it receives lottery proceeds.

Most of the lottery funds allocated to public education are given to K-12 and community college districts. In fiscal year (FY) 2012/13, K-12 education received 81 percent of the lottery fund allocation for public education. Community college districts received 13 percent, and the California State University (CSU) received less than four percent.

The CSU's allotment, based on units of full-time-equivalent student enrollment, is given directly to the Board of Trustees (BOT). Since the passage of the Act in 1984, the CSU has received nearly \$1 billion in lottery funds. The annual amount has generally increased each year, and the CSU allocation for FY 2012/13 was \$43.9 million. Some of the funds are retained by the chancellor's office (CO) for use in systemwide programs, but the majority are distributed to the individual campuses for use in enhancing instruction. More than \$30 million was allocated to campuses in FY 2012/13.

The Act has been codified in Government Code §8880. In addition to outlining terms for the administration of lottery games, the legislation addresses the Act's intent to ensure that lottery funds are considered supplemental to state education funding. It also mandates that lottery funds be managed separately from state appropriations and deposited in and expended from the California State Lottery Education Fund. Further, it emphasizes the intent that lottery fund allocations to educational institutions are to be used exclusively for the education of students and specifically prohibits the use of the funds for the acquisition of real property, construction of facilities, financing of research, or any other non-instructional purpose.

The CO Budget Office provides the following written guidance for campus lottery fund allocations:

- ▶ *Lottery Budgeting and Allocation Process* outlines the principles of the Act, including the provisions stating that the funds are supplemental to state appropriations and are intended to be used for instructional purposes. It also provides guidelines for both appropriate and prohibited expenditures; states that lottery funds are to be administered separately from state-appropriated funds; and outlines campus and systemwide reporting requirements for the annual report to the BOT, governor and Legislature. Sections discuss in detail the proper use of lottery funds in campus-based programs and in systemwide programs administered by the CO.
- ▶ *General Guidelines for Expenditures*, dated September 3, 2008, provides more detailed guidelines regarding appropriate lottery fund expenditures, including specific discussion about the use of lottery funds for faculty compensation. The guidelines prohibit using lottery funds to pay faculty for classroom instruction, to fund faculty overloads, or to increase the compensation rate for any staff, but do allow lottery funds to be used for faculty development, in certain circumstances.

- ▶ *Carry-Forward Fund Policy*, dated August 28, 2007, states, in part, that lottery fund allocations should be spent in the year they are allotted, and that excess funds may be subject to de-allocation by the CO. It further states that campuses may carry forward no more than 80 percent of the fiscal year allocation, and that campuses with carry-forward balances will be required to provide to the CO, as part of the financial reporting package, an annual supplemental report addressing the balance.
- ▶ *Process for Reporting Expenditure Plan for Amounts that Exceed Carry-Forward Policy*, dated April 21, 2008, provides campuses with more specific instructions on the treatment and reporting of lottery fund carry-forward balances.

The CSU also has policies for the fiscal management of funding sources, including lottery funds. Executive Order (EO) 1000, *Delegation of Fiscal Authority and Responsibility*, dated July 1, 2007, provides the authority and responsibility for effective oversight of all state funds held by the campuses and all funds held in a fiduciary capacity. Lottery funds are one of the many funding sources for CSU campuses and are, as such, subject to the budget and accounting requirements as outlined in the EO.

## **PURPOSE**

Our overall audit objective was to ascertain the effectiveness of existing policies and procedures related to lottery funds and to determine the adequacy of controls that ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, and campus procedures.

Within the overall audit objective, specific goals included determining whether:

- ▶ Administration of the lottery fund program is well-defined and includes clear lines of organizational authority and responsibility and documented delegations of authority.
- ▶ Policies and procedures related to lottery funds are current, comprehensive, and effectively distributed.
- ▶ The campus is providing accurate and timely lottery fund expenditure information to the CO for annual BOT and state reporting.
- ▶ The allocation process for lottery funds is well-documented and includes appropriate review and approval.
- ▶ The campus is appropriately budgeting and accounting for lottery fund allocations.
- ▶ The campus is properly administering and maintaining appropriate reserves of lottery fund allocations.
- ▶ The campus is complying with programmatic restrictions for funds received for specific CO lottery fund programs.
- ▶ Lottery funds expended in campus-based programs are in compliance with state and CSU requirements and restrictions.

