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January 19, 2018

Dr. Mary A. Papazian, President
San José State University
One Washington Square
San José, CA 95192

Dear Dr. Papazian:

Subject: Audit Report 17-08, *Tower Foundation*, San José State University

We have completed an audit of *Tower Foundation* as part of our 2017 Audit Plan, and the final report is attached for your reference. The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

I have reviewed the management response and have concluded that it appropriately addresses our recommendations. The management response has been incorporated into the final audit report, which has been posted to the Office of Audit and Advisory Services' website. We will follow-up on the implementation of corrective actions outlined in the response and determine whether additional action is required.

Any observations not included in this report were discussed with your staff at the informal exit conference and may be subject to follow-up.

I wish to express my appreciation for the cooperation extended by the campus personnel over the course of this review.

Sincerely,



Larry Mandel
Vice Chancellor and Chief Audit Officer

c: Timothy P. White, Chancellor

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The California State University
Office of Audit and Advisory Services

TOWER FOUNDATION

San José State University

Audit Report 17-08
December 8, 2017

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to confirm compliance with regulatory requirements for the establishment and governance of auxiliary organizations; ascertain the effectiveness of operational, administrative, and financial controls for the activities conducted by the Tower Foundation (TF); evaluate adherence to auxiliary policies and procedures and applicable Integrated California State University Administrative Manual (ICSUAM) policies, or, where appropriate, to an industry-accepted standard; and to ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, and campus procedures.

CONCLUSION

We found the control environment for some of the areas reviewed to be in need of improvement.

Based upon the results of the work performed within the scope of the audit, except for the weaknesses described below, the operational, administrative, and financial controls for TF as of October 27, 2017, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

We found that employee payroll hours, including overtime, were not always reviewed and approved prior to payment. In addition, members of the TF's board of directors did not always complete conflict-of-interest forms, as required by TF policy. Finally, we noted that the charter of the TF's audit committee was not updated to reflect current committee composition requirements.

Specific observations, recommendations, and management responses are detailed in the remainder of this report.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. EMPLOYEE TIMESHEET APPROVAL

OBSERVATION

Employee payroll hours were not always reviewed and approved prior to payment.

We reviewed timesheets and payroll records for 15 employees and found that four had unapproved regular hours entered in their timesheets. Of these four, two also had unapproved overtime hours.

The TF payroll processing policy requires that designated time-card approvers review and approve employee hours entered in Stratus Time, the timekeeping system, as part of processing payroll. The TF explained that because California Labor Code requires that employees be paid for hours worked, it is compelled to pay hours entered in Stratus Time even if those hours were not reviewed or approved by the designated time-card approver.

Proper review and approval of employee timesheets provides assurance that employee hours entered in the timekeeping system and paid during the payroll process are accurate, ensures that foundation funds are spent appropriately, and increases the accuracy of operating expenses.

RECOMMENDATION

We recommend that the campus, in conjunction with TF:

- a. Develop and document policies and procedures, such as reminders and management exception reporting, to enhance compliance with and impose enforcement of timesheet review and approval requirements.
- b. Provide training regarding the requirements to individuals responsible for implementation.

MANAGEMENT RESPONSE

We concur.

- a. TF will develop policies and procedures to enhance compliance with and impose enforcement of timesheet review and approval requirements by February 28, 2018.
- b. TF will provide training regarding the requirements to individuals responsible for implementation by February 28, 2018.

2. BOARD OF DIRECTORS CONFLICT-OF-INTEREST DISCLOSURE FORMS

OBSERVATION

Members of TF's board of directors did not always complete required conflict-of-interest disclosure forms.

We reviewed the conflict-of-interest disclosure forms for 2015, 2016, and 2017, and we noted that two directors in 2015 and two directors in 2016 had not completed the forms.

Compliance with regulations addressing leadership conflict-of-interest disclosures provides greater assurance of transparency and ethical behavior on the part of the board of directors and provides a baseline for monitoring board member activities.

RECOMMENDATION

We recommend that the campus, in conjunction with the TF, provide further reminders or additional training to the members of the board of directors to improve their compliance with established policies and procedures regarding conflict-of-interest disclosure forms.

MANAGEMENT RESPONSE

We concur. TF will provide reminders and training to the members of the board of directors to improve their compliance regarding conflict-of-interest disclosure forms by February 28, 2018.

3. AUDIT COMMITTEE CHARTER

OBSERVATION

The audit committee charter was not updated to reflect changes made in the required composition of the committee.

The composition of the TF's audit committee was changed in January 2016 to exclude the TF's chief executive officer (CEO), to comply with the California Nonprofit Integrity Act of 2004. However, the audit committee charter was not updated to reflect this change and still states that the TF's CEO is required to be a member of the committee.

Updating the audit committee charter to reflect changes improves the documentation of current practices in place and shows compliance with applicable regulations.

RECOMMENDATION

We recommend that the campus, in conjunction with TF, update the audit committee charter to reflect changes in the required composition of the committee.

MANAGEMENT RESPONSE

We concur. TF will update the audit committee charter to reflect changes in the requirement regarding the composition of the committee by January 30, 2018.

GENERAL INFORMATION

BACKGROUND

Auxiliary organizations are separate business and legal entities that perform activities essential to the education program of each campus that cannot be legally or effectively administered using state funding. California Code of Regulations (CCR) Title 5, §42401 states that auxiliary organizations provide the fiscal means and the management procedures that allow the campus to carry on activities providing those instructional and service aids not normally furnished by the state budget.

