



Transmitted via e-mail

June 17, 2011

Mr. George Ashkar, Assistant Vice Chancellor/Controller
California State University, Office of the Chancellor
401 Golden Shore
Long Beach, CA 90802

Dear Mr. Ashkar:

Final Report—Audit of California State University's Proposition 1D Bond Funds

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of the California State University's (CSU) oversight of Proposition 1D bond funds.

The enclosed report is for your information and use. CSU's response to the report findings and our evaluation of the response are incorporated into this final report. We appreciate CSU's willingness to implement corrective actions. The observations in our report are intended to assist management in improving its program.

This report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov> within five working days of this transmittal.

A detailed Corrective Action Plan (CAP) addressing the observations and recommendations is due within 60 days from receipt of this letter. The CAP should include milestones and target completion dates.

We appreciate the assistance and cooperation of the CSU staff. If you have any questions regarding this report, please contact Diana Antony, Manager, or Chikako Takagi-Galamba, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Benjamin F. Quillian, Executive Vice Chancellor/Chief Financial Officer, California State University, Office of the Chancellor
Ms. Elvyra San Juan, Assistant Vice Chancellor, California State University, Office of the Chancellor, Capital Planning, Design, and Construction
Ms. Joanne Coville, Vice President, California State University, Channel Islands, Finance and Administration
Mr. David Salazar, Associate Vice President, California State University, Long Beach, Physical Planning and Facilities Management
Ms. Sharon Taylor, Associate Vice President, California State University, Long Beach, Financial Management
Mr. Dave Chakraborty, Assistant Vice President, California State University, Channel Islands, Operations, Planning, and Construction
Mr. Larry Mandel, University Auditor, California State University, Office of the Chancellor
Ms. Roberta McNeil, Manager, California State University, Office of the Chancellor, Internal Control and Compliance Systemwide Financial Operations
Mr. Alexander Porter, Business Manager, California State University, Long Beach, Physical Planning and Facilities Management
Ms. Theresa Cilley, Project Coordinator, California State University, Channel Islands, Operations, Planning and Construction

AN AUDIT OF BOND FUNDS

California State University Proposition 1D



Source: Daily 49er – The Student Publication of California State University Long Beach



Source: California State University, Channel Islands

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE TEAM

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Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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TABLE OF CONTENTS

Executive Summary	iv
Background, Scope, and Methodology.....	1
Results.....	4
Response.....	7
Evaluation of Response	11

EXECUTIVE SUMMARY

In accordance with the California Department of Finance's (Finance) bond oversight responsibilities, we audited the California State University's (CSU) oversight of the Proposition 1D bond funding. Our overall audit objectives were to determine if (1) bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and (2) adequate monitoring processes are in place.

Overall, the CSU awarded bond funds in compliance with applicable legal requirements and established criteria. Additionally, CSU has established several key fiscal controls over state bond funds, including:

- Policies and procedures are in place for reviewing projects prior to commitment of funds, including review criteria, and CSU Board of Trustees' review and approval of the prioritized project list.
- The Chancellor's Office developed the system-wide change order procedures to provide guidelines to campuses in managing contracts.
- The Capital Planning Design and Construction Unit performs post project performance reviews and issues a post project review report to ensure the project is completed as approved.
- The Office of the University Auditor performs audits of completed projects to ensure that construction management practices are in accordance with CSU system-wide construction management policies and procedures. Policies and procedures are in place to follow-up on audit findings, including requiring corrective action plans.

To further build on these controls, CSU's fiscal and administrative procedures could be improved in the following areas:

- In-progress reporting needs additional expenditure detail to improve project fiscal oversight. Currently, project expenditure reports submitted by campuses to the Chancellors Office do not contain the critical information, such as expenditure details, to allow for adequate in-progress fiscal oversight. Based on a review of sampled campus projects, the audit identified \$148,000 of ineligible and unauthorized expenditures for one project.
- Upon completion, project amounts reported on the Bond Accountability website should reflect actual project expenditures as required by the Governor's Executive Order S-02-07.
- Funding sources are not considered in selecting projects to audit, and administrative costs are not reviewed, increasing the risk of inadequate state bond audit coverage.