## **SCOPE AND METHODOLOGY**

The proposed scope of the audit as presented in Audit Agenda Item 4 of the January 28 and 29, 2014, meeting of the Committee on Audit stated that *Lottery Funds* includes activities for the budgeting, receipt, accounting, and expenditures of lottery fund proceeds allocated to the campuses. Proposed audit scope could include, but was not limited to, review of campus lottery fund allocation and expenditure policies and procedures to ensure compliance with CSU and state requirements; review of internal campus processes for monitoring, reviewing, and approving campus discretionary allocations to specific programs; and examination of specific programs receiving lottery funding to confirm the expenditures are in conformance with state and CSU restrictions.

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 whether fiscal, operational, and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with federal and state regulations and guidance, Board of Trustee policies, and Office of the Chancellor and campus policies, letters, and directives. The audit focused on procedures in effect from July 1, 2011, through February 28, 2014.

We focused primarily on the internal administrative, compliance, and operational controls over Lottery Funds activities. Specifically, we reviewed and tested:

- ▶ Administration of lottery fund allocations, including defined responsibilities and current policies and procedures.
- ▶ Processes to identify appropriate programs or areas for receipt of campus lottery fund allocations.
- ▶ Budgeting and accounting processes.
- ▶ Administration and reporting of carry-forward balances.
- ▶ Use of lottery fund allocations for administrative expenses.
- ▶ Expenditures from lottery fund allocations.

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## **OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES**

### **BUDGETING AND ALLOCATION**

The campus was exceeding lottery fund allocation carry-forward limitations.

Specifically, we found that the campus had lottery fund carry-forward balances in excess of 80 percent of the annual lottery fund allocation for fiscal years (FY) 2011/12 and 2012/13.

The California State University (CSU) Budget Office *Carry-Forward Fund Policy*, dated August 28, 2007, states that campuses are expected to spend all lottery funds during the fiscal year in which they are allocated. It further states that if a campus does carry forward lottery funds from one fiscal year to the next, the carry-forward amount is limited to no more than 80 percent of that fiscal year's allocation, and that excess funds are subject to de-allocation by the chancellor's office.

The vice president of administration and finance/chief financial officer (CFO) stated that after several years of budget reductions and mid-year reductions, the campus took a conservative approach and held back lottery fund allocations in light of the uncertainty regarding the passage of Proposition 30. He further stated when the need for a mid-year reduction was eliminated, there was not enough time left in the fiscal year to spend the remaining lottery funds.

Excessive carry-forward balances increase the risk that lottery funds are not being used appropriately and expose the campus to the possibility of de-allocation by the chancellor's office.

#### **Recommendation 1**

We recommend that the campus comply with lottery fund allocation carry-forward limitations.

#### **Campus Response**

We agree. Subsequent lottery fund expenditures for FY 2013/14 have reduced the carry-forward balances below the 80 percent threshold as of March 31, 2014. Academic affairs has implemented a new business process to monitor the carry-forward balances. A copy of the business process guide will be provided by July 15, 2014.

### **CAMPUS PROGRAM EXPENDITURES**

Campus administration of lottery fund expenditures needed improvement.

We reviewed 50 lottery-fund expenditures and found that:

- ▶ In FY 2011/12, the campus used lottery funds for special consultant payments and for health benefit costs related to overload compensation for a faculty member.

- ▶ In two instances, sales tax on instructional equipment purchases was over-accrued in the lottery fund, and a subsequent credit was not made to properly reflect the actual expense incurred.
- ▶ Seven expenses had not been approved by an individual authorized by the delegation of fiscal authority.
- ▶ The associate director of financial aid did not have delegation of fiscal authority to authorize lottery-funded scholarship disbursements for the future scholars program.

