Table of Contents

An Audit Report on Management Controls at Stephen F. Austin State University

August 1997

Table of Contents, continued

Table of Contents, continued

Key Points of Report

An Audit Report on Management Controls at Stephen F. Austin State University

August 1997

Overall Conclusion

Major deficiencies exist in Stephen F. Austin State University's (University) design or implementation of management controls in several areas. Collectively, these deficiencies reduce the University's ability to safeguard assets and ensure its mission and objectives will be fully accomplished. Several of the deficiencies have continued from prior audits.

Key Facts and Findings

- The University has not always maintained adequate internal controls over the management of cash, resulting in a material weakness. The material weakness was caused by the University's failure to reconcile bank statements promptly and perform supervisory review of the bank reconciliations, monitor bank account and ledger cash balances adequately, and formally recognize borrowing between accounts and fund groups in the University's accounting records. This weakness limits the ability of University management and the Board of Regents (Board) to meet their fiduciary responsibility for funds under their control.

- The University has not used its internal audit function effectively, thereby increasing the risk that errors and irregularities could occur without timely detection. The Board of Regents, until recently, has not been sufficiently proactive in using the internal audit function to reduce risk. There is no formal documentation of the Board's oversight function, nor is there a formal process in place for the approval of significant deviations from the audit plan. During fiscal years 1995 and 1996 the Department of Audit Services completed only 20 percent and 25 percent, respectively, of its planned audit work, and did not provide any coverage of electronic data processing systems, program results, and accomplishment of goals.

- The University has not exercised appropriate oversight of the University Police Department (UPD) to ensure it is operating efficiently and within appropriate financial constraints. Analysis does not exist to determine whether the level of staffing and resources of the UPD is appropriate given the University's size and nature of operations. The UPD's budget, number of automobiles, and officer staffing level is significantly higher than other state universities of similar size. Additionally, management does not subject the UPD to the same internal controls regarding the use of cellular phones, as applied to other departments, leading to unnecessary costs and increased risk of cellular phones misuse.

Contact

Pat Keith, CQA, Audit Manager, (512) 479-4700

Office of the State Auditor
Lawrence F. Alwin, CPA

This audit was conducted in accordance with Government Code, Sections 321.0132 and .0133.

Executive Summary

Major deficiencies exist in the Stephen F. Austin University's (University) design or implementation of management controls in several areas. Collectively, these deficiencies reduce the University's ability to safeguard assets and ensure its mission and objectives will be fully accomplished. Some of the deficiencies have continued from prior audits. Weaknesses in controls over cash management reduce the University's ability to exercise fiduciary responsibilities over funds under their control. The Board of Regents (Board) and executive management need to increase their oversight of the internal audit function to ensure risks to the University are addressed. Increased oversight is also needed over the University's police department activities.

Improve Controls Over Cash Management (Prior Audit Issue)

The University has not always maintained adequate internal controls over the management of cash, resulting in a material weakness. A material weakness results when a control system can not promptly detect an occurrence of material errors (unintentional mistakes) and/or irregularities (intentional improprieties). The material weakness was caused by the University's failure to reconcile bank statements in a timely manner and perform supervisory review of the bank reconciliations, monitor bank account balances and ledger cash balances adequately, and formally recognize borrowing between accounts and fund groups in the University's accounting records. This weakness also limits the ability of University management and the Board to meet their fiduciary responsibility for funds under their control.

The University did not complete the August 1996 bank reconciliation for the University's main operating account until December 1996, after the University had closed its books and submitted its annual financial report to the Comptroller of Public Accounts. Additionally, as of the end of May 1997, the University had not completed its reconciliation for this account for September 1996, the first month of the fiscal year. The main operating account is the University's largest bank account, which processed $12.5 million in inter-account transfers, disbursements, and other activity in August 1996.

Management has not regularly monitored bank account balances, instead relying on the banks to notify University officials in the event of deficit balances. During the period between December 6, 1995, and November 12, 1996, the bank statements for the University's main operating account reflected negative daily balances on 25 days. On 13 of these 25 days, there were insufficient compensating balances in other accounts at the bank, such that the University's overall cash position with the bank was negative.

Approximately 40 accounts within the University's Agency Funds regularly reflected negative cash balances during the period from September 1995 to March 1997. Agency Funds are used to account for funds the University holds in trust for others. The University made payments from various accounts in excess of the amounts available for such payments, using other accounts' funds. Excess payments from $2 to $34,000 were made without first verifying sufficiency of funds.

Improve the Internal Audit Function to Address Risks to the University

The University has not used its internal audit function effectively, which may increase the risk that errors and irregularities may occur and not be detected in a timely manner by management. Internal audits are an important tool to reduce risk through evaluation of key control systems. During fiscal years 1995 and 1996 the Department of Audit Services (Department) completed only 20 percent and 25 percent, respectively, of its planned audit work. The Department's annual reports for fiscal years 1995 and 1996 indicate that none of the audits completed provided any coverage of electronic data processing systems and controls or of program results and accomplishment of goals. None of the audits completed during fiscal year 1996 addressed economy and efficiency issues, focusing primarily on compliance issues.

Although we noted the Board has increased its oversight of the Department's activities, there is no documentation of its oversight function, nor is there a formal process in place for the approval of significant deviations from the audit plan.

Increase Oversight Over the University Police Department (Prior Audit Issue)

The University has not exercised appropriate oversight over certain aspects of the University Police Department (UPD) to ensure it is operating efficiently and within appropriate financial constraints. Analysis does not exist to determine whether the level of staffing and resources of the UPD is appropriate given the University's size and nature of operations. Management does not subject the UPD to the same internal controls over the use of cellular phones applied to other departments.

When compared to other university police departments on the basis of student headcount, the UPD's budget, officer staffing level, and the number of automobiles used by the UPD appear to be excessive.

Additionally, management has not subjected the UPD to the same controls over the use of cellular phones applied to other departments. For example, the UPD switched from a trunk phone system to its current cellular phone system without performing the cost/benefit analysis we recommended in a prior audit report. The UPD paid for a monthly recurring access charge for one cellular phone which totaled $2,900 for a 13-month period ending September 1996. No other department pays such a high access charge. The charge is unique to the UPD and management had no analysis to justify such a high charge.

The UPD's detailed cellular phone bills are not reviewed by the Telecommunications Department or Accounts Payable prior to payment. The lack of review also increases the risk that cellular phones may be used for non-business purposes and not be detected. Annual telecommunications costs in the UPD have risen from $10,000 cited in our prior audit report in 1993 to approximately $17,000 in fiscal year 1996.

Improve Human Resource Controls

Improvements in the performance evaluation system, training, job descriptions, analysis of human resource processes, and records maintenance would enhance the University's human resource management system. Human resource expenditures comprise the single largest use of the University's funds. Wage and salary expenditures totaled $43.6 million in fiscal year 1996. Therefore, appropriate human resource controls have a significant effect on the efficient and effective use of resources.

Human resource controls could be improved in the following areas:

- Perform periodic formal (written) appraisals of the University's nonclassified, nonacademic employees.

Also, develop more specific rating criteria for classified employees' evaluations.

- Develop job descriptions for nonclassified employees.

- Perform periodic analysis related to recruitment and selection, employee turnover and retention, and the performance appraisal system.

Continue to Seek Additional Sources of Funding for Athletics (Prior Audit Issue)

Expenditures for the University's intercollegiate athletics programs have increased faster than revenues, leading to an increased dependence on other sources of revenue to support the Athletic Department's operations. In fiscal year 1996, only two other state-supported institutions had a greater reliance on supplemental funding for athletics in terms of total dollars. When stated on a full-time equivalent student basis, the Athletic Department's level of reliance on supplemental funding in fiscal year 1996 was the highest of all state-supported institutions. Supplemental funding for athletics has grown from $1,480,092 in fiscal year 1992 to an estimated $2,250,074 in fiscal year 1997. This equates to $120.37 per full-time equivalent student in fiscal year 1992 to an estimated $202.20 in fiscal year 1997. As long as the Athletic Department's reliance on General Fees increases, opportunities may be lost to use these discretionary funds for activities which more closely align with the University's educational mission.