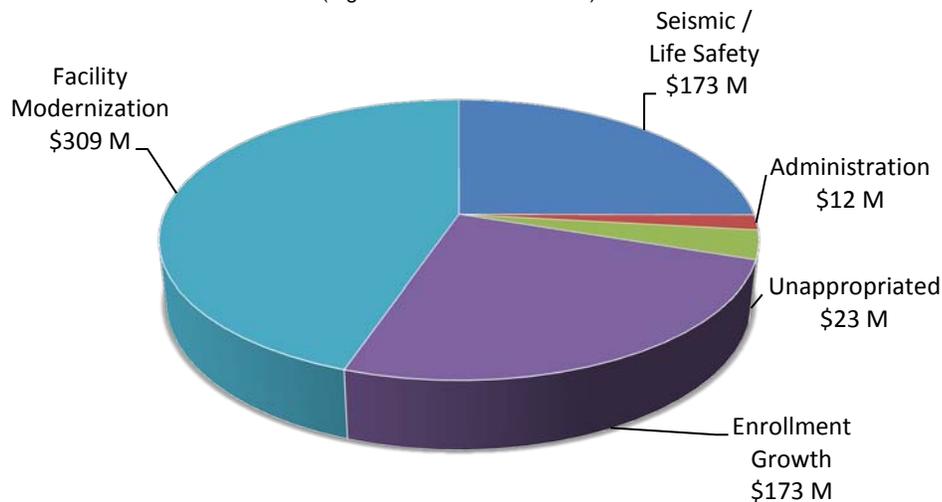
CSU's accountability procedures and controls over bond funds could be strengthened if it develops a corrective action plan to address the observations and recommendations noted in this report.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

In November 2006, California voters passed Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006. The Act authorized bonds totaling \$10.416 billion for educational facilities for kindergarten through 12th Grade Schools, California Community Colleges, California State University, and University of California. The California State University will receive \$690 million to construct and renovate facilities to meet the demands of its growing student population, address seismic and safety needs, improve energy efficiency, and enhance sustainability.

Figure 1: Proposition 1D Distribution
(Figures in millions of dollars)



Source: California State University, Capital Planning, Design and Construction

California State University

The individual California State Colleges were brought together as a system in 1961 and in 1982 the system became the California State University (CSU). Today, the 23 campuses of the system serve 412,000 students, who are taught and supported by 43,000 faculty and staff.

Responsibility for the California State University is vested in the Board of Trustees, whose members are appointed by the Governor. The Trustees appoint the Chancellor, who is the chief executive officer of the system, and the Presidents, who are the chief executive officers of the respective campuses. The Board of Trustees, Committee on Audit, is comprised of seven Trustees. The Committee on Audit's responsibilities include the governance of the internal audit function, review and approval of the annual audit plan, review and monitoring of audit reports, campus responses, and campus implementation of audit recommendations.

Two units within the Chancellor's Office play significant roles in the delivery and oversight of facility construction for CSU. One unit is the Capital Planning, Design, and Construction (CPDC) unit. CPDC is responsible for carrying out the authority of the Board of Trustees in the construction and physical development of CSU campuses and any buildings, facilities, and improvements connected with the CSU. The second unit is the Office of the University Auditor (OUA). OUA responsibilities include assisting university management and the Trustees in the effective discharge of their fiduciary and administrative responsibilities through construction audits.

Chancellor's Executive Order 672, *Delegation of Capital Outlay Management Authority and Responsibility*, dated July 25, 1997, delegates to campus presidents the authority to manage directly state and non-state funded capital outlay projects. (Source: California State University)

SCOPE

In accordance with the Department of Finance's (Finance) bond oversight responsibilities, we conducted an audit to determine whether Proposition 1D bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and to determine if CSU had adequate project monitoring and reporting processes in place.

