

AGENDA

COMMITTEE ON AUDIT

Meeting: 9:00 a.m., Wednesday, May 13, 1998
Auditorium

Ali C. Razi, Chair
James H. Gray, Vice Chair
Roland E. Arnall
Ronald L. Cedillos
Harold Goldwhite
Laurence K. Gould, Jr.
William Hauck
Joan Otomo-Corgel
Ralph R. Pesqueira
Alice S. Petrossian
Stanley T. Wang

Consent Items

Approval of Minutes of March 18, 1998

Discussion Items

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

**MINUTES OF MEETING OF
COMMITTEE ON AUDIT**

**Trustees of The California State University
Glenn S. Dumke Conference Center
400 Golden Shore
Long Beach, California**

March 18, 1998

Members Present

Ali C. Razi, Chair
James H. Gray, Vice Chair
Bernard Goldstein
Laurence K. Gould, Jr.
William Hauck
Joan Otomo-Corgel
Ralph R. Pesqueira
Alice S. Petrossian
Stanley T. Wang

Members Absent

Roland E. Arnall
Ronald L. Cedillos

Other Trustees Present

Jim Considine
Martha C. Fallgatter, Chairman of the Board
Eric C. Mitchell
Charles B. Reed, Chancellor

Chancellor's Office Staff

June M. Cooper, Senior Vice Chancellor and Interim Chief of Staff
Charles W. Lindahl, Interim Senior Vice Chancellor, Academic Affairs
Richard P. West, Senior Vice Chancellor, Business and Finance
Christine Helwick, General Counsel
Samuel A. Strafaci, Interim Senior Director, Human Resources
Larry Mandel, University Auditor

Presidential Liaisons

Manuel A. Esteban, President, California State University, Chico, absent
Alexander Gonzalez, Acting President, California State University, San Marcos, present

Chair Razi called the meeting to order at 9:36 a.m. He announced that on March 17, 1998, Chancellor and Mrs. Reed bestowed a scholarship in behalf of the Trustees' Award for Outstanding Achievement and indicated that two other trustees also had previously bestowed such scholarships. Chair Razi thanked Chancellor and Mrs. Reed and the trustees for their beneficence and stated that such actions were representative of the CSU's mission to provide access to excellent educational opportunities.

Approval of Minutes

The minutes of January 27, 1998, were approved as submitted.

Status Report on Current and Follow-up Internal Audit Assignments

Larry Mandel, university auditor, noted that Risk Management and Continuing Education were the subject audits selected during the last committee meeting and stated that staff are currently performing such audits. He affirmed that FISMA internal control audits are conducted on a continuous basis and added that such audits are currently being carried out on four campuses. Mr. Mandel stated that a pilot audit for Continuing Education was recently launched at the Fullerton campus and a second pilot audit, a Risk Management audit at the San Diego campus, will commence before the end of the month.

Construction Audits—Mr. Mandel noted that three such audits are currently being conducted: the first draft report was received and is under review for an audit of the central plant on the Long Beach campus; a draft report was received for the second project, a student activity center on the San Diego campus; and fieldwork by Peat Marwick has commenced for the third project, an audit of the central plant on the Los Angeles campus.

Information Systems Auditing—Mr. Mandel indicated that he has experienced difficulties in recruiting an Information Systems Audit Manager. As a result, a search firm will assist with this recruitment. Viable candidates referred by the search firm will appear before the selection committee on March 27, 1998.

Auxiliary Audit Program Development Review—Mr. Mandel articulated that he and staff are in the process of developing this program, and the target completion date is April 1, 1998. Upon finalization of this new audit program, the information will be shared with the campuses and external auditors contracted by each campus.

Follow-ups—Mr. Mandel made reference to the audit matrix shown in the trustees' agenda and affirmed that follow-ups are continuing for past assignments including FISMA (second round), Development, Delegations of Authority, Occupational Health, and Seismic Safety.

Report to Management Related to the Combined Audit of the Financial Statements in Accordance with Generally Accepted Accounting Principles

Richard West, senior vice chancellor, business and finance, noted that the Report to Management was a follow-up item from the January 1998 meeting. Information regarding the combined financial statements was presented during this meeting. The Single Audit Report, the federal funds audit, was done in association with the systemwide financial statement audit. Mr. West introduced Mark Thomas, the external auditor from KPMG Peat Marwick, and stated that Mr. Thomas would present the Single Audit Report and the Report to Management.