Education Code §89900 states, in part, that the operation of auxiliary organizations shall be conducted in conformity with regulations established by the Trustees, and CCR Title 5, §42402 confirms the campus president's authority and responsibility for auxiliary organization operations. Campus management is responsible for establishing and maintaining an adequate system of internal compliance/internal control and assuring that each of its auxiliary organizations similarly establishes such a system.

Education Code §89904 states, in part, that the Trustees of the California State University (CSU) and the governing boards of the various auxiliary organizations shall:

- Institute a standard systemwide accounting and reporting system for businesslike management of the operation of such auxiliary organizations.
- Implement financial standards that will assure the fiscal viability of such various auxiliary organizations. Such standards shall include proper provision for professional management, adequate working capital, adequate reserve funds for current operations and capital replacements, and adequate provisions for new business requirements.
- Institute procedures to assure that transactions of the auxiliary organizations are within the educational mission of the state colleges.
- Develop policies for the appropriation of funds derived from indirect cost payments.

Executive Order (EO) 1059, *Utilization of Campus Auxiliary Organizations*, dated June 6, 2011, represents Trustee policy addressing appropriate use of CSU auxiliary organizations. This EO requires CSU auxiliary organizations to operate within the regulations and oversight of the campus. The EO reiterates that the campus president is responsible for ensuring the fiscal viability of auxiliary organizations and their compliance with applicable CSU policies, and it further designates the campus chief financial officer as the individual responsible for administrative compliance and fiscal oversight of auxiliary organizations.

The San José State University (SJSU) campus contracts with five separate auxiliary organizations, each of which provides a function that contributes to the educational mission of the university. TF was established in 2004 as a non-profit public benefit corporation dedicated solely to philanthropy and assisting with the development, investment, administration, and banking for all SJSU philanthropic donations. The TF also aims to grow the university's endowment through donations, bequests, and prudent investment management, including real estate investment transactions. In academic year 2015/16, the TF helped the campus obtain \$39.3 million in gift commitments. The TF is governed by a board of directors

composed of representatives from the university administration, faculty, student body, alumni, and community. The TF has a total of ten full-time employee positions and relies on the university advancement office and a third-party service provider for administrative and accounting support services.

SCOPE

We visited the SJSU campus and TF from September 5, 2017, through October 20, 2017. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls are in place and operative at TF. The audit focused on procedures in effect from July 1, 2015, to October 20, 2017.

Specifically, we reviewed and tested:

- Timely and proper execution of agreements, contracts, and memoranda of understanding.
- Corporate governance, including compliance with education, government, and corporation codes.
- Fiscal, operational, and program compliance, such as review of cost reimbursement, reserves, conflict of interest, risk management, cash controls and trust accounts.
- Segregation of duties and administration of key fiscal and operational areas.
- Gifts and endowments.

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.

Our testing and methodology was designed to provide a review of key operational, financial, and administrative controls and included testing of a limited number of financial transactions and operational procedures.

CRITERIA

Our audit was based upon standards as set forth in CSU Board of Trustee policies; Office of the Chancellor policies, letters, and directives; campus procedures; and other sound administrative practices. This audit was conducted in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

This review emphasized, but was not limited to, compliance with:

- Education Code §89720
- Education Code §89756
- Education Code §89900
- Education Code §89901

- Education Code §89904
- California Code of Regulations (CCR) Title 5, §42401, *Declaration of Policy*
- CCR Title 5, §42402, *Authority of Campus President*
- CCR Title 5, §42500, *Functions of Auxiliary Organizations*
- CCR Title 5, §42602, *Board of Directors Composition*
- California Senate Bill 1262, *Nonprofit Integrity Act of 2004*
- Government Code §12586, *Uniform Supervision of Trustees for Charitable Purposes Act*
- Assembly Bill 469, *Wage Theft Protection Act of 2011*
- Code of Civil Procedure Title 10, *Unclaimed Property Law*
- Resolution of the Committee on Finance 7-81-4
- EO 676, *Delegation of Gift Evaluation and Acceptance to Campuses*
- EO 1031, *Records/Information Retention and Disposition Schedule Implementation*
- EO 1059, *Utilization of Campus Auxiliary Organizations*
- CSU Auxiliary Organizations Compliance Guide
- CSU Auxiliary Organizations Sound Business Practices Guidelines
- CSU Conflict of Interest Manual
- ICSUAM §15000, *University Advancement*
- SJSU Tower Foundation Articles of Incorporation
- SJSU Tower Foundation By-laws
- SJSU Tower Foundation Reserve Policy
- SJSU Tower Foundation Payroll Processing Policy
- SJSU Tower Foundation Fundraising Policy
- SJSU Tower Foundation Pledges Receivable Policy and Procedures
- SJSU Tower Foundation Endowment Investment Policies, Guidelines and Objectives
- SJSU Tower Foundation Accounts Payable Policy
- SJSU Tower Foundation Procurement Card Program Policies and Procedures
- SJSU Tower Foundation Hospitality Guidelines
- SJSU Tower Foundation Travel Policy
- SJSU Tower Foundation Banking Policy
- SJSU Tower Foundation University Gift Acceptance Policies
- SJSU Advancement Services Cash Handling Policy and Procedures
- SJSU Advancement Services Matching Gift Procedures

AUDIT TEAM

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Audit Manager: Ann Hough
Senior Auditor: Jon Saclolo