The audit did not include an assessment of the bond authorization, issuance, or sale processes. Because CSU's OUA audits completed projects, our audit focused on determining if CSU's fiscal oversight, including the extent of audit coverage, was adequate. Accordingly, we did not perform a comprehensive review of project expenditures.

METHODOLOGY

To determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and whether adequate monitoring processes were in place, we performed the following procedures:

- Reviewed the applicable legal provisions, bond acts and regulations, policies, procedures, and program guidelines.
- Interviewed management and key staff responsible for administering bond funds to obtain an understanding of how CSU oversees the various project stages.
- Gained an understanding of construction audit procedures through interview of audit staff and review of OUA's construction audit program, work papers, and quality control review documents.
- Reviewed the information reported on the Strategic Growth Plan Bond Accountability website.¹
- Reviewed the administrative costs charged to bond funds for reasonableness.
- Performed site visits of two selected campuses and conducted interviews of key campus staff responsible for project management and monitoring.

¹ Bond accountability website address is: www.bondaccountability.ca.gov

- Reviewed a sample of project files and accounting records.

Recommendations were developed based on review of documentation made available to us and interviews with CSU management and key staff directly responsible for administering bond funds. The audit was conducted during the period October 2010 through December 2010.

This audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and recommendations based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our observations and recommendations.

In accordance with Governor’s Executive Order S-02-07 and previously established fiscal policies, the California State University (CSU) has developed a three part bond accountability structure and several key fiscal controls over bond funds, including:

- Front-end accountability controls have been established to review all project merits prior to commitment of funds, including CSU Board of Trustees’ review and approval of the prioritized project list.
- The Chancellor’s Office developed the system-wide change order procedures to provide guidelines to campuses in managing contracts.
- The Capital Planning Design Construction Unit performs post project performance reviews and produces a post project report to ensure the project is completed as approved.
- The Office of the University Auditor (OUA) performs construction audits of completed projects to ensure construction management practices are in compliance with CSU system-wide construction management policies and procedures. Campuses are required to develop corrective action plans to address audit findings. If findings are unresolved, a campus may be put on probationary status or lose its delegation of authority to self manage their projects.

**Governor’s Executive Order S-02-07
Three-part Bond Accountability
Requirements**

Front-End Accountability: Create a strategic plan with performance standards for projects prior to the expenditure of funds.

In-Progress Accountability: Document what ongoing actions it will take to ensure that the infrastructure projects or other activities funded from bond proceeds are staying within the scope and cost that were identified. Additionally, each department shall make semi-annual reports to the Department of Finance to ensure that the projects and activities funded from bond proceeds are being executed in a timely fashion and achieving their intended purposes.

Follow-Up Accountability: Audit completed projects to determine whether the expenditures were in line with the goals laid out in the strategic plan.

To build on these controls, CSU’s fiscal and administrative procedures could be improved as follows:

Observation 1: Increased Expenditure Reporting is Needed to Provide Better In-Progress Project Fiscal Oversight

Per Delegation of Authority, each campus is responsible for managing and monitoring projects during construction and equipment phases. Campuses submit quarterly progress reports to the Chancellor’s Office. However, quarterly reports do not provide sufficient information, such as expenditure details, for the Chancellors Office to conduct an adequate secondary review.

For example, our cursory review of account payable activities for CSU Channel Islands' Infrastructure Improvement project revealed unauthorized and ineligible expenditures of \$148,000 for furnishing and related costs. Additional expenditure reporting requirements would allow the Chancellors Office to provide better fiscal oversight and could prevent unauthorized use of state bond funds, as noted above. In-progress project monitoring should be a collective responsibility between the campuses and Chancellor's Office.

Recommendations:

- A. Require campuses to provide documentation to support project costs, such as a detailed schedule of expenditures.
- B. On a sample basis, the Chancellor's Office should perform a periodic expenditure review to ensure timely detection of ineligible and non-project related expenditures.
- C. Conduct a complete review of the CSU Channel Islands' Infrastructure Improvement project expenditures to determine eligibility of costs.

