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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

October 30, 1998

Dr. John W. Ryan
Chancellor
State University of New York
State University Plaza
Albany, New York 12246

Re: SUNY Brockport Auxiliary Service Corporation Selected Financial Management Practices
Report 97-S-31

Dear Dr. Ryan:

Pursuant to the Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law, we have audited selected financial management practices of the State University of New York (SUNY) College at Brockport Auxiliary Service Corporation. Our audit covered the period June 1, 1994 through November 14, 1997. Follow up work resulting from the compliance issues identified during our field work continued until April 6, 1998.

A. Background

The SUNY College at Brockport (College) is a college of arts and sciences which offers programs at both the baccalaureate and masters levels. During the 1996-97 academic year, the College reported an enrollment of about 6,500 undergraduate and 1,900 graduate full and part-time students. Revenues collected for the Fall and Spring terms during the 1996-97 fiscal year for tuition, room and board totaled about $35 million.

The Brockport Auxiliary Service Corporation (BASC) is a campus-based, not-for-profit corporation. BASC provides the College with vending machine, catering, bookstore, telecommunications, video recreation, and conference center services. BASC has a Board of Directors which includes administrative, faculty and student representatives from the College. For the fiscal year ended June 30, 1997, BASC revenues from operations totaled about $6.7 million and expenses totaled about $6.3 million.

Recently, the standard contracts between SUNY and auxiliary service corporations (ASCs) have been revised to delegate greater authority to campuses for oversight of ASCs. This change reflects concepts included in the *Rethinking SUNY* report which had been provided to SUNY Trustees in October 1995. This report called for campuses to encourage entrepreneurship by allowing the ASCs to generate excess revenues which could be used by the campuses to support initiatives not funded by the State. This concept was reinforced in the December 1995 SUNY Board of Trustees Report to the Governor which recommended that the University become more entrepreneurial and self-sufficient.

With this new management delegation, SUNY now provides less control over ASC activities than it had in the past. Formerly, SUNY approved ASC budgets, and required ASCs to submit contracts for review and maintain reserves within certain limits. Currently, however, SUNY does not approve ASC budgets, generally does not require ASCs to submit contracts for review and allows ASCs to maintain greater reserves. Therefore, while increased autonomy for the ASCs may create new opportunities, it may also increase the risk that ASCs will not maintain their financial viability and will not comply with appropriate laws, rules and regulations.

The SUNY Brockport Foundation (Foundation) is another organization which operates on the College campus. The Foundation provides funds for those programs not supported by the State. These programs include student scholarships, interest-free loans and various programs for academic enrichment.

In 1996, BASC decided to build a new bookstore on the College campus. The vendor which had been operating the College bookstore provided $1 million to fund the capital construction of the new building. In return, in order to permit the vendor to recover this $1 million, BASC agreed to accept reduced commissions from the vendor over a payment period of ten years. The new bookstore opened in the Fall of 1997. The vendor's investment was identified as a "gift" in College public announcements and in the Foundation's accounting records and financial statements.

B. Audit Scope, Objectives and Methodology

We audited selected financial management practices of BASC pertaining to the establishment of the College bookstore, the operation of conference center and catering services and the provision of miscellaneous program support for the period June 1, 1994 through November 14, 1997. The objectives of our audit were to determine whether these selected financial management practices of BASC complied with appropriate laws, rules and regulations and whether these practices could impact BASC's long-term financial viability. To accomplish our objectives, we examined BASC and Foundation financial statements, reports and records; interviewed SUNY System Administration, College, BASC and Foundation officials; and examined the contract for the operation of the bookstore.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of BASC which are included in the audit scope. Further, these standards require that we understand BASC's internal control structure and compliance with those laws, rules and regulations that are relevant to the operations which are included in the audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach to select activities for audit. We focus our audit efforts on those activities we have identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. We devote little audit effort to reviewing operations that may be relatively efficient or effective. As a result, we prepare our audit reports on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

C. Results of Audit

We acknowledge that the new bookstore serves the needs of College students and generally enhances the College campus. However, we concluded that BASC did not have the authority to enter into a capital construction contract to erect a building on State property. Also, we found that BASC did not competitively bid the bookstore construction contract, or submit it to the State Comptroller for approval, as required by State law. Therefore, BASC may not have paid the lowest possible price for the bookstore construction. In addition, we question whether it is fair from either a public accountability or a financial reporting perspective to refer to the vendor's investment in the bookstore as a "gift" because the vendor will recoup its investment by paying reduced commissions to BASC. As commission revenues enable BASC to support campus programs or to maintain or reduce costs for services to students, the bookstore investment is ultimately paid for by the campus community.

