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April 3, 2019

Dr. Gayle E. Hutchinson, President
California State University, Chico
400 W. First Street
Chico, CA 95929

Dear Dr. Hutchinson:

Subject: Audit Report 18-10, Centers and Institutes, California State University, Chico

We have completed an audit of *Centers and Institutes* as part of our 2018 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 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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CENTERS AND INSTITUTES

California State University, Chico

Audit Report 18-10
March 1, 2019

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of operational, administrative, and financial controls related to centers and institutes (CI) and to evaluate adherence to 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 CI as of December 14, 2018, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

Overall, the audit revealed that several CI-specific activities require attention. Specifically, one CI, the Passages Adult Resource Center (Passages), did not appear to meet the campus criteria for inclusion as a CI or the CSU Chico Research Foundation's (RF) standards for sponsored programs. Also, the campus did not have effective policies and procedures to administer the granting of faculty release time, a repeat finding from a special investigation performed in 2011. Additionally, the Center for Entrepreneurship (CFE) did not always keep records of the required reviews of each approved Accelerator Fund loan application and did not hold borrowers accountable to their convertible note terms and conditions. Furthermore, the campus did not have an effective policy governing CI during the audit period, and an interim policy had not yet been fully implemented. Moreover, the tracking of tagged equipment for CI needed improvement.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. PASSAGES ADULT RESOURCE CENTER

OBSERVATION

The campus relationship with Passages, a community resource center for senior citizens, did not appear to meet the campus criteria for inclusion as a CI or the RF's standards for sponsored programs.

Passages provides and supports critical services and community resources for senior citizens in the area. Although the campus does not have records for the entire history of Passages, anecdotal evidence indicates that it was established in the late 1970s to help residents of Chico and the surrounding areas find resources for elderly care and support and has evolved since that time. The center expanded its services in 1981 and henceforth began to identify as an Area Agency on Aging (AAA), defined as a non-profit entity designated by the California Department on Aging to engage in community planning, coordination, and program development, as well as provide social and nutritional services via contractual arrangements. Passages typically spends from \$1 million to \$3 million dollars annually in combined county, state, and federal grant and contract funds, and the AAA designation was recommended by the state to ensure that state funding and support would continue. However, because Passages operates as a project under the RF, the RF, not Passages, is the actual contractor and therefore the legally designated AAA.

In our review of Passages documentation and discussions with campus management, we noted the following:

- The campus was unable to provide evidence that Passages directly or indirectly contributed to the curriculum or academic/professional growth of students and faculty, which is required of all CI by the systemwide policy, coded memorandum Academic Affairs (AA) 2014-18, as well as the campus policy, Executive Memorandum (EM) 18-018, *Interim Executive Memorandum for Oversight of Ancillary Units (including Campus Centers and Institutes)*. There was some anecdotal evidence about occasional internships and project collaborations and one instance of minor research funding to a faculty member, but there were no systematic programs for these purposes. Further, the Office of Research and Sponsored Programs (RESP) policy *Working with the University and Research Foundation* (RESP Policy) states that although projects are reviewed on a case-by-case basis for appropriateness, there must be some mutual benefit of the relationship between the university and external entities.
- The Passages connection to AA, a requirement of both campus and RF policy, was tenuous. The RESP Policy states that generally, university faculty or staff serve as project directors for RF projects, with students commonly being directly involved in conducting project activities. The Passages board of directors included campus representation, including the dean of the college of behavioral and social sciences, but otherwise, the center was run entirely by individuals outside the campus academic community, and, as noted above, student involvement was undefined and unstructured.

- We were unable to find an assessment of the risks involved in some of the activities undertaken by Passages and the potential effect on the university, a step required in both the RESP Policy and campus policies noted above. Of note are programs that provide respite care to relieve caregivers, perform minor home repairs, and provide counseling services.
- Allocations from grants and contracts that Passages provided to the campus to offset costs were below the standards set by the state and the RF. At Passages, the average allocation for modified total direct costs (MTDC), or facilities and administrative (F&A) costs, was approximately 9 percent. This was well below the 25 percent standardized rate negotiated between the state and the CSU and University of California, and lower than the 13 percent of overall F&A necessary that the RF estimated it needed to break even. An F&A rate below the break-even milestone could result in costs associated with Passages programs being covered by the excess F&A from other grants and contracts.
- It is unclear whether it was appropriate for the RF to be an AAA. The campus has not analyzed whether the roles and responsibilities the RF takes on as a AAA are consistent with the university and RF mission, or whether this designation represents additional risks. Passages is the only state AAA connected to a university.