Observation 2: Improvements Needed to Meet Project Status Reporting Requirements

On the Bond Accountability website, the project status information on the *Project List* page does not agree with the detailed project data on the *Capital Outlay Projects* pages. Of the 11 projects reviewed, project statuses for 9 projects did not agree. For example, project status for Bakersfield Nursing Renovation shows "Closed" on the *Project Listing* page; however, the *Capital Outlay Project* status indicates "Equipment". This is misleading to the public. In addition, project expenditures are not updated to reflect actual project costs at completion.

Recommendations:

- A. Reconcile project status information on the *Project List* page to detailed project data on the *Capital Outlay Projects* pages.
- B. Upon project completion, update project expenditures to reflect actual amount spent on the project and report project savings. Also, include web links to close-out reports, such as Post-Performance Reports and Construction Audit Reports.

Observation 3: Considerations Should Be Given To Ensure Adequate Bond Audit Coverage

The CSU's follow-up accountability states all projects are subject to an independent financial audit process. As discussed earlier, the OUA performs construction audits of completed projects on a risk basis.

However, we noted there was no consideration given to the funding source during the audit sample selections, which may not assure adequate audit coverage of state bond funded projects. Further, the current audit does not include a review of administrative costs paid with state bond funds, increasing the risk of exceeding CSU's established seven percent cap. As a consequence, this could result in less money for construction projects.

Recommendations:

- A. Consider funding source as part of the audit selection process.
- B. Review administrative costs for reasonableness and ensure the established cap is not exceeded.



The California State University
OFFICE OF THE CHANCELLOR

BAKERSFIELD

May 31, 2011

Benjamin F. Quillian
Executive Vice Chancellor and
Chief Financial Officer

CHANNEL ISLANDS

CHICO

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DOMINGUEZ HILLS

EAST BAY

FRESNO

RE: Draft Report – Audit of California State University’s Proposition 1D Bond Funds

FULLERTON

HUMBOLDT

Dear Mr. Botelho:

LONG BEACH

Thank you for the opportunity to review the Draft Report on the use of Proposition 1D Bond funds. Enclosed are our responses to the report observations and recommendations; this response will be incorporated into the final report and placed on your website.

LOS ANGELES

MARITIME ACADEMY

We understand a detailed Corrective Action Plan addressing observations and recommendation is due within 60 days from the date of the final report and that it should include milestones and target dates to correct all deficiencies.

MONTEREY BAY

NORTHRIDGE

The May 9, 2011 Exit Conference with your staff was helpful to review the report and understand the Department of Finance (DOF) audit process. The below are our responses:

POMONA

SACRAMENTO

Observation 1: Increased Expenditure Reporting is Needed to Provide Better In-Progress Project Fiscal Oversight

SAN BERNARDINO

SAN DIEGO

Recommendations:

SAN FRANCISCO

SAN JOSÉ

A. Require campuses to provide documentation to support project costs, such as a detailed schedule of expenditures.

SAN LUIS OBISPO

Response: It is correct that the Office of the Chancellor does not regularly review expenditure details during the course of construction or equipment phases. The Chancellor’s Executive Order 672, *Delegation of Capital Outlay Management Authority and Responsibility* gives campuses the authority and accountability for the process. However, two specific actions are being taken that will improve our review of project financial information. First, the California State University (CSU) has been implementing the Common Financial System to replace the legacy

SAN MARCOS

SONOMA

STANISLAUS



The California State University
OFFICE OF THE CHANCELLOR

Financial Reporting System. As part of this initiative is a data warehouse that is intended to enable the Office of the Chancellor to remotely review project budgets, encumbrances, and expenditures on a quarterly basis. When fully implemented across all campuses the data warehouse will enable the chancellor's office to oversee project fiscal administration. Second, Capital Planning, Design and Construction (CPDC) recently recruited and filled a Project Manager position whose duties include review of campus project financial data.