We did not observe any immediate problems affecting BASC's ability to remain financially viable. However, liabilities related to the bookstore and certain costly services warrant continued monitoring.

1. Construction of the College Bookstore

On July 12, 1994, BASC signed a contract with a vendor to operate a bookstore on the College campus. Under the terms of the contract, the vendor agreed to fund either the improvement of the current bookstore at a cost of $350,000 or the construction of a new bookstore at a cost of $1 million. In 1996, BASC decided to build a new bookstore in the form of an extension to the Student Union building. BASC agreed to accept from the vendor reduced commissions from

bookstore operating revenues over a ten-year period in return for the vendor's investment to build a new bookstore.

To initiate the project, the vendor hired an architectural firm to develop a preliminary design and cost estimate for the bookstore. The College decided to use a design/build concept where the project design and construction would be handled by a single firm. The College formed a Bookstore Committee, which consisted of representatives from the College, BASC, the vendor, and one student representative, to develop a Request For Proposal (RFP) for the design/build contract. The Bookstore Committee sent an RFP to ten firms, from which there were received eight responses. After a series of interviews with four of the firms, the Bookstore Committee selected the contractor. The new bookstore building began operation in August 1997.

SUNY guidelines for ASCs state that the purpose of these corporations is to establish, operate, manage and promote educationally related services for the benefit of the campus community in harmony with the educational mission and goals of the College. We do not believe that services can be defined to include the implementation or the financing of capital construction projects. Therefore, we conclude that BASC did not have the authority to provide for the implementation of a capital project on the campus.

In addition, according to the Public Building, State Finance and Education Laws, a public work is generally defined as the acquisition, construction, reconstruction, rehabilitation and improvement of or on public lands. Such public works projects are subject to competitive bidding requirements which help ensure widespread participation by contractors who will compete to offer the best price. However, we found that BASC did not publicize the RFP to meet the competitive bid requirements required by law and SUNY construction guidelines. For example, BASC did not place invitation to bid advertisements in public newspapers. As a result, BASC may not have paid the lowest price for the project. Although Chapters 552-555 of the Laws of 1985 grant SUNY colleges and universities the flexibility to let contracts for construction of campus facilities without the previously required involvement of the University Construction Fund, our opinion is that campus-let contracts are subject to the same competitive bidding requirements that would apply to the Construction Fund.

We also found that, in violation of Section 112 of the State Finance Law, Section 376(8) of the Education Law and SUNY construction contract procedures, the contract was not submitted to the State Comptroller or the Attorney General for approval. As a result, SUNY lacks the assurance that the required review and approval of the contract terms would provide.

College and BASC officials told us that they did not seek approval from SUNY to build the bookstore on State land because they did not believe that they were required to do so.

2. Characterization of the College Bookstore

In various correspondence, public announcements and at certain events, the College, BASC and the Foundation each characterized the construction of the bookstore as being the result of a contribution, investment or gift. For example, at a BASC Board of Directors meeting held on December 16, 1996, the Board passed a resolution stating that "the vendor will provide a contribution to the SUNY Brockport Foundation capital campaign in the sum of $1 million dollars. This contribution is given solely for the purpose of the construction, outfitting and equipment for the new bookstore on campus." The Foundation's audited financial statements for the year ended May 31, 1997 included vendor payments in the amounts reported as temporarily restricted "donation and gift" revenues. Related expenses were shown as "College enhancement" expenses. A College press release dated April 4, 1997 reported "a new bookstore and cafe generously funded by a $1 million investment from (the vendor)." In none of these examples was it acknowledged that the vendor would be recouping its investment over a ten-year period as specified in its contract with BASC.

We believe that public accountability would have been better served by also disclosing that the vendor would recoup its investment at the expense of BASC.

