



UCSB Audit and Advisory Services

Internal Audit Report

**Integration and Control of Auxiliaries
Phase 2 Final Report**

September 24, 2014

Performed by:

Amin Berrah, Senior Auditor
Laurie Liao, Staff Auditor

Approved by:

Robert Tarsia, Director

Report No. 08-15-0004

This page intentionally left blank.



AUDIT AND ADVISORY SERVICES
SANTA BARBARA, CALIFORNIA 93106-5140
Tel: (805) 893-2829
Fax: (805) 893-5423

September 24, 2014

To: Distribution

Re: **Integration and Control of Auxiliaries - Phase 2 Final Report
Audit Report No. 08-15-0004**

As part of the 2013-14 annual audit services plan, Audit and Advisory Services began an audit of auxiliaries and other campus entities with certain similar characteristics, such as those that accept fees for services rendered to the campus community, are classified as charitable 501(c)(3) organizations, or are otherwise not fully integrated into the University's accounting systems. Phase 1 of this project was completed as part of our 2013-14 plan, with the Phase 1 Interim Report issued in July 2014. This report is our final report.

This project was included in our 2013-14 plan to obtain and document a better understanding of the operations of these organizations. We also anticipated that some of the results of our work could help inform future decisions regarding more complete integration of these entities with existing campus processes and systems, at a time that the campus is implementing a new financial system and other enterprise systems.

Phase 1 of the project included work to gain and document an understanding of current UCSB auxiliaries and other related entities, including their organization and governance, financial and accounting management, banking and cash management practices, personnel and payroll processes, and IT environments, including the use of existing campus systems and reliance on specialized systems not supported campus-wide. Phase 2, summarized in this report, emphasized detailed follow-up work in selected areas for the following organizations:

- Associated Students
- Career Services
- The Daily Nexus
- The Office of Student Life

The audit did not identify critical weaknesses in the areas reviewed. Our work did identify common opportunities for potential improvements in cash handling and other processes, including opportunities to improve separation of duties practices and other internal controls.

Detailed observations and management corrective actions are included in the following sections of the report. The management corrective actions provided indicate that each audit observation was given thoughtful consideration and that positive measures have been taken or planned to implement the management corrective actions. The cooperation and assistance provided during the review by personnel in Associated Students, Career Services, The Daily Nexus, the Office of Student Life, and Business and Financial Services was greatly appreciated. If you have any questions, please feel free to contact me.

Respectfully submitted,



Robert Tarsia
Director
Audit and Advisory Services

Enclosure

cc:

Chancellor Henry Yang
Vice Chancellor Administrative Services Marc Fisher
UCSB Audit Committee
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca

Distribution:

Student Affairs

Vice Chancellor for Student Affairs Michael D. Young
Bill McTague, Executive Director of Resource Planning, IT, and Sustainability
Marisela Márquez, Executive Director, Associated Students
Cindy Lopez, Assistant Director for Finance and Budgets, Associated Students
Tom Bennett, Business Officer, Career Services
Linda Meyer, Publications Director, Daily Nexus
Katya Armistead, Associate Dean for Student Life & Activities
Miles Ashlock, Associate Director, Office of Student Life

Administrative Services

Acting Associate Vice Chancellor Pam Lombardo
Jim Corkill, Controller and Director, Business and Financial Services
Leslie Griffin, Associate Director, Business and Financial Services

PURPOSE AND SCOPE

As part of the 2013-14 annual audit services plan, Audit and Advisory Services began an audit of auxiliaries and other campus entities with certain similar characteristics, such as those that accept fees for services rendered to the campus community, are classified as charitable 501(c)(3) organizations, or are otherwise not fully integrated into the University's accounting systems. Phase 1 of this project was completed as part of our 2013-14 plan, with the Phase 1 Interim Report issued In July 2014. This report is our final report.

The purpose of this project was to assess the current state of auxiliaries and other selected campus entities in regard to:

- The use of campus accounting, payroll, and other systems.
- Applicability of, and compliance with, UC and UCSB policies and procedures.
- Overall adequacy of select business processes and internal controls.

This project was included in our 2013-14 annual audit services plan for several reasons, one of which was to obtain and document a better understanding of the operations of these organizations. It was anticipated that the results of this audit may help inform future decisions regarding more complete integration of these entities with existing campus processes and systems, at a time that the campus is implementing a new financial system and other enterprise systems.

Phase 1 of the project included substantial work to gain and document an understanding of current UCSB auxiliaries and other related entities, including their:

- Organization and governance.
- Financial and accounting management.
- Banking and cash management practices.
- Personnel and payroll processes.
- IT environments, including the use of existing campus systems and reliance on specialized systems not supported campus-wide.