Mr. Thomas began his presentation by highlighting the various types of communications required of KPMG Peat Marwick to the board and stated that the purpose of the communications is to convey to the board certain items related to the conduct of the audit. The first type of required communication includes informing the board of KPMG's responsibility under Generally Accepted

Auditing Standards, which involves auditing the CSU's financial statements and providing an opinion on these statements. Mr. Thomas pointed out that the significant accounting policies of the university are defined in the first couple of footnotes of the financial statements. The second required communication relates to significant or unusual transactions and Mr. Thomas stressed that the only significant transaction was the settlement made with the California State Employees' Association, which totaled over \$20 million. The third required communication relates to significant estimates used by management in the preparation of financial statements, and Mr. Thomas stated that one of the most significant estimates in the financial statements was the self-insurance reserve. He explained that the CSU used actuaries to develop estimates on the reserve, and KPMG audited the actuaries. After reviewing the estimates, KPMG concluded that the numbers presented were reasonable. The fourth required communication relates to the topic of audit adjustments to ensure that the board understands which types of audit adjustments were proposed by the auditors in the financial statement audit process. Mr. Thomas explained that the majority of the adjustments, particularly the significant adjustments posted during the audit process, related to adjustments necessary to restate the financial information from a legal basis of accounting to a GAAP basis of accounting. The fifth type of required communication includes reporting situations where KPMG is aware of situations where management is shopping for other opinions and price quotes. He affirmed that KPMG knows of no such situations, and he underscored the importance of reporting any disagreements with management over accounting issues or situations where management is seeking other opinions. Mr. Thomas emphasized that this did not happen during the conduct of the audit. He went on to state that the final item pertained to whether major issues were discussed prior to the retention of the audit firm and pointed out that the Audit Committee participated in the retention process and is aware of the issues discussed.

Mr. Thomas reviewed the Report to Management Related to the Combined Audit of the Financial Statements and explained that two levels of management letters will ultimately be a product of this audit, including a report to management (management letter) to address campus-specific issues and a management letter to address systemwide issues. He pointed out that the differences between the two are the levels and types of comments, and he added that the management letter presented was the systemwide management letter that addressed issues impacting the system as a whole. Mr. Thomas went on to highlight the segments of the management letter regarding (1) Segregation of Duties; (2) Allowance for Uncollectible Receivables; (3) Account Reconciliations; and (4) Financial Reporting.

Trustee Vitti inquired as to whether there was a plan in place to ensure that the recommendations made were implemented. In response, Senior Vice Chancellor West stated that he would provide an update on this issue at the September 1998 meeting.

Trustee Goldstein inquired about the meaning of a phrase in the management letter that states, "Our audit procedures may not bring to light all the weaknesses of the policies and procedures that may exist. . . ." Mr. Thomas responded to this inquiry by stating that the focus of the audit was to get to a point where KPMG could provide an opinion on the financial statements, whether or not they fairly represented the CSU's financial position. He pointed out that, in the audit process, KPMG evaluates certain internal controls. However, the audit does not contemplate a 100 percent look at every transaction. As a result, not all weaknesses will be found.

Trustee Gray raised a concern about the allowance for uncollectible receivables and pointed out the potential that receivables could remain on the books for several years because a determination had been made that these monies might, at a future date, become collectible. He recommended that GAAP be used, not to exceed the state guidelines of one year.

Trustee Wang inquired about a comment made regarding transactions between the Chancellor's Office and the campuses. Mr. Thomas responded by stating that the amounts were not material to the financial statements and that the differences between the campuses and the Chancellor's Office were not the major portion. He went on to state that the emphasis is on the reconciliations between the seventy auxiliary organizations and the campus organizations. Mr. West added that the seventy auxiliaries are separate financial entities that have their own sets of systems of internal controls and, because a campus can have four or five auxiliary organizations, it is a much more difficult reconciliation process for the campuses and the Chancellor's Office. He stressed the importance for campuses to pay close attention to their reconciliations with the auxiliary organizations, and he added that this issue would be discussed with the campus business officers to ensure that such transactions are clear and documented.

