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An Audit Report on Management Controls at Southwest Texas State University

April 1996

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An Audit Report on Management Controls at Southwest Texas State University

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Overall Conclusion

In several areas, Southwest Texas State University's management control systems are deficient in design and/or implementation. These deficiencies impact the University's ability to ensure that its mission and objectives will be fully accomplished and that assets will be appropriately safeguarded.

Key Facts And Findings

- The University did not effectively use or analyze available information to support decisions regarding the purchase and lease of major auxiliary enterprise acquisitions such as Aquarena Springs (for $7 million), the Sound and Recording Studio (leased for $66,000 per year), and the Clear Springs Apartments (for $2.7 million). As a result purchase prices, lease terms, and potential liabilities may not have been as favorable to the University as possible. Monitoring of and intervention in operations at Aquarena Springs (with cumulative losses in the first 20 months of over $1.3 million) was not timely and may have resulted in a higher cost to the University.

- The University Athletic Department has shown a consistent pattern over several years of not being able to stay within budget. Over the past five years, the original Board-approved budget has been overspent by over $3.1 million. The Athletic Department has been allowed to continue this pattern of overspending by being granted numerous budget increases during the fiscal year and being allowed to run deficits in excess of those increases. There were 131 budget changes in fiscal year 1995. After intra-period budget increases, the Athletic Department has still run deficits in three of the last five years totaling $849,845.

- Although the University requires all divisions and departments to have strategic plans, the quality and content of these plans vary greatly within the University. Of the plans reviewed, some division and department plans did not have strategies and some plans did not clearly distinguish between goals, objectives, and strategies. Other plans contained strategies stating reasons why objectives can not be accomplished, as opposed to means to accomplish the objectives.

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This economy/efficiency audit was conducted in accordance with Government Code, §§ 321.0132 and .0133.

Executive Summary

In several areas, Southwest Texas State University's management control systems are deficient in design and/or implementation. These deficiencies impact the University's ability to ensure its mission and objectives will be fully accomplished and that assets will be appropriately safeguarded. Controls over auxiliary enterprise activities, especially in the Athletic Department, could be strengthened. Improved use and analysis of available information, as well as improved controls over budgetary processes, would have reduced the University's risk in the recent acquisitions of $9.7 million in auxiliary enterprise operations, as well as in the administration of Athletic Department expenditures of over $5 million.

The University Has Not Effectively Used Information to Support Key Decisions and Control Operations in Auxiliary Enterprise Activities

The University did not effectively use or analyze available information to support decisions regarding the purchase and lease of major auxiliary enterprise acquisitions such as Aquarena Springs (for $7 million), the Sound and Recording Studio (leased for $66,000 per year), and the Clear Springs Apartments (for $2.7 million). As a result, purchase prices, lease terms, and potential liabilities may not have been as favorable to the University as possible. Monitoring of and intervention in operations at Aquarena Springs (with cumulative losses in the first 20 months of over $1.3 million) was not timely and may have resulted in a higher cost to the University. Budgets developed for these facilities have not accurately captured revenue and expenditure items. This lessens the budgets' use as a control mechanism.

The Athletic Department Has Not Effectively Instituted Appropriate Internal Controls, and Standard University Controls Are Not Applied to the Department

The Athletic Department has shown a consistent pattern over several years of not being able to stay within budget. Over the past five years, the original Board-approved budget has been overspent by over $3.1 million. The Athletic Department has been allowed to continue this pattern by being granted numerous budget increases during the fiscal year and being allowed to run deficits in excess of those increases. There were 131 budget changes in fiscal year 1995. After intra-period budget increases, the Department has still run deficits in three of the last five years totaling $849,845. Having to fund Athletic Department overspending impacts the ability of the University to fund other programs.

Standard University controls over such things as salary supplements, moving expenditures, and cellular phone usage have not been consistently applied to the Athletic Department. Almost $100,000 in proceeds from an interfund loan have been used for purposes not approved by the Board. The source of revenue for repaying this loan has not been developed, and repaying the loan is exacerbating the Department's deficit.

Enhance the Existing Strategic Planning Process by Developing a More Comprehensive Assessment Process and Keeping Policies and Procedures Current

Although all divisions and departments are required to have strategic plans, the quality and content of these plans vary greatly within the University. Of the plans reviewed, some division and department plans did not have strategies and some plans did not clearly distinguish between goals, objectives, and strategies. Other plans contained strategies stating reasons why objectives can not be accomplished, as opposed to the means by which to accomplish the objectives.

The University does not consistently monitor its progress toward achievement of the University strategic plan goals, objectives, and strategies. The University does produce a Strategic Progress report which highlights each division's accomplishments. However, the report does not discuss whether the University accomplished or made progress toward its goals during the year.

Monitoring the progress toward achievement of the strategic plan goals, objectives, and strategies is inconsistent at the division and department levels. Some departments do not monitor progress toward the accomplishments of goals at all, while other departments only monitor informally.

The University is in the process of implementing a total quality management program. However, the University does not have a comprehensive university-level quality planning and assessment process. While an Assessment Council exists to review progress against planning goals, the charge and resources available to this committee limit its ability to function effectively. There are no standardized policies and procedures to ensure an effective quality planning and assessment process is established.

University, division, and department policies and procedures are not revised regularly. Forty percent of the University Policies and Procedures Statements have not been reviewed and revised by the Vice Presidents on or before the University's designated deadline. Not all division and department policies have set review cycles to ensure that policies are current to address the division's or department's needs.

Human Resource Management Controls Need Enhancements

Human resource controls over administrative and staff personnel need to be improved to ensure effective and efficient management of this resource. Total salary and wage expenditures for all employees in fiscal year 1995 were over $68 million.

Currently, it is possible that applicants could be hired who do not possess the education, experience, or other requirements necessary for their positions. The University has a decentralized recruitment and selection process. Individual departments are largely responsible for screening applicants (i.e., interviews, contacting references, verifying past employment, obtaining evidence of education or professional certification). However, no evidence of the results of these screening procedures is contained in the employees' personnel files.

Job descriptions are not available for all positions. Currently, the University does not have job descriptions for 38 percent of its positions. Eighty-one position titles are not required to have job descriptions. The majority of these are nonclassified/ administrative positions.

A sample of employee time sheets revealed errors that resulted in the misstatement of Fair Labor Standards Act (FLSA) overtime and state compensatory time leave balances. One employee was paid in a lump sum for more than 400 hours of FLSA overtime. This payment is not in compliance with federal regulations requiring governmental entities to maintain FLSA overtime hour balances at less than 240 hours.

The University has not effectively monitored salary supplements given to employees. Five employees received total supplements in excess of the annual maximum rate of $12,283 (25 percent of the average nine-month appointed professor's salary) set by the Board of Regents. One employee received $36,023 in salary supplements in fiscal year 1995.

Additional Controls Over Fixed Assets and Inventory Should Be Implemented to Minimize the Risk of Loss

Fixed asset and inventory controls could be improved to ensure efficient and effective management of these resources. The carrying value of equipment and computers at the end of fiscal year 1995 was over $36 million. The carrying value of inventories was over $1.8 million.

Performing independent verification of fixed asset inventories, separately recording surplus property, updating inventory systems, conducting test counts of perpetual inventories, and appropriately segregating duties would minimize the risk of loss to University assets and inventory.

Construction Planning Processes Could Be Improved

Cost estimates varied significantly from actual bids on two out of three of the University's major projects ($5 million or more) over the last five years. The cause was the architect/ engineer's error in estimating the projects. Ideally, cost estimates for new construction should be within plus or minus 10 percent of the actual bid amount.

Summary of Management's Responses

Southwest Texas State University was publicly honored by the Texas Higher Education Coordinating Board at its regular meetings in October 1992 and October 1994, for having the lowest administrative costs among public universities in the State. This thin administrative structure, while cost effective, is accomplished by decentralizing controls which contributes to many of the findings in this report.

We believe the Auditors' recommendations will help us become even more effective in the future. There are some findings, though, with which we disagree. These are so noted in our responses.

Summary of Audit Objective and Scope

The objectives of this audit were to evaluate the existing management controls systems within Southwest Texas State University and to identify both strengths and opportunities for improvement.

Generally, the outcome of management control audits is to provide recommendations in areas where improvements can be made. However, the University also has achieved some positive results in its operations. The University is fully accredited by the Southern Association of Colleges and Schools. Enrollment in graduate programs has increased from 1,844 total graduate students in the 1990 fall semester to 2,214 students in the 1994 fall semester. Minority students are better represented in the student population, comprising 21.7 percent of the student body in the 1994 fall semester as opposed to 19.5 percent in the 1990 fall semester. In addition, the number of degrees granted increased from 3,160 in fiscal year 1990 to 3,631 in fiscal year 1994.

The scope of the audit included consideration of the University's policy, information, resource, and performance management systems and the key processes which support them.

Section 1: DECISION-MAKING

The University Has Not Effectively Used Information to Support Key Decisions and Control Operations in Auxiliary Enterprise Activities

The University did not effectively use or analyze available information to support decisions regarding the purchase and lease of major auxiliary enterprise acquisitions such as Aquarena Springs, the Sound and Recording Studio, and the Clear Springs Apartments. As a result purchase prices, lease terms, and potential liabilities may not have been as favorable to the University as possible. Monitoring of and intervention in operations at Aquarena Springs was not timely and may have resulted in a higher cost to the University. Budgets developed for these facilities have not accurately captured revenue and expenditure items. This lessens the budgets' use as a control mechanism.

Section 1-A:

Appropriate Cost Benefit or Needs Analysis Was Not Performed To Support Some Major Auxiliary Enterprise Acquisitions

Aquarena Springs

The University purchased Aquarena Springs in December 1993, for approximately $7 million. Several important factors were not adequately considered prior to the purchase. For example:

- An independent consultant study assessed the appropriate purchase price at $5 million. The consultant's study also pointed out that to justify a purchase price of $7 million, the facility would have to generate between $910,000 and $1.75 million per year in net operating income. The highest net operating income achieved in prior years had been $532,000, according to the study.[1]

- The purchase was funded by tax-exempt bonds. When the purchase of a facility is financed by tax-exempt bonds, the Internal Revenue Service puts strict limitations on leasing and profit sharing arrangements with profit-making corporate enterprises. As a result, the University was limited to offering a fee-based management contract to operate Aquarena Springs. This limitation hampered efforts to attract a corporate lessee or operator for the facility.

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[1] Net operating income does not recognize certain expenses such as interest payments on borrowed funds or depreciation of equipment. In addition, the consultant's valuation was based on Aquarena Spring's value as a business enterprise. Unique features of the land itself or consideration of other uses for this facility were not analyzed by the consultant.

- Despite the facility losing $260,000 in the year before the purchase, the University did not consider discontinuing operations of the theme park, golf course, restaurant, and inn. The University did consider a "dooms day" scenario to close the facility in its entirety, but did not establish loss thresholds for these component operations. In addition, the University did not present a maximum acceptable loss amount to the Board of Regents.

- The University's food service vendor (the Vendor) was selected, without bid, to be the management operator of the facility despite the University not having any evidence that the Vendor had relevant experience in theme park, golf course, or inn operations. According to the University's attorney, there was no legal requirement to bid for a management contract. However, prudent business practices would dictate that an institution explore its available options before committing to a high-dollar, multi-year contract.

- Two final operating scenarios provided by the Vendor were given to the Board of Regents. The "worst case" scenario projected an operating loss of approximately $400,000 for the 1994 calendar year. There is no evidence that the University closely questioned the assumptions underlying this scenario. The University's business office did not prepare independent projections. The Internal Audit Department criticized the assumptions in the Vendor scenarios and estimated losses as high as $1.2 million. Actual losses were $984,000 for the 1994 calendar year.

- From January 1994 to November 1995, the University paid property taxes at a rate of approximately $100,000 per year. The University and the Texas State University System are currently seeking a legal determination as to the necessity and appropriateness of paying these taxes. We encourage this effort.

- While the University did identify academic programs and departments that could benefit from access to Aquarena Springs, an analysis of how the facility would fit into the educational mission was not completed prior to the purchase. Similarly, the purchase of the facility was not explicitly tied to any of the University's strategic planning goals, objectives, or strategies.

Sound and Recording Studio

In November 1993, the University entered into a contract with the University Support Foundation for the lease of property that includes office space, a sound and recording studio, and a parking lot. The Foundation receives a guaranteed monthly rental payment of $5,500 from the University. To generate revenues to pay for the lease, the University sublets the office space, parking, and excess studio time. The lease process and terms may not have fully protected the University's interests. For example:

- The University agreed to lease this facility from the Foundation after completing a competitive bid process. The University's request for proposal contained certain specifications that only the Foundation's facility could meet, such as square footage, proximity to the campus, and availability of adjoining office space. However, prior to drafting the request for proposal, the University did not perform a formal needs analysis to determine the number of square feet or the quantity and type of equipment required to operate the Sound and Recording Technology program. The University also did not perform a cost analysis to determine the feasibility of renovating an existing campus structure to create a sound and recording studio.[2]

- The lease terms provide for the University to attract tenants, collect sublet rentals, and provide all maintenance to the facility. Therefore, all risk associated with the facility is transferred from the Foundation to the University. In fiscal year 1995, providing maintenance to the facility required the University to replace the outdated cooling system. Capital improvements of this nature are generally the responsibility of the landlord and not the lessee.

- In fiscal year 1995, the difference between the lease payments and the revenues generated by the University was more than $40,000. This deficit was funded through auxiliary enterprise activities.

Clear Springs Apartments

In September 1994, the University purchased the Clear Springs apartment complex for approximately $2.7 million. The University purchased Clear Springs from a real estate partnership that held the property since 1990. Several important factors were not adequately considered prior to the purchase. For example:

- In 1990, the real estate partnership paid $850,000 for these same apartments. During the summer of 1994, the partnership invested another $250,000 to provide improvements to the property. Therefore, the partnership invested a total of $1.1 million in Clear Springs. The University's purchase for $2.7 million represented a profit of $1.6 million to the partnership, or a 146 percent return on the investment over four years.

- The University obtained three appraisals from independent real estate appraisers. All three appraisals place the indicated market value between $2.75 million and $3.0 million. However, there are several discrepancies between these reports that should have raised questions. For example, two appraisals reported the complex's lot size as 3.47 acres, whereas the third reported it as 2.615 acres. Of the two appraisals that agree on lot size, one estimated its value at 32 percent higher than the other appraisal. None of the appraisals reported the buildings as having the same number of gross square feet. One appraisal reported net leasable square feet as higher than gross

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[2] The University did arrange to have an individual from the Houston Community College System's audio department perform a four-hour inspection of the studio prior to the purchase. This individual provided an analysis of the merits of the studio and future equipment needs.

square feet. These disparities were not considered by the University in evaluating the validity of the appraisals.