3. Financial Accounting for the Bookstore

The $1 million bookstore investment paid by the vendor went through the College Foundation accounts as follows. BASC reviewed and approved the bookstore construction contractor's requests for payments and then submitted the requests to the vendor who wire transferred the money to BASC. Upon receipt, BASC forwarded the funds to the Foundation, which deposited them into its account, and then wrote a check for the same amount to BASC. Finally, BASC redeposited the funds and paid the contractor. According to College officials, the sole purpose of passing the contract payments through the Foundation was to enable the Foundation to account for and to report $1 million in capital campaign contributions. The officials said that accounting for and reporting the transaction in this manner promotes good will and encourages other businesses in the area to donate funds.

There is no evidence that SUNY System Administration was consulted for guidance about the correct accounting for the bookstore transaction. However, Financial Accounting Board Statement No. 116, which was issued to set standards for the accounting of contributions, defines a contribution as a voluntary, unconditional and nonreciprocal transfer of cash assets to an organization. The Statement further points out that a transaction in which each party gives and receives goods and services is not a contribution. Statement No. 116 provides insight as to how the bookstore transaction should be accounted for. Considering the definitions in Statement No. 116 and the recoupment by the vendor from BASC for the bookstore investment, it is questionable whether the bookstore transaction can be treated as a capital contribution.

On the one hand, this transaction may have been correctly recorded on BASC and Foundation accounting records if each organization is viewed as a separate party. The Foundation, which accepts donations on behalf of the College and BASC, recorded the transaction as a gift. The Foundation then transferred contribution proceeds to BASC, which incurred construction expenses when it used the proceeds to build a new bookstore. However, on the other hand, if BASC and the Foundation are viewed as related parties serving the general needs of the College, the contribution and the building expenses cannot be examined in isolation; recognition must be given to an investment made on the condition that BASC would accept reduced commissions. This viewpoint would argue against accounting for the transaction as a gift on the Foundation's records. At a minimum, BASC's financial statements should disclose BASC's ten-year liability of $1 million incurred in return for the vendor's initial investment.

BASC officials informed us that the same certified public accountants audited both the Foundation and BASC's 1997 financial statements and provided unqualified opinions for those statements. BASC officials also told us that they had asked their certified public accountants to review the terms of the bookstore transaction. In this regard, the officials provided us with a memorandum from the certified public accountants which advised BASC and the Foundation that the entire $1 million would be recorded as a contribution if it were received by June 30, 1997, the end of the fiscal year. However, we found that the memorandum prepared by the certified public accountants did not address the issue of whether the vendor's investment was a contribution, but only whether the contribution was given in the context of a restriction or a condition.

After our fieldwork ended, Foundation officials requested the certified public accountants to provide them with a letter explaining the accounting for the bookstore transaction. The accountants state that, while they believe reasonable support exists for the Foundation's classification of these funds as a contribution, a clear answer to the accounting classification is not evident.

We believe SUNY System Administration should provide guidance to ensure that these types of transactions are properly recorded in ASC and foundation accounting records. Such guidance should determine what, if any actions are needed to adjust financial records for BASC and the Foundation as a result of their treatment of the transaction involving the investment by the vendor to provide a bookstore to the College. SUNY should have a particular interest in clarifying this matter and ensuring this transaction has been properly recorded in BASC's financial statements because errors in BASC's financial statements would be incorporated into SUNY's financial statements. In addition, the 1998-99 State Budget includes a new program whereby capital funds are available to campuses on a matching basis for funds donated privately. Therefore, it is especially important that clarity be brought to the issue of what constitutes private donations.

As a result of our audit, SUNY System Administration officials have indicated that they plan to take steps to ensure that campuses comply with the requirements for building on State land. The officials indicate that they will issue a general advisory to all campuses reminding them of the procedures to be followed with respect to construction projects, and cautioning them about

potential violations. The advisory will make it clear that construction projects on campuses must comply with State laws applicable to public construction, including the requirement for public bidding, and that the Construction Fund is available to undertake such projects for SUNY and assume responsibility for compliance with applicable laws. System Administration officials also agree that the bookstore transaction should be further examined. If this examination concludes that correcting accounting entries is necessary to properly reflect the bookstore transaction, System Administration officials will work with BASC, its independent auditor and campus officials to make the corrections.