Single Audit Report of Federal Awards

Mr. Thomas reviewed the Single Audit Report of Federal Awards and stated that, in fiscal year 1996/97, the CSU received federal financial assistance of approximately \$789 million. Of this amount, he stated that approximately \$744 million was for student financial aid and approximately \$35 million was from federal emergency management (FEMA) funds, primarily for the Northridge campus. He added that the audit focused on these two areas. Mr. Thomas went on to discuss the complexity of the rules and regulations pertaining to student financial aid and affirmed that none of the findings was considered a reportable condition or significant, and he pointed out that KPMG is required to document this type of information in the report.

Mr. Thomas stated that the system is required by the Code of Federal Regulations to track Unofficial Withdrawals, and that there was one systemwide finding related to this issue. He stressed that the Code of Federal Regulations requires a refund to be calculated based on a student's last day of attendance. He explained that this was a difficult issue, as some campuses have policies while others do not, and he added that the Chancellor's Office agreed to head up a systemwide effort to develop consistent policies in this area.

Trustee Goldstein made reference to the corrective action plans attached to the single audit report. Mr. Thomas responded by indicating that KPMG reviewed the corrective action plans developed by the Chancellor's Office and the campuses, and they concluded that the proposed corrective action is appropriate for the comments identified in the single audit report.

Adjournment

The meeting adjourned at 10:01 a.m.

BRIEF

Information Item

Agenda Item 1
May 12-13, 1998

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 1998 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Risk Management and Insurance, and Continuing Education. In addition, follow-up on past assignments (FISMA, Development, Delegations of Authority, Occupational Health, and Seismic Safety) is currently being conducted on prior campus reviews. Attachment A, summarizing the reviews in tabular form, will be distributed at the committee meeting.

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Agenda Item 1
May 12-13, 1998

COMMITTEE ON AUDIT

Status Report on Current and Follow-up Internal Audit Assignments

At the January 1998 meeting of the Committee on Audit, an audit plan was approved calling for the review of the following subject areas: FISMA (Financial Internal Controls), Risk Management and Insurance, Continuing Education, Information Systems Auditing, and Construction Auditing.

FISMA

The audit plan indicated that approximately 137 staff weeks of activity (32 percent of the plan) would be devoted to auditing financial internal controls on twelve campuses. At present, fieldwork is continuing at three campuses, while report writing continues for an additional four campuses.

Risk Management and Insurance

The audit plan indicated that approximately 106 staff weeks of activity (25 percent of the plan) would be devoted to a review of risk and liability assessments, insurance coverage and carriers, mitigation and loss prevention programs, and claims reviews and processing at eleven campuses. The audit program for this subject is now being field tested by the audit manager in charge of the project.

Continuing Education

The audit plan indicated that approximately 106 staff weeks of activity (25 percent of the audit plan) would be devoted to a review of continuing education programs and Continuing Education Revenue Fund operations at eleven campuses. Fieldwork is continuing at two campuses, while report writing continues for the initial campus.

Information Systems

The audit plan indicated that approximately 40 staff weeks of activity (9 percent of the plan) would be devoted to the development of an information systems (IS) risk assessment and subsequent IS audit plan. A new information systems audit manager has been selected and began work with the Office of the University Auditor on April 27, 1998. His first assignment will be the completion of the second phase of the information systems risk assessment. In addition, he will be integrally involved with systemwide Year 2000 projects/committees.

Follow-ups

The audit plan indicated that approximately 13 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 thirty-nine prior audits (FISMA, Development, Delegations of Authority, Occupational Health, and Seismic Safety) to determine the responsiveness of the corrective action taken for each recommendation and determining whether additional action may be required.

Consultations and Investigations

The audit plan indicated that approximately 13 staff weeks of activity (3 percent of the plan) would be devoted to campus consultations and special requests. The Office of the University Auditor consults with the campuses on an ongoing basis. No unplanned audits or special requests have occurred during 1998.

Auxiliary Audit Program Development and Review

The audit plan indicated that approximately 9 staff weeks of activity (2 percent of the plan) would be devoted to developing an audit program covering internal compliance/internal controls and reviewing campus submissions. The audit program is currently under development and will be distributed to the campuses approximately May 1, 1998.

Construction

For the 1997/98 fiscal year, six construction projects are being reviewed by KPMG Peat Marwick with coordination from the Office of the University Auditor. Areas under review include contractor's job cost accounting system, change orders, contractor's pay requests, contract compliance, liquidated damages, close out documents and final accounting. Two reviews have been completed while two others are currently in progress.