- The University did not purchase Clear Springs as a result of a housing shortage. The complex contains 85 apartments and would not have significantly abated a shortage in housing even if a shortage existed. Additionally, no specific benefit from or need for the facility itself has been identified by the University. Clear Springs was identified in the University's Campus Master Plan as a strategic acquisition to "create a 'portal,' strengthening the sense of arrival to the campus." However, this appears to be more of an aesthetic consideration than an actual need.

Recommendation:

We recommend that the University adopt the following additional controls to improve the acquisition process:

- A needs analysis and/or cost benefit analysis should be performed prior to major acquisitions. Further, all acquisitions should be reviewed to determine their alignment with the University's mission and strategic planning goals, objectives, and strategies.

- The University should prepare independent business plans that include projections for revenues and expenditures to support all major acquisitions. If the services of an outside entity are used to prepare business plans, the basis for all assumptions relating to marketing, cash flow, capital improvement needs, purchase price, and long-term liabilities should be closely scrutinized. Outside entities should be required to explain discrepancies in their reports to ensure these reports are reliable.

- Multiple scenarios should be considered in all business plans for sale prices, sale volume, market strength, mix of products and/or services, and other relevant factors impacting revenue and expense.

Management's Response:

SWT believes it has prepared appropriate needs analyses and cost/benefit analyses on major acquisitions and agrees to continue to do so. Improved documentation will be maintained in the future. We also believe the three acquisitions cited are aligned with our mission and strategic plan but agree to ensure such items are explicitly included in the future. SWT also has no concerns about preparing "independent" business plans or multiple scenarios within those plans.

However, we would like to make the following points about the specific matters noted on these three projects:

1) Aquarena Springs

The study which assessed the value of Aquarena Springs at $5 million evaluated the "business value" of the property. SWT also had two "real estate" appraisals in hand (one paid for by SWT and one secured by the seller) which placed the value of Aquarena Springs at $8.9 million and $13.5 million. Even though SWT operated the property as a business, the primary interest is in the long term ownership of the land and preservation of the springs. Therefore, the real estate appraisals are the more appropriate measure when assessing the final purchase price of $7 million. Also, SWT used the "business value" appraisal in negotiations to reduce the final purchase price to an amount below the real estate appraisals.

As a part of the purchase, SWT also acquired the rights to 66,207 acre feet of water from Spring Lake and the San Marcos River. These are the most senior water rights on the river. Given concerns about the Edwards Aquifer and the availability of a consistent water supply in the future, this could prove to be an extremely valuable asset that is not accounted for in the "business value" appraisal or the "real estate" appraisal.

SWT is working with the tax counsel associated with the Texas State University System's Bond Counsel and the Internal Revenue Service to mitigate the problems caused by tax-exempt financing. The decision to utilize tax-exempt bonds for the entire system-wide $27 million tuition revenue bond issue was made at the System level in 1993 after thorough consultation with tax counsel.

SWT did consider discontinuing the operation of the park, golf course, restaurant and/or the inn. In numerous conversations with the original management firm, both before and after the purchase, SWT considered these alternatives. In every instance, we believed changes could be made to gradually restore each component's profitability. For example, a separate decision to lease Capers Restaurant to a new manager or close it was made in the summer of 1995.

A multi-year cash flow analysis based on the cumulative "worst case" scenario which was presented to the Board of Regents prior to the purchase was represented verbally to the Board as SWT's maximum acceptable loss. It indeed proved to be the measurement by which the decision to cease theme park operations was made on February 23, 1996.

SWT's food service vendor was selected to manage Aquarena Springs because they stepped in early during the purchase negotiations and offered to guarantee the debt service. This was before legislative authority was granted to use Tuition Revenue Bonds to purchase the facility. Even though no debt service guarantee was needed, it was determined that their familiarity with the property gained to date and their experience in operating conference centers made them the appropriate entity to operate the property.

When the "best" and "worst case" scenarios were presented to the Board of Regents, the underlying operating assumptions as well as a proposed marketing plan for improving profitability were included. Even though "no evidence" exists, SWT developed the scenarios and marketing plan in collaboration with the Vendor. We agree to document such actions in the future.

An Attorney General's opinion has been requested on the issue of property tax.

SWT believes identifying academic programs and departments that can enhance their program by utilizing Aquarena Springs does provide an analysis of how the facility fits within the educational mission. This was provided to the Board of Regents at the time of purchase and to the Texas Higher Education Coordinating Board when the acquisition was reviewed. The Board of Regents used this information in making their decision to cease the theme park operations.

2) <u>Sound Recording Studio</u>

Although it was discussed, no formal cost analysis to determine the feasibility of renovating an existing campus structure or constructing a new facility for a sound recording studio was conducted because of the numerous recommendations from experts in this field indicating that the best training for students could only come from a classroom setting that was also an operating, commercial recording studio. With the availability of such a facility a few blocks from campus, it made little sense to do a detailed analysis of new construction or a renovation project. SWT did consider a modification to the on-campus television studio to accommodate the sound recording technology program, but that was quickly dismissed as academically impractical. We agree to better document such actions in the future.

SWT will again review the terms of the lease with the Support Foundation. When these matters were considered in 1992, we were made aware that a lessor would require a higher rental fee to offset the cost of establishing a depreciation or repair and replacement fund. It was determined that in lieu of higher rent, SWT preferred to pay for any needed repairs.

The degree program in sound recording technology is highly selective and already widely acclaimed across the state. The $40,000 in auxiliary enterprise profits or general use fee income used to subsidize the studio is considered by SWT to be money well spent.

3) <u>Clear Springs Apartments</u>

The State of Texas has established in law a process for the approval of such purchases by public universities. The Board of Regents must first approve the purchase. The Texas Higher Education Coordinating Board must review and approve the purchase as well. Finally, since Housing System Revenue Bonds were used to finance the purchase, the Texas Bond Review Board was required to approve the transaction.

SWT thoroughly considered every factor described by the auditors in this section. Questions about the price paid by previous owners and the comparability of appraisals were all raised at one time or another.

At the meeting of the Board of Regents, questions about the appraisals were raised. SWT was able to satisfactorily answer those questions, because we had noticed the discrepancies and reconciled them among the three appraisers by telephone prior to the meeting. The three agreed the lot size was 3.47 acres, and all said that one or the other would not have materially altered their appraisal value. Through this process, we confirmed that we were indeed acquiring all of the parcels in this tract.

The Coordinating Board requires that appraisals be submitted to them as a part of the approval process. They expressed no concerns about the validity of them.

One of the appraisals notes the 1990 sales price and correctly states that Clear Springs Apartments were just one of a package of apartments purchased for a single price. The sales figure cited was merely assigned to Clear Springs by the owners. Three independent real estate appraisals made at a time contemporaneous to the sale are a much better gauge of the appropriate purchase price.

The Board of Regents asked SWT early in the analytical period of this transaction to obtain three separate appraisals. Only one could come from a San Marcos appraiser. The others came from Austin and San Antonio firms. As noted, all three appraisals placed the value at between $2.75 million and $3.0 million.

As noted, the apartments were considered a strategic acquisition by our Campus Master Plan architects. They believed that it is very important for a University to control its "front door." This represents more than just aesthetics. Furthermore, University administrators would not be doing their job if they focus only on immediate needs and ignore the future needs of the institution.

Finally, as noted in section 1.C. of this report the apartments are covering debt service and producing a net profit.

Auditor's Follow-Up Comment:

Aquarena Springs

We reviewed the real estate appraisals for Aquarena Springs but did not find them to be useful information. The difference in valuation between the two reports, $8.9 million versus $13.5 million, is over $4.5 million and represents estimation disagreement of more than 51 percent. We therefore concluded that one or both of these reports was unreliable. This conclusion was further supported by the very fact that the prior owner was willing to sell the facility for $7 million or 21 percent lower than the lesser of the two valuations. However, that the University would rely on these remarkably different valuations, and apparently find both to be valid, speaks directly to the problem of not effectively analyzing information to support decisions.

Since the University operated Aquarena Springs as a business for a period of more than two years, the “business value” of the property was a more appropriate benchmark of value than the real estate value. Furthermore, the University’s primary interest in acquiring Aquarena Springs should not have been the chief determinant in setting a valuation on the property. Market considerations should have driven the price the University was willing to pay (i.e., what would another purchaser have been willing to pay for the facility). Given that the facility was losing money, that deferred maintenance in excess of $1 million had been identified, and that development opportunities may be limited on acreage containing an environmentally sensitive spring, logic suggests the price would be either the “business value” or possibly some lower value.

The University asserts that protection of the Edwards Aquifer and availability of a consistent water supply in the future were also factors in the purchase of Aquarena Springs. There is nothing in the University’s mission addressing protection of environmental resources.

The University contends that consideration was given to shutting down individual business segments of Aquarena Springs such as the golf course, restaurants, and inn. In the extensive documentation reviewed during this audit, there was no evidence of this kind of decisionmaking having taken place. In fact, we uncovered only one shut down scenario, known internally as the “doomsday” scenario, for the complete closure of Aquarena Springs. However, even under this scenario, no specific dollar loss threshold to trigger “doomsday” was ever documented.

The University states that the food service vendor was awarded the management contract in recognition of its offer to assist the University with the purchase of Aquarena Springs, as well as its familiarity with the property and experience in operating conference centers. Since the Legislature authorized the Tuition Revenue bonds, the food service vendor did not provide any material consideration in return for obtaining the management contract. Furthermore, participating in the purchase negotiations between the University and former owner could not have endowed the food service vendor with sufficient “familiarity with the property” to substitute for the operational expertise needed to manage a facility such as Aquarena Springs. Finally, since there is no conference center on the facility, this does not serve as a reason for selecting the food service vendor.

Sound Recording Studio

The University’s response clearly illustrates University management’s decision making process:

- A decision was made to pursue a sound recording technology program.

- Advice was obtained that an operating, commercial studio would provide the best training for students.

- An operating, commercial studio existed a few blocks from campus. Further, the University Support Foundation already owned the studio under consideration.

- Therefore, there was no need to carefully weigh other alternatives or consider the relative costs and benefits of the Foundation's studio.

The State Auditor's Office believes that careful consideration of all viable alternatives is always prudent.

The University states that "it was determined that in lieu of higher rent, SWT preferred to pay for any needed repairs." How that determination was made is unclear. The University did not perform a comparison of lease costs to projected repairs. Therefore, no basis exists for assessing whether the rent price takes into account a reasonable allowance for repairs.

Clear Springs Apartments

The University contends that management was able to satisfy the Board's concerns about discrepancies in the three real estate appraisals as a result of a reconciliation of the information in the three appraisals. The University states it was able to have all three appraisers agree as to lot size and state that lot size would not have materially altered their appraisal. However, given that the appraisals contained a range of $430,000 in land valuation alone, this statement does not appear logical. Furthermore, this statement does not address differences in reported square footage. The University should still have raised questions as to the accuracy and professional diligence of these appraisals.

The University appears to believe that the value of the Clear Springs apartments rose from $850,000 in 1990 to at least $2.7 million in 1994. We find no evidence that commercial real estate prices in San Marcos increased 300 percent in this time period.

Finally, the University relies on the Campus Master Plan architect's belief "that it is very important for a University to control its 'front door.' This represents more than just aesthetics." The University does not go on to describe any operational need for the apartments that extends beyond aesthetics.

Section 1-B:

The University Did Not Sufficiently Monitor Operations, or Take Action on Available Information to Limit Losses at Aquarena Springs

In the period from January 1, 1994, to August 31, 1995, Aquarena Springs incurred operating losses of $1,352,003. In the first eight months of this period, the University did not require the Vendor to provide month-to-month budgets for the facility. Therefore, the Vendor only reported actual losses and the University had no yardstick to measure the facility's financial status against.

Starting in September 1994, the University required the Vendor to produce a monthly budget report. However, although losses exceeded monthly budget projections by more than $400,000 in the period from September 1, 1994, to January 31, 1995, the University did not take direct action to stem excessive losses until February 21, 1995. At this date, the University sent the Vendor a letter requiring an action plan to immediately curtail the excessive losses at Aquarena Springs.

The Texas State University System is currently reviewing costs associated with Aquarena Springs to determine if any of the overhead or fees charged to the University can be recovered. We encourage this effort. With the exception of the Athletic Department, the largest burden on auxiliary enterprise resources has been Aquarena Springs.

<u>Recommendation</u>:

We recommend the University perform the following procedures to ensure that Aquarena Springs does not continue to be a financial liability:

- Aquarena Springs should continue to be closely monitored.
- Month-to-month budgets should continue to be produced, and variances should be monitored by line item.
- Variables such as cost of goods sold, attendance, prices, and overhead should be continually reviewed.

<u>Management's Response</u>:

Aquarena Springs has always been closely monitored. In addition to annual income and expenditure projections, monthly profit/loss statements by component with expenditures by object of expense were provided by the management firm to SWT. Each report was reviewed by SWT with the management firm. Beginning in October, 1995 semi-monthly financial reports were provided to management and forwarded to the Finance Committee and SWT Local Committee of the Board of Regents.

Although no other entity within the University has monthly operating budgets, SWT repeatedly requested them from the management firm from January, 1994 to July, 1994 with no success. In July, 1994, we agreed to concentrate on fiscal year 1995 and monthly budgets beginning September, 1994 were provided.

The following is a list of meetings between SWT and representatives of the management firm that originally operated Aquarena Springs. At every meeting strategies for increasing revenues and decreasing expenses were discussed.

1994
January 3, February 1, February 9, March 1, March 11, March 25, April 15, April 22, May 16, May 20, June 6, June 16, June 24, July 18, August 17, September 8, September 19, September 23, October 19, November 2, November 8, and December 8.

1995
January 20, February 17, March 10, March 24, April 21, May 8, May 19, June 23, June 26, July 31, August 10, September 7, and October 2.

Additionally there were numerous telephone calls and personal visits with the CEO of the management firm during this time. "Direct action" was taken on many of these occasions with the on-site management even though no formal correspondence was sent to the corporate headquarters until February 21, 1995.

The financial history of SWT's involvement with Aquarena Springs shows the following chronology:

From January 1, 1994 through August 31, 1994 the entire property lost $379,316. Of that amount $336,072 was lost at Capers Restaurant. Consequently, much of the early concern centered on the restaurant.

Aquarena Springs has always been a seasonal business, so in the fall and winter of 1994-95 losses were expected. Monthly budgets provided to SWT by the manager predicted such losses but they did not appear to be insurmountable during the upcoming tourist season. The most significant deviations from budgeted expectations continued to be in Capers Restaurant which continued to command most of the attention. Six months into fiscal year 1995, the demand letter of February 21, 1995 mentioned by the Auditors was sent.

At the March, 1995 meeting of the Board of Regents a mid-year financial report was reviewed. The terms of the Management Contract which required SWT to give the manager 90 days to cure any deficiency upon notice were discussed. It was also noted that the manager can only be terminated on the anniversary date of the contract (January 1) with a 90-day notice. The management firm's representatives were invited to and did attend the May, 1995 meeting of the Board of Regents to discuss their plans for improving the profitability of Aquarena Springs.