Phase 2, summarized in this report, emphasized detailed follow-up work for four organizations: Associated Students, Career Services, The Daily Nexus, and the Office of Student Life.

METHODOLOGY

Data Gathering

We performed extensive background and data gathering work to inform the risk assessment phase of this project, including review of:

- Completed questionnaires from every auxiliary and other organization within the potential scope of this audit, which we distributed to obtain basic background information about their operations and the subject areas listed above.
- CPA audits and other relevant financial and operating information.

- Policies and procedures, including:
 - Evaluating University of California (UC) and University of California, Santa Barbara (UCSB) policies and procedures relevant to the audit, including those that establish and define auxiliaries; campus regulations governing organizations; cash handling, procurement, personnel and payroll, and IT procedures; and other potentially relevant areas.
 - Identifying UCSB departmental policies and procedures that are possible campus best practices.
 - Internet research to identify common policies and procedures other institutions have in the functional areas in the scope of the audit.
 - Researching federal regulations applicable to the organizations in the scope of this audit.
- Other audits and reviews relevant to this audit, including work by UCSB Audit and Advisory Services, other UC campuses, and other universities and institutions.

We also performed interviews with UCSB personnel, including staff from some of the organizations for which detailed work was performed.

Risk Assessment

We created a risk assessment model with 19 potential risk factors based on our Phase I observations and interviews; the Appendix to this report lists the broad categories of risk we used in our assessment. We then evaluated each of the organizations within the potential scope of this audit to determine which risk factors were present, and assigned an overall risk rating to each organization on a 1-3 scale, based on the number of risk factors observed, the financial exposure to the University, and the existence of any prior audit findings.

Areas of Focus

As a result of our campus-wide assessment, we selected the following organizations for detailed Phase 2 audit work:

- Associated Students
- Career Services
- The Daily Nexus
- The Office of Student Life

Our work in these organizations included:

- Gaining and documenting a more in-depth understanding of the organizations in regard to business processes and systems, the applicability of UC and UCSB policies, and selected internal controls.
- Evaluation of cash handling and other key processes, separation of duties practices, and other internal controls. The work performed for each organization varied based on our earlier work and the input of responsible personnel.
- Detailed testing, as considered necessary, to determine whether departmental processes are in place and operating as intended, including testing of cash deposits and disbursements.

This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

BACKGROUND

Auxiliary enterprises are defined by UC Policy BFB-BUS-72, *Establishment and Review of Auxiliary Enterprises*, and UCSB Policy 6000, *Establishment and Review of Auxiliary Enterprises*, as self-supporting activities that provide non-instructional support in the form of goods and services to students, faculty, and staff upon payment of a specific user charge or fee. Examples include Housing and Residential Services and Transportation and Parking Services. This audit focused on both auxiliaries and other campus entities with some similar characteristics, such as those that accept fees for services rendered to the campus community (e.g. Career Services), are classified as charitable 501(c)(3) organizations (e.g. the Alumni Association), or are otherwise not fully integrated into the University's accounting systems (e.g. the Office of Student Life).

Regulations and Policies

Regulations, policies, and procedures considered most relevant to the scope of this audit included:

- UC Business and Finance Bulletin (BFB) BUS-72, *Establishment and Review of Auxiliary Enterprises*, and UCSB Policy 6000, *Establishment and Review of Auxiliary Enterprises*, which define auxiliaries and provide guidance for their fiscal organization and oversight.
- Internal Revenue Code Section 501(c)(3), *Exemption From Tax on Corporations, Certain Trusts, etc.* (26 U.S.C. §501(c)(3)), allows for federal tax exemption of nonprofit organizations, specifically those that are considered public charities, private foundations, or private operating foundations. In order to qualify for 501(c)(3) status, an entity must be organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes. While this status confers some benefits on exempted organizations, it also imposes specific reporting and compliance requirements.
- Internal Revenue Code Section 512, *Unrelated Business Tax Income* (26 U.S.C. § 512), defines income subject to the Unrelated Business Income Tax (UBIT), which applies to organizations otherwise exempt from income tax under IRC section 501(c) if they earn income in a trade or business unrelated to their tax exemption.
- *Campus Regulations Applying to Campus Activities, Organizations, and Students*, a UCSB policy and procedure, addresses the rights and responsibilities of members of the University community and provides campus-wide standards for the formation, privileges, and responsibilities of registered campus organizations, including guaranteed access to an on-campus accounting service and restrictions on how student organization funds may be spent. This guidance also grants UCSB's Chancellor fiscal oversight of student organizations to ensure their compliance with UCSB policies and sound business practices.
- Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (SAS 115), along with related campus guidance, includes important information regarding key controls that departments are responsible for documenting.