Ensuring that Passages meets all requirements of a designated campus CI reduces risk and enhances any potential mutual benefit to both the center and the university.

RECOMMENDATION

We recommend that:

- a. The campus and RF evaluate and define the appropriate relationship with Passages based on the criteria set in AA-2014-18.
- b. Based upon the results of the evaluation and conclusions determined from (a) above, implement an oversight framework for educational and financial activities.

MANAGEMENT RESPONSE

We concur. The campus and RF will:

- a. Evaluate and define the appropriate relationship with Passages based on the criteria set in AA-2014-18.
- b. Based upon the results of the evaluation and conclusions determined from (a) above, develop a plan to implement an oversight framework for educational and financial activities, if appropriate.

Completion: August 30, 2019

2. RELEASE TIME

OBSERVATION

The campus did not have effective policies and procedures to monitor the granting of faculty release time. This is a repeat finding from a 2011 special investigation conducted by Audit and Advisory Services (A&AS).

The California Faculty Association *Collective Bargaining Agreement 2014-2020* (contract), in Article 20, Workload, allows for faculty release time from instructional hours under certain circumstances. Article 20.2c states that the scheduling of academic leaves, sabbaticals, and other professional responsibilities will be determined by the appropriate administrator after consultation with the department chair or designee and/or the individual faculty member and shall be consistent with campus policies on such matters. Systemwide policy and the contract do not provide guidance on how release time should be reviewed, approved, and monitored, leaving it, as indicated in the article above, to the discretion of the campuses to determine the best process to achieve these goals.

Of the five CI we reviewed, three had directors who were granted release time for their work at the CI. In one case, the release time was reimbursed by external funding; in two cases, the release time was non-reimbursable, and therefore the payroll costs were absorbed by the director's academic department.

We requested records demonstrating justification and approval for the release time and were told that the process was not entirely formalized and therefore difficult to test. The closest policy was a form and checklist provided by academic publications and scheduling services (APSS) that included limited information on scheduled release time. However, in our inquiries, we found that:

- One faculty member used the APSS assigned weighted teaching units (AWTU) certification of effort and outcome assessment form to request release time, but the form was not approved by the dean, as required, on the form.
- APSS was unable to locate several of the AWTU forms that were required to be sent and archived by its staff, according to its Workload Report Due Dates checklist, and indicated that this requirement had not been effectively communicated.

We reviewed the response and follow-up in the 2011 A&AS special investigative report, and we found that the campus proposed creating policies and procedures, including forms similar to the ones we were provided, as a remediation for the observations. However, our interviews and reviews indicated that these policies, if ever implemented, were not sustained.

A thorough and detailed set of campus policies and procedures governing release time would ensure that faculty and staff are aware of their duties and responsibilities that come with the benefit of release time, including submitting requests, certifying outcomes, and recording effort and other appropriate deliverables.

RECOMMENDATION

We recommend that the campus:

- a. Create and implement policies and procedures for the administration of academic release time that includes criteria for justifying, granting, monitoring, and reporting.
- b. Train stakeholders on these policies and procedures.

MANAGEMENT RESPONSE

We concur. The campus will:

- a. Create and implement policies and procedures for the administration of academic release time that includes criteria for justifying, granting, monitoring, and reporting.
- b. Train stakeholders on these policies and procedures.

Completion: August 30, 2019

3. CONVERTIBLE NOTES

OBSERVATION

The CFE did not always keep records that it performed required due diligence on each approved Accelerator Fund loan application and did not hold borrowers accountable to their convertible note terms and conditions.

The Accelerator Fund was established via a donation to the CFE, with a stated intention of encouraging student entrepreneurship. The program provides convertible note loans to students for proposed business enterprises. Students apply for loans by completing an application and making a presentation before a due diligence committee, which assesses the applications and makes decisions regarding awards. The CFE director observes these proceedings and is responsible for taking notes of the findings and the committee's discussion and recommendations, as record of the due diligence process. Applicants who receive financing for their businesses agree to reporting requirements included in their signed promissory notes. The note agreements state that the loan recipient must provide statements of income, shareholders' equity, and cash flows as soon as practicable after the end of the first fiscal year and in any event within 30 days thereafter. Further, borrowers must provide updated financial statements every six months after the initial reporting date.