Following the May, 1995 Regents' meeting, SWT gave the manager the 90 day deficiency notice required by the contract. This was to allow the manager the summer months to recoup the losses that occurred in the winter.

During the summer of 1995, the property's profitability compared to the summer of 1994 improved, but not enough to offset the winter's losses. Therefore, on September 15, the manager was given the notice required in the management contract that the contract was being terminated. The manager waived the 90-day notice period and left Aquarena on October 11, 1995. SWT has been operating Aquarena Springs directly since October 12, 1995.

On February 23, 1996, the Board of Regents terminated the theme park operations of Aquarena Springs and SWT began the process of converting the property to educational and general use.

<u>Auditor’s Follow-Up Comment</u>:

The University states that monthly profit/loss statements by component were provided by the management firm to the University and that beginning in October 1995 bimonthly financial reports were also provided. Historical documents do not allow for direct management and preventative actions to address operating problems, nor do historical documents allow for projections of future performance.

The University states that during the seven-month period from January 1994 to July 1994, the vendor refused to provide monthly budgets. Yet, University management took no action against the Vendor for this lack of cooperation during that time.

The University states that from January 1, 1994, to August 31, 1994, cumulative losses were $379,316. While this may be true, it is also true that the facility lost $1,036,183 during the next six-month time period. The University understood that the lower losses in the first eight months were due to higher revenues during the busy spring and summer seasons. Maintaining more careful vigilance over expenditure items in the lower revenue generating fall and winter seasons could have limited the University’s losses.

The University contends that the Capers Restaurant accounted for most of the concern at Aquarena Springs. This statement again illustrates the University’s inability to effectively use available information. During calendar year 1994, which encompasses the first four months of fiscal year 1995, losses exceeded “worst case”projections by approximately $495,000. Capers accounted for only $92,000 of this amount. The remaining $403,000 were fixed expense charges by the food service vendor for maintenance, landscaping, marketing, accounting, and administration.

Section 1-C:

Some Auxiliary Enterprise Projections May Not Accurately Capture All Revenue and Expenditure Items

Aquarena Springs

On September 26, 1995, the University provided the Board of Regents with five operating scenarios to limit losses at Aquarena Springs. The scenario accepted by the Board on September 29, projected no more than $149,486 in total losses for the period from October 1, 1995, to February 28, 1996. This equates to a loss of approximately $30,000 per month. On October 7, 1995, the current manager of Aquarena Springs provided his independent estimate of probable losses for the period. He predicted total losses of $257,522, or 71 percent higher than the estimate provided to the Board. This equates to a loss of approximately $51,500 per month.

The scenario accepted by the Board was given to the current manager of the facility, after the fact, to use as a budget. The manager was not involved in the development of the scenarios prepared for the Board.

As a point of comparison, during the same five-month period in 1994 when the Vendor operated this facility, losses were $880,312, or approximately $176,000 per month. However, it should be noted the operating assumptions (reduced hours of operation, significant personnel reductions, reduced overhead expenses) have changed since 1994.

The Board of Regents directed University management to terminate the contract with the Vendor for operating Aquarena Springs. University management was also directed to develop alternative scenarios for self-operating the facility during an interim period beginning October 1, 1995, and ending February 28, 1996. The objective of the scenarios was to reduce the amount of losses incurred until a more permanent solution could be developed.

Sound and Recording Studio

The University projected revenues of $90,000 during the first nine months of its lease of the Sound and Recording Studio (December 1, 1992, to August 31, 1993). The facility realized actual revenues of $25,859, or 71 percent less than projected. During the same period, the University projected expenditures of $90,000. Actual expenditures were $73,966, or 18 percent less than projected. For fiscal year 1994, the University budget projected revenues of $117,784. Actual revenues were $84,233, or 28 percent less than projected. For fiscal year 1995, the University projected expenditures of $93,363. Actual expenditures were $133,111, or 43 percent more than projected.

Clear Springs Apartments

The University projected Clear Springs would produce revenues of $479,520 during fiscal year 1995. The actual revenues were $427,536, or 11 percent less than projected. The difference between projected and realized revenues was mostly attributable to the University not correctly estimating occupancy rates the first year. The University did not take into account that many of the non-student residents of Clear Springs had leases that terminated in the middle of academic semesters. Since the University requires residents of Clear Springs to be students, many of these apartments remained empty until the beginning of the next semesters.

For fiscal year 1995, the University calculated net operating income for Clear Springs of $102,718. Net operating income is calculated as revenues minus operating expenses, capital maintenance, and debt service. This figure was realized by deferring $62,300 in renovations that would have brought the complex into compliance with current Life Safety Code requirements. Had these renovations been completed, the net income would have been $40,418.

Net income projections for fiscal years 1996 to 2000 are shown in Figure 1.

Figure 1
Net Income Projection - Clear Springs Apartments

FY 1996	FY 1997	FY 1998	FY 1999	FY 2000
$755	$18,136	$17,722	$17,295	$16,856

Source: Southwest Texas State University

These net income projections are based on achieving $506,220 in each fiscal year. Net income also anticipates completing the deferred Life Safety Code renovation in fiscal year 1996. In subsequent fiscal years, $50,000 is included for repairs and renovations. Since the apartments were built 29 years ago, this allowance for repairs and renovations appears reasonable, if not conservative.

The University prepared its income estimate for fiscal year 1996 during November 1995. This is the third month of the fiscal year. The income level of $506,220 is $78,684, or 18 percent more than actual income for fiscal 1995. This difference is accounted for by a rise in rentals and achieving a higher average occupancy rate. Since the new rent levels were not set until after the fall semester began, and presumably, commitments to many of the annual leases were also set, the income estimate may be difficult to achieve. Given an expected net income of only $755, Clear Springs is at risk of operating at a deficit in the current fiscal year.

Estimates of both income and expense for fiscal years 1997 through 2000 may also be inaccurate. Most categories of both income and expense remain constant through this four-year window. As an example in the detailed income and expense estimate, the line item Salaries & Wages is stated at $26,476 for each year. The University is currently proposing a five percent pay raise for employees during fiscal year 1997. If this pay raise is implemented, this line item will need to be adjusted to $27,800. Similarly, estimates for utilities, insurance, and routine maintenance are all constant through the period. The University has not incorporated an inflation factor for these items.

Utilities Operations[3]

Actual expenditures for Utilities Operations have exceeded budget projections in each of the last three years. In fiscal years 1993 and 1994, expenditures exceeded budgets by approximately $700,000 and $1.9 million, respectively. In fiscal year 1995, expenditures exceeded budgets by $828,760. There are three causes for Utilities Operations expenditures exceeding budgets: (1) there is some degree of uncertainty in projecting usage since it depends on the severity of the weather; (2) the University may not have had adequate appropriations to meet the utility needs of its educational buildings; and, (3) the University failed to include foreseeable expenditures in the budget. The first two reasons are largely out of the University's control. However, in fiscal year 1995, we found the third reason accounted for a large portion of the expenditure excess, as shown in Figure 2.

Figure 2
Unanticipated Utility Expenditures - Fiscal Year 1995

Item Description	Dollar Amount
LoanStar Program Repayment	$196,851
Engine Repairs for Cogeneration Plant	$179,000
Excess Purchased Utilities Costs	$300,000
Total	$675,851

Source: Southwest Texas State University

The LoanStar Program is a loan program administered by the Governor's Office for the benefit of state institutions. The program's purpose is to allow state institutions to obtain energy efficient technology. The University was in the third year of repaying this loan, but did not include the repayment amount in the Utilities budget.

The expenditure for engine repairs for the cogeneration plant relate to a contract with an outside firm that was authorized by the Board of Regents in May 1994. This contract was to be paid for by funds from Utility System Revenue Bond reserve funds and insurance proceeds derived from claims against the policy on the cogeneration plant. The University did not include these foreseeable expenditures in the budget.

The excess purchased utilities costs stemmed from power factor charges and peak usage penalties charged by the City of San Marcos to the University. These charges were incurred because the University's cogeneration plant was not operational for several months of the fiscal year. However, the cogeneration plant had been out of service since December 1993 and these charges could have been predicted.

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3 Utility operations encompass both auxiliary enterprise activities and the educational and general activities of the University.

General Observations

As noted in this section, some auxiliary enterprise operating budgets contain inaccurate revenue and expenditure projections. To balance their budgets, some auxiliary enterprise operations will have to defer maintenance or receive subsidies in the form of General Use Fees or transfers from other auxiliary enterprise activities.

In general, revenue and expenditure projections are generally considered accurate if within ten percent of actual outcomes. When projections consistently vary by more than ten percent, whether over or under estimated amounts, the budget loses its usefulness as a means of matching income and expense.

Recommendation:

We recommend the following additional controls to improve the accuracy and monitoring of budgets during the budget execution cycle:

- Prior years' data, as well as conservative market sales projections, should be used to derive revenue projections for auxiliary enterprise activities. When prior years' data comes from outside sources, some level of due diligence procedures should be performed to ensure that the data is accurate and the level of revenue can be repeated.

- In all cases, participation and input from personnel most closely associated with auxiliary enterprise activities should be sought in budget development. This input should then be carefully scrutinized to ensure that it is balanced and does not reflect desires to enhance program activity, rather than absolute need.

- The University should develop budgets based on the most accurate available information. Information used by the Accounting and Auxiliary Services departments should be reconciled to ensure accuracy.

- Budgeted expenditure amounts should reflect expected and necessary expenditures rather than being tied to the income a particular auxiliary enterprise activity is projected to generate. This will eliminate "overspent" budgets that have to be funded from other resources at year end.

- Once realistic budgets are developed, the individuals responsible for administering those budgets should be held highly accountable for staying within budget. Variances of more than ten percent, either over or under projected amounts, should be closely questioned. If variances persist for several years, the individuals responsible for administering the budget should be changed.

- The University should prepare a consolidated budget report for all Auxiliary Enterprises Operations. Management can use this budget to determine which programs consistently exceed or fail to meet budgets. It can also be used as a tool to compare programs to one another.

Management's Response:

SWT believes the recommendations contained in this section are reasonable and represent sound practices. However, we believe they are already for the most part in place and the findings have reasonable explanations. We will be more diligent in the future about documenting such activities.

For example, regarding Aquarena Springs, the auditors cite the lack of involvement in the preparation of the operating projections by "the current manager." On September 26, 1995, "the current manager" was the Director of Marketing for the previous management company. There was absolutely no reason to consult specifically with the Director of Marketing at that time, although he did participate in one group meeting in this timeframe with his supervisors. He did not become Acting General Manager until October 12, 1995.

SWT cut the previous manager's loss in 1994-95 by about 50 percent from October, 1995 through February, 1996 by operating Aquarena Springs itself. While it is not as dramatic as had been predicted, it represents significant improvement.

The Sound Recording Studio income is difficult to predict because of the nature of the music recording business. As we become more familiar with this operation, budget projections will improve.

The auditors' figures cited in the section on Clear Springs Apartments are for the most part obtained from a document referred to internally as "Room and Board Rate Worksheets." The columns beyond the next fiscal year do not currently represent final net income projections for those years. Those columns are merely included for reference purposes. In the future, we will make preliminary long range projections for each of the years on the worksheet.

The auditors state that "rent levels were not set until after the fall semester began." Rents for Clear Springs Apartments for fiscal year 1996 were set by the Board of Regents in March, 1995 when they approved all room, board and apartment rates for SWT for the next fiscal year. The projected income and expenditures for Clear Springs Apartments were merely updated on the aforementioned "Room and Board Rate Worksheets" in November, 1995 based on current occupancy rates as a part of the process used to assess the need for rate increases in the following fiscal year.

The Life Safety Code issue mentioned involves the width between vertical spacers on handrails. The Code allows 36 months from the date of purchase of an existing building to make these modifications.

The budget for Utilities for fiscal year 1995 was prepared in February and March, 1994 as a part of the budgeting process leading to approval of the budget by the Board of Regents in May, 1994. In the spring of 1994, the contract for the cogeneration plant repairs had not been executed, the claim with the insurance company for reimbursement had not been settled and we did not know the date on which the cogeneration plant would become operational again in order to predict the extra charges from the city.

SWT recognized the problems associated with utility budgets during fiscal year 1995 and held regular meetings between the Vice President for Finance and Support Services, Comptroller, Director of Budgeting and Director of Physical Plant during the year to attempt to minimize the overexpenditure. In hindsight, a mid-year budget adjustment should have been made to adjust for these factors once they were known. However, even mid-year estimates are subject to being inaccurate because mild or harsh summers can dramatically effect final expenditure levels. We will attempt to make such mid-year utilities budget adjustments in the future as information becomes available.

Auditor's Follow-Up Comment:

The University states that there was "absolutely no reason" to consult with the current manager of Aquarena Springs on September 26, 1995, when operating projections were being prepared for the Board. The reason stated by the University is that at the time this individual functioned as Director of Marketing for the previous management company. These statements imply that University management was unaware this individual would be selected to manage Aquarena Springs 17 days later.

The University states that columns projecting revenues and expenditures for the Clear Springs apartments for fiscal years 1997 to 2000 are only "included for reference purposes." It is unclear to what "reference purposes" the University alludes. The only viable reason to include columns of revenues and expenditures for a multi-year time frame is to project future revenues and costs. Performing this analysis, with suitable adjustments for inflationary factors, is sound and routine business practice.

The spreadsheet we used to perform our initial analysis was dated October 1995. This spreadsheet indicated revenues of $12,314 less than the current revenue projections. The reason, as explained by University management in a meeting of the President's Cabinet, was that room and board rates were not finalized until November. If indeed the room and board rates are finalized in March, we cannot understand why the University did not include the updated rates in worksheets prepared the following October. It appears the University is at least six months behind in updating its revenue and expenditure projections.

The University states that the Utilities budget was prepared in February and March 1994 in preparation for the 1995 fiscal year. However, our analysis was based on final budget authority. Final budget authority reflects all changes made through the last day of the fiscal year. Thus, our analysis of the expenditures exceeding budgets included all changes made through August 31, 1995.

Section 2: ATHLETIC

The Athletic Department Has Not Effectively Instituted Appropriate Internal Controls, and Standard University Controls Are Not Applied to the Department

The Athletic Department has shown a consistent pattern over several years of not being able to stay within budget. The Athletic Department has been allowed to continue this pattern by being granted numerous budget increases during the fiscal year and being allowed to run deficits in excess of those increases. Having to fund Athletic Department overspending impacts the ability of the University to fund other programs. Standard University controls over such things as salary supplements, moving expenditures, and cellular phone usage have not been consistently applied to the Athletic Department. Proceeds from an interfund loan have been used for purposes not approved by the Board. The source of revenue for repaying this loan has not been developed, and repaying the loan is exacerbating the Department's deficit.