The *General Guidelines for Expenditures*, dated September 3, 2008, states that the activity funded must represent a bona fide educational experience for students, or result in the development of materials to be used with students, or lead to the development of a program course. It further states that lottery funds may not be used to finance faculty overloads or increases in the rate of compensation paid to existing staff; thus stipends and honoraria are not permissible.

The California State University, East Bay *University Directive 12-01-Special Consultant Appointment*, dated October 29, 2012, states that current CSU employees who accept additional employment as special consultants are subject to the additional employment policy and the applicable collective bargaining agreement, which limit total employment within the CSU to a maximum of 125 percent of full time. It further states that for full-time faculty, the maximum days worked annually as a Special Consultant cannot exceed 60, and the time worked should be considered and/or coordinated with any other CSU appointment(s).

Coded memorandum Human Resources 2002-05, *Additional Employment*, dated February 19, 2002, states that additional employment refers to any CSU employment that is in addition to the employee's primary appointment. It further states that additional employment limitations are based on time-base rather than salary, and that a maximum of 125 percent time base is allowed under certain circumstances.

Executive Order 1000, *Delegation of Fiscal Authority and Delegation*, dated July 1, 2007, delegates authority to campus presidents to manage funds and approve certain fiscal transactions.

Integrated California State University Administrative Manual §3103.01, *Disbursements – General*, effective January 1, 2014, states that it is the policy of the CSU that funds disbursed are properly authorized, supported by a documented business purpose, substantiated by applicable receipts, and correctly processed for payment. It further states that the campus CFO or his/her delegate is responsible for implementing this policy on behalf of the president, and may delegate in writing to additional staff members, in part or in whole and with appropriate limitations, authority to disburse or expense from campus authorized funds.

The vice president of administration and finance/CFO stated that the campus was unaware of the unpublished web-link to the 1998 CSU general guidelines for lottery expenditures until it was discussed during the course of the audit and had been relying on the National Association of College and University Business Officers and Office of Management and Budget Circular A-21 definitions of instruction; as a result, the campus thought that faculty additional compensation costs were compliant with these definitions and appropriate for the lottery fund. The director of fiscal services stated that

the two sales tax over-accruals occurred in FY 2011 and 2012, were related to one specific vendor, and occurred due to the system's automated tax accruals and oversight. The director of academic affairs budget and communications stated that delegation of fiscal authority over lottery funds was granted on a case-by-case basis from the college dean's offices to departments based on the budgeted allocations. She further stated that expenses were not always incurred by an individual with delegation of fiscal authority and evidence of approval by an authorized individual was not always obtained due to oversight. The executive director of financial aid stated that although the associate director had fiscal responsibility over the various financial aid programs administered by the office of financial aid, including the future scholars program, documented delegation of fiscal authority had not been obtained due to oversight.

Inadequate administration of lottery funds and absence of proper delegations of fiscal authority over expenditures increases the risk of unauthorized and unallowable purchases and subjects the campus to possible regulatory scrutiny.

### **Recommendation 2**

We recommend that the campus:

- a. Discontinue the practice of using lottery funds for special consultant payments and health benefits costs related to overload compensation for faculty members.
- b. Record sales tax accrual credit adjustments to lottery funds when appropriate.
- c. Obtain approvals for lottery fund expenditures from individuals authorized by delegations of fiscal authority.
- d. Provide appropriate delegation of fiscal authority to the associate director of financial aid.

### **Campus Response**

We agree.

- a. A new business process guide for lottery fund disbursements will ensure that all disbursements are reviewed and approved by the director of academic affairs, budget and communications. A copy of the business process guide will be provided by July 15, 2014.
- b. The business process will be updated to analyze and adjust the system-calculated tax accruals as needed. A copy of the updated business process guide will be provided by June 30, 2014.
- c. As part of the recent CSU-wide financial system upgrade, the campus scanned the Delegation of Fiscal Authority forms for funds and departments into the delegation of authority module in the financial system, enabling the staff to determine whether an individual has appropriate delegation of authority for a fund or a department, including lottery fund expenditures. A copy of the Delegation of Authority by Fund Matrix will be provided by May 15, 2014.