We reviewed three convertible notes that were issued from the Accelerator Fund during the audit period and we found that:

- For one applicant who was issued a note, the CFE could not provide documentation of the due diligence committee review.

- For all three notes, the CFE could not provide documentation to verify that the loan recipient performed mandatory initial and periodic reporting.

Maintenance of the due diligence committee’s meeting minutes provides justification and accountability for lending decisions and can help future decision-making as committee members can refer back to prior discussions for retrospective analysis. Enforcement of note provisions on reporting requirements demonstrates proper stewardship of donor funds for the loan program, aids in monitoring the borrower payments and/or decision to convert to stock, and instructs borrowers on proper business accountability.

RECOMMENDATION

We recommend that the campus, in coordination with CFE:

- a. Retain committee minutes that record the due diligence process for determining loan recipients.
- b. Develop procedures for enforcing terms of notes, including methods to assure that all required reports are received and reviewed on the schedule outlined in the note.

MANAGEMENT RESPONSE

We concur. The campus will:

- a. Develop a process to retain committee minutes and ensure that the due diligence process for determining loan recipients is recorded.
- b. Develop procedures for enforcing the terms of notes, including methods to assure that all required reports are received and reviewed on the schedule outlined in the note.

Completion: August 30, 2019

4. CI FORMATION AND REPORTING POLICIES

OBSERVATION

During the audit period, the campus did not have an effective policy governing CI, and an interim policy had not yet been fully implemented.

In 2014, the chancellor’s office issued AA-2014-18, *Centers and Institutes: Guidelines Replacing Executive Order 751*, which directed campuses to develop and maintain policies and procedures related to the oversight and reporting of all CI and established minimum standards for formation, approval, reporting, and entity reviews. At the time, the campus had a related policy, EM 02-007, *Policy on Institutes and Centers*, in place. Our review of EM 02-007 indicated that it did not address certain requirements of the new systemwide policy, namely:

- Information on financial support.
- Information on organizational structure.

- Other required organizational documents.
- Annual reporting requirements.

Additionally, the campus did not comply with certain elements of EM 02-007. Specifically:

- Charters or similar documents for each CI were not maintained as directed.
- A process for administering the dissolution of a CI was not implemented.

In July 2018, the campus superseded EM 02-007 with an interim policy, EM 18-018, *Oversight of Ancillary Units Including Campus Centers and Institutes*. We found that this policy addresses all required elements of systemwide policy AA-2014-18, but that the campus, as of the audit period, had not yet created all committees and processes or implemented the oversight policy.

Detailed policies regarding CI formation can help to ensure that organizations with such a designation fulfill their proper duties and responsibilities. Maintaining annual reporting requirements can alert relevant personnel, such as those on the governing committee, as to the circumstances and challenges faced by the CI on campus and help them respond accordingly.

RECOMMENDATION

We recommend that the campus finalize and implement the interim CI policy to comply with AA-2014-18.

MANAGEMENT RESPONSE

We concur. The campus will finalize and implement a CI policy that complies with AA-2014-18.

Completion: August 30, 2019

5. CI EQUIPMENT CUSTODIANS

OBSERVATION

The tracking of tagged equipment for CI needed improvement.

We reviewed the RF equipment ledger for one CI and found that a retired faculty member was listed as the custodian for a piece of tagged equipment. Through the CI organizational chart and discussions with CI staff, we found that the faculty member had left the university several years ago.

Adherence to the University Foundation (UF)/RF *Property Policy* ensures that the individual responsible for a piece of equipment is an active faculty member who can verify the location and condition of property under his or her charge, thereby helping to safeguard assets.

RECOMMENDATION

We recommend that the campus periodically update and review CI equipment ledgers for accuracy.

MANAGEMENT RESPONSE

We concur. The campus will develop procedures to review and update CI equipment inventories.

Completion: August 30, 2019

GENERAL INFORMATION

BACKGROUND

Campus CI are formally approved interdisciplinary and/or collaborative units that are organized around scholarly, creative, research, education, and/or public service activity and sometimes offer services to constituents beyond the campus community. CI should provide clear benefits to the campus and align with the university's overall mission.