4. Conference Center and Catering Program

BASC has operated a Conference and Catering Program (Conference Program) since 1989. Prior to this time, the Conference Program was operated by the College. The Conference Program provides conference, catering and lodging facilities for student groups and College academic and administrative departments. The administrative offices of the Conference Program are in Thompson Hall, a former dormitory which the College closed in the late 1980s because of declining student enrollment. Because the Conference Program is now operated by BASC, it enables BASC to use student revenues to fund the maintenance and utility charges (about $100,000 annually) of Thompson Hall, which prior to 1989 had been paid from the College budget. The Conference Program also enables the campus to use empty dormitory facilities when the College is not is session.

BASC officials told us that the primary purpose of the Conference Program has been to serve the needs of the campus community. In keeping with this policy, BASC has discounted a number of its fees to campus users, who generate about 80 percent of Conference Program revenues. BASC officials told us that the use of this facility by outsiders is limited because most rooms lack basic amenities that are expected by hotel guests today.

As a result, the Conference Program has operated at a significant loss since it started in 1989. For the four years ended June 30, 1996, the Conference Program's total deficit was $673,000. However, although the losses have been significant, the financial condition of the Conference Program has shown some improvement in the last several years. We analyzed the revenue and expense statements of the Program for the four fiscal years ended June 30, 1997, and found that net losses have decreased, from about $191,000 for the year ended May 31, 1994 to about $141,000 for the year ended May 31, 1997. BASC officials told us they have recently focused their efforts on bringing in more outside customers, which generate higher service revenues. Although the financial outlook has improved, BASC officials expect the Conference Program to continue to generate losses of about $100,000 to $125,000 annually. These significant losses warrant that BASC and the College continually monitor the Conference Program to assess its impact on BASC's financial viability.

5. Program Funding

Each year, BASC's Board of Directors votes to fund of a number of programs and activities sponsored by various campus organizations. For example, BASC program funds help pay for freshmen orientation activities, celebrations for special events, and support for a dinner to recognize accomplishments of the Education Opportunity Center Program. We noted that, in the last five years, the total amount of program funding provided by BASC to the campus has increased annually, from $145,145 for the year ended May 31, 1993, to over $246,000 for the year ended May 31, 1997. Thus, BASC program funding has increased by nearly 70 percent in five years. Meanwhile, College enrollment has declined about 12 percent from 9,600 students in 1990.

While BASC may be financially viable today, declining enrollment, coupled with decreased revenue from its bookstore operation, may limit BASC's ability to sustain program funding. As indicated earlier in this report, SUNY no longer approves ASC budgets. Therefore, the College and BASC should assume responsibility for monitoring the impact of program funding commitments on BASC's long-term financial viability.

Recommendations to the College and BASC

1. *Obtain State authorization and approvals for construction on State land and use competitive bidding procedures, as required by State laws.*

2. *Acknowledge in future public announcements that BASC will accept a reduced commission over a ten-year period to repay the vendor for its investment in the bookstore.*

3. *Review the entire bookstore transaction with SUNY System Administration to ensure it has been properly recorded in the accounting records and presented in the financial statements. If necessary, make accounting adjustments.*

4. *Continue to monitor the financial impacts associated with BASC program funding and Conference Program initiatives.*

5. *Disclose in BASC financial statements the reduced commissions liability created by the bookstore transaction.*

Recommendations to SUNY System Administration

6. *Determine the proper accounting to be followed for transactions which record vendor investments in a campus while the vendor is also under financial obligation to the campus for the delivery of goods and services.*

7. *Work with BASC and College officials to examine the bookstore transaction to ensure it is properly reflected in accounting records and financial statements. Make corrections where necessary.*

A draft copy of this report was provided to SUNY System Administration, College and BASC officials for their review and comment. Their comments have been considered in the preparation of this report and are included as Appendix A. Officials agree with all of our recommendations.

The College's response indicates that all aspects of the financing of the bookstore project have been made known to the campus community through discussions with and involvement of the Brockport Student Government Board. Officials add that there were articles discussing the project in the school newspaper. As discussed in our report, we found no documentation supporting full disclosure to the campus community about the financing of the bookstore project. The College also responds that there is no direct link between student revenues and the funding of Thompson Hall maintenance and utility charges. We acknowledge that a variety of BASC revenue sources are available to cover these expenses. However, it should be noted that the bulk of BASC revenues comes from student charges. Therefore, it is fair to say that student revenues are funding Thompson Hall maintenance and utility charges. Finally, College officials point out that, prior to 1989, the operating expenses of Thompson Hall had been paid by the Dormitory Income Fund Reimbursable Program as opposed to the College budget.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chancellor of the State University of New York shall report to the Governor, the State Comptroller, and leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this report were Bill Nealon, Karen Bogucki, Marcia Petersen, Michael Wrobel, and Nancy Varley.