Summary of Management's Responses

Management generally concurs with the findings and recommendations contained in this report. The University has already begun implementing many of these recommendations.

Summary of Audit Scope and Objective

The objective of this audit was to evaluate the existing management control systems within Stephen F. Austin University to identify strengths and opportunities for improvement.

This page intentionally left blank.

Section 1:

Improve Controls Over Cash Management (Prior Audit Issue)

The University has not always maintained adequate internal controls over the management of cash. The resulting material weakness in this area threatens the ability of University management and the Board of Regents (Board) to meet their fiduciary responsibility for funds under their control. A material weakness can result in material errors (unintentional mistakes) and irregularities (intentional improprieties) that may not be promptly detected.

The material weakness results from the University's failure to:

- Reconcile cash accounts to bank statements in a timely manner and perform supervisory review of the bank reconciliations.
- Monitor bank account balances adequately.
- Monitor ledger cash balances adequately and follow up with appropriate action.
- Formally recognize borrowing between accounts and fund groups in the University's accounting records.

Section 1-A:

Complete Bank Reconciliations Promptly and Perform Supervisory Review

Since April 1996 the University has not reconciled cash accounts to bank statements in a timely manner or performed supervisory review of the reconciliations. Without timely reconciliations there is a greater risk that errors and irregularities will not be detected in a timely manner, that appropriate adjustments to the accounting records will not be made promptly, and the resulting accounting records and internal and external reports will be inaccurate.

- The University did not complete the August 1996 bank reconciliation for the University's main operating account until December 1996, after the University had closed its books and submitted its annual financial report to the Comptroller of Public Accounts. The bank reconciliation should have been prepared before the University closed its books. Additionally, as of the end of May 1997, the University had not completed its reconciliation for this account for September 1996, the first month of the fiscal year. The main operating account is the University's largest bank account, processing $12.5 million in inter-account transfers, disbursements, and other activity in August 1996.
- The August 1996 bank reconciliation for the main operating account included 21 outstanding items from fiscal year 1992 totaling $7,926.45 and 31 items from fiscal year 1993 totaling $10,261.19. These items should not have been

carried as reconciling items since they had already been cleared prior to completion of the reconciliation in December 1996.

- The University's other 11 bank accounts were also not reconciled in a timely manner.

- There are no detailed written policies and procedures over the bank reconciliation function.

Recommendations:

- Bring bank reconciliations for all accounts to current status at the earliest date possible, and thereafter reconcile all accounts on a timely basis.

- Provide for backup personnel to perform reconciliations in the event that the personnel normally responsible are not able to do so. Reconciling items should be adequately researched and, where necessary and appropriate as a result of the reconciliation process, timely adjustments should be made to the accounting records.

- Develop detailed, written policies and procedures over bank reconciliations.

Management's Response:

A controller's office personnel shortage toward the end of fiscal year 1996 contributed to the checking account reconciliation delays reported by the auditors. However, all checking account reconciliations are currently up to date. Recently revised reconciliation procedures will be established as written procedures by February 28, 1998, and such procedures will include a provision for back-up personnel to perform reconciliations.

Section 1-B:

Improve Monitoring of Bank Accounts

Management has not regularly monitored bank account balances. Instead it has relied on the banks to notify University officials in the event of deficit balances. During the period between December 6, 1995, and November 12, 1996, the bank statements for the University's main operating account reflect negative daily balances on 25 days. On four occasions this account ran deficit balances for several days. In one case, the account ran a deficit for 9 days, including a weekend and a holiday, culminating in a deficit of $2,078,665.34. On 13 of these 25 days there were insufficient compensating balances in other accounts at the bank, such that the University's overall cash position with the bank was negative. Prudent cash management practices dictate that management be proactive with respect to oversight of its bank accounts.

Recommendations:

Management should immediately establish procedures to monitor bank account balances at depositories at regular intervals in order to prevent account deficits and restore account balances on a timely basis should deficits occur. These procedures should be included as part of the University's ongoing cash management process.

Management's Response:

University management is now proactive with respect to oversight of its bank accounts. Compensating balance agreements are considered a standard feature of depository contracts. Such agreements minimize the need to transfer cash among bank accounts to achieve an "all-positive-balances" goal. The University maintains such agreements with its depositories and monitors checking account balances on a daily basis. University investments are sufficiently liquid to resolve any short-term deficits that may occur.

Section 1-C:

Monitor General Ledger Cash Balances and Take Appropriate Action to Eliminate Deficit Cash Balances in the Ledger Accounts

Management has not regularly monitored general ledger accounts for reasonableness or taken appropriate action to eliminate ledger deficit cash balances. The failure to promptly identify and address cash deficits in the general ledger has resulted in both actual and potential violations of fiduciary responsibility for funds under the University's control. Regular monitoring should (1) prevent pooled cash belonging to certain accounts from subsidizing other accounts' deficit cash balances and (2) ensure that any borrowing between accounts complies with the applicable restrictions governing those accounts involved.

- Approximately 40 accounts within the University's Agency Funds regularly reflected negative cash balances during the period from September 1995 to March 1997. Agency Funds are used to account for funds the University holds in trust for others. Management confirmed that payments had been made to certain recipients in excess of amounts to which they were entitled, using funds held on behalf of others. Excess payments from $2 to $34,000 were made without first verifying sufficiency of funds. Had management reviewed these accounts for reasonableness, most of these instances could have been prevented; however, this situation was allowed to continue for at least 19 months.

- The University's accounting records and monthly financial reports provided to the Board and executive management reflect long-running deficits in other cash accounts. In one instance, the deficit on the books reached $6 million in October and November 1996, causing Designated Funds total assets per the University's ledgers to drop to a deficit position of nearly $1.9 million. This occurred when, at the beginning of fiscal year 1997, management posted a transfer of cash representing the total anticipated fee revenue for the entire fiscal year out of its Designated Funds group in advance of its having been completely collected. In effect, this was a transfer of more funds than existed. This recorded transfer contributed to an overall Designated Funds cash deficit in the accounting records which has continued since September 1996 and has been subsidized by unrecognized borrowing from other sources.

Cash and investments belonging to the University's fund groups are pooled with various depositories and fund managers. As a result, the University's accounting records provide the only means to maintain the integrity of accounts and to ensure the University properly performs its fiduciary responsibilities for these assets. When cash is physically pooled and deficit cash balances are carried in the accounting records, the net effect is the commingling of funds and the loss of integrity of all accounts affected. Without the identification and formal recognition of a source of funding for cash deficits and a review of the restrictions governing that funding source, management cannot ensure it has met its fiduciary duty for the assets with which it has been entrusted.

<u>Recommendations</u>:

- Obtain restitution for Agency Fund accounts carrying a deficit cash balance and other accounts determined to be delinquent. In the event that such attempts are unsuccessful, management should restore these deficits from appropriate institutional funds.

- Review general ledger accounts for reasonableness on a regular basis, and follow up with appropriate investigation and resolution of questionable items. With few exceptions, deficits in cash and other asset accounts should not be allowed. When deficits arise, provisions should be made to restore them through the liquidation of other assets or through formal borrowing from other accounts. In the event of borrowing between accounts, management should specifically identify the funding source, review the restrictions governing that funding source to ensure that use of its cash in such a manner is appropriate, and recognize the borrowing through appropriate accounting entries.

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

The controller's office now reviews all accounts and provides management with a monthly summary report. Accounts-receivable billing and collection activities have improved significantly and 30 of the agency fund accounts cited in the auditor's report are being liquidated. Future designated funds transfers will be effected as fees are collected.

Section 1-D:
Document Cash Management Procedures

The University's cash management procedures are not adequately documented. This condition increases the risk that cash management will not be performed in accordance with University policies. Management provided us with a one-page chart projecting cash needs for the fiscal year based on the prior year's debits. We were also told that staff periodically met, with no set schedule, to discuss cash needs and investments. However, no records have been maintained of these meetings. Documented procedures serve to provide a written expression of management's expectations with respect to an area of the University's operations. In addition to providing guidance to current and future employees, documented procedures also serve to establish accountability with certain functions or individuals for key processes and responsibilities.

<u>Recommendations</u>:

Management should develop documentation for significant activities and processes in the University's cash management. Management should identify all significant reports and other information sources used in these activities and clearly define the responsibilities and duties of the key individuals involved.

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

The University will adequately document cash-management activities and procedures by February 28, 1998.

Section 2:
Improve the Internal Audit Function to Address Risks to the University

The University has not used its internal audit function effectively, which may increase the risk that errors and irregularities could occur and not be detected in a timely manner by management. Internal audits are an important tool to reduce risk through evaluation of key control systems.

During fiscal years 1995 and 1996 the Department of Audit Services (Department) did not complete the majority of its planned audit work. The Department's annual reports for fiscal years 1995 and 1996 indicate that none of the audits completed provided any coverage of electronic data processing systems and controls or of program results and accomplishment of goals. Additionally, none of the audits completed during fiscal year 1996 addressed economy and efficiency issues, but instead focused primarily on compliance issues.

The following examples illustrate weaknesses in the management of the internal audit function:

- During fiscal years 1995 and 1996, we estimate the Department completed only 20 percent and 25 percent of planned audit work, respectively. More time than planned was spent on activities such as administration, special projects, and other indirect activities. In fiscal year 1995, the result was that projects related to payroll, food service contracts, and purchasing/accounts payable were delayed and carried over to fiscal year 1996. Continued overemphasis on indirect activities in fiscal year 1996 forced the planned audit work in purchasing/accounts payable to be delayed for yet another year.

- Although our interviews indicate the Finance Committee of the Board has increased its oversight of the Department's activities, there is no formal documentation of its oversight functions, nor is there a formal process in place for the approval of significant deviations from the audit plan.

  The annual audit plan reflects the Department's assessment of the most significant risks faced by the University, and as such, should dictate the most effective use of available audit resources. As the Department deviates significantly from its approved audit plan, there is an increased danger that the University may not adequately address those risks deemed to be most significant. Accordingly, there should be a system in place to require formal Board approval of significant deviations from the approved audit plan. Such a process would ensure that the Board and management acknowledge and accept the increased risk inherent in diverting audit resources to other areas.

Recommendations:

To improve the effectiveness of the internal audit function, the following controls should be implemented:

- All significant deviations from the approved annual audit plan should be approved in advance by the Board or its Finance Committee, and approval should be documented. The Finance Committee should increase its oversight of the Department to ensure adherence to the approved plan, and to ensure that significant risks are addressed effectively

- The risk assessment process and the resulting annual audit plan should provide for adequate coverage of all significant risks, including those relating to the University's automated information systems. Care should be taken to ensure that economy and efficiency issues and the achievement of program goals receive adequate consideration in developing the Department's annual audit plan.

Management's Response:

The University has already developed and implemented the use of a form to document authorization for the Department of Audit Services to deviate from its approved audit plan.

The Department of Audit Services (Department) does utilize a risk assessment approach to audit coverage and it realizes that the resulting audit plan will not necessarily cover "all significant risks" in any given fiscal year. At the beginning of each year, the Department's risk assessment and audit plan are reviewed with the Administration and provided to the Finance Committee for its review and approval. Therefore, the Committee is aware of the areas identified with their related risks and the areas to be reviewed in the upcoming fiscal year. Each review completed, including all of the special projects which caused a "deviation", is considered progress towards covering "the most significant risks faced by the University." When it approved the Department's 1997 fiscal year plan, the Finance Committee stressed the necessity of complying with the plan and required that all proposed deviations from the audit plan be communicated to, and verbally approved by, the Chairman of the Finance Committee. In accordance with the State Auditor's recommendation, such approvals will thereafter be documented in writing.

The University has implemented several significant automated applications in the last two years. The Department did test financial transactions within the new financial records system during the Payroll and ARA Contract Reviews, and tested the accuracy and integrity of data in the student information system during the performance of routine audits of semester credit hours. As the new system implemented by the University is very integrated, data from one part of the system may initiate activity in any other part of the system. However, these parts or modules were implemented at different times beginning in Fall 1995 and continuing through the current fiscal year. Therefore, it was determined that the Department could be more effective if it was involved in the decision-making processes during implementation and then subsequently tested the systems once installation was completed. When the installation of the EDP systems and related controls is completed, the Department will perform audits in these areas. It is anticipated that the completion of the Disbursements area audit, which is included in the fiscal year 1997 audit plan, will satisfactorily meet the State Auditor's concerns about addressing economy and efficiency issues.

Stephen F. Austin State University, as approved by the Board of Regents, is in the process of acquiring a third auditor for the Department's staff effective Fall 1997. This should improve the audit coverage of the University's major risk areas.

Section 3:

Increase Oversight Over the University Police Department (Prior Audit Issue)

The University lacks appropriate oversight over certain aspects of the University Police Department (UPD) to ensure the UPD is operating efficiently and within appropriate financial constraints. Analysis does not exist to determine whether the level of staffing and resources of the UPD is appropriate given the University's size and nature of operations. Management does not subject the UPD to the same internal controls over the use of cellular phones applied to other departments.

Section 3-A:

Review the UPD's Staffing Level and Budget

When compared to other university police departments on the basis of student headcount, the UPD's budget, number of peace officers on the payroll, and the number of automobiles used by the UPD appear to be excessive. In response to our own preliminary survey of other universities, the UPD conducted its own more extensive survey. Partial results are shown below:

Table 1

Survey of University Police Departments at Other Universities					
Institution	**Number of Officers**	**Number of Vehicles**	**Fiscal Year 1997 Budget**	**Fiscal Year 1996 Fall Semester Enrollment**	**Budget Per Student Headcount**
Stephen F. Austin State University	**25**	**13**	**$1,270,492**	**11,758**	**$108.05**
University of North Texas	37	14	$2,218,055	25,000	$88.72
Southwest Texas State University	41	14	$1,330,795	20,955	$63.51
The University of Texas - Pan American	10	8	$776,548	12,500	$62.12
Sam Houston State University	13	6	$730,144	12,564	$58.11
Lamar University - Beaumont	14	6	$497,217	9,708	$51.22

Observations include the following:

- Stephen F. Austin State University UPD has higher per-student costs than the University of North Texas, Southwest Texas State University, The University of Texas - Pan American, and Sam Houston State University, even though it has the lowest student headcount of the five universities.

- Though the UPD serves a lower student headcount than either The University of Texas - Pan American or Sam Houston State University, the UPD's budget is 64 percent and 74 percent greater, respectively.

- Similarly, the UPD has one and one-half times the number of vehicles as The University of Texas - Pan American and double the number of vehicles as Sam Houston State University.

- According to the UPD survey, only four other state-supported universities had higher per-student costs than the University. These four universities are located in urban areas, another factor which should be considered in any comparison.

The University's survey considered other factors such as the number of available and occupied beds in student housing. However, a firm correlation between those factors and the present size of the UPD has not been established.

When we queried management as to the availability of data used to justify the current staffing level and budget for the UPD, management was unable to provide any analysis. Management did indicate the University's informal agreements with other local law enforcement agencies to provide mutual assistance represented some costs to the University as well as some benefits. However, management was unable to quantify the costs or benefits of such agreements, or provide an assessment of the potential legal and financial risks these informal arrangements pose to the University.

Recommendations:

- Complete an analysis to determine whether the size of the UPD is appropriate given the size and nature of University operations and adjust resources to the UPD accordingly.

- Perform additional analysis of the costs and benefits associated with informal assistance agreements with local law enforcement agencies. This analysis should enable the University to better budget the resources to be allocated to such activities.

Management's Response:

By January 15, 1998, the University will complete an analysis to determine whether the size and scope of the UPD is appropriate. The analysis will examine informal assistance agreements with local law enforcement agencies. The decision will be reached by the Board of Regents and reflected in the 98-99 Budget.

Section 3-B:

Increase Controls Over the Use of Cellular Phones in the UPD

The University does not exert sufficient oversight over cellular phone use in the UPD, which has resulted in increased costs to the University. The following instances indicate a lack of oversight:

- In our previous report on management controls (*A Review of Management Controls at Stephen F. Austin State University*, SAO Report No. 93-127, June 1993), we questioned the need for the trunk phone system then in use by the UPD. We considered the phone system elaborate compared to other universities. We recommended the University analyze the cost of the trunk system, which was approximately $10,000 per year, versus converting to a cellular phone system. The University subsequently switched from the trunk phone system to its current cellular phone system without performing any cost/benefit analysis. The cost to operate the current cellular phone system during fiscal year 1996 was approximately $17,000.

- At least $12,000 in cellular phone charges were billed to the UPD for the 13-month period from September 1995 through September 1996. Of this amount, $2,900 was for a recurring "access" charge for one phone number that was initially $232 per month, but then was later reduced to $224. This charge is billed monthly to the University whether or not the phone is used during a given month. Cellular phones in other University departments do not incur such a charge. The University has not performed any analysis to determine whether the current level of access charges is appropriate.

- The Police Chief's detailed cellular phone bills are not subjected to normal review procedures that cellular phones bills throughout the rest of the University receive. Normal review procedures help detect or prevent inappropriate use of the phone(s) and ensure reasonableness of charges. These reviews are performed by the University's Telecommunications and Networking Department and the Accounts Payable Department. Therefore, the University has little assurance the UPD cellular phones are being used appropriately.

- The University is paying state and local taxes on the UPD's phone bills. Taxes in one vendor's billings amounting to $228.00 during the period reviewed. Taxes on cellular phone charges for other departments are deducted before the University pays the phone bills. This is done during the normal review process. Since the UPD cellular phone bills are not reviewed by someone independent of the UPD, the taxes on these bills are not being deducted before the bill is paid.

- Some of the UPD phone numbers do not have a "detailed billing" feature providing extensive detail as to where and when calls were made. Accountability is therefore reduced for these phone numbers.

<u>Recommendations</u>:

To improve oversight over cellular phone use in the UPD, management should implement the following controls:

- Subject UPD cellular phone bills to the same control procedures applied to other University departments' bills.

- Analyze and determine whether the nature and level of current monthly charges, particularly the monthly access charge on one phone number, is appropriate.

Management's Response:

In order to improve over-sight over cellular phone use, effective September 1, 1997, UPD cellular phone bills will be subjected to controls similar to other university departments' bills.

The University will analyze and determine whether the nature and level of current monthly charges are appropriate by November 15, 1997.

Section 4:

Improve Human Resource Controls

Improvements in the performance evaluation system, training, job descriptions, analysis of human resource processes, and records maintenance would enhance the University's human resource management system.

Human resource expenditures comprise the single largest use of the University's funds. Wage and salary expenditures totaled $43.6 million in fiscal year 1996. Therefore, appropriate human resource controls have a significant effect on the efficient and effective use of resources.

Section 4-A:

Improve the Current Performance Appraisal System

The current performance appraisal system does not provide for formal, periodic appraisals of the University's nonclassified, nonacademic employees. Additionally, the appraisal system in place for classified employees contains rating criteria which may be too general, and employees conducting performance appraisals are not receiving formal training to perform them.

Appraisals for Nonclassified, Nonacademic Employees - A University-wide formal performance appraisal system does not exist for nonclassified, nonacademic employees such as administrators and other support personnel making up approximately 155 job titles. Included are such positions as vice presidents, directors, and other high-level positions. Although management asserts that informal performance appraisals are conducted annually for these employees, formal written appraisals are not required.

As an accountability system, formal, written appraisals establish a link between performance and compensation, placement and promotion, and training and development. A system of appraising worker performance can also assist in human resources planning and job definition. Furthermore, appraisal systems can assist state entities in managing performance and fostering employee perceptions of legitimacy and fairness in entity policies.

Specific Performance Factors and Rating Criteria - The performance appraisal form used for classified employees contains performance factors that may be too nonspecific. Standard performance factors include quantity of work, quality of work, and responsibility and dependability. However, the factors do not directly reflect the specific job responsibilities of the individual. Further, criteria for rating employee performance under these factors contain terms or phrases that appear vague or difficult to measure, such as “Adequate,” “Average,” and “Unreliable.”

The use of nonspecific performance criteria weakens the effectiveness of the performance appraisal system. Criteria used in the performance appraisal system to evaluate an employee should directly reflect the job responsibilities of that individual. Performance criteria should be developed for each performance expectation and specific examples of performance should be used.

Training for Employees Who Conduct Performance Appraisals - For at least two years, training has not been provided to those individuals who conduct performance evaluations. An effective performance appraisal process can help accurately assess employee job performance. However, for a performance appraisal process to work as designed appraisers must be trained. Performance appraisers who are trained to recognize effective and ineffective performance and who are more aware of possible system problems will provide more reliable ratings than untrained appraisers. Training can help appraisers develop a common frame of reference for evaluating performance.

Recommendations:

To improve the current performance appraisal system, management should:

- Develop a formal performance appraisal system for all nonclassified, nonacademic employees at the University. The system should require written performance appraisals at least annually. To the extent possible, all pay actions, promotions, demotions, and other personnel actions should be based on written appraisals.

- Include more job-specific performance factors in the performance appraisal form(s) to directly reflect the job responsibilities of the individual being appraised. Develop rating criteria for each factor that are supported by examples for each rating. The rating scales should be validated by using examples of employee performance scaled and compared to the performance standards. Then, examples of the individual employee’s performance should be documented on the appraisal form and compared to the performance standard to support rating levels.

- Develop and conduct periodic training for managers on the evaluation process of the performance appraisal system.

Management’s Response:

The University will develop a performance appraisal system applicable to all classified and non-classified (non-academic) employees by September 1, 1998. It is *anticipated that the system will include performance appraisal training and the requirement for written performance appraisals.*

Section 4-B:

Improve Training and Development Processes

Employee training and development is not monitored and coordinated by the University's Personnel Services Office, resulting in a system that could lead to duplication of training efforts and inefficient use of training resources. Other weaknesses related to employee training and development include:

- Management does not have a system to identify University-wide training needs.
- With the exception of Continuing Education classes attended by staff, formal evaluations of training classes are not completed.
- Transcripts or other records detailing employees' training are not routinely maintained.

The ongoing training and development of all employees plays a vital role in achieving efficiency and effectiveness. The training process begins with new employee orientation and continues throughout the employee's career with the University. Rapidly changing legal, technological, economic, and sociological environments further dictate that employees possess the knowledge and skills required by new and more demanding assignments.

Recommendations:

- Develop and document a training and development plan and link it to the University's mission.
- Establish a means of identifying and placing priorities on training and development needs.
- Establish a method for evaluating the effectiveness of training and development programs.
- Develop a system to monitor and evaluate training provided to individual employees.
- Establish a system for training class evaluations by those attending them.

Management's Response:

The performance appraisal system will include documentation of training activities and the personnel office will key training data into the human resource system.

Section 4-C:

Develop Job Descriptions for All Positions

Although the University maintains job descriptions for its classified employees, not all job descriptions exist for nonclassified employees. This weakens the University's ability 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. Nonclassified employees include administrative and support personnel, among others. A list of position identification codes identified 155 nonclassified job titles at the University.

Job descriptions improve accountability by helping to ensure employees and supervisors are aware of job requirements. Appropriate job descriptions are especially important for nonclassified and administrative positions that require more highly developed and specialized skills. Job descriptions also serve as foundations for hiring and evaluation processes by specifying job duties and responsibilities, as well as the knowledge, skills, and abilities required for competent performance of the job. Complete, accurate, and up-to-date job descriptions should be written and available for all positions within the University.

Recommendation:

Develop job descriptions for all staff, including nonclassified, administrative, and executive positions after performing appropriate job analysis.

Management's Response:

The University will examine its options and develop a cost-effective approach to the development of job descriptions for non-classified employees. Funding will be provided as part of the FY 98 budget.

Section 4-D:

Periodically Review Human Resource Processes

Management does not perform periodic analyses related to recruitment and selection, employee turnover and retention, and the performance appraisal system. This increases the risk that the associated human resources processes are not designed and operating effectively.

A formal recruitment and selection review process helps ensure recruitment and selection plans align with University goals and objectives. Recruitment and selection processes and systems should periodically be reviewed to determine their ability to limit both legal risk and litigation. Analysis should also include an assessment of the effectiveness of methods and tools for gathering data on applicants, candidates, and new hires.

Formal analysis of employee turnover and retention is necessary to measure the rate of attrition. Also, specific reasons for voluntary separations or involuntary terminations should be documented and evaluated.

Performance appraisal systems must be continually monitored to ensure rating accuracy and system effectiveness. Appraisers' ratings and decisions should be reviewed by management. Information should be collected on the managers' and employees' reactions to the system and how frequently it is used. Some examples of measures that could be used in the monitoring process are:

- Performance appraisal timeliness, which measures the average number of days between appraisals and compares the average to stated policies and procedures.

- Low rating outcomes, which measure the kind of corrective action taken, such as training, personal counseling, or discipline when a low rating is received.

- High rating outcomes, which measure rewards given, such as merit pay increases, achievement bonus, or other forms of recognition when a high rating is received.

- Outcome equity comparisons, which compare ratings and/or salary increases by manager, age, organizational group, gender, race, job, or other applicable categories to assess the possibility of bias.

<u>Recommendation</u>:

Management should establish review processes to monitor and evaluate the effectiveness of the recruitment and selection function, employee turnover and retention, and the performance appraisal system.

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

By September 1, 1998, the University will initiate development of a system to monitor and evaluate 1) the effectiveness of the employee recruitment and selection function, 2) employee turnover and retention, and 3) the performance appraisal system.

Section 5:

Continue to Seek Additional Sources of Funding for Athletics (Prior Audit Issue)

Expenditures for the University's intercollegiate athletics programs have increased faster than revenues, leading to an increased dependence on other sources of revenue to support the Athletic Department's operations. In fiscal year 1996, only two other state-supported institutions had a greater reliance on supplemental funding for athletics in terms of total dollars. When stated on a full-time equivalent student basis, the Athletic Department's level of reliance on supplemental funding in fiscal year 1996 was the highest of all state-supported institutions. For fiscal year 1997, supplemental funding is estimated to exceed $2,250,000, or $202.20 per full-time equivalent student. Table 2 illustrates the Athletic Department's increasing reliance on supplemental funding:

Table 2

Method of Funding for Intercollegiate Athletics					
Fiscal Year	Athletic Expenditures	Athletics Self-Generated Revenues	Student Service Fees Applied to Athletics	**Supplemental Funding Needed for Athletics**	**Supplemental Funding per Full-Time Equivalent Student**
1992	$3,122,156	$380,169	$1,261,895	**$1,480,092**	**$120.37**
1993	$3,366,014	$304,948	$1,325,000	**$1,736,066**	**$144.58**
1994	$3,592,001	$328,961	$1,371,000	**$1,678,608**	**$141.54**
1995	$3,656,898	$365,596	$1,371,000	**$1,625,643**	**$142.79**
1996	$3,875,476	$486,009	$1,381,000	**$2,008,467**	**$179.38**
1997 Budgeted	$4,032,074	$401,000	$1,381,000	**$2,250,074**	**$202.20 (est.)**

The majority of the supplemental funding since fiscal year 1994 has come from General Fee revenue, which is directly tied to enrollment. However, since fiscal year 1994, enrollment has decreased by approximately 734 full-time equivalent students, or 6.2 percent. Declining enrollment places an additional strain on General Fee revenue as a funding mechanism for the athletics program. In addition, as long as the Athletic Department's reliance on General Fee revenue increases, opportunities may be lost to use these discretionary funds for activities which more closely align with the University's educational mission.

In order to increase athletic self-generated revenues, management plans to raise football and basketball ticket prices, but the University's projected revenue increases are not significant compared to the current level of revenues or expenditures. For example, the University projects that increases in football and basketball ticket prices in fiscal year 1998 will generate additional revenue of approximately $12,431 in fiscal year 1998. However, this amount represents only a 3 percent increase over estimated fiscal year 1997 self-generated revenues of $401,000, and is negligible compared to estimated fiscal year 1997 athletic expenditures of over $4 million. The additional revenue from ticket sales is projected to decrease annually until fiscal year 2001, the last year in the projection. Moreover, the expected ticket revenue increase may not be fully realized since the University's projections do not take into account any potential drop in the number of tickets sold when ticket prices are increased.

The University has also recently announced the receipt of $408,000 as an initial installment of what is ultimately expected to be a total gift of $600,000. The funds will be deposited in an endowment which will benefit the football program. If the endowment earns interest at a rate of 5 percent to 10 percent, the football program could receive $30,000 to $60,000 per year. However, this represents at best only 3 percent of estimated 1997 supplemental funding needs of $2.25 million.

Athletic expenditures have been increasing at an average rate of just over 5 percent since fiscal year 1992. Management cites increased athletic scholarship expenditures resulting from state-mandated tuition increases, other fee increases, and inflation as prime contributing factors. Neither management nor the Board of Regents has expressed an intent to set a limit on the extent to which they are willing to commit supplemental funding to support athletics. The widening gap between expenditures and self-generated revenues emphasizes the need for some definitive action to reduce the reliance on supplemental funding to support athletics.

Recommendations:

- Continue to closely monitor the increasing gap between athletic self-generated revenues and expenditures.
- Establish goals for the level of athletic operations funding to be derived from both internal and external sources and develop contingency plans in case goals are not met.
- Continue to aggressively pursue additional sources of funding for athletics programs.

Management's Response:

The University has taken several significant steps toward reducing the cost of its athletic program over the past few years. We have moved from two Athletic Directors, one for men's sports and one for women's sports, to one Athletic Director thereby saving an estimated $75,000 per year. In order for the University to comply with Title IX requirements, we needed to have more opportunities for women athletes. Instead of adding a new sport at an additional cost, the Board of Regents eliminated Men's Baseball and added Women's Soccer at no new cost to our athletic program. Additionally, the University will increase its gate prices over the next two years.

The University will establish goals for the level of athletic operating funding for both internal and external sources and develop contingency plans.

The University will continue to closely monitor the difference between self-generated revenues and expenditures. SFA is committed to reducing the total percentage of dollars spent on our athletic program from student sources. The University will continue to aggressively pursue additional funding sources. During the past year, the athletic department received substantial gifts totaling over $500,000. In addition, the University is beginning its first ever University-wide Capital Campaign. Over the next five years, one major benificiary of this campaign will be our athletic program.

Section 6:

Improve Controls to Provide for the Safeguarding of State Property

Timely reconciliations were not performed to determine the reasons for a significant difference between the property and equipment value reported in the State Property Accounting system and the amount reported in the annual financial report. Also, controls over cellular phones do not ensure cellular phone charges payable by the individual user are identified and reimbursed to the University. Usage analysis is not regularly performed to justify an individual's continued need for a phone.

Section 6-A:

Reconcile Property and Equipment in a More Timely Manner

There was a difference of $5.2 million in fiscal year 1996 and $6.4 million in fiscal year 1995 between the property and equipment value reported in the State Property Accounting (SPA) system and the amount reported in the annual financial report. State agencies and universities are required to reconcile their general ledger inventory balances to the supporting detail in the SPA system. Timely reconciliations reduce the risk of misstatements and irregularities in the property records and abuse of state property.

Upon our request, management prepared reconciliations for each of the two years. However, some reconciling items have not been fully resolved.

Recommendations:

To improve accountability over property and equipment, the University should:

- Complete the reconciliations, identify all needed adjustments, and make the adjustments as soon as feasible.

- Develop and enforce procedures to ensure future reconciliations are timely.

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

Management concurs that the reconciliations were not prepared on a timely basis. State Property Accounting (SPA) is implementing the reconciliation requirements over a five-year period. The standard for FY '96 reports requires that our records reflect no more than a 4% variance to SPA records. Our 1996 report total is within 1.38% of the SPA total and FY '97 reports are current and within the SPA standard. The University is committed to complying with SPA reconciliation requirements.

Section 6-B:

Strengthen Controls Over the Use of Cellular Phones

Controls over cellular phones do not ensure reimbursements due the University are properly identified and collected. A University-wide cellular phone policy and procedure statement does not exist. The memoranda used by some departments as a basis to issue a cellular phone to an individual(s) should be uniform, and should require justification for a phone. Currently, usage analysis is not regularly performed to ensure an individual's continued need for a phone.

Instances of control weaknesses include:

- For two months (October 1996 and February 1997) of phone bills reviewed, 38 percent and 37 percent of the cellular phones in service at the University were not used. However, these phones contributed to $70.64 and $109.40 to the months' cellular phone bills, respectively.

- A variety of academic and administrative departments, including Purchasing, Fine Arts, the Counseling Clinic, and Housing, do not require written justification for cellular phone purchases and use.

- A number of departments have several cellular phones such as Athletics (11), Forestry (8), and the Area Health Education Center (7). There are instances where some individuals are often assigned more than one cellular phone. However, it was not clear who the end user actually was.

- A standard form has not been developed University-wide whereby the individual assigned the cellular phone acknowledges receipt of the phone and acknowledges personal responsibility and accountability for its use.

- Current procedures require the user of the phone to identify which charges in the monthly phone bills he or she should reimburse to the University for nonbusiness calls. However, there is no provision for an independent third party to review the bills to ensure all charges that should be reimbursed have been identified.

Recommendations:

- Management should create a formal policy related to cellular phone use.
- Management should evaluate whether current cellular phone users and departments require a cellular phone to perform their duties, and if so, the number of cellular phones required.
- Each department that uses cellular phones should maintain copies of all cellular phone bills for each individual who uses a cellular phone. These bills should be organized either by individual and/or by month.
- Each department should routinely review the cellular phone bills to ensure that phones are used only for University business, and that if personal use occurs, the University is reimbursed for the cost. Business calls could be tracked by a list of business-related phone numbers or a log of calls made.
- The University should require that individuals seeking to be assigned cellular phones submit a written justification for the phone. The individual's supervisor, as well as the Telecommunications and Networking Department, should review and approve the request. This request should be made on a standard cellular phone request/justification form.

Management's Response:

The Board of Regents approved a revised Telephone Services policy July 15, 1997. The policy specifies the format for the memorandum authorizing the licencing of cellular telephone service. Departmental supervisors must approve requests for cellular phone service. Cellular phone use is charged to departmental accounts. It is the responsibility of departmental management to determine whether there is sufficient need to justify the continuation of any service.

In addition, as a follow-up to the state auditor's visit, management is requesting written evaluations and justifications for all cellular phone usage. We anticipate completion of this project by October 1, 1997.

Section 7:

Improve Controls Over Automated Systems Access and Over Physical Security (Prior Audit Issue)

Weaknesses continue to exist in controls over management information systems. Access controls and existing policies and procedures do not adequately prevent the threat of unauthorized access to data by programmers, operators, or other unauthorized users. Written policies and procedures are also needed related to physical security issues, and security over network telecommunications resources needs to be strengthened.

Section 7-A:

Improve Controls Over Access to Automated Systems

Access to production programs and data files is not adequately controlled. The following conditions were noted:

- Application programmers and operators have access to the production data files and programs.
- A former student and former employee had access to the administrative systems months after being terminated.
- Terminated employees' accounts are usually deleted monthly. Therefore, employees terminated early in the month will usually have access until early the next month.
- Access is not periodically reviewed for accounts with high levels of access. One individual was given update access to two administrative systems when dual access was not needed to perform the individual's job duties.

Written policies and procedures are needed with respect to the following areas:

- Responsibility for access to systems software, data files, passwords, access violations, and program/job control instructions.
- Assignment of a new password when a user forgets his/her password.
- Investigation of terminal access violations or control and maintenance over passwords.
- Changes to system software.

When programmers, operators, and terminated personnel have access to the application production's related data files, the possibility of unauthorized manipulation or unintentional use of the data is increased. This can significantly decrease the integrity of the system.

Recommendations:

Security should be reassessed and access should be granted only to those individuals who require that type of access to perform their jobs. Programmers and operations personnel should not have the ability to effect changes to production files and data. Periodic reviews should be performed to determine if access at the current level is needed. In addition, written policies and procedures should be developed for all the areas named above.

Management's Response:

Management has replaced all of its mainframe administrative systems over the past 30 months. Programmers and systems staff have been provided higher levels of systems access because of this compressed time period and the small number of professionals assignable to these tasks. As these systems begin to reach basic levels of stability, policy and procedural documentation can begin. Policies regarding administrative systems access will be submitted to the Board of Regents within 18 months.

Section 7-B:

Improve Physical Security of Computer and Telecommunications Equipment

The University does not have written policies and procedures that address the security of its computer facilities. In addition, a consultant's report noted that over $2 million worth of telecommunications equipment is physically located directly below cooling towers, and high-pressure boilers are separated from the facilities by only sheetrock walls.

Weaknesses in controls over the security of equipment increase the risk of damage or loss of physical system resources.

Recommendations:

Controls over the physical security of the computer and network resources should be improved by developing written policies and procedures for physical security. Also, the University should assess the risks associated with the current location of the telecommunications equipment noted in the consultant's report and take prompt appropriate action.

Management's Response:

The University will continue to assess the risks associated with the current location of its telecommunications equipment and develop a plan to relocate applicable equipment as resources permit. Policies regarding physical security issues will be submitted to the Board of Regents within 18 months.

Section 8:

Revise *University Policies and Procedures Manual* Regularly

As noted in other sections of this report, the University should develop or improve written policies and procedures at the departmental level for specific areas or job functions. In addition, the University needs to increase its commitment to update the *University Policies and Procedures Manual* (Manual). The University does not regularly review and update the University-wide policies and procedures in the Manual. The Manual provides guidance at a high level to help employees implement Board policy and comply with applicable laws and regulations. As such, it should be kept current to incorporate changes in laws, regulations, and Board policies as they occur. We observed the following:

- The University has updated 27 policy statements in the current fiscal year through April 1997. However, 14 of the fiscal year 1997 revisions were to policies that were created before 1990 and were overdue for some level of review and update as a matter of prudence. From fiscal year 1990 to fiscal year 1996 only 25 other policy and procedure statements were revised and updated. There are approximately 75 more policy statements created in the 1970s and 1980s that have not been reviewed and updated. The University currently has 258 policy statements.

- A current, formal plan for the regular review and revision of policies and procedure statements does not exist. Without regular review and revision cycles, there is no assurance that University-wide policies and procedures are in alignment with the University's current practices and the University's strategic plan, or in compliance with new or revised laws and regulations.

Recommendations:

- Develop a review schedule for University-wide policies and procedures. The schedule should be prioritized so that critical policies and procedures are reviewed frequently.

- Develop detailed policies and procedures for all important functions at the departmental level. Ensure that departmental-level policies and procedures align with University-wide policies and procedures.

Management's Response:

The University agrees that many of our written policies need review and/or updating. However, 77 or approximately 1/3 of the 258 policies have been written or updated within the last twelve months. The remaining policies are scheduled to be updated over the next 18 months. Once all policies have been reviewed, future modification of critical policies will be scheduled for the annual April Board of Regents meeting. Additionally, all non-critical policies will be reviewed on a three year cycle. All *changes will be reflected in our electronic Policy Manual within 30 days from the appropriate approval.*

Section 9:

Ensure Student Fees Are Properly Tracked, Supported, and Reflected in the Operating Budget

The University has only partial controls in place to ensure that student fees such as lab and computer use fees are tracked from collection to their expenditure, are properly supported, and are accurately reflected in the budget document.

Section 9-A:

Improve the Tracking of Fees (Prior Audit Issue)

The University does not directly allocate or transfer laboratory fee revenue and a portion of the computer use fee revenue to departments for expenditure. Although the collection of fees is initially tracked in individual accounts, the collected fees are then combined with other sources of funding prior to their expenditure. There is no demonstrable link between the lab fees charged when registering for a class and the amount of funding the class receives from the fees. In the absence of accounting for the fees from their collection to their expenditure, it is difficult to determine how such fees are actually being used and whether they are used for their intended purpose. For fiscal year 1997, laboratory fee revenue is budgeted at $165,547, while computer use fee revenue is budgeted at $1,668,925.

Recommendation:

In order to establish accountability for student fee revenues, management should establish a means of accounting for student fees from the time they are collected to when they are expended.

Management's Response:

The University is accounting for student fees, either when they are received or when they are expended. The University's FY '98 Operating Budget allocates laboratory fees to departments based upon estimated 1997-98 enrollment. Departmental budgets will be revised throughout the year as actual net collections are determined.

Section 9-B:

Establish Support for the Level of Various Fees

There is no documentation supporting the dollar amount of the laboratory fee, the computer use fee, and the $6 course fee. In addition, the documentation to support another fee, the "incidental" fee (course fees greater than $6), was supported only for 8 of 12 courses tested. One course fee had no support for the level of the assessed fee. Full support for a fee should consist of a line-by-line breakdown of cost category and dollar amount.

Education Code, Chapter 54.504, requires "incidental fees" to reasonably reflect the actual cost to the University of the materials or services for which the fee is collected. At this institution, this section of the Education Code applies to both the course fee and the incidental fee.

Recommendation:

Management should establish support for the level of all fees charged to students to ensure students do not pay more than a reasonable amount.

Management's Response:

At its April, 1997 meeting, the Board of Regents approved a 1997-98 course-fee schedule. These recommended course fees were submitted for approval by each of the University's colleges. A similar project, involving laboratory fees, is planned for the 1997-98 academic year. Stephen F. Austin State University is less costly to attend than some of Texas' State universities and more costly than others.

Section 9-C:

The Operating Budget Should Accurately Reflect Academic Departments' Funding Sources

The Source and Application of Funds - Designated Funds section in the fiscal year 1996-1997 Operating Budget does not accurately depict academic departments' funding sources. Every academic department in reality receives funding from a variety of sources, including course fees and general fees. However, this section of the Operating Budget shows only 24 of 36 academic departments as receiving funding from the $6 course fee assessed for all courses. Twelve other departments are depicted as receiving no funding from this fee and instead are shown as being funded from General Fees or other sources. General Fees are paid by all students based on the number of hours enrolled.

The combined effect of this method of depicting the source of academic departments' funding renders this portion of the document misleading.

Recommendation:

Management should accurately depict academic departments' funding in the Source and Application of Funds - Designated Funds section of the Operating Budget.

Management's Response:

The University's FY '98 Operating Budget shows the Designated Funds allocation of course fees and general fees (SB 1907 Tuition) by academic department.

Section 10:

The University Should Improve Controls to Ensure It Meets Statutory Requirements

Although the University has developed procedures to ensure all payments to vendors are made in compliance with the Prompt Payment Act, not all departments are complying with the procedures. Also, improvements in marketing and outreach efforts in the Physical Plant and in the University's procedures for reporting historically-underutilized business (HUB) activity are needed to help ensure the University is able to fully comply with statutory requirements.

Section 10-A:

Improve Timeliness of Payments to Vendors (Prior Audit Issue)

Although the University has developed procedures to ensure all payments to vendors are made in compliance with the Prompt Payment Act, not all departments are complying with the procedures. The check issuance date for 7 of 25 disbursements (28 percent) tested was at least 30 days after the invoice date. Most of the problem appears to be a delay in the submission of invoices to accounts payable by departments that are making local purchases. These types of departmental purchases are normally limited to $500 or less.

A contributing problem appears to be a lack of clear responsibility of all parties involved for ensuring prompt payments. Management addressed this issue in a prior audit report (SAO Report No. 93-127) by responding that responsibility for compliance with the Prompt Payment Act had been assigned to the Controller of the University. However, it appears this was not completely resolved.

Government Code, Section 2251.021, commonly referred to as the Prompt Payment Act, requires universities to pay vendors within 30 days of the receipt of goods and services or invoice receipt date, whichever is later. The Prompt Payment Act was designed to encourage agencies to pay bills in a timely manner and to take advantage of available discounts.

Recommendations:

In order to improve the timeliness of payments to vendors, management should clearly assign responsibility for compliance with the Prompt Payment Act to a specific individual or individuals in writing, and establish procedures to ensure that payments to vendors are made on a timely basis. In addition, management should periodically review a sample of expenditures to ensure that payments are being made within the period required by law.

Management's Response:

Departmental budget authorities are responsible for compliance with all statutory requirements. The University's payment-approval process requires receiving departments to certify receipt of goods and/or services. The purchasing and controller's offices contact departments when an irregularity in the payment cycle appears likely. The controller's office is developing a proposal to charge additional processing fees to departments violating the prompt-payment guidelines.

Section 10-B:

Improve Controls to Ensure Compliance With Statutory Requirements Over the Historically Underutilized Business (HUB) Program

Improvements in marketing and outreach efforts in the Physical Plant Department and in the University's procedures for reporting HUB activity would help ensure the University is able to fully comply with statutory requirements.

Marketing and Outreach Efforts in the Physical Plant Department - While the Purchasing Department appears to be making a good-faith effort to support the HUB program, the Physical Plant Department (Physical Plant) has not been as diligent. Marketing and outreach efforts by the Physical Plant are not sufficient to encourage increased participation by qualified HUBs. The University reported no participation by HUBs during fiscal year 1996 for the Building Construction category. For fiscal year 1996, the Special Trade category reported less than 1 percent ($15,750) HUB participation out of $1.8 million in expenditures, while the Other Services category reported less than 2 percent ($130,514) HUB participation out of $6.9 million in expenditures reported.

HUB Reporting Requirements - The University failed to comply with several program reporting requirements. Instances include:

- Specific programs to accomplish the University's HUB-related goal were not included in the University's current strategic plan. Specific programs are required in the strategic plan by Chapter 41, Section 2161.123, of the Government Code.

- The University did not include in its fiscal year 1996 annual financial report a section documenting progress under its plan for increasing use of HUBs, as required by Article IX, Section 77, of the 1996-1997 General Appropriations Act.

- The University did not submit the fiscal year 1997 estimate of the total value of expected HUB contract awards. This estimate was due by the 60th day of the fiscal year, as required by Chapter 41, Section 2161.183, of the Government Code.

Recommendations:

To ensure the University as a whole is making a good-faith effort to support the HUB program and comply with program reporting requirements, the University should:

- Reexamine its approach and commitment to increasing HUB participation in all areas. Actions should include development of specific programs for all applicable departments of the University, and these programs should be delineated in the University's strategic plan.

- Develop and adopt measures to increase HUB participation in the Physical Plant, particularly as they apply to outreach and marketing. Measures should include increased oversight by the University's HUB coordinator over Physical Plant efforts to increase HUB participation.

- Develop written policies and procedures to ensure compliance with HUB reporting requirements and disseminate the policies and procedures to employees who are responsible for HUB compliance.

Management's Response:

Purchasing will notify GSC-certified HUB vendors of construction-project bids. Bid packages and responses to bids will be processed by the construction manager. The University will meet with construction managers to clarify the HUB statutes and requirements. Construction managers will be assigned responsibility for notifying the University's purchasing office of qualifying contractors requiring assistance with the certification process. Purchasing will review the University's insurance requirements to determine the possibility of reducing indemnity levels to encourage participation by small HUB-based contractors. The FY '97 HUB progress report will be included in the University's FY '97 Annual Financial Report. FY '98 estimates of HUB contract awards will be submitted in accordance with the statutory requirements.

Section 11:

Perform a Thorough Analysis to Ensure That the University Received the Best Contractual Agreement for Food Services

The University has not rebid the contract for food service operations since it was initially awarded to the current contractor in 1986. The contract has been renewed twice with the same contractor, with the most recent renewal at the end of fiscal year 1996 for a period of five years. The University decided not to bid the contract after management conducted a survey of other universities. The survey consisted mainly of a comparison of per-meal costs at each university. The decision not to bid the contract did not appear to take into account other considerations, such as contractual provisions, which could materially impact the value of the agreement. Therefore, the University cannot be assured it is receiving the best service at the best price. University officials estimated the value of the current contract at $3 million.

While the University's per-meal payments to the food services contractor was low compared to other universities, contractual provisions that should have been considered in the analysis include:

- Arrangements wherein the University transfers $350,000 to the contractor at the beginning of each contract year and is repaid the same sum at the end of the year; this appears to be an interest-free loan to the contractor since there is no provision for interest payments to the University by the contractor. At a 10 percent rate of interest, this loan could cost the University $35,000 per year.

- The amount and nature of contractor payments to the University from the contractor for such items as equipment and improvements compared to similar arrangements, if any, at other universities

- The allocation between the University and the contractor of revenue from casual meals and snack bar operations; if there are similar sharing arrangement at other universities, the allocation percentages may differ as well as the base amount against which the percentage rate should apply.

- The allocation of receipts, gross or net, between the University and the vendor from the University's athletic events, and any guarantees to the University

- The amount of performance and payment bonds, if any, required to be provided by the vendor; the contract signed in 1996 did not require the contractor to provide a payment and performance bond. Performance bonds help to ensure the performance of a contractor's obligations.

<u>Recommendations</u>:

- Perform a complete analysis of the provisions in the current food services contract. If a comparison is made with other universities, care should be taken to ensure the comparisons address pertinent contract provisions.

- Based on the results of the analysis performed, determine an appropriate course of action regarding whether to renegotiate the current food services contract.

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

The analysis employed by the University for retaining ARAMARK for five more years included the following rationale:

- *The contracted meal prices were already among the lowest in the state.*

- *ARAMARK agreed to negotiate a new contract with no price increase for the first year.*

- *ARAMARK provided the University with $500,000 in food area renovations.*

- *Documented customer satisfaction surveys with students, faculty, and staff supported the decision.*

- *Positive feedback was provided by the Food Service Advisory Board, which meets weekly.*

- *Annual inspection tours were conducted by the Food Service Advisory Board.*

- *Favorable comparisons of the food service program with other colleges and universities.*

By February 1, 1998, the University will perform an analysis of the provisions of the current food service contract. Based on the results of the analysis, we will determine the appropriate short course for action. Over the long term, should the current ARAMARK contract stay in force, the food service contract will be submitted for competitive bid as the ARAMARK contract nears expiration.

Section 12:

Improve Financial Reporting

The University has misreported investment activity in the annual financial report for fiscal year 1996. Additionally, improvements are needed in the methods by which construction in progress is reported in internal monthly reports.

We noted the following errors:

- Management recognized unrealized market gains in accounting for investment activity during fiscal year 1996. This valuation method resulted in material misstatements in the Endowment Funds in the University's annual financial report for fiscal year 1996. As a result of the valuation methods used and the inclusion of certain items that would be more appropriately treated as part of the University's quasi-endowments, investment income for the University's endowments was overstated by $525,697, or 97 percent. Investment income for individual endowments was overstated by up to 270 percent. The overstatement of ending investment balances was also reflected in the University's balance sheet, as well in Note 3, "Deposits and Investments."

  The revaluation of the University's investments to market value, and the inclusion of unrealized gains in investment income, resulted from a misapplication of Statement of Financial Accounting Standards No. 124, which applies to nonprofit entities, but does not currently apply to the University as a unit of state government.

- The University's internal interim monthly financial reports indicate that the Unexpended Plant fund group has carried a continual negative fund balance since September 1996, and that the deficit is increasing. As of March 31, 1997, the deficit amounted to nearly $2.4 million. As cash is used in this fund group, it is expended rather than being applied to construction in progress, a compensating asset. As a result, the University's monthly financial reports generally reflect a declining level of cash and total assets in this fund group, leading to a decreasing fund balance. This treatment does not portray an accurate depiction of this fund group's true financial state.

Erroneous or otherwise misleading information could lead to faulty decisions by both internal and external users of the information.

<u>Recommendations</u>:

The University should develop and implement measures to ensure accuracy in the University's financial reports, including:

- Develop a report review process where all annual financial reporting requirements are acknowledged by those involved with preparing and reviewing the annual financial report. Any departures from generally accepted accounting principles or other relevant guidance should be discussed with the Comptroller's Office prior to preparation of the annual report.

- Recognize accumulated expenses from Unexpended Plant funds as Construction in Progress to the extent applicable for purposes of monthly financial reporting. This treatment would provide users of the monthly reports with a more accurate depiction of this fund group's true financial state.

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

Management agrees with the auditor's finding. We will restate the August 31, 1996 balance sheet for inclusion in the August 31, 1997 annual financial report to comply with the auditor's recommendation. In the future when authoritative pronouncements allow for alternative presentations, we will seek guidance from the Comptroller's Office prior to preparation of our annual report.

Stephen F. Austin State University will recognize accumulated construction expenses and bond proceeds attributable to the Plant Funds as recommended in the Annual Financial Reporting Requirements in its monthly internal financial reports.

Additionally, the University will adopt the use of a reporting and disclosure check-list.

Appendix 1:

Objectives, Scope, and Methodology

Objectives

Our audit objectives were to evaluate the management control systems within Steven F. Austin State University, including its management of resources, and to identify strengths and opportunities for improvement. We evaluated whether the control systems provide reasonable assurance that the University's goals and objectives will be accomplished. The audit evaluated control systems in place during fiscal year 1996 and fiscal year 1997.

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 implemented, 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 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, and evaluate 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
- 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.

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 each control system. 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 adequacy of the system and to identify opportunities for improvement.

An understanding of the control systems was gained through interviews with the Board of Regents, management, faculty, and staff. Written questionnaires and reviews of University documents were also