Section 2-A:

Budgetary Controls are Not in Place

The Athletic Department has developed a consistent pattern of overspending budgeted amounts over the past several years. Having to fund Athletic Department overspending impacts the ability of the University to fund other programs.

Figure 3

Athletic Department Original Budget vs. Actual Expenditures

Fiscal Year	1991	1992	1993	1994	1995
Budgeted Expenditures	$2,963,821	$3,256,386	$4,019,721	$3,957,827	$4,120,144
Actual Expenditures	$3,778,000	$4,160,304	$4,116,572	$4,361,408	$5,047,302
Difference	**($814,179)**	**($903,918)**	**($96,851)**	**($403,581)**	**($927,158)**
Percent Over Budget	**27.5%**	**27.8%**	**2.4%**	**10.2%**	**22.5%**

Source: Southwest Texas State University

For the past five years, the Athletic Department overspent its budget by almost $3.15 million. This equates to cumulative overspending of 17.2 percent.

In large part, this overspending is due to the Department's unrealistic projections of self-generated revenues. Self-generated revenues are items such as concessions, advertising, game guarantees, and ticket sales. Actual self-generated revenues have fallen short of projected self-generated revenues as shown in Figure 4.

Figure 4
Projected Revenue vs. Realized Revenue

Fiscal Year	1991	1992	1993	1994	1995
Projected Revenue	$972,000	$911,279	$1,308,395	$953,149	$1,235,110
Realized Revenue	$797,619	$623,127	$644,768	$779,556	$1,017,593
Shortfall	**($174,381)**	**($288,152)**	**($663,627)**	**($173,593)**	**($217,517)**
Percent of Shortfall	**17.9%**	**31.6%**	**49.3%**	**18.2%**	**17.6%**

Source: Southwest Texas State University

For the past five years, the Athletic Department failed to realize over $1.51 million in projected self-generated income. This equates to cumulative shortfalls from projected revenues of 28.2 percent. The cumulative shortfall also accounts for 48.2 percent of the Department's cumulative overspending for the period.

Athletic Department budgets have three sources of funding. Self-generated income, as discussed above, is one source. Student Service Fees are a second source. Student Service Fees are allocated by a Student Service Fee Allocation Committee consisting of student body representatives, as is required by the Texas Education Code. The third source of funding is General Use Fees. General Use Fees are charged to students, but allocated at the institution's discretion. For the past five years, Athletic expenditures have been funded as shown in Figure 5.

Figure 5
Five-Year Athletic Department Budget - Source of Funds

Fiscal Year	1991	1992	1993	1994	1995
Self-generated (Percent)	$797,619 (21.1%)	$623,208 (15%)	$644,768 (15.7%)	$794,172 (18.2%)	$1,017,593 (20.2%)
Student Service Fee (Percent)	$2,210,708 (58.5%)	$2,373,463 (57%)	$2,160,127 (52.5%)	$1,966,893 (45.1%)	$2,357,036 (46.7%)
General Use Fee (Percent)	$769,673 (20.4%)	$1,163,632 (28%)	$1,311,678 (31.8%)	$1,600,342 (36.7%)	$1,672,673 (33.1%)
Total	**$3,778,000**	**$4,160,304**	**$4,116,573**	**$4,361,407**	**$5,047,302**

Source: Southwest Texas State University

Over the five-year period, self-generated revenues have remained fairly flat as a source of funding. Reliance on Student Service Fees has decreased as a source of funding, and General Use Fees have increased substantially as a source of funding. The reason for increasing reliance on General Use Fees is that these fees are the most discretionary source of funding to finance differences between budgeted and actual expenditures.

Increased reliance on General Use Fees stems from three causes. The first cause is the self-generated income shortfall discussed above. The second cause is the overall growth in Athletic Department expenditures. Over the last five years, total expenditures have increased $1.27 million, or more than one-third. Of the $1.27 million, more than 70 percent came from increased General Use Fee funding. The third cause is the failure to properly administer the budget during the budget execution cycle.

Each year, the Athletic Department requests changes to increase its budget during the fiscal year. These intra-period increases have resulted in average budget growth during the last five years of 12.5 percent. Even after these intra-period increases in budgeted amounts, the Department has run a deficit in three of the five years totaling $849,845. In fiscal year 1995, the Department was granted 131 budget changes, increasing the budget by almost $670,000.

Despite these supplements to the Athletic budget, on June 23, 1995, the Athletic Business Manager notified all coaches that their budgets had been depleted or were in deficit and that they must immediately stop all expenditures for the remainder of the year. This memo was sent out with more than two months remaining in the fiscal year.

Based on total annual semester hour enrollment of approximately 512,000 hours, athletics consumed $4.60 per hour in Student Service Fees and $3.27 in General Use Fees for every hour students enrolled. For the average undergraduate student enrolled in 12 semester hours, the fee bill for athletics was $94.40 per semester.

Finally, the presentation of the Athletic Department budget in the official budget document prepared for the Board of Regents is potentially misleading. The budget document divides the Athletic Department into two sections, one labeled "Student Service Fee" and the other labeled "Auxiliary Income Generating." In the fiscal year 1995 budget, the Auxiliary Income Generating section of the Athletic Department budget comes to more than $2 million. However, as noted above, only $1.2 million was even anticipated from self-generated revenue. The remainder was anticipated to come from General Use Fees. Since this is not truly "income generating" activity, it is mislabeled.

Recommendation:

We recommend the following controls be adopted to manage the Athletic Department budget process and ensure that budgets given to the Board are not misleading:

- The Athletic Department should be required to develop a realistic budget that can be administered within available funds. Individuals within the Department should be held accountable for ensuring that the budget is maintained during the budget execution cycle. If individuals show a consistent pattern of being unable to maintain budgets, they should not have the authority to develop or administer the budget.

- The Athletic Department should be required to forecast self-generated revenues based on prior year results to enhance the likelihood of achieving projected revenues.

- Perform biweekly line item review of the Athletic Department budget. Produce a report for the President's review and sign off at least once per month outlining every line item over expenditure of more than 5 percent.

- Produce a separate annual budget document for the Athletic Department to be reviewed and approved by the Board. Provide a quarterly report to the Board on that status of the Athletic Department budget.

- Change the presentation of the Athletic Department budget to reflect the actual sources of funding (e.g., self-generating income, general use fees, and student service fees).

Management's Response:

The University agrees to implement increased monitoring, along the lines recommended by the State Auditor, to assure that athletic expenditures do not exceed approved athletic budgets.

The first chart in this section reflects the original budget developed by Athletics, often as early as five months before the start of the fiscal year. The University budgeting process recognizes the need to adjust budgets throughout the year as needs arise. The budget process provides for review of the budget adjustments and reporting adjustments to the Board of Regents according to procedures developed by the Texas State University System. Adjustments to the original budget have been made to account for university-directed salary increases, to pay for accrued vacation for staff leaving during the fiscal year, to account for previously approved expenditures from student service fee reserves, (e.g., purchase of bleachers and weight room equipment) once the size of the reserve is known and as better information becomes available. Consequently, the following chart reflects the adjustments to the original budget and the difference between the approved adjusted budgets for athletics and actual expenditures.

Fiscal Year	*1991*	*1992*	*1993*	*1994*	*1995*
Original Budget	*$2,963,821*	*$3,256,386*	*$4,019,721*	*$3,957,827*	*$4,120,144*
Budget Adjustments					
- Salary Adjustments	*1,093*	*60,637*	*34,897*	*46,496*	*28,834*
- Payments for accrued vacations	*12,057*	*0*	*371*	*27,751*	*4,100*
- Pre-approved allocations (e.g., weight room, bleachers)	*0*	*176,621*	*21,978*	*10,901*	*150,000*
- Update to operating expenses (M&O, travel, and wages)	*435,117*	*436,199*	*43,480*	*319,077*	*486,173*
Total adjusted budget	*$3,412,148*	*$3,929,843*	*$4,120,447*	*$4,362,052*	*$4,789,251*
Actual expenditures	*3,778,000*	*4,160,304*	*4,116,572*	*4,361,408*	*5,047,302*
Difference	*(365,852)*	*(230,461)*	*3,875*	*644*	*(258,051)*
Percent over budget	*10.7%*	*5.9%*	*---*	*---*	*5.4%*

Although realized revenue has increased over the last several years, especially in the area of corporate sponsorships and advertising, projected revenue estimates have not been met. Attendance at major sporting events have not met expectations resulting in underrealized ticket sales and concession sales. Consequently, in order to provide more realistic revenue projections, the prior year's actual revenues generated will be the basis for budget projections.

The increased expenditures in Athletics over the five years reflect an increase in scholarships for tuition, fee, room and board changes, as well as an increased number of scholarships for women; the implementation of an administrative intern program; increased efforts in promotions and marketing; expanded program for academic support; expansion of women's programs to address gender equity concerns; and some capital improvements to athletic facilities.

The University has attempted to increase the amount of self-generated revenue and to decrease the amount of general use fees going to support Athletics. We have only been partially successful in this endeavor. Stricter budget controls such as those recommended, will be put in place to reduce the percent of the athletic budget coming from the general use fees.

A presidential task force has been studying the appropriate role of athletics at SWT. As part of this study, recommendations will be made regarding support necessary to successfully fulfill this role and the appropriate source of this support. Concerns raised in this audit regarding use of student fees for athletics are being addressed by the task force.

Separate accounts for student service fee funds and income generating funds complicate the budget change process. Based on information recently provided by the Texas State University

System Office regarding the accounting for student service fees, it appears that the current chart of accounts for Athletics can be significantly reduced by combining the student service fee account and income generating account for each entity (e.g., baseball) and maintaining a record of source of funds for transfers into the combined account. This change should significantly reduce the number of budget changes being processed for the department, while meeting legislative requirements to separately account for each source of funds.

Finally, the University will discuss with the Board of Regents the need for providing more detailed and timely information to the Board regarding the athletics budget and source of funds supporting the budget.

<u>Auditor's Follow-Up Comment</u>:

The University's response includes a table illustrating "adjusted budget" amounts for the fiscal years 1991 to 1995. We find this chart misleading in that it reflects <u>all</u> budget adjustments made from the original budget prepared in March to the end of the actual fiscal year at August 31. Therefore, all changes, whether reflecting legitimate administrative changes like across-the-board salary increases, or simply over-expenditures being covered by budget changes, are reflected in this "adjusted budget" figure.

Furthermore, line items comprising the difference between the original budget and the "adjusted budgeted" are dominated by the amounts described as "update to operating expenses (M&O, travel, and wages)." These lump sum amounts of over $1.72 million represent exactly the lack of controls over spending described in our finding. For example, in fiscal year 1995, over $321,000 of the $486,173 in "updated operating expenses" were funds put solely at the discretionary authority of the Athletic Director <u>after</u> the Board approved the original budget.

Section 2-B:

Interfund Loan Proceeds Were Used for Unintended Purposes

The Board of Regents approved a $282,000 loan from the Telephone Operations reserve fund to Athletics in March 1993, based on a proposal from the Athletic Department. The loan terms require the Athletic Department to pay back Telephone Operations in $57,000 increments over a five-year period. The repayment was to be financed by net income produced by a golf driving range. The driving range was going to be built from $93,150 of the loan proceeds. The golf driving range was never built and all but $1,100 of the loan has been expended.

Instead of building the driving range, the loan funds were used for purposes not included in the proposal given to the Board:

- $99,750 was used to buy new bleachers for the baseball stadium.
- $9,870 was used to buy out a lease on the land where the golf driving range was to be built. This land was already owned by the University, but was under contract to a local rancher.
- $8,607 was used to build a pole vault pit for the track and field team.
- $3,900 was used to pay the travel expenses for a visiting football team.

According to Board of Regents rules, all purchases in excess of $50,000 have to be approved by the Board. Consequently, in the November 1994 Board meeting, authorization was given by the Board for the purchase of new bleachers costing $199,500. The Board was not informed that half of the payment for the new bleachers ($99,750), was going to come from the money the Athletic Department borrowed from the Telephone Operations reserve fund.

In fiscal year 1995, the first repayment of the loan to Telephone Operations was made by the Athletic Department. Since the golf course was never built, the $57,000 payment had to come out of operating funds, thus exacerbating the Department's deficit for the year. In fact, the Department's deficit for fiscal year 1995 was $258,051.

<u>Recommendation</u>:

We recommend the following actions be taken to address the current status of the interfund loan to the Athletic Department:

- The University should clarify polices and procedures to ensure that the Board is always timely informed when approved funds are going to be used for purposes other than originally intended.
- The Board should be informed immediately that loan proceeds from the Telephone Operations reserve fund were spent to purchase the new baseball bleachers. The University should either seek Board ratification for that use of funds or propose an action plan to reimburse the loan account.
- The University should either build the golf driving range as intended or notify the Board that the driving range will not be built. If the range is built, then new financing and operations plans will need to be developed. If the range is not built, then the University should seek a new tenant for the unused land. The University should also make the loan repayment a line item in the Athletic

Department budget for the remaining fiscal years until the reserve fund is repaid.

Management's Responses:

The University has made several attempts to proceed with the construction of the proposed golf driving range. Voluntary labor and donated material included in the original proposal did not materialize. Discussions with two firms to construct the facility resulted in significantly higher costs than the department was able to justify. Joint ventures were explored with external entities, but terms proposed were not acceptable to the University. The University is now conducting a best-use study for the land proposed as site of the golf range.

Revenue generated by the department has increased as a result of marketing and promotions activities funded by the interfund loan. Repayment of the loan has begun and will continue until complete. A line item will be carried in the athletic budget for the loan repayment.

The University will provide the Board with an accounting of the expenditure of funds from the interloan proceeds and will review procedures to ensure that the Board is informed in a timely manner whenever approved funds are used for other purposes than originally intended.

Section 2-C:

Employees Received Salary Supplements in Excess of Normal University Limits

Athletic Department personnel receive salary supplements as compensation for participating in summer athletic camps and clinics. In fiscal year 1995, two employees each received supplements in the amount of $14,797 for this work. Both employees hold 12-month appointments and these supplements were in addition to an added $2,000 per month of summer salary payments for operating the camps and clinics. The $14,797 supplements exceed the normal annual limit for salary supplements of $12,283 set in the University Policy and Procedures Statements.[4] However, the Athletic Department has been granted exception to this rule governing all other University employees.

The two supplements were derived from a percentage of the gross proceeds collected from a single summer athletic camp. Combined, these two supplements amounted to over 22 percent of the gross proceeds generated by the camp. The supplements and

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[4] University Policy and Procedures Statements dictate that no employee may receive salary supplementation in excess of 25 percent of the average nine-month appointed professor's salary. Using this formula, the cap equates to $12,283.

salary payments amounted to a 57 percent increase over base salary for one employee and a 73 percent increase over base salary for the other employee.

A third employee received a $11,078 salary supplement for participating in another summer camp. This payment amounted to 29 percent of the gross proceeds generated by this camp. The salary supplement amounted to a 18 percent increase over base salary for this employee.

These two camps produced total proceeds of $156,860 and paid out salary supplements of $40,672, or more than 25 percent. Given the Athletic Department's deficit position, this did not represent a prudent use of funds. Total payments to Athletic employees for all camp and clinic work was $64,485 in fiscal year 1995.

Recommendation:

The Athletic Department should be subject to the University-wide limits on salary supplementation. Once the Athletic Department is brought under the policy, the Personnel Office should review the supplements that are approved on a monthly basis to ensure they are appropriate and do not exceed the set limits.

Management's Responses:

In an attempt to provide competitive salaries to coaches, the department provides a supplement to coaches' salaries for conduct of summer camps. Such camps provide a source of revenue to the department, as well as a vehicle to recruit students to the University.

The department has voluntarily agreed to conform to the University policy on salary supplements. The Personnel Office will review supplement payments to assure limits are not exceeded. However, as noted in Section 5.B the salary supplement policy for the University is being reviewed.

Section 2-D:

A Questionable Moving Expenditure Reimbursement Was Made

The Athletic Department reimbursed one of its employees $1,624 for moving expenses incurred when the employee moved from New Braunfels to San Marcos. The reimbursement took the form of a request for budget change and was administratively handled as a salary supplement. The funds were transferred from a non-salary budget into salary budget and disbursed to the employee. This transfer appears to be in non-compliance with University policy.

University Policy and Procedures Statements state that, " . . . the total amount of salaries may not be increased by transfers from other expense categories within the account . . . " The exception is that a Vice President may approve a transfer between salary and non-salary items. The request for budget change did not have the approval of a Vice President.

With few exceptions, the University does not reimburse employees for moving expenses. In general, the only department that routinely reimburses employee moving expenses is the Athletic Department. The Department has paid for seven employees to move to the San Marcos area in the past two years. However, these were new employees and were all moving from considerable distances. In fact, all but one of the seven moved from out of state. The employee who was reimbursed the $1,624 was an existing employee and was moving less than 30 miles.

Recommendation:

We recommend that the University adopt the following controls to ensure equitable and consistent application of the moving expense reimbursement policy:

- The University should adopt a formal policy on when it is appropriate to reimburse employees for moving expenses.

- The Budget Department should enhance controls over the request for budget change approval process to ensure that transfers from non-salary to salary budget groups are not approved without a signature from an appropriate Vice President.

Management's Response:

Payment of moving expense was part of the negotiations between the former Athletic Director and the football coach at time of hire. These expenses were to be paid from booster club funds.

University accounts will be reimbursed for these expenses from booster club funds.

The University will review current procedures for determining payment of moving expenses to see if a University policy is necessary.

The Budget Office will ensure the signature of the appropriate vice president appears on the budget change request form.

Section 2-E:

Cellular Phone Usage Has Not Been Analyzed and Records Are Not Maintained

At least 18 individuals within the Athletic Department have been assigned cellular phones. Audit procedures revealed over $675 worth of unreimbursed personal phone calls made on the University's cellular phones by these individuals during fiscal year 1995. This was possible because the Department maintains virtually no records for the cellular phones, does not analyze usage, and there are no University polices and procedures to regulate the use of cellular phones.

We obtained copies of cellular phone bills and the home phone numbers for the 18 individuals who have been assigned cellular phones. We reviewed the bills to determine calls made from the phones to the individuals' homes and ran totals for the cost of these calls. We then reviewed reimbursement records to determine if calls to individuals homes were paid for by those individuals. We were able to identify $675 of unreimbursed personal calls based in these procedures. Since we performed limited procedures, it is probable that other personal calls went undetected.

Additionally, we were unable to fully review unreimbursed personal usage because the Department did not possess phone bills for all individuals for every month of the fiscal year. Department personnel stated that as phone bills come in they are forwarded to the responsible individuals to review, mark off personal calls (and make reimbursement), and return to be processed for payment. If the individual does not return the bill to the Department, it is not paid and no copy exists.

As a result of this system, the Accounting Department reports that cellular phone bills routinely come in two or three months after the due date on the bill. As no independent review is made of the calls included on these bills, it is completely up to the individuals to accurately report their personal usage. Further, the overall usage of the cellular phones is not reviewed to ensure that phones have only been assigned to staff having a legitimate business need. Athletic Department personnel reported that some individuals just pay their own phone bill out of pocket every month, ostensibly because the phones are never used for University purposes.

<u>Recommendation</u>:

We recommend that the Athletic Department and the University adopt the following controls to ensure adequate supervision over cellular phone usage:

- The Department should maintain copies of all cellular phone bills for each individual assigned a cellular phone. These bills should be organized either by individual and/or by month.

- The Department should routinely review the cellular phone bills to ensure the phones are used only for University business, and that if personal use occurs, the University is reimbursed for the cost.

- The Department should require that individuals seeking to be assigned cellular phones submit a written justification for the phone. The Department, as well as Telephone Operations, should review and approve the request.

<u>*Management's Response*</u>:

All requests and justifications for purchase of cellular telephones are reviewed by the Athletic Director, both Associate Athletic Directors, and the Athletic Business Manager. Cellular phones have increased the efficiency of the staff and provided improved security for staff, especially coaches who often travel late at night by themselves.

Staff members are required to reimburse the University for personal use of the cellular phones. However, it is appropriate for staff, in some instances, to call home to check for messages.

Although the Business Manager currently provides a cursory review of cellular bills, a more thorough review procedure as outlined in the recommendations, will be implemented.

Section 3: POLICY AND PERFORMANCE MANAGEMENT

Enhance the Existing Strategic Planning Process by Developing a More Comprehensive Assessment Process and Keeping Policies and Procedures Current

The existing strategic planning process can be improved by making the plans more consistent and by developing a more comprehensive assessment process. Improvements in the quality planning and assessment process, the internal audit function, and the policy and procedure revision process would enhance the University's management process.

Section 3-A:

Improve Quality and Consistency of Strategic Plans at the University

Although all divisions and departments are required to have strategic plans, the quality and content of these plans vary greatly within the University. Of the plans reviewed, some division and department plans did not have strategies, and some plans did not clearly distinguish between goals, objectives, and strategies. Other plans contained strategies stating reasons why objectives cannot be accomplished, as opposed to the means by which to accomplish the objectives. One plan did not contain division/department specific goals and objectives, but used the University goals and objectives. However, the University goals and objectives are too broad for any one division or department to accomplish.

Strategic plans reviewed were not always linked to the appropriate plan. The department goals are supposed to link to division goals and objectives, and the division goals and objectives are supposed to link to the University goals and objectives. One department plan was linked to the University strategic plan instead of the division strategic plan. This is a problem because the department may not be accomplishing the goals that the division feels are important. If the University is going to use strategic planning as an effective tool to direct University activities, it is important that the plans link properly.

Recommendation:

The University should train staff on ways to develop a quality strategic plan. Additionally, the University should ensure that existing planning guidelines are followed by all of the Departments.

Management's Response:

Previous planning and management systems implemented at SWT in a top-down fashion, with stringent guidelines on format and content, resulted in too much attention given to the process and not enough attention given to the results. Managers tended to view the planning activity as more of a bureaucratic exercise instead of a useful management tool.

Attempts have been made in development of the current strategic planning process to provide departments with some flexibility in content and format, and to focus more attention on end-results. Feedback from various units on-campus indicate that more attention is being given to end-results.

As a result of an assessment of the University's strategic planning process conducted by an external consultant in May, 1995, several actions have been identified to improve the planning process. The University will clarify and strengthen the guidelines provided in the Strategic Planning Guide to assure more consistency in form and content in the plans at various levels of the institution. The University will expand its training efforts on the planning process to all levels of the institution. The Executive Planning Council will assure adherence to these guidelines. The University has developed strategies to better link its planning, budgeting, assessment and quality initiatives. One strategy involves extensive training of all managers and academic deans and chairs on the integration of these processes, including orientation sessions for new managers and refresher sessions for continuing managers.

Section 3-B:

Improve Efforts to Measure Progress Against Strategies, Goals, and Objectives

The University does not monitor its progress toward achievement of the University strategic plan goals, objectives, and strategies. The University does produce a Strategic Progress report which highlights each division's accomplishments. However, the report does not discuss whether the University accomplished or made progress toward its goals during the year.

Monitoring the progress toward achievement of the strategic plan goals, objectives, and strategies is inconsistent at the division and department levels. Some departments do not monitor progress toward the accomplishments of goals at all. Other departments only monitor informally.

The University has not developed a consistent and comprehensive approach to assessment. While there is an University Advisory Assessment Council, the charge, duties, and time allotted to Council duties is probably not adequate to ensure a consistent University-wide approach to measuring what has been achieved.

The University does compile a formal Assessment Update report. The Assessment Update is designed to report on a description of the assessment activities, changes that have been introduced as result of what have been learned from the assessment efforts, how the assessment activities relate to the division's strategic plan, and the assessment initiatives planned for the immediate future. The Assessment Update includes information from each division and has a standard format of items that must be included. Only those departments that have conducted some outstanding assessment activity during the semester are included in the assessment report.

There is wide discrepancy in the quality of assessment programs between departments and even divisions, although most departments are performing some type of assessment of their programs. One division produces assessment instructions that are general guidelines on how to conduct a self study. Another division has assessment instructions that are specific and more of a requirement. Some departments provide assessments of programs and relate the assessments back to the strategies in the strategic plan. However, these reports do not contain an assessment of every strategy in the plan. No examples were found of a department that uses a report to measure how well they met their outcome/output measures for each strategy. Because of the inconsistent monitoring and assessment, the University cannot determine the quality of the original strategic plan, their progress toward it, or how to effectively plan for the future.

Performance measures used for tracking progress toward goals and objectives have not been developed by most departments and divisions. Measures have been developed at the University level. The University only tracks the measures that are reported to the Legislative Budget Board (LBB), but does not use these measures to monitor University progress toward accomplishing the goals and objectives in its strategic plan.

Recommendation:

The University should institute a comprehensive monitoring and assessment system to review its strategic plan. For example:

- Measures should be developed to track progress toward achieving goals.
- Each department should produce a report that states how well they have met every goal, objective, and strategy in their strategic plan.
- The divisions should take the department reports and put all of the department results (accomplished or not) into the division plan and produce a similar report summarizing the results of the divisions, with the department plans as backup.
- The University should produce a report based on the five division reports, which outlines their progress toward accomplishing each of their goals and objectives. This report can be used to assess whether or not the University is accomplishing its goals and objectives.
- The reports at each level should contain similar information and be in a consistent format.

Management's Response:

Monitoring and assessment of strategic plans is inconsistent throughout the University. Much of the monitoring that is conducted is done on an informal basis and is not well- documented. For example, each vice president annually reviews with the President progress on divisional plans, including a discussion on lack of progress toward goals, and strategies to remedy the situation.

The University has taken steps to establish a University-wide monitoring system for the strategic plan. Training on the use of benchmarking is being offered as part of the University's quality initiative; experiences of the Division of Finance and Support Services in the use of benchmarks developed by NACUBO is being integrated into the training curricula. Access to data for benchmarking and monitoring progress toward objectives is being improved through development of a data warehouse.

As part of the effort to better link planning and assessment, the University Advisory Assessment Council's responsibilities will be expanded to develop measures for University-level goals and objectives, and to coordinate the divisional development of assessment measures for strategic plans.

The Executive Planning Council (EPC) will establish parameters for the University-wide monitoring system. Monitoring reports addressing all University goals and objectives will be reviewed by the EPC twice a year. The *assessment/monitoring activities will be covered in detail in training sessions on the planning/budgeting/assessment process.*

Section 3-C:

Institute A University-Wide Quality Planning and Assessment Process

The University does not have a comprehensive university-level quality planning and assessment process. No one individual or division oversees quality control initiatives that exist throughout the University. There are no standardized policies and procedures to ensure an effective quality planning and assessment process is established.

Quality planning and assessment initiatives vary considerably in extent and quality between the divisions and departments. Some departments use formal tools such as customer surveys, Follow-Up surveys, and on-site visits to identify the strengths and weaknesses of the department. Other departments have not formally identified benchmarks or best practices, have not identified acceptable deviations between planned and actual performance, and use historical data as a basis of good performance. Historical data may be excessive and not represent the most efficient operation results. In some cases, feedback is obtained informally or only when someone complains. This inconsistency in the quality planning and assessment process does not allow the University to have adequate assurance that its products and services are ultimately of high quality, and are effectively and efficiently delivered to customers.

Recommendation:

The University should develop a university-level quality planning and assessment process. For example:

- The University should institute a quality planning and assessment process for each program, department, and division in the University. Responsibility should be assigned to an appropriate level of management to develop relevant policies and procedures to guide the quality planning and assessment process.

- The actual delivery of the products or services should be compared against planned performance targets on an ongoing basis. The planned performance targets should align with the University's objectives, goals, strategies, and mission.

- The reasons for the differences between planned and actual performance should be determined and used as a basis to adjust the strategies used to accomplish the University's goals and objectives.

Management's Response:

The University has had a team consisting of the Assistant Vice President for Planning and Administration, the Director of Budgeting, the Associate Vice President for Academic Affairs and Director of Assessment, and the Special Assistant to the President/Director of Quality, working for the past year to develop a plan to integrate planning, budgeting, assessment, and the quality initiative. The plan developed is being considered by the President's Cabinet and the Executive Planning Council for implementation.

The plan developed addresses many of the recommendations of the external planning consultant and incorporates the objectives of the quality planning and assessment process recommended by the State Auditor.

Section 3-D:

Revise Policies and Procedures Regularly

University, division, and department policies and procedures are not revised regularly. Forty percent of the University Policies and Procedures Statements (UPPS) have not been revised by the Vice Presidents on or before the University's designated deadline. Not all division and department policies have set review cycles to ensure that policies are current to address the division's or department's needs. Without regular review and revision cycles, employees could be implementing policies and procedures that are not the current practices of the University, not in line with the University's strategic plan, or not in compliance with a new/changed laws and regulations.

Recommendation:

All policies and procedures should be reviewed and revised as scheduled. A revision schedule should be developed for divisional and departmental policies commensurate with the importance of the policy. The policies should be prioritized so that critical policies are reviewed frequently and those that are not as critical can have a longer review cycle.

Management's Response:

The President's Cabinet has recently implemented a process to expedite the timely review of University Policy and Procedure Statement (UPPS) documents. At the monthly UPPS review meeting, the vice presidents receive a list of "delinquent" UPPS's. A portion of the "delinquent" list is scheduled for review at the next UPPS review meeting.

The University feels it has an adequate review schedule which considers the "importance of the policy." The review cycle of each UPPS is determined on the basis *of the importance and volatility of the policy/procedure. Further, the review cycle for each UPPS is reconsidered with the review of the UPPS itself.*

The Assistant Vice President for Planning and Administration has been asked to work with each vice president to develop a review/revision cycle for divisional and department policies consistent with the University UPPS review cycle.