- UC BFB BUS-49, *Policy for Cash and Cash Equivalents Received* (BUS-49), establishes the University's policies related to handling and processing cash and cash equivalents, and defines roles and responsibilities related to receipt, safeguarding, reporting and recordkeeping for all University cash and cash equivalents. Under BUS-49, cashiering functions are classified as a Main Cashiering Station (campus operating unit from which collections are deposited directly to a University bank account); a Sub-cashiering Station (campus operating unit from which collections are deposited to a Main Cashiering Station); or a Cash Handling Department (a campus operating unit that typically collects cash or cash equivalents and deposits to either a Main Cashiering Station or a Sub-cashiering Station).

Phase 2 Entities

Associated Students - The Associated Students is a non-profit organization and a UCSB department, funded by undergraduate student fees and on-campus operations such as a ticket office, publications, and bike shop. The organization's mission is to help students uphold high academic standards and give them leadership, employment, cultural, and growth opportunities to serve the campus community.

Career Services - The mission of Career Services is to help students and recent graduates of the University of California identify and fulfill their career goals by providing comprehensive resources, programs, and counseling on career development, internships, employment, and graduate school. Career Services provides various students and recent alumni placement services, and organizes campus career fairs for participating employers in exchange for a fee.

The Daily Nexus - The Daily Nexus is an independent student-run publication; according to its staff, it is organized as a campus department. The editor-in-chief oversees the editorial content of the newspaper, while the publications director manages its fiscal operations. The Chancellor appoints a press council that consists of three students, one faculty member, and one professional; the council approves the newspaper's budget and mediates controversies between the public and the Daily Nexus.

The Office of Student Life - The Office of Student Life (OSL) is part of the Student Life Suite in Student Affairs. OSL administers campus organizations, fraternities and sororities, and leadership development programs, as well as several special activities initiatives including After Dark, CommUnity Grants, and Student-Initiated Outreach Programming. OSL acts as the fiscal agent for approximately 450 organizations, including student government, academic and community service organizations, and sports and social clubs.

SUMMARY OPINION

The audit did not identify critical weaknesses in the areas reviewed. Our work did identify common opportunities for potential improvements in cash handling and other processes, including opportunities to improve separation of duties practices and other internal controls.

DETAILED OBSERVATIONS AND MANAGEMENT CORRECTIVE ACTIONS

A. Associated Students

In consultation with the organization, our detailed review work focused on compliance with 501(c)(3) requirements and internal controls over cash receipt procedures. The results of our work in these areas did not identify serious concerns, including any significant weaknesses in accountability over Associated Students funds. We did identify areas for improvement in the separation of duties and documentation of cash handling procedures, including better compliance with BUS-49 and sound internal control practices.

1. Separation of Duties

We found that some cash receipt and related processes should be evaluated and revised to ensure that there is appropriate separation of duties:

- Mail receipt processes should be evaluated to ensure that mail remittances are handled by two employees, as required by BUS-49. Currently, a student employee receives and sorts the majority of incoming checks. Although checks received by mail remittance are listed in an Excel spreadsheet used to track such revenues, the student employee is not supervised during the process and is not maintaining a mail log. We also noted that another employee who occasionally receives checks is currently responsible for the monthly reconciliation.
- Monthly reconciliation procedures should be revised so that an employee independent of the cash receipts process is responsible for reviewing and approving monthly reconciliations. While we determined that monthly reconciliations are performed, there is no documented, independent review of the reconciliation worksheets.

2. Cash Deposit Procedures

We found that, in certain instances, substantial cash receipts were being delivered to the bank by Associated Students employees rather than by armored car. BUS-49 requires that deposits be adequately protected from loss while in transit. Based on our work on this project, we believe it would be prudent for Associated Students to consult with Business and Financial Services to determine the proper classification of the Associated Students Cashiers and Ticket Office in the University Center as either a Main Cashiering or Sub-Cashiering station under BUS-49, and to request a review of physical security and other cash controls that are relevant to the classification.

Management Corrective Actions

Subsequent to the audit, Associated Students staff informed us that all deposits are now being taken to the bank by armored transport.

Associated Students will address the remaining issues by:

- Implementing a hard copy mail log. The Administration Office Coordinator will oversee the opening of the mail, and verify that all the checks are logged and given directly to the record keeping specialist. This change will be implemented by December 2014.
- Completing training of the Financial Analyst to perform monthly reconciliations of the operating bank accounts. The Associate Director of Business and Finance will review and approve the reconciliations. This change will be implemented by December 2014.
- Consulting with Business & Financial Services regarding the applicability of BUS-49. Although Associated Students management believes that the organization might be exempt from the BUS-49 cashiering station classifications, the department will work with Business & Financial Services to determine if it needs to be classified as either a Main Cashiering or Sub-Cashiering station.

Audit and Advisory Services will follow up on the status of this issue by January 31, 2015.

B. Career Services

Our detailed review work in Career Services included a review of internal controls over cash receipts and critical functions related to procurement, personnel, payroll, and accounting. Although we determined that cash receipt procedures are adequate to ensure the safeguarding of funds, we did identify potential for improvement in the area of segregation of duties.

We recommend that Career Services:

- Evaluate mail receipt processes to ensure that mail remittances are handled by two employees, as required by BUS-49. Currently, the employee who receives checks is also responsible for entering them into the Excel workbook used for tracking employer career fair registrations and performing the monthly reconciliation.
- Review and revise monthly procedures for the reconciliation of check receipts, so that an employee independent of the cash receipts process is responsible for performing the reconciliation, and ensure that the review of the reconciliation is properly documented. This would help ensure that processes are consistent with sound internal control practices.

Management Corrective Actions

Subsequent to the audit, Career Services implemented the audit recommendations by:

- Revising mail receipt procedures so that the mail is processed by two employees and documented in a paper mail log. The Business Officer enters check data and the Assessment Officer verifies the log and documents her review.
- Modifying procedures so that the review of the reconciliation of spreadsheet totals to deposit slip totals is properly documented.

C. The Daily Nexus

The information that the Daily Nexus provided to us during our initial audit work included data regarding cumulative deficits of \$860,833, the aggregate of annual deficits accumulated between 1998 and 2007. Daily Nexus staff explained to us that the organization's fiscal situation has changed in the last few years, as advertising revenues have declined during the transition to a more digital era in publishing. During this period, the Daily Nexus has focused on staying solvent, and has reduced staff and made other cost-cutting measures. Daily Nexus staff has a plan in place to address the structural deficit, including a ballot measure planned for spring 2015 on increasing student fees dedicated to the publication of the Daily Nexus. To potentially assist with this effort, we agreed with Daily Nexus staff that our review would focus on validating the organization's reported financial data, and on confirming that advertising revenues are being properly collected. We found the following:

- *Reported Financial Data:* We were not able to completely validate the financial data provided to us using UCSB Data Warehouse reports. The unreconciled differences between the two sources of data may be due to the timing of entries at fiscal year-end or other reasons. To ensure that the Daily Nexus can substantiate its reported financial data, we recommend that Daily Nexus staff review and reconcile reported financial data with Data Warehouse reporting, and make any necessary adjustments.
- *Revenue Collection Procedures:* Procedures over the collection of advertising revenues could be strengthened. While Daily Nexus staff follow up on outstanding accounts monthly by sending out invoices and making phone calls to advertisers with past due accounts, previous staff had discontinued practices that included sending outstanding non-University accounts to a collection agency at the end of each fiscal year, and ensuring that it collects all internal University accounts. We recommend that the Daily Nexus resume the practices of sending outstanding accounts to a collection agency and collecting all University accounts, to maximize revenue while minimizing the workload of the limited Daily Nexus staff.

Management Corrective Actions

The Daily Nexus will address these issues as follows:

- *Reported Financial Data:* Daily Nexus staff, in conjunction with supporting OSL financial and payroll staff, will review and reconcile reported financial data with campus Data Warehouse reporting, and make any necessary adjustments in time to ensure that records are accurate in setting the new lock-in fee request.
- *Revenue Collection Procedures:* With approval from Business and Financial Services, the Daily Nexus will resume the practices of sending outstanding accounts to a collection agency and collecting all University accounts.

Audit and Advisory Services will follow up on the status of this issue by January 31, 2015.

D. The Office of Student Life

As discussed in the Background section of this report, OSL acts as the fiscal agent for approximately 450 organizations, including student government, academic and community service organizations, and sports and social clubs. At the time of our review, the organization was transitioning to a new accounting system that it had determined would be more effective for its day-to-day business needs, and was also revising its cash receipt and handling processes. In consultation with OSL, our detailed review emphasized cash receipt and handling processes to help ensure that there are adequate controls in place as OSL transitions to its new accounting system. We also assessed certain issues related to accountability and oversight.