We wish to thank the management and staff of SUNY Brockport College and BASC for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Jerry Barber
Audit Director

cc: Robert L. King
John Murphy
Dr. Paul Yu

50 YEARS SERVICE, PRIDE & EXCELLENCE

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October 8, 1998

Mr. Jerry Barber
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Albany, New York 12236

Dear Mr. Barber:

In accordance with Section 170 of the Executive Law, we are enclosing the comments of State University College at Brockport and SUNY System Administration regarding the draft audit report on Selected Financial Management Practices, SUNY Brockport Auxiliary Service Corporation (97-S-31).

Sincerely,

Donald G. Dunn

Donald G. Dunn
Executive Vice Chancellor

Enc.

SUNY Brockport Auxiliary Service Corporation
Selected Financial Management Practices
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State University College at Brockport Comments

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Regarding the issue of "public accountability," it should be acknowledged that all aspects of the financing of this project were known to the campus community The Executive Director of BASC attended a Brockport Student government (BSG) Board meeting to discuss the bookstore project including the financing of the project. The BASC Board of Directors which included the President, Vice President and Treasurer of BSG were fully informed of (and involved in the decision process regarding) the contracted terms and the Vice President of BSG was a Bookstore Committee member.

In addition, there were articles in the school newspaper, The Stylus, which discussed the project.

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The reference to "student revenues" funding the maintenance and utility charges of Thompson Hall is misleading. BASC generates revenue from students, faculty, staff, visitors and outside groups, as well as from investments of cash reserves that offset the expenses of operations such as the conference center. There is no direct link of "student revenue" to specific expenses (such as maintenance and utility charges) in operating our conference facilities. Furthermore, the statement in the draft audit that the College budget paid for maintenance and utility charges for Thompson Hall prior to 1989 is inaccurate. As residence hall room charges (under the Dormitory Income Fund Reimbursable Program) pay all operating expenses of running our residence hall facilities, student revenues paid the maintenance and utility charges for Thompson Hall prior to it being converted to a BASC operated conference facility.

State University of New York System Administration Comments

In July 1998, we advised SUNY campuses regarding construction activities. We informed the campuses that the law on design/construction activities has not changed; the only entities legally permitted to engage in construction on SUNY campus property are the Dormitory Authority of the State of New York, the New York State Office of General Services, the State University Construction Fund (and the University itself). Construction by others can be authorized only by the State University Trustees pursuant to special legislation.

Recommendations to the College and BASC

(OSC) 1. Obtain State authorization and approvals for construction on State land and use competitive bidding procedures, as required by State laws.

(SUCB) 1. Agree.

(OSC) 2. Acknowledge in future public announcements that BASC will accept a reduced commission over a ten-year period to repay the vendor for its investment in the bookstore.

(SUCB) 2. As noted in our response to recommendation number five below, this information will be disclosed in the financial statements.

(OSC) 3. Review the entire bookstore transaction with SUNY System Administration to ensure it has been properly recorded in the accounting records and presented in the financial statements. If necessary, make accounting adjustments.

(SUCB) 3. Agree.

(OSC) 4. Continue to monitor the financial impacts associated with BASC program funding and Conference program initiatives.

(SUCB) 4. Agree.

(OSC) 5. Disclose in BASC financial statements the reduced commissions liability created by the bookstore transaction.

(SUCB) 5. Agree. We are working with our independent certified public accountant and SUNY System Administration as to the appropriate presentation in the financial statements of BASC.

Recommendations to SUNY System Administration

(OSC) 6. Determine the proper accounting to be followed for transactions which record vendor investments in a campus while the vendor is also under financial obligation to the campus for the delivery of goods and services.

(SUNY) 6. Agree; see item No. 7 below.

(OSC) 7. Work with BASC and College officials to examine the bookstore transaction to ensure it is properly reflected in accounting records and financial statements. Make corrections where necessary.

(SUNY) 7. Agree; System Administration is currently in discussion with BASC and College officials as to the appropriate accounting and disclosure of the bookstore transaction in the accounting records and financial statements of BASC.