Systemwide policy for CI is delineated in AA-2014-18, *Centers and Institutes: Guidelines Replacing Executive Order (EO) 751*, which delegates responsibility for the approval and oversight of CI to campus presidents. Each campus is required to establish a written policy on the management of CI that includes requirements for the establishment of CI, periodic reporting and review, and suspension or dissolution.

In July 2018, California State University, Chico (CSU Chico) implemented a new policy, EM 18-018, addressing administration and oversight of ancillary units (AU), a broader term designed to encompass CI and other similar entities. Under EM 18-018, the campus president is responsible for CI oversight but can delegate this responsibility to the provost and subsequently to the deans. The policy also establishes the Ancillary Units Review Committee, a committee of the Academic Senate, which has responsibility for the systematic review of the AUs and advises the president on decisions of acceptance and continuation.

CSU Chico's most recent report to the chancellor's office indicated that the campus had 28 recognized CI. CI activities vary greatly and include, but are not limited to, research, professional development, creative activities, teaching, and public service. CI on campus include the California Mechatronics Center, the Northeast Information Center, and the Center for Bilingual/Multicultural Studies.

SCOPE

We visited the CSU Chico campus from October 1, 2018, through December 14, 2018. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls are in place and operative. The audit focused on procedures in effect from July 1, 2016, through December 14, 2018.

Specifically, we reviewed and tested:

- CI administration and organization, including clear lines of organizational authority and responsibility, documented delegations of authority, and current and comprehensive policies and procedures.
- Establishment and approval of CI, including alignment with the university mission and strategic plan.
- Operation and monitoring of CI, including annual reporting and periodic reviews.
- Suspension and dissolution of CI.
- Appropriate reimbursement to the campus by CI for services and resources used.

- CI activities, including the administration of conferences and other events, including appropriate approvals, financial controls, and risk management review, when necessary.
- Processes to ensure that CI expenditures are appropriate, allowable, authorized, and processed in accordance with CSU and campus policy, as well as relevant governmental regulations.
- Activities and risks associated with the specific CI selected for review.

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, which was designed to provide a review of key operational, administrative, and financial controls, included interviews, walkthroughs, and detailed testing on certain aspects of campus CI. Our review was limited to gaining reasonable assurance that essential elements for the administration of CI were in place and did not examine all campus CI.

CRITERIA

Our audit was based upon standards as set forth in federal and state regulations and guidance; 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:

- AA-2014-18, *Centers and Institutes: Guidelines Replacing Executive Order 751*
- Coded memorandum Academic and Student Affairs 2017-30, *Report on Campus Centers, Institutes, and Similar Entities*
- Coded memorandum Risk Management 2012-01, *Insurance Requirements*
- EO 1000, *Delegation of Fiscal Authority*
- EO 1059, *Utilization of Campus Auxiliary Organizations*
- Integrated California State University Administrative Manual (ICSUAM) §1101.00, *Delegation of Authority to Obligate the University*
- ICSUAM §3000, *General Accounting*
- ICSUAM §3552.01, *Cost Allocation/Reimbursement Plans for the CSU Operating Fund*
- ICSUAM §5000, *Contracts and Procurement*
- ICSUAM §11002.01, *General Policy Requirements for the Administration of Grants and Contracts in Support of Externally Funded Research and Sponsored Programs Activities*
- ICSUAM §13680.00, *Placement and Control of Receipts for Campus Activities and Programs*
- State Leadership Accountability Act, Government Code §13400 through §13407
- Executive Memorandum (EM) 02-007, *Policy on Institutes and Centers*

- The California Faculty Association *Collective Bargaining Agreement 2014-2020*
- EM 18-018, *Interim Executive Memorandum for Oversight of Ancillary Units (including Campus Centers and Institutes)*
- CSU Chico Research Foundation and RESP *Facilities and Administration Cost Rates Policy and Working with the University and Research Foundation*
- RESP *Colleges and Universities Rate Agreement*
- UF *Foundation Travel Policy*
- UF *Hospitality Expense Policy*
- RF/UF *Property Policy*

AUDIT TEAM

Audit Manager: Ann Hough
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