Section 4: INTERNAL AUDIT

Ensure Internal Audit Follows Approved Audit Plan, Reports Any Deviations from the Plan to the Board in a Timely Fashion, and Has Independence

The Office of Internal Audit did not complete 43 percent of the projects in the audit plan for fiscal year 1995. Internal Audit does not consistently monitor actual time against planned budgets by audit project. Accordingly, information on budget overages and shortages is not readily available. To the extent that the Internal Audit does not accomplish its audit plan, there is an increased risk to the University that its assets and financial resources are not adequately protected, that errors in its operational data will go undetected, and that illegal or fraudulent acts will occur.

The Director of Internal Audit may not be able to exercise full independence in some audit areas. The Board of Regents Rules and Regulations indicate that the Director of Internal Audit should report directly to the Finance Committee. However, the Regents Rules allow for day-to-day oversight of the Internal Audit Department to be assigned to the President or a Vice President.

Currently, the Director of Internal Audit reports to the Executive Vice President of the University. The Executive Vice President hires, dismisses, and initiates pay actions of the Director of Internal Audit. The Executive Vice President has operational responsibility for the Athletic Department, Computing Services, the University Attorney, Planning and Administration, Public Affairs, and Staff Development and Affirmative Action. The Internal Auditor should report to a senior level of executive management that is not directly responsible for operations, because the director of internal audit may not be able to exercise full independence in audit areas that are the responsibility of his immediate superiors.

The Finance Committee of the Board of Regents was not informed in a timely manner of the variances between the projects completed and the projects yet to be completed. Once per year, the Committee approves the audit plan and is informed of the adjustments to the audit plan. The Finance Committee needs this information more than once per year to ensure that the Internal Auditor is providing the necessary coverage for the University.

Recommendation:

The following recommendations would strengthen the Internal Audit function:

- The Director of Internal Audit should report administratively to the President of the University.
- The Office of Internal Audit should develop and use monitoring tools to identify and explain variances between the number of actual and planned audit projects. This information should be used to adjust audit strategies to accomplish the audit plan and to support adjustments to the audit plan.
- All significant variances from the audit plan or any adjustments to the audit plan should be approved by the Finance Committee before the adjustments are made.

Management's Response:

University policy, UPPS 04.03.01 -- Office of Internal Auditor -- points out that the Internal Auditor reports functionally to the President and administratively to the Executive Vice President. The President reviews and apposes the annual audit plan; the President receives individual audit reports, ensuring that there is adequate consideration of the report and appropriate action taken on audit issues.

The University will review policies and procedures governing the operation of the Office of Internal Audit to address concerns raised about assurance of full independence of Internal Audit.

The Internal Auditor has fully implemented a system to monitor on a timely basis the audit hours spent and compare those with the audit plan.

Significant variances from the audit plan and any adjustments to the audit plan will be approved by the Executive Vice President, the President, and the TSUS Director of Audits and Analysis before the adjustments are made and reviewed by the Finance Committee of the Board of Regents at their quarterly meeting.

Auditor's Follow-Up Comment:

We are encouraged that the University is going to review the policies and procedures governing the operation of the Office of Internal Audit. We strongly recommend that the responsibility for evaluating and initiating pay actions for the Director of Internal Audit be removed from the Executive Vice President. To ensure compliance with the Texas Internal Auditing Act, these duties should be placed at a level of the organization that does not have direct operational responsibilities.

Human Resource Management Controls Need Enhancements

Improvements in leave administration, job description development, recruitment and selection processes, performance appraisals, training activities, and employee turnover analysis would enhance the University's human resource management system.

Section 5-A:

Improve Procedures for Calculating and Monitoring FLSA Overtime and State Compensatory Time Leave Balances

A sample of 36 employee time sheets[5] revealed 62 mathematical or administrative errors. Some of the mathematical errors resulted in misstated Fair Labor Standards Act (FLSA) overtime and state compensatory time leave balances. Administrative errors included no supervisory signatures on time sheets, leave approval forms not being completed, and manual time sheets not agreeing with the automated timekeeping system leave balances. One employee was paid in a lump sum for more than 400 hours of FLSA overtime. This payment is in noncompliance with federal regulations requiring governmental entities to maintain FLSA overtime hour balances at less than 240 hours.

Some employees' leave balances have been overstated or understated. Individual departments are required to calculate employees' overtime and compensatory time balances. The employee, the employee's supervisor, or a designated department timekeeper performs the function. All calculations are done manually, creating opportunities for human error. The Personnel Office only receives a monthly summary report of departmental employees' leave balances, not their actual time sheets and leave calculations. The Personnel Office does not conduct audits to verify calculations or leave balances. Employees responsible for calculating leave balances do not receive regular training and updates on applicable state and federal laws.

To comply with federal law and avoid possible sanctions, universities must correctly calculate FLSA overtime for nonexempt employees. Understating employees' FLSA overtime balances can result in serious liabilities. The University could be required to recalculate employees' overtime balances for two or three years which would be complicated by inadequate manual record keeping. In addition, should it be found that the University incorrectly calculated a group of employees' overtime, a sizeable amount of back pay could be owed that was not planned in the budget.

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5 The Personnel Office assisted in the identification of this sample. The Personnel Office had concerns that certain departments were not appropriately reporting employee time and leave. We selected our sample from those departments identified by the Personnel Office.

Overstating FLSA overtime balances results in granting employees time-and-a-half when the employees were entitled to straight time. This puts the University in non-compliance with state regulations.

Leave calculations for nonexempt employees are often complicated and should be performed only by trained employees to avoid these negative consequences.

The University does not have standard procedures for how to calculate state compensatory hours for employees exempt from the FLSA. Individual departments handle this differently. Some FLSA-exempt employees receive state compensatory time for working over 40 hours and others do not.

The automated timekeeping system does not track these compensatory leave hours. Since employees are manually tracking their own compensatory leave hours, the University cannot ensure that they take this time off within the 12-month time limit that is required by state regulations. FLSA-exempt employees who do not take the time off within required 12 months could accrue large compensatory time balances that should have dropped off from their earned leave balance.

Recommendation:

The following controls would strengthen the leave administration procedures:

- The University should consider having a trained employee(s) in the Personnel Office calculate all employees' FLSA overtime/state compensatory time leave balances.

- If the University continues to have the departments perform overtime and compensatory leave calculations, a designated department employee should be assigned this duty. These departmental representatives should undergo extensive training on federal and state regulations governing FLSA overtime and state compensatory time, as well as how to calculate leave balances.

- The Personnel Office should develop an automated time sheet system to limit the department representatives to entering only actual hours worked and taken off.

- If the Personnel Office is responsible for calculating leave balances, then the departments should be required to turn in the actual time sheets, not just monthly summaries. If department representatives retain this responsibility, then they should maintain the actual time sheets. The time sheets should be retained for three years in case the University should ever be subject to a Department of Labor investigation.

- The Personnel Office should conduct audits of a certain percentage of department time sheets each month to catch mistakes and determine the departmental representatives' need for further training.

- The University should develop a policy that would standardize how FLSA-exempt employees accrue state compensatory time. Records should be kept of these employees' time and they should be included in the automated timekeeping system to ensure that the employees take the time off within the 12-month limitation.

Management's Response:

SWT recognized the problems cited in this section in 1994, and implemented in 1995 an automated time keeping system with regular training sessions for departmental time keepers. We will consider all of the recommendations made as means to continue to improve this area.

We are concerned that the inclusion of state compensatory time for FLSA exempt employees in the automated system may not be cost beneficial since no liability accrues to the University for these hours. However, we will strengthen our procedures to ensure that compensatory leave for exempt employees is not taken more than one year after being earned.

Section 5-B:

Improve Monitoring of Salary Supplements

The University has not effectively monitored salary supplements given to employees. Five employees received total supplements in excess of the annual maximum rate of $12,283 (25 percent of the average nine-month appointed professor's salary) set by the Board of Regents. One employee received $36,023 in salary supplements in fiscal year 1995.

Although it is not a written policy, the Budget Office has determined that for administrative reasons, employees should not receive in excess of $1,365.77 a month ($12,283/9 months). Forty-eight employees received monthly supplements in excess of this monthly maximum rate. In addition, the University has not updated the policy to reflect changes to state law. At one time, faculty could not receive more than $7,500 per year for teaching correspondence courses. That rider was deleted from the General Appropriations Act in 1991.

Recommendation:

The administration of salary supplements should be strengthened by the following:

- The University should strengthen the monitoring of employee salary supplements. Supplements that are approved monthly should be reviewed to ensure they are appropriate and do not exceed the set limits.

- The Faculty Records Department should review faculty supplements and the Personnel Office should review all other staff supplements. The University should update its *Pay in Excess of Base Salary* policy to reflect the change in state law regarding correspondence course compensation.

Management Response:

SWT has made the change regarding correspondence course compensation and is reviewing the administration of the salary supplement policy as suggested.

Section 5-C:

Develop Job Descriptions for All Positions

Job descriptions are not available for all positions. Currently, the University does not have job descriptions for 38 percent of its positions. Eighty-one position titles are not required to have job descriptions. The majority of these are nonclassified/administrative positions.

Job descriptions should be developed for all positions to ensure that employees and supervisors are aware of job requirements. Analysis of the knowledge, skills, and abilities needed for each job is necessary to ensure that the appropriate applicants are selected for positions. This is especially important for nonclassified/administrative positions that require more highly developed and specialized skills. Job descriptions also serve as a foundation to measure employee performance against. Comparisons to the market for appropriate salary data are impossible without adequate job descriptions. Since many management decisions are based on job requirements, this is an important management tool.

Recommendation:

The University Personnel Office should develop job descriptions for all staff, including nonclassified/administrative and executive positions.

Management's Response:

SWT concurs and will develop the job descriptions as noted.

Section 5-D:

Improve Recruitment and Selection Processes by Verifying Applicant Information and Hiring Only at Salaries Stated in Job Postings

Applicants could be hired who do not possess the education, experience, or other requirements necessary for their positions. The University has a decentralized recruitment and selection process. Individual departments are largely responsible for screening applicants (i.e., interviews, contacting references, verifying past employment, obtaining evidence of education or professional certification). However, no evidence of the results of these screening procedures is contained in the employees' personnel files. The Personnel Office is not involved in most of the screening process, and there are no compensating safeguards to ensure that individual departments are administering the screening process with due diligence.

Whenever possible, the University should verify applicant information, including but not limited to, work and salary history, academic credentials, professional certifications and affiliations, and personal references. By performing screening procedures centrally, or requiring individual departments to submit evidence that the procedures have been performed, the University helps to ensure that individuals possessing appropriate credentials fill all positions.

Applicants have also been hired at higher salaries than those listed in the job posting. Departments can offer higher salaries to an applicant if they consider him or her outstanding compared to the other applicants, or as a negotiating tool to get the applicant to accept the job.

When individuals are hired at salaries in excess of those listed in job postings, it increases the risk that a population of more highly qualified applicants was excluded from the hiring process. Individuals who may not have considered applying for a position at the lower posted salary may have applied at the higher salary. The University also increases its liability of being accused of discrimination. Posting jobs at a lower rate than the salary eventually offered can give the appearance of preselecting an individual candidate by soliciting a less qualified applicant pool for the individual to compete against.

Recommendation:

The following controls would strengthen the recruitment and selection process:

- Departments should be required to verify all applicant information including employment and personal references, education, and professional certifications or affiliations. This information should be included in the selection documentation kept by the Personnel Office.

- The University should not offer salaries higher than those listed in the job posting. If the departments desire some flexibility in what salary can be offered, then the job posting should state a salary range rather than a specific salary rate. If the departments post at a specific salary rate and then desire to hire at a different salary rate, than the job should be reposted at the different rate and a new applicant pool should be considered.

Management's Response:

SWT believes its decentralized recruitment and selection procedure is a cost effective system. Individual departments are responsible for ensuring that unqualified applicants are not hired. However, we will implement the recommendations to strengthen our process if it can be done without incurring additional costs. Individual departments, at a minimum, will be required to submit documentation to the Personnel Office that they have verified all applicant information.

With respect to hiring individuals at salaries higher than posted, SWT agrees to incorporate the recommendations into its procedures.

Section 5-E:

Implement New Performance Appraisal System and Complete Appraisals on Time

The Personnel Office has developed a new performance appraisal policy and form that are a marked improvement over the current policy and form. However, as of November 10, 1995, neither the policy nor the form had been formally approved or implemented. Several appraisal factors in the current evaluation system are subjective and are not job-specific. Examples of subjective or nonspecific factors include quantity of work, attitude, and dependability. In addition, the dependability factor requires the supervisor to rate the employee's punctuality and attendance. Rating attendance as performance criteria is no longer an acceptable practice due to requirements promulgated under the Family and Medical Leave Act.

The new form has certain set performance expectations and room for more job-specific ones. Performance standards must be developed for each performance expectation using the position's job description. A five-level quantitative rating scale is used to rate each expectation, and the expectations are weighted based on their importance. The form also addresses future training needs and allows the employee to offer feedback on the appraisal process.

Although the proposed appraisal system contains many positive elements, it could be further improved. Actual performance examples have not been gathered and scaled for each of the performance standards. The form does not contain space for the supervisor to cite specific examples of employee performance for comparison to the performance standards.

Performance appraisals should be based on job-specific criteria. Performance standards should be developed for each rating level and rating scales should be validated to ensure rating accuracy. Specific employee performance examples should be documented in order to support the ratings assigned.

While the Personnel Office does review performance appraisal rating averages by division, ratings of individual supervisors are not performed. As a result, there is no assurance of inter-rater reliability. In other words, the potential exists that two different supervisors might rate the same performance differently. In addition, no information is collected on performance appraisal ratings categorized by race, sex, or age. Thus, any potential pattern of discrimination in the application of performance appraisal ratings would not be detected.

Performance appraisals are not always conducted on time, and supervisors are not held accountable for completing appraisals by the required deadlines. Fifty-four appraisals (four percent) were not completed for fiscal year 1994. However, these 54 employees received the same three percent performance salary increase given employees who received a "satisfactory" or higher rating on their annual performance appraisal. It is possible that some of the 54 employees would not have been eligible for this salary increase.

Appraisals should be timely and given as frequently as the stated policy indicates. Supervisors should be held accountable for completing their staff's appraisals by the required time period.

Recommendation:

The following controls would strengthen the performance appraisal process:

- Management should approve the proposed performance appraisal system (with recommended changes) and implement it as soon as possible. The proposed performance appraisal system should be strengthened to include specific performance examples for each rating level. The rating scales should be validated by having examples of employee performance scaled and compared to the performance standards. Actual examples of employee performance should be documented on the appraisal form and compared to the performance standard to support rating levels.

- The Personnel Office should provide training to all supervisors on the new performance appraisal system.

- Supervisors should be held accountable for not completing appraisals in a timely manner. Timely completion of staff appraisals should be a performance standard on each supervisor's performance appraisal.

- Management should not allow compensation decisions to be made without current appraisals.

<u>*Management's Response*</u>:

The new performance appraisal system developed by the Personnel Office was pilot tested by SWT's Physical Plant Department. The results are to be submitted to the University administration for review to determine if changes are needed before full implementation. We will review the auditors' suggestions for possible inclusion in the final system to be adopted.

Section 6: FIXED ASSETS AND INVENTORY

Additional Controls Over Fixed Assets and Inventory Should Be Implemented to Minimize the Risk of Loss

Performing independent verification of inventories, separately recording surplus property, updating inventory systems, conducting test counts of perpetual inventories, and appropriately segregating duties would minimize the risk of loss to University assets and inventory.

Section 6-A:

Perform Independent Verification of Tagged Inventories

No one independent of the custodial function verifies annual asset inventories. The Materials Management Department sends out an inventory listing to all departments annually. Each department is expected to check asset inventories against the list and certify that the department is still in possession of the assets. The departments then return the completed list to Materials Management. However, Materials Management does not verify these inventories, neither through spot checks nor surprise counts, unless there is a reason to suspect a serious abuse. The Internal Audit Department also recommended that physical inventory should be verified by someone independent of the custodial function (*Review of Property Management - December 1993*).

Physical inventories should be performed by someone other than the custodian. Having an employee who is not responsible for the custodianship of an asset verify asset inventories ensures that accounting records and financial reports are appropriately stated. Even more important, it ensures that the University actually has possession of the kind, value, and amount of assets it has expended its resources on. Furthermore, proper controls protect employees from charges of inattention or impropriety when assets are discovered lost, stolen, or inappropriately replaced.

Recommendation:

The Materials Management Department should begin regular, independent, unannounced counts of the departments' asset inventory. The cycle of counts could be based on a combination of covering different departments, types of equipment, and dollar values in each period. While it would be optimal to achieve a 100 percent count within some specified period, at least the high-dollar/high-risk items would be accounted for regularly. This will ensure that assets reported on the accounting system are actually in the University's possession.

Management's Response:

The lack of surprise inventory counts or independent verification is the result of understaffing in the Materials Management area specifically and administrative functions generally at SWT. We will attempt to redirect existing employee time toward this effort. However, at least one new employee may be needed to achieve this.

Section 6-B:

Record Surplus Property Separately Prior to Disposition

When items are removed from a department and put in surplus property in preparation for auction, the items are not removed from the department's accounting records until the actual sale. A surplus property account has not been created to monitor the number and cost of the items.

Fixed assets should be properly classified, described, and disclosed in financial statements. Individual departments' asset lists may be overstated. There is no way for the University to monitor the number and cost of items in surplus.

Recommendation:

A surplus property account should be created, and items should be transferred to that account and deleted from the departments' accounts when items are taken to the warehouse for storage in preparation for an auction.

Management's Response:

SWT agrees to implement this recommendation.

Section 6-C:

Update Physical Plant Inventory System

The Physical Plant inventory system appears to be outdated. The Physical Plant is carrying $300,000 - $400,000 more equipment and parts than it needs. The reason is that the Physical Plant does not have a system that meets its forecasting/reordering needs. They hope to have a new system by September 1996 if there are sufficient funds to cover the purchase.

Inventory systems should promote efficiency and meet the needs of the users, especially as those needs relate to determining optimal inventory levels and reorder points. This outdated system has resulted in carrying excess inventory that ties up funds that could be used for other purposes.

<u>Recommendation</u>:

The University should obtain and utilize an adequate automated inventory system for the Physical Plant to improve forecasting of inventory needs, and thereby determine appropriate timing to reorder stock.

<u>Management's Response</u>:

As noted, SWT is conducting a feasibility study on a new system that could be in place by September, 1996. Interestingly, the cost of the new system is approximately equal to the noted excess parts and equipment inventory. However, the new system has additional benefits that improve productivity and provide other efficiencies.

Section 6-D:

Conduct Test Counts for Perpetual Inventories at Physical Plant

The Internal Audit Department recommended that the Physical Plant implement a testing plan to verify the completeness/accuracy of its perpetual system and develop written procedures for these tests *(Review of Physical Plant Inventory - January 1994*). The Physical Plant conducted two tests in fiscal year 1994. However, the Physical Plant discontinued testing in fiscal year 1995. The recommended procedures were never developed.

The Physical Plant conducts a full count in March. Conducting a full count is inappropriate with a perpetual inventory system. Also, since the count is done in March, five months before the end of the fiscal year, the dollar amount of assets in the Annual Financial Report may not be accurate.

Periodic test counts of the Physical Plant are necessary to ensure the accuracy of the inventory. There are no assurances that the perpetual inventory is correct when periodic tests are not conducted. The risk is increased that inventories could be stolen or misplaced.

Recommendation:

Management should develop procedures for testing physical counts to verify perpetual inventories of the Physical Plant. The Vice President for Fiscal and Support Services should approve the procedures. Tests should be conducted on a consistent and regular basis.

Management's Response:

The testing procedures suggested have been implemented.

Section 6-E:

Appropriately Segregate Duties Over Consumable Inventories

Purchasing, receiving, inventory record keeping, and custody of stock are not adequately separated in Duplicating Services, Print Shop, and Central Supply. In some of these departments the same employee who is the custodian of the inventory also performs the inventory count.

Duties between the authority to initiate transactions, custodial responsibility over goods, and record keeping assignments should be segregated. An employee independent of the inventory custodial function should conduct the actual counts.   As stated earlier, this ensures that financial reports are accurately stated, that the University actually has the goods on hand, and that employees are protected from charges of impropriety.

Recommendation:

Duties should always be adequately segregated if possible. If having a small staff responsible for certain inventories prevents clear segregation, inventory counts should be verified or spot checked by staff outside of the area such as a supervisor, the Accounting Department, or the Internal Audit Department.

Management's Response:

Due to the small number of staff in the areas noted, SWT will request the Internal Audit Department to perform these test counts.

Construction Planning Processes Could Be Improved

Cost estimates varied significantly from actual bids on two of three of the University's major projects ($5 million or more) over the last five years. The cause was the architect/engineer's error in estimating the projects. Ideally, cost estimates for new construction should be within plus or minus 10 percent of the actual bid amount.

Projects reviewed are listed in the tables below.

Figure 6

Project Budgeted Over $5 Million	Project Estimate	Actual Bid	Percent Diff.
Student Center/Bookstore/Garage	$21,241,000.00	$27,955,800.00	32.0%
Health Science Building	$10,103,300.00	$8,014,400.00	(20.7%)
Recreation Sports Complex	$6,139,800.00	$6,629,120.00	8.0%

Figure 7[6]

Project Phase	Acceptable Variance
Program of requirements	+/- 50%
Preliminary plans	+/- 30%
50% construction document review	+/- 15%
90% construction document review	+/- 10%

Projects that bid over budget strain limited financial resources. If the projects are canceled because of overruns, the University is hampered in its efforts to deliver services. If the project proceeds with scope reductions, the level of services may be diminished. In addition, scope reduction will not always result in a dollar for dollar cost reduction benefit. For example, a contractor may not be likely to return to the University 100 percent of the cost of an item it is requested to eliminate from the scope of work. The contractor usually, at least retains, a portion of the administrative and overhead costs related to the omitted item. More than $4.1 million in scope reductions were made on the Student Center/Bookstore/Garage project in order to bring it close to the original budget.

Similarly, a project that bids significantly less than the budgeted estimate may not be designed to provide the end-user with their required needs. The end-user may be

6 Cost estimate variances should generally follow this sequence through the plan development process. (Good scope definition should occur in the design development phase.)

"short-changed" by a project design that will not enable them to provide the level of services they originally intended. In addition, a project that costs significantly less than the planning estimates unnecessarily ties up funds that could be used on other projects or for other purposes. If bonds are sold to finance the construction, a significant underestimate could result in unnecessary obligations that the University would be required to pay for.

According to the University's Master Plan, more than $160 million in new construction and renovation projects, as well as other campus site improvements, are planned through the year 2005. For this reason, it is imperative that controls are in place that will effectively and efficiently execute the design and construction of these projects. The accuracy of cost estimates can never be guaranteed because of the many variables inherent in the process. However, the University can implement added controls to help narrow the gap between architect/engineer cost estimates and contractor bids.

Recommendation:

Dividing the project planning into distinct phases and including this as a requirement of the architect/engineer contract will enhance the success of construction planning. The University should consider the following for inclusion into its construction plan development process:

- Divide the project planning process into these phases:

  1) program of requirements
  2) preliminary plans
  3) 50 percent construction document review
  4) 90 percent construction document review

- Require a detailed cost estimate from the architect/engineer, prepared by a competent, independent cost estimating consultant. This would be paid for by the architect/engineer at the 90 percent construction document review phase. Management should establish criteria, based on minimum project size and complexity, for the independent cost estimating consultant requirement. Each planning phase and the corresponding budget should be approved in writing by the appropriate University authority. Tie the architect/engineer's payment for services to this structure.

- Ensure that adequate scope definition occurs at the 50 percent or Design Development phase in the planning process. Maintain control over end-user requests for more space.

- Strengthen the Ownership of Documents clause in the architect/engineer contract. The University should retain the right to ownership of all of the documents prepared by the architect/engineer that are a part of the project.

This requirement should extend to all of the architect/engineer's consultants used on the project. Refer to Texas A&M University System Facilities Planning and Construction office architect/engineer contract for sample contract language to use.

- Review the General Services Commission standard Architectural/Engineering Agreement for general format and additional provisions to enhance the University's current standard contract.

- In the architect/engineer selection process, require the prospective architectural firms to furnish information on how close actual project costs came to their final construction estimates on projects designed and bid on over the last three to five years. Make this information available to the Board before they vote to hire an architect/engineer firm for a project.

- Consider requiring that the architecture/engineering firms the University contracts with furnish professional liability insurance to cover errors and omissions. Assess the risk and the complexity of the project to determine if the project warrants the coverage.

Management's Response:

We would note that the "Project Estimate" figures cited in the first chart in this section are the figures developed at the "Program of requirements" phase in the second chart. All three projects cited are within the 50 percent acceptable error margin noted for that phase.

Also, the "Project Estimate" figure for the Health Science Building is the Total Project Cost (TPC) while the "Actual Bid" is construction cost only. Typically, the TPC is 17 percent higher than the construction cost because of architects' fees, site development, furniture and equipment and other owner's services. For the other two buildings, the "Project Estimate" does not include the construction contingency while the "Actual Bid" includes the construction contingency.

Notwithstanding this, however, we agree to work with the System Administrative Office to include the recommendations into our construction contract and review procedures.

Issues for Further Consideration by the University

Review Contracting Procedures

Police Chief Consulting Contract Did Not Equate Value of Services to Payment Made. The University hired a new Police Chief who began work on August 1, 1995.

The University also signed a pre-employment service contract with this employee to cover the period of June 6 through July 31, 1995.

The contract terms stipulated four specific services to be rendered by the Chief during the eight-week time frame of the contract. However, the University did not analyze the price paid for these services. A reasonable basis for determining a fair price might have been an hourly rate based on the Chief's annual salary multiplied by the number of hours estimated to complete the contract terms. The University also did not analyze the value of these services to the institution. Rather, the contract amount of $7,080 represented the estimated cost of moving the Chief from Florida to Texas and for three trips between Florida and Texas.

Recommendation:

Contract amounts should be based on analysis of the fair value of specific contract terms. Contract payments should not be based on factors bearing no relation to the services to be rendered. The University should consider more closely monitoring the contracting process to ensure that terms and payments in future contracts are justified.

Management's Response:

We agree. In the future, the University will more closely monitor contracts to ensure that terms and payments more accurately reflect the fair value of services rendered.

Appendix 1:

Objective, Scope, and Methodology

Objective

The audit objective was to evaluate the existing management control systems at Southwest Texas State University. We determined whether the control systems are providing reasonable assurance that the University's objectives will be accomplished. We also identified strengths and opportunities for improvement and reviewed the University's management of resources.

Management controls are policies, procedures, and processes used to carry out an organization's objectives. They should provide reasonable assurance that:

- goals are met
- assets are safeguarded and efficiently used
- reliable data is reported
- laws and regulations are complied with

Management controls, no matter how well designed and operated, can only provide reasonable assurance that objectives will be achieved. Breakdowns can occur because of human failure, circumvention of control by collusion, and the ability of management to override control systems.

Scope

The scope of this audit included consideration of the University's overall management control systems: policy management, information management, resource management, and performance management.

Consideration of the University's policy management systems included a review of:

- processes used to create, monitor, and evaluate University strategic and operating plans
- processes used to create, monitor, and revise University budgets
- processes used to evaluate and implement changes to the organization's structure
- processes used to create, implement, evaluate and revise University policies and procedures

Consideration of the University's information management systems included a review of:

- processes for identifying, collecting, classifying, evaluating, maintaining, and updating information

- existing management reports
- timeliness, accuracy, and availability of information

Consideration of the University's resource management systems included a review of:

- processes used to select, train, evaluate performance, and compensate University employees
- processes used to control the University's cash
- investment policies and practices at the University
- processes used to ensure proper acquisition, storage, security, and management of inventory assets
- processes used to ensure that fixed assets and infrastructure are economically purchased and used and adequately protected against waste and abuse
- revenue identification and collection processes
- maintenance and protection of computers and computer applications

Consideration of the University's performance management system included a review of:

- processes used to develop, track, and use performance measures
- processes used to evaluate programs and to ensure quality products and services

A review of each of the control areas revealed some specific issues that were examined further.

Methodology

The audit methodology consisted of gaining an understanding of how each control system was supposed to work. In select areas, tests were then performed to determine if the control systems were operating as described. Finally, the results were evaluated against established criteria to determine the system's adequacy and identify opportunities for improvement.

An understanding of control systems was gained through interviews with members of the Texas State University System (System) Board, the University President, Vice - Presidents, management, and staff. An understanding was also gained by using written questionnaires and the reviewing numerous University and System documents. Control system testing was conducted by comparing the described and actual processes. The testing methods primarily consisted of document analysis, process and resource observation, and employee interviews.

The following criteria were used to evaluate the control systems:

- Statutory requirements
- System rules

- Southwest Texas State University policies and procedures
- General and specific criteria developed by the State Auditor's Office Inventory of Accountability Systems Project
- State Auditor's Office Project Manual System: The Methodology
- State Auditor's Office Project Manual System: The HUB
- Other standards and criteria developed though secondary research sources both prior to and during fieldwork

Other Information

Fieldwork was conducted from July 1995 through November 1995. We did not verify or review the accuracy of the data provided by Southwest Texas State University. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

No significant instances of noncompliance with these standards occurred.