- d. A formal delegation of fiscal authority executed by the executive director and the associate director of financial aid will be provided by May 15, 2014.

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## APPENDIX A: PERSONNEL CONTACTED

<u>Name</u>	<u>Title</u>
Leroy M. Morishita	President
Matthew Evans	Administrative Analyst, College of Education and Allied Studies
Maggie Graney	Director, Compliance and Internal Control
Jonathan Hale	Buyer II, Purchasing
Darrell Haydon	Associate Vice President, Financial Services
Rhonda Johnson	Executive Director, Financial Aid
Lillian Joseph	Administrative Analyst, Academic Programs and Graduate Studies
Audrey Katzman	Director, Academic Affairs Budget and Communications
Lana Lewis	Manager, Accounts Payable
Carolyn Nelson	Dean, College of Education and Allied Studies
Susan Opp	Associate Vice President, Academic Programs and Graduate Studies
Anita Patino	Associate Director, Financial Aid
Sherry Pickering	Director, Fiscal Services
Susan Rath	Library Services Specialist IV, Library
Adora Rominque	Administrative Analyst, College of Letters, Arts, and Social Sciences
Kathleen Rountree	Dean, College of Letters, Arts, and Social Sciences
Brad Wells	Vice President, Administration and Finance/Chief Financial Officer
John Wenzler	Dean of Libraries
Donna Wiley	Senior Director, Academic Programs and Graduate Studies

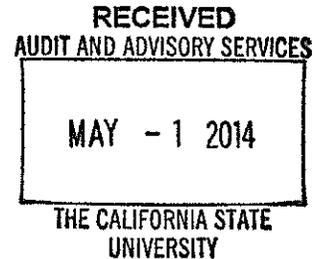


**CALIFORNIA STATE  
UNIVERSITY**  
E A S T B A Y

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and Finance & Chief Financial Officer  
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510.885-3803 • 510.885.4745 (fax) • www.cstatebay.edu

May 1, 2014

Mr. Larry Mandel  
Vice Chancellor and Chief Audit Officer  
The California State University  
401 Golden Shore  
Long Beach, CA 90802



**RE:           Campus Response to Incomplete Draft Audit Report  
              Lottery Funds (14-23), California State University, East Bay**

Dear Mr. Mandel,

The campus has provided our corrective action plan, with responses and deadlines to the above audit recommendations via e-mail to your office today.

I have reviewed and approved them.

Please let us know if you have any questions or need additional information.

Sincerely,

A handwritten signature in cursive script that reads "Bradley Wells".

**Bradley Wells**  
Vice President, Administration & Finance, CFO

cc:     Leroy M. Morishita, President  
          Maggie Graney, Director of Compliance and Internal Control

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**LOTTERY FUNDS**  
**CALIFORNIA STATE UNIVERSITY,**  
**EAST BAY**

**Audit Report 14-23**

**BUDGETING AND ALLOCATION**

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**Campus Response**

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

BAKERSFIELD

CHANNEL ISLANDS

May 9, 2014

CHICO

DOMINGUEZ HILLS

MEMORANDUM

EAST BAY

TO: Mr. Larry Mandel  
Vice Chancellor and Chief Audit Officer

FRESNO

FULLERTON

FROM: Timothy P. White  
Chancellor



HUMBOLDT

SUBJECT: Draft Final Report 14-23 on *Lottery Funds*,  
California State University, East Bay

LONG BEACH

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of May 9, 2014, I accept the response as submitted with the draft final report on *Lottery Funds*, California State University, East Bay.

MONTEREY BAY

NORTHRIDGE

TPW/amd

POMONA

SACRAMENTO

SAN BERNARDINO

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS