

The logo for UCIrvine, featuring the letters 'UCI' in a large, bold, serif font, followed by 'RVINE' in a smaller, all-caps serif font. A vertical line separates the 'UCI' and 'RVINE' parts of the logo.

UCIRVINE

The text 'INTERNAL AUDIT SERVICES' in a serif font, positioned to the right of the UCIrvine logo. A vertical line is to the left of this text.

INTERNAL  
AUDIT SERVICES

## University Club

*Internal Audit Report No. I2014-327*

November 13, 2013

***Prepared By***

Mike Shead, Senior Auditor

***Reviewed By***

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***Approved By***

Mike Bathke, Interim Director



INTERNAL AUDIT SERVICES  
IRVINE, CALIFORNIA 92697-3625

November 13, 2013

**GARY W. MATKIN Ph.D.**  
**DEAN**  
**CONTINUING EDUCATION, DISTANCE LEARNING, SUMMER SESSION**

**RE: UC Irvine University Club Review**  
**Report No. I2014-327**

Internal Audit Services has completed the review of the University Club and the final report is attached.

We extend our gratitude and appreciation to all personnel with whom we had contact while conducting our review. If you have any questions or require additional assistance, please do not hesitate to contact me.

*Mike Bathke*

Mike Bathke  
Interim Director  
UC Irvine Internal Audit Services

Attachment

C: Audit Committee  
David Tomcheck, Executive Director - University Club

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## I. MANAGEMENT SUMMARY

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At the request of the University Club (UClub) Board of Directors (BoD) and management, Internal Audit Services (IAS) reviewed the calendar year (CY) 2012 business operations and financial activities of the UClub. The UClub was established in 1967 as a 501(c)(3) nonprofit organization designed to serve UC Irvine faculty, staff, students, and other defined members. The UClub is currently beset with several challenges, including revenue and profitability, resources for deferred maintenance and facilities enhancements, substantial debt, and strong competition from both on-campus and off-campus entities. Certain operations and activities could be improved to assist the UClub in attaining financial stability. The following areas were reviewed.

**Operations and the Business Environment** – An overview was completed of the UClub’s strengths and opportunities, and its weaknesses and challenges. The review is documented in section V.1.

**Financial Reporting** – Financial reporting processes were reviewed to determine that financial reports provided to stakeholders are timely, accurately prepared in accordance with generally accepted accounting principles (GAAP), and/or facilitate management control and decision-making. Concerns were noted. This observation is discussed in section V.2.

**Governance** – The UClub’s governance structure was reviewed to determine that it is functional, compliant with key policies and procedures, and able to address current challenges. Stakeholder consensus is needed for a unified vision of the UClub’s future. Details related to these issues are provided in Section V.3.

**Internal Controls and Fraud Risk** – Key internal controls were reviewed in cash handling and depositing, accounts receivable (A/R), accounts payable (A/P), and payroll processes to determine that control measures are adequate to prevent/detect fraudulent and/or non-compliant activities. Concerns are discussed in section V.4.

**Other Concerns** – Employees were interviewed and observations were made to determine the nature of other operational concerns. Concerns were noted in revenue and cash flow, marketing and sales, facilities management, and other areas. This observation is discussed in section V.5.

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## II. BACKGROUND

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The UClub was established in 1967 as a separate, non-University of California (UC) entity. The UClub's purpose was to further the educational objectives of the UC by operating facilities to provide members with a place to meet and interchange ideas and information to achieve the University's goals. In the early 1980s, UC Irvine employees and Irvine community members donated construction funds to the UC Regents to build a meeting facility and principal offices for the UClub. The UClub facility was completed in 1982. It is owned by the UC and leased to the UClub. The UClub is strategically located on the outer circle of the Irvine campus, and offers a variety of activities for UC faculty, staff, students, other defined members, and the Orange County community.

Currently, the UClub is divided into two business units to facilitate unrelated business income tax (UBIT) reporting. Two sets of accounting records are maintained, one for the (not-for-profit) UClub, and the other for the (for-profit) UClub Catering Services. An unaudited profit and loss (P&L) statement and balance sheet are prepared annually for each business unit. The UClub outsources the preparation of required tax returns.

For the previous 20 years, the UClub has had difficulties generating sufficient income from business operations to support ongoing maintenance, repair and capital improvement needs. From 1984-92, the UC Irvine Chancellor provided \$40,000 a year to fulfill these needs. However, an early-1990s recession ended these annual allocations. Subsequently, a 1993 agreement was formed between the UC Regents and the UClub, which required UC Irvine to pay for all of the UClub's maintenance, repair, and equipment expenditures that exceeded \$2,500. However, UClub management has stated that, notwithstanding the 1993 agreement, UC Irvine administrators expect the UClub to be a fully self-supporting entity.

The UClub is governed by a seven-member BoD. The UClub Executive Director, an ex-officio BoD member, is responsible for daily operational oversight of the UClub. The Executive Director is assisted by a full time general manager, wedding coordinator, event manager, event coordinator and two part time bookkeepers. Currently, the UClub has 16 full time and 32 part time, (all non-UC) employees.

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### III. PURPOSE, SCOPE AND OBJECTIVES

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The scope of the review focused on CY 2012 UClub financial activities and business operations. Certain UClub financial activities occurring prior to CY 2012 were also reviewed. The primary purpose of the review was to assess the current business operations and financial position of the UClub. In addition, the governance structure, financial reporting processes, certain key internal controls, and other operational concerns were assessed. Collectively, these areas were evaluated to determine that UClub business operations are efficient and effective, and that adequate control measures are in place to prevent or detect fraudulent and/or non-compliant transactions.

The review included the following procedures.

1. Completed an overview of operations and the business environment to determine current strengths/opportunities and weaknesses/challenges.
2. Reviewed financial reporting processes to determine that financial reports are timely, accurately prepared in accordance with GAAP, and/or facilitate management control and decision-making.
3. Reviewed the governance structure to determine that it is operating in a functional manner, is compliant with key policies and procedures, and is able to meet present and future challenges.
4. Reviewed key control measures in cash handling and depositing, A/R, A/P, and payroll processes to determine that internal controls are adequate to prevent/detect fraudulent and/or non-compliant activities.
5. Reviewed other identified concerns affecting the efficiency and/or effectiveness of UClub business operations.

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### IV. CONCLUSION

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The UClub is currently experiencing several operational challenges which impede its ability to maintain financial stability. Improvements are warranted in governance, financial reporting and accounting practices, certain key internal

control measures, and other identified concerns. These details are presented below.

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## V. OBSERVATIONS

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### 1. UClub Operations and the Business Environment

#### Observation

IAS completed an overview of the UClub's operations and the business environment to determine current strengths/opportunities and weaknesses/challenges.

#### Strengths and Opportunities

The UClub's core competencies include on-site/catered food and beverage services, and event planning, sales and management for on/off campus customers. The UClub's competitive advantages include pricing, particularly with events; adaptability in serving the needs of eclectic groups of clientele; flexibility in meeting event customers' time sensitive demands; on-campus customer convenience, via its prime location; and service experience, with many long-term, loyal employees.

Primarily through its ability to differentiate some of its business activities from those of on/off campus competitors, the UClub has realized rapid growth, and may have additional growth opportunities in certain high profit-margin, niche markets that include wedding/anniversary events, bar/bat mitzvahs, and certain other events sponsored by on/off-campus customers. Overall, event planning, sales, and management activities have been the primary influence that has enabled the UClub to endure a challenging business environment.

#### Weaknesses and Challenges

The recent recession severely impacted the UClub's patronage and substantially undermined financial results. At the end of CY 2012, the UClub (both business units combined) reported liabilities of \$593,000. Most of the

liabilities involved amounts owed to UC Irvine. Liabilities included \$150,000 in outstanding loans from UC Irvine, and a \$190,000 outstanding A/P balance due to the Facilities department and other UC Irvine departments. As a result, total UClub liabilities exceeded total assets by \$104,000 at December 31, 2012. Additionally, the reported UClub liabilities did not include a \$56,000 liability involving accrued expenses for employee paid time off.

Although the annual building lease payment to UC Irvine is nominal (\$1.00 per year), the UClub has been unable to generate adequate cash flow from business activities to pay down outstanding debt and payables owed to UC Irvine. The UClub has also had difficulties establishing an emergency reserve fund and accumulating funds for future capital expenditures. Competition in food and dining services appears to be a primary reason.

UC Irvine cannot protect its vendors from outside competition; off-campus contractors often compete with University vendors (including the UClub) for food/dining services at many University-sponsored events. In addition, some of the UClub's food and dining services are duplicated by other University vendors. As a result, the UClub's business activities and cash flows are negatively impacted. In addition, the UClub has negligible fund-raising efforts. Altogether, these factors undermine the UClub's ability to maintain financial stability. With its current business model, the UClub may not be able to pay off outstanding obligations, establish adequate reserve funds, and reach financial stability without outside support.

### **Recommendation**

The BoD and UClub management should discuss the UClub's operating/financial concerns with University officials. Attempts should be made to obtain additional income through increasing on/off-campus sales. The UClub's finances could also be improved through persistent fund-raising efforts and/or direct University support.

## 2. Financial Reporting

### Observation

IAS reviewed the UClub's financial reporting processes. In addition, a limited review of CY 2012 financial statements (P&L statement and balance sheet) was performed. The following concerns were noted.

- a. Unaudited Financial statements are prepared just once per year for the UClub's two business units.
- b. Several omissions and inconsistencies were noted in the UClub's unaudited financial statements. Noted exceptions included, but were not limited to the following:

#### Outstanding Loans

At December 31, 2012, the UClub reported \$150,000 in loans owed to UC Irvine, consisting of a \$100,000 loan for equipment and major/minor repairs, and a \$50,000 emergency loan for payroll and other operating expenses. The \$50,000 loan was established in June 2007, and appears to be accurately valued. However, discussions with UClub management disclosed that documentation does not exist for the \$100,000 loan. The loan appears to have been established at least ten years ago. Both loan amounts were reported as current liabilities. However, the loans will not be repaid in calendar year 2013, and should have been reported as long-term liabilities.

#### Expense Accruals

As aforementioned, year-end accrued expenses for employee paid time off (PTO) were not recorded on the P&L statement. Similarly, the unused portion of accrued expenses for PTO (\$55,760 at December 31, 2012) was not recorded on the balance sheet, thereby understating the UClub's liabilities.

#### Other Noted Items

- 1) The accumulated depreciation for one asset class appeared to exceed the value of the asset class itself. Other depreciable asset classes did not appear to have any associated accumulated depreciation.



- 2) Inter-company receivables and payables were not properly accounted for and presented. Negative balances were reported for some of the liabilities.

Overall, the CY 2012 financial statements prepared by the UClub are not prepared in accordance with GAAP. Omissions, inaccuracies and inconsistencies in the UClub's financial statements may undermine their overall credibility to the BoD.

### **Recommendation**

The UClub's bylaws require the books and records of account to be audited annually after the end of the calendar year. UClub management should consider hiring an independent professional firm to perform an annual audit of the U-Club's books and records of account (both business units).

In addition, management should discuss financial reporting needs with the BoD and consider preparing quarterly financial statements that include a P&L statement, balance sheet, and statement of cash flows. The UClub Accounting Office may need some assistance in preparing financial statements that conform to GAAP.

### **Observation**

IAS also reviewed the UClub's financial reporting processes to determine whether prepared reports facilitate management control and decision-making. The following concerns were noted.

- a. Reports disclosing contribution margins are not prepared, and cost analyses are not used extensively by management to monitor UClub operations.
- b. Industry-specific, diagnostic "tools" are not used extensively by management to increase sales revenue, control costs and/or improve profit margins.

## Recommendation

Management should consider a more extensive use of cost accounting practices in management control and decision-making. Computations of contribution margins/ratios, cost-volume-profit analyses, break-even analyses, price/quantity variance analyses and/or opportunity cost analyses may increase management's ability to effectively monitor business operations and improve financial performance.

Furthermore, the use of certain industry-specific, diagnostic "tools" may assist management in controlling costs in problematic areas common to the food and beverage industry, including inventory management, liquor and food waste/shrinkage, labor costs, and facility maintenance. In addition, detailed financial analyses and management observations of UClub business operations could be further utilized to increase revenue and/or control costs.

## Observation

IAS reviewed the financial reporting "structure" for the UClub and the UClub Catering Services business units. The following concerns were noted.

- a. Efforts by the Accounting Office to maintain two sets of books consumes a significant amount of employee resources that could be better utilized.
- b. Accounting for inter-company transactions, which has occasionally involved a cumbersome movement of funds between bank accounts, has been problematic for the Accounting Office.
- c. Most expenditures are initially recorded on the (not-for-profit) UClub's books, because they cannot be identified solely as "not-for-profit" or "for-profit" expenses. A one-time allocation is completed annually to move a portion of expenses to the (for-profit) UClub Catering Services' books. However, this allocation process may not be apparent to the BoD and other financial statement users, and may distort each business unit's actual financial performance;
- d. A "combined" UClub P&L statement is not prepared by the Accounting Office. As a result, BoD members have difficulties evaluating the financial performance of the UClub in entirety.

### **Recommendation**

Management should explore the idea of maintaining just one set of books for all UClub operations. Recording revenue and expenses in appropriate not-for-profit and for-profit accounts that are encapsulated in one set of books would be less time-consuming and cumbersome, while continuing to enable financial statement preparation and UBIT reporting.

Additionally, in preparing the UClub's financial statements, management should include footnotes that fully disclose significant accounting policies. Accounting policies that should be disclosed include methodologies/estimates for allocating expenses between the UClub and UClub Catering Services.

### **3. Governance**

#### **Observation**

IAS reviewed the UClub's governance structure to determine whether it is operating in a functional manner, compliant with key policies and procedures, and able to meet existing and future challenges. The following concerns were noted.

- a. The vision, mission, and goals of the UClub, as stated, are incongruent with current operations. Furthermore, the UClub's primary stakeholders have different opinions as to what the UClub's current vision, mission, and goals should be.
- b. The BoD has not been meeting at the intervals required in the bylaws, and may not provide sufficient leadership and guidance in UClub business activities. The overwhelming majority of the current BoD consists of members who are retired and not engaged in the day-to-day activities of the UCI campus.
- c. Portions of the bylaws and the operating agreement between the University and the UClub are out of date and/or not synchronized with the UClub's current operations, which may hinder governance of the UClub.

## Recommendation

Key stakeholders should agree on a definition of success for the UClub, and the vision, mission, and goals for the UClub should align accordingly.

The composition of the BoD may need to be reconstituted and revitalized to better provide the necessary oversight to UClub operations. BoD membership should consist of individuals whose interests and skills are aligned with the UClub's mission. Standards of performance for the BoD should be updated and enforced.

The UClub's bylaws should also be updated so that they align with UClub operations in the current business environment. The BoD also needs to partner with University administrators to update and re-work the operating agreement. Financial stability for the U-Club should be the agreement's foundation.

In addition, roles and responsibilities need to be further defined for the UClub's management and staff. Written process descriptions and policies/procedures need to be developed. The UClub may also need assistance from UC Irvine Human Resources in policy development and training.

## Observation

IAS reviewed the UClub's current business strategies. The following concern was noted.

One of the current business strategies may be disadvantageous to the UClub's overall success. In-house dining at the UClub appears to be a required offering that is also a loss leader. A "loss-leader" strategy can be successful when losses directly result in sales revenue and profit increases in other business activities. However, it is unclear how sustained financial losses in UClub in-house dining services result in greater customer awareness, revenue, and profit in on/off-campus event planning, sales and management.

## Recommendation

Changes may be warranted in the UClub's current business strategies. Management may need to fine-tune in-house dining services until this business operation can either become self-supporting, or can sufficiently offset its losses by increasing revenue/profit in the UClub's other business activities.

## 4. Internal Controls and Fraud Risk

### Observation

IAS reviewed internal controls in cash handling and depositing, A/R, A/P, and payroll processes to determine whether control procedures are adequate to prevent and detect fraudulent and/or non-compliant activities. Noted internal control concerns included, but were not necessarily limited to the following.

#### a. Cash/Equivalent Handling, Depositing, and Reconciliation

##### Cash Handling

- 1) The UClub's change fund balances fluctuate, depending on operational needs. Although the change funds are verified, they are not always verified in joint custody, and the verification results are not adequately documented;
- 2) Surprise cash counts of change funds are not performed/documented by individuals who do not routinely handle cash/equivalents. Similarly, surprise reconciliations of change funds to the cash drawer tracking sheet and to the "cash drawer" general ledger account is not being performed/documented;
- 3) Petty cash funds are reconciled by the same person who requests, disperses, and approves petty cash disbursements. Periodic surprise verifications and reconciliations of the petty cash fund are not performed and documented by individuals who do not routinely handle cash/equivalents;
- 4) Bartenders may sometimes fail to record beverage sales in the point of sale (POS) system. As a result, at closing time the amount of cash/equivalents in the cash drawer may be significantly more than the amount of recorded sales. To correct this imbalance, estimated sales

transactions are rung in the POS system until the imbalance is eliminated.

#### Check Handling

- 1) Customer checks are often received by front office employees and routed to the Accounting Office where the checks are endorsed and a deposit slip is prepared. The checks are then returned with the completed deposit slip to front office employees responsible for depositing the funds.
- 2) In addition, some checks received in the mail are opened by the Accounting Office under single custody. Other mailed-in checks that are addressed to a particular employee are routed to the employee's desk. As a result, the check may not be deposited for several days.

#### Depositing and Reconciliation

- 1) Deposits are not prepared daily, based on daily cash/equivalent receipts.
- 2) Deposit slips are not prepared for currency/coins that are being deposited.
- 3) Bank reconciliations are sometimes completed two or more months after the bank statement dates.
- 4) Bank reconciliations may sometimes be completed by Accounting Office employees who also have general ledger posting and other accounting duties.

#### b. Accounts Receivable

At July 10, 2013, there was \$50,940.84 in open A/R for the UClub Catering Services business unit. Fifty percent of the open A/R balance (\$25,370.63) was outstanding for 90 or more days. Most of the receivables result from amounts owed for seasonal wedding events. Discussions with UClub management disclosed that individuals with outstanding balances in excess of 90 days have been contacted by the UClub and/or have been placed on repayment plans.

#### c. Accounts Payable

At July 11, 2013, there was \$214,914.90 in open A/P for the UClub. Seventy-eight percent of the open A/P balance (\$168,617.06) was 90 or

more days overdue. The single creditor for this amount was the UC Regents. The total outstanding A/P balance owed to the UC Regents was \$190,695 (88.73% of total A/P).

d. Payroll Processes

Payroll register information (by employee) is not periodically reconciled to approved timesheets, approved pay rates, the general ledger, and (as necessary) to the employee's earnings statement/paycheck by individuals who are independent of timekeeping/payroll processes.

### **Recommendation**

Management should consider certain procedural changes to strengthen internal controls over the following processes.

a. Cash/Equivalent Handling, Depositing, and Reconciliation

Cash Handling

- 1) The change fund balance should be maintained at the same amount; additional back-up change funds should be established by a manager(s) and utilized when warranted by increased business activity. All change funds should be verified daily in joint custody; each individual should initial/date a verification sheet as proof of the verification;
- 2) Surprise cash counts and reconciliations of change and petty cash funds should be completed periodically and documented by individuals who do not routinely handle cash/equivalents. Responsibilities for requesting, approving, dispersing, and reconciling petty cash funds should be adequately separated.

Check Handling

- 1) Ideally, customer checks and other cash/equivalents should be restrictively endorsed immediately upon receipt, and should not be handled by employees responsible for recording cash/equivalents. However, Accounting Office employees have stated that a hardship would be created by altering the routing of customer checks. At a minimum, Accounting Office employees should maintain an adequate

separation of duties between the handling and recording of customer checks;

- 2) Ideally, UClub mail should be opened in joint custody, and should not be handled solely by employees responsible for recording cash/equivalents. Accounting Office employees are encouraged to open all mail received at the UClub (including mail addressed to UClub employees) under joint custody, and route accordingly while maintaining an adequate separation of duties.

#### Depositing and Reconciliation

- 1) Management has stated that they cannot perform daily deposits. As a work-around, deposits (made up of daily cash/equivalent receipts) could be prepared daily, put in an envelope for that day and stored in the safe until all daily envelopes can be deposited together at the end of the week;
- 2) Improvement in internal controls over currency/coin deposits may be warranted; currency/coins for deposit should ideally be verified beforehand under joint custody. A deposit slip should be prepared by employees who do not have depositing responsibilities (similar to procedures for check deposits);
- 3) Bank reconciliations should always be completed in a timely manner;
- 4) Bank reconciliations should be completed by employees who are independent of accounting and cash/equivalent handling duties.

#### b. Accounts Receivable

Further review of UClub Catering Services' A/R balances at October 13, 2013 disclosed only \$22,085.64 in open A/R, a significant improvement over previous A/R balances. Management may still want to consider increasing the deposit amounts required for certain events to lessen subsequent A/R balances. Management may also want to consider offering incentives to customers to pay off balances early, thereby avoiding lengthy repayment periods on open A/R.

#### c. Accounts Payable

If possible, management should take steps to increase UClub cash flows to enable the timely payment of open A/P and repayment of outstanding loans to UC Irvine.



d. Payroll Processes

Internal controls over payroll processes should include periodic reconciliations of approved timesheets, approved pay rates, the general ledger, and (on occasion) the employee's earnings statement and/or paycheck by an employee who is independent of these processes.

5. Other Concerns

**Observation**

As part of the review, IAS interviewed several UClub employees and made observations to determine the nature of significant operational concerns affecting the UClub. Concerns were noted in the following areas.

*Revenue and Cash Flow*

- 1) Cash flow generated from the UClub's business activities is inadequate to provide cash for daily operations and an emergency reserve fund;
- 2) Unearned event deposits received from customers are current utilized by management to provide sufficient operating cash for UClub operations.

*Marketing and Sales*

- 1) Customer surveys and follow-up questionnaires regarding UClub services do not appear to be consistently obtained and utilized in management decision-making.
- 2) Focused research by the UClub to determine additional "market niches" that could be successfully pursued appears to be limited.
- 3) Practices for taking customer deposits may vary among event coordinators; some practices may not always follow UClub policy.

*Facilities Management*

- 1) Cash flow generated from the UClub's business activities is inadequate to provide for a capital improvement fund.
- 2) Whether the University or the UClub is responsible for capital expenditures on the UC-owned facilities is unclear. Current practice is inconsistent with the 1993 agreement.

- 3) Deferred maintenance exists on the UClub's facilities, which may undermine the UClub's ability to attract/retain clientele.

*Other Concerns*

- 1) Parking availability continues to hinder the UClub catering business unit's events; employee parking is also an issue, due to the limited capacity of the UClub's parking lot;
- 2) Some of the UClub's meeting rooms may not be ideally proportioned to attract/retain some events, which may also undermine the UClub's ability to attract/retain clientele.

**Recommendation**

If possible, management should take steps to further develop the existing partnership with UC Irvine, increase cash flows, and seek opinions from past, current, and potential customers to resolve these concerns.