- B. On a sample basis, the Office of the Chancellor should perform a periodic review to ensure timely detection of ineligible and non-project related expenditures.

Response: Agree. The current plan is to conduct quarterly reviews with closer scrutiny given as CSU prepares its request for re-appropriations and near year-end. However, the frequency of the reviews will be evaluated regularly to determine if they are needed more often.

- C. Conduct a complete review of the CSU Channel Islands' Infrastructure Improvement project expenditures to determine eligibility of costs.

Response: Agree. CPDC will ask the campus for a written update and access to the financial transactions with the objective of completing this review prior to the submission of the corrective action plan.

Observation 2: Improvement Needed to Meet Project Status Reporting Requirements

Recommendations:

- A. Reconcile project status information on the (website's) *Project List* page to detailed project data on the *Capital Outlay Projects* pages.

Response: Agree. CPDC will include the update to the Bond Accountability website created for Proposition 1D as an additional task to complete as part of the regular update of the *Quarterly Project Reports* submitted to the DOF and Legislative Analyst's Office.

- B. Upon project completion, update project expenditures to reflect actual amount spent on the project and report project savings. Also include web links to close out reports, such as Post Performance Reports and Construction Audit Reports.

Response: Agree to update the Bond Accountability website created for Proposition 1D as an additional task to complete as part of the *Project Savings Report* as submitted to the Joint Legislative Budget Committee. Agree to include a web link for the published Construction Audit Report.

Observation 3: Consideration Should Be Given To Ensure Adequate Bond Audit Coverage

Recommendations:



The California State University
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A. Consider funding source as part of the audit selection process.

Response: As noted in the observation, the Office of the University Auditor (OUA) selects the project(s) to audit on a risk basis. The OUA will capture and consider the funding source; however, the dollar value of construction, previous construction audits at the campus, and the complexity of the project will remain the key variables as this selection method targets the projects with the most potential risk exposure and provides the best risk coverage with the available construction audit resources. If projects with Proposition 1D Bond funds were to place just below those selected via this method, the OUA would consider them for selection.

B. Review administrative costs for reasonableness and ensure the established cap is not exceeded.

Response: Based on past inquiries to other state and school agencies, the CSU is efficient and economical in the administrative staffing and management of projects. The budgeted seven percent (7%) for Construction Management is typically used to fund positions in the Office of the Chancellor and at the campuses, along with funding inspectors, project managers, testing, etc. In addition, the CSU separately budgets for other project soft costs from Required Additional Services for other state agencies such as, the Division of the State Architect, the State Fire Marshal, plan check, peer review, etc. If the DOF Office of State Audits and Evaluations collects information on other agencies, it could be helpful in an assessment of the reasonableness of the CSU costs.

If you have any questions, please contact Elvyra F. San Juan, Assistant Vice Chancellor, at (562) 951-4090.

Sincerely,

Original signed by:

Benjamin E. Quillian
Executive Vice Chancellor
Chief Financial Officer

BFQ:ESJ:jdes

c: George V. Ashkar, Assistant Vice Chancellor/Controller, CSU Chancellor's Office
Larry Mandel, University Auditor, CSU Chancellor's Office
Elvyra F. San Juan, Assistant Vice Chancellor, CSU Chancellor's Office

EVALUATION OF RESPONSE

The Department of Finance, Office of State Audits and Evaluations (Finance) reviewed the California State University's (CSU) response to the draft report. We provide the following comments:

Observation 3: Consideration Should Be Given To Ensure Adequate Bond Audit Coverage

While CSU addressed how the budgeted seven percent for Construction Management is used to fund administrative costs, Finance did not question this established cap. Further, CSU did not comment on the fact that its current bond audit process does not include a review of administrative costs paid with state bond funds. Therefore, we recommend the CSU conduct a periodic review of administrative costs to determine eligibility and ensure the established cap is not exceeded.