The following members of the State Auditor's Staff performed the audit work:

- William Hirsch, CPA (Project Manager)
- Kelli Dan, CCP, PHR
- Randy Davis, CPA
- Verma Elliott
- David Gaines, CPA
- Nancy Hennings, CPA, CISA
- Joe Seitz
- Randy Townsend, CPA (Audit Manager)
- Craig Kinton, CPA (Audit Director)

Appendix 2:

Background Information

Appendix 2.1:

University Profile

Mission

Southwest Texas State University's (University) mission is "to provide effective teaching supported by research for the advancement of knowledge and service to the community." The University is a comprehensive public university committed to providing an intellectually stimulating and socially diverse climate for its graduate and undergraduate students, faculty, and staff. Southwest Texas State University believes the primary purpose of higher education is to promote learning and stimulate inquiry in an atmosphere of freedom.

The following principles guide Southwest Texas State University in its conduct and as it carries out its mission:

- provide quality academic programs
- admit a broad spectrum of students, reflecting the diversity of Texas who can benefit from academic education
- provide good stewardship for the management of the institution
- be accountable to the citizens of the State of Texas
- offer a diversity of educational opportunities

Background

The Texas Legislature established Southwest Texas State University in 1899 as a teacher preparation institution, and it opened in 1903 as Southwest Texas Normal School. Over the years, the Legislature has broadened the scope of the institution from a teacher preparation school to a comprehensive university. During this time, the University has expanded its curricula to include a variety of undergraduate and graduate programs while endeavoring to keep the feel of a community school.

Operations

The University is a part of the Texas State University System. The University has 900 faculty members that serve approximately 21,000 students, and operates on a budget of more than $139,297,840. In fall 1993, the University had the seventh largest enrollment in the State of Texas, and was among the top ten for non-doctoral-granting institutions in the United States.

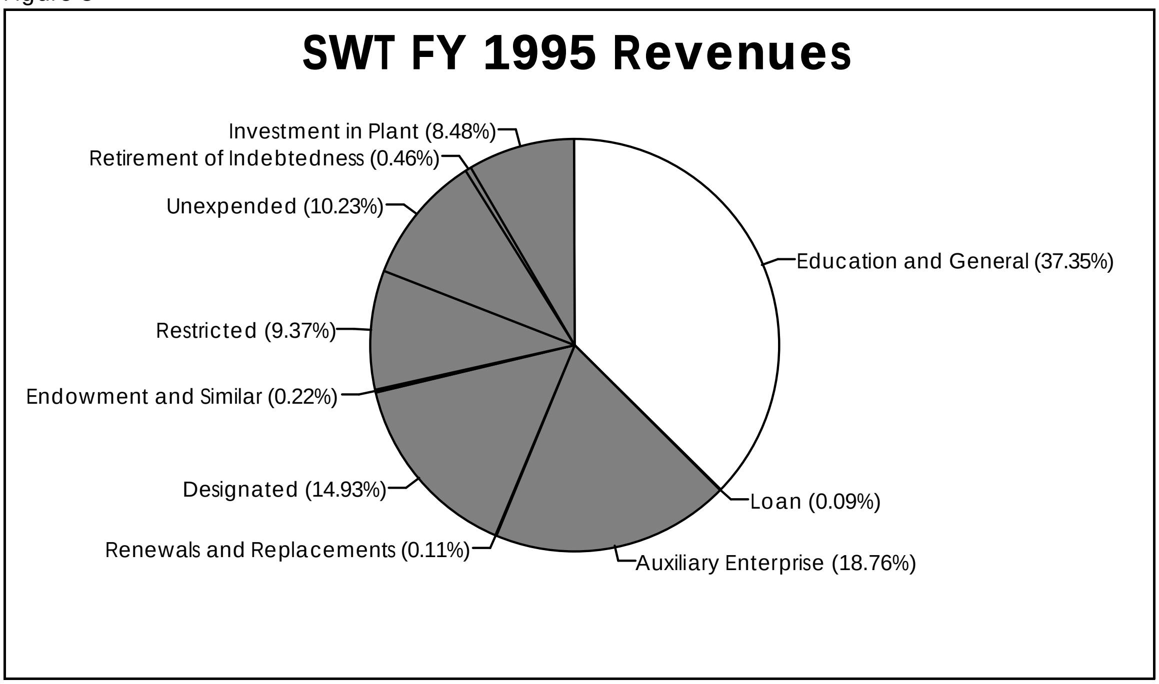
The University covers 422 acres in central San Marcos, Texas. Additionally, the University owns Aquarena Springs, the Traffic Safety and Horticulture Centers, the

University Farm and Camp, and the Freeman Ranch. The University has seven academic schools that offer 130 majors and 40 program choices in the graduate school. The University has leading programs in the fields of Geography and Physical Therapy.

Appendix 2.2:
Financial Information

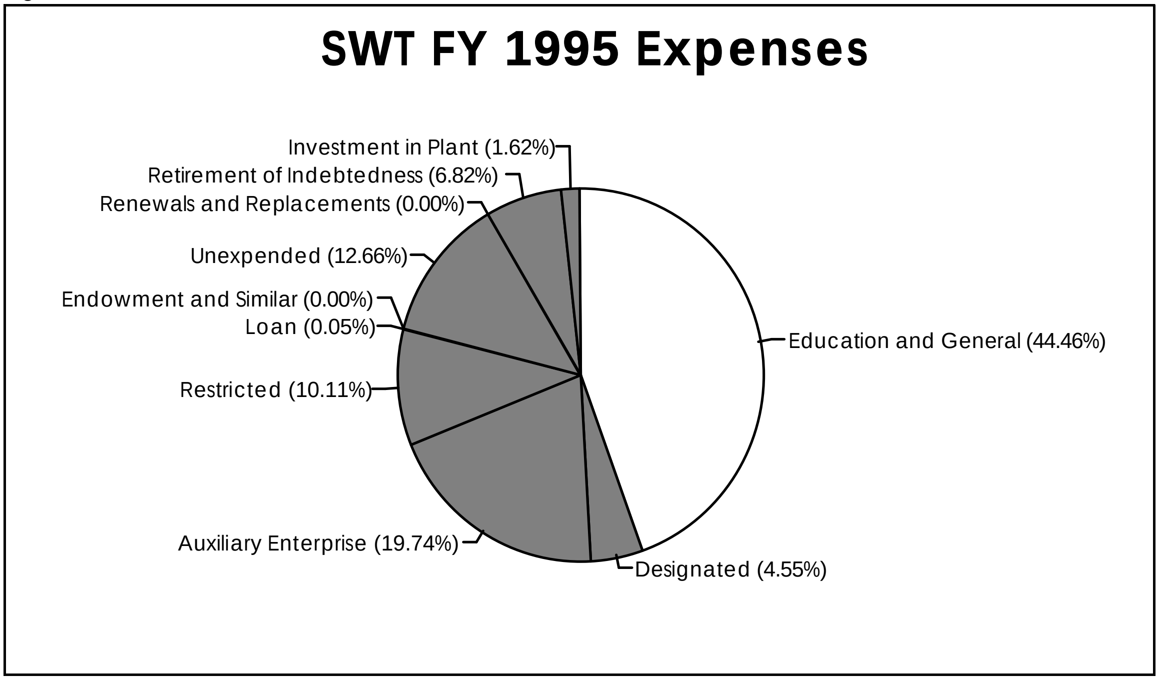
Southwest Texas State University had revenues totaling $198,083,281 and expenditures totaling $184,833,628 in fiscal year 1995. As expected, the largest amount of revenue and expenses were in the Education and General fund. The University's fund balance totaled $356,246,124 in fiscal year 1995. The largest fund balance was in the Investment in Plant fund, and the smallest fund balance was in the Educational and General fund.

Figure 8



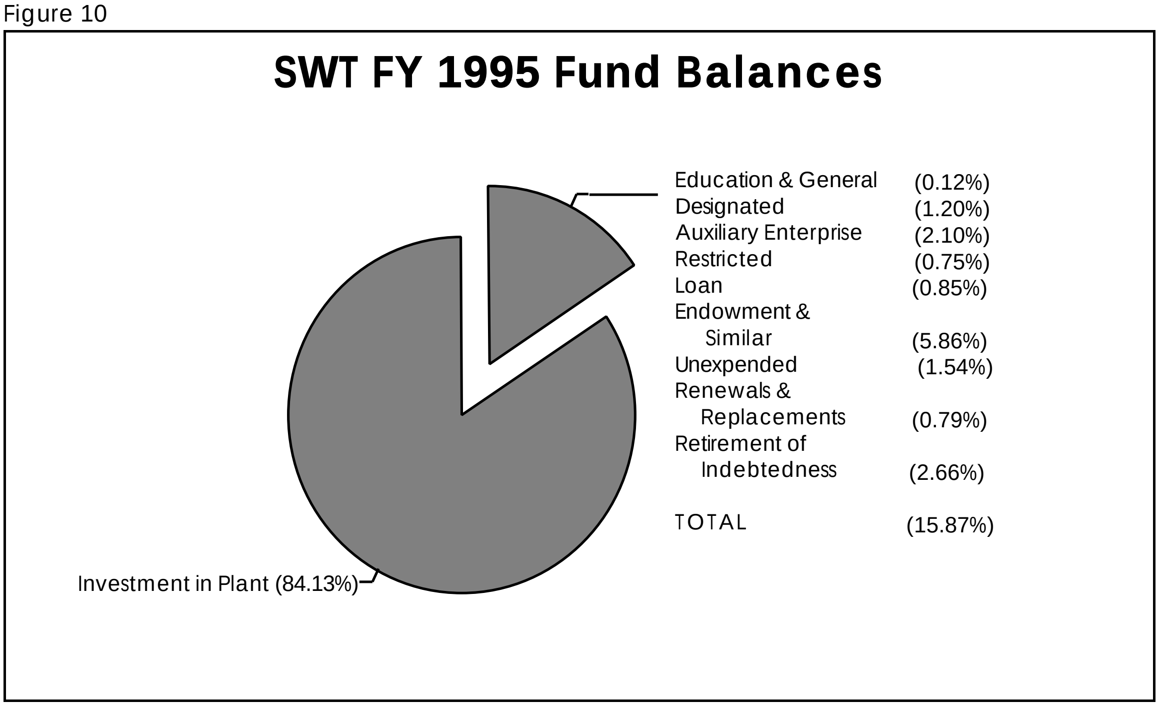
Source: 1995 Annual Financial Report for Southwest Texas State University

Figure 9



Source: 1995 Annual Financial Report for Southwest Texas State University

Figure 10



Source: 1995 Annual Financial Report for Southwest Texas State University

Appendix 3:

Supplemental Information

Appendix 3.1:

Accountability Systems Assessment

Key accountability systems are the controls a university uses to ensure that what should happen does happen. Accountability systems are established by management to achieve expected results, to establish and maintain an environment that protects against scandals and financial disasters, and to ensure that resources are used economically and effectively.

Key Accountability Control Systems Of State Agencies and Universities

Figure 11

Policy Management			Information Management	Performance Management		
Strategic Planning	**Organization Structure**	**Policies & Procedures**		**Performance Measures**	**Program Evaluation**	**Quality Control/ Assurance**
Environmental Scans Risk Assessment Mission Analysis Goal Setting Budgeting Action Plans Measures Monitor/Review Evaluate/Revise	Board/Management Oversight Responsibility Assignment Authority Assignment Staffing Levels Functional Groups Evaluation	Development Documentation Communication Enforcement Review Revisions	Selection Collection Classification Evaluation Reporting Storage Updating	Progress Tracking Evaluation Alignment	Appropriateness Customer Satisfaction Alignment	Benchmark Monitoring Feedback Adjustment

Resource Management								
Human Resources	**Cash**	**Investments**	**Inventory**	**Fixed Assets/ Infrastructure**	**Purchased Services**	**Revenue**	**Debt**	**Automation**
Recruitment/ Selection Training Job Descriptions Evaluation Compensation	Receipts Disbursements Balances Management Custody Collateral Allocation	Acquisition Custody Collateral Performance Disposal	Acquisition Storage Usage Disposal	Acquisition Construction Safeguarding Maintenance/ Renovations Depreciation Disposal	Service Definition Contract Design Contracting Monitoring	Identification Collection Enforcement Resolution	Needs Analysis Authorization Issuance Performance Disposal	Needs Analysis Development Cycle Physical Security Disaster Recovery Access Input Processing Output/ Distribution Interfaces

Accountability systems are grouped into four major *management areas.* These are **policy management, information management, resource management,** and **performance management.** Generally, the systems related to policy, information, and resources will cut across all aspects of the University's operations. Performance management systems may often be associated with specific strategies of the University.

The following is the assessment of the control systems at Southwest Texas State University. Nine of the accountability areas had control systems that could be improved. The Organizational Structure, Cash, and Inventory accountability areas had control systems that appeared to have adequate controls. We did not do enough work in two of the accountability areas to determine if the control systems were adequate. Risk assessments performed indicated that these areas were not necessarily material to the current environment. One of the accountability areas is controlled at the system level which made it beyond the scope of this audit.

Figure 12

ACCOUNTABILITY CONTROLS	
Policy Management	
Strategic Planning	The design or implementation of the control systems does not appear to provide reasonable assurance it is functioning as intended.
Organization Structure	Controls appear to provide reasonable assurance that the University's structure is being evaluated and changed as necessary.
Policies and Procedures	The design or implementation of the control systems does not appear to provide reasonable assurance it is functioning as intended.
Resource Management	
Human Resources	The design or implementation of the control systems does not appear to provide reasonable assurance it is functioning as intended.
Cash	Controls appear to provide reasonable assurance that processes are in place to manage cash effectively.
Investments	For a discussion of the University's investment controls see *Derivative Investments by Texas State Entities*, SAO Report No. 95-035.
Inventory	Controls appear to provide reasonable assurance that inventory is being properly acquired, stored, secured, and managed.
Fixed Assets/ Infrastructure	Instances where controls were not providing reasonable assurance that fixed assets and infrastructure are economically purchased and used, and adequately protected against waste and abuse, were not noted.
Purchased Services	Extensive review of this area was not performed, therefore, there is not enough information to assess. Risk assessments performed indicated that this area was not necessarily material to the current environment.
Revenue	The design or implementation of the control systems does not appear to provide reasonable assurance it is functioning as intended.
Debt	Not applicable because debt issuance is performed at the system level.
Automation	Extensive review of this area was not performed, therefore, there is not enough information to assess. No major computer initiatives were implemented in the recent past.

ACCOUNTABILITY CONTROLS	
Performance Management	
Performance Measures	The design or implementation of the control systems does not appear to provide reasonable assurance that it is functioning as intended.
Program Evaluation	The design or implementation of the control systems does not appear to provide reasonable assurance that it is functioning as intended.
Quality Control/ Assurance	The design or implementation of the control systems does not appear to provide reasonable assurance that it is functioning as intended.
Information Management	
	The design or implementation of the control system does not appear to provide reasonable assurance that it is functioning as intended.