1. Accountability and Oversight

Our discussions with OSL staff and other audit work identified opportunities to improve accountability and oversight, consistent with the organization's role as fiscal agent for approximately 450 other organizations:

- Annual, independent financial audits or reviews would help ensure that there is sufficient transparency and oversight, as well as help address the appropriate design of internal controls, and any potential concerns relating to compliance with applicable regulations, policies, and procedures.
- There is an existing agreement between OSL and the Department of Recreation that we found to be insufficient to constitute an effective memorandum of understanding (MOU) between the organizations. The agreement, which is over 19 years old, does not adequately define roles and responsibilities, or resolution procedures for incorrect or erroneous disbursements. The document also refers to two former employees by name as approvers instead of a specific procedure or title, and may not contain the correct listing of currently approved sports clubs. We recommend that OSL work with the Department of Recreation on an MOU that clearly outlines the roles and responsibilities of both organizations.

2. Accounting and Cash Handling

Although the results of our limited review of OSL's new system suggest that it will provide better functionality and improved internal controls, we did identify some areas for improvement in internal controls over cash receipts:

- The receipts designed by OSL and given to student organization members making deposits¹ are not adequately detailed. It would be difficult to identify a lost or stolen part of a deposit, because checks are not individually listed on deposit sheets, and the total number of checks deposited is not consistently recorded on the receipts.
- Certain student organization deposits are processed by an OSL employee who also enters the student organization account activity into the accounting system, and delivers these checks to the Associated Students Cashiers and Ticket Office window for deposit. BUS-49 requires procedures that ensure that no single individual is responsible for collection, handling, depositing, and accounting for cash received. Although the employee with these duties is not responsible for cashing, the current procedure does not provide sufficient assurance that deposits are intact when they are delivered to the Associated Students Cashiers and Ticket Office.

Management Corrective Actions

The Office of Student Life has already implemented revised mail-handling procedures to ensure that check collection and depositing are adequately separated among personnel. Specifically, incoming mail is now reviewed by two people (always excluding the campus organizations accountant) who keep a written record of all checks received prior to delivering them to the campus organizations accountant. The Office of Student Life (OSL) will implement the report's remaining suggested actions as indicated below:

- By December 1, 2014, the Office of Student Life will enter into new agreements with the Department of Recreation (regarding accounting services for sport clubs) and the Associated Students (regarding services rendered to OSL by the Associated Students' Cashier). These agreements will be valid for a two-year term and will be renewed biennially thereafter.
- Effective December 1, 2014, the Office of Student Life will require that all receipts filed by the Associated Students Cashier include an itemized list of deposited checks, including payer surname, check number and amount. This change will be specified in the agreement with the Associated Students.
- After June 30, 2015, but not later than September 1, 2015, OSL will procure the services of an independent auditor to review the unit's policies, procedures, controls, and service delivery related to campus organization accounting. The first audit will serve as a review of the 2014-15 fiscal year, and will thus provide detailed feedback on the new accounting system implemented in July 2014. Audits will be scheduled annually thereafter in the same June 30 to September 1 timeframe.

Audit and Advisory Services will follow up on the status of the proposed MOUs and revised accounting and cash handling procedures by January 31, 2015, and will follow up on the status of the independent audits by October 31, 2015.

¹ These deposits are made at the Associated Students Cashiers and Ticket Office.

Appendix	Potential Risk Factors of Auxiliaries and Other Entities
Materiality / Exposure	
Revenues and expenses.	
Organization & Governance	
Organization is a separate entity, e.g., 501(c)(3).	
Taxpayer Identification Number (TIN) distinct from the University's.	
The organization's operations may not incorporate certain UC and/or UCSB procedures.	
Delegated procurement or contracting authority.	
Financial / Accounting Management	
No audited financial statements.	
Does not use the University's financial systems or uses them differently than other departments.	
The organization has an agency account.	
Banking and Cash Management	
No recent review of cash handling procedures.	
Non-UC Regent / University bank account(s).	
Designated payees other than UC Regents.	
Maintains a petty cash fund.	
Personnel and Payroll	
Does not use the UC payroll system, PPS.	
Employees not on UC's payroll.	
Owes the University at least one month's payroll expense.	
The organization does not use the University's timekeeping system, Kronos.	
Systems / Information Technology	
Use of IT systems or computer application not provided / supported by the campus.	
Other Potential Risks	
Department or process-specific risk.	

Source: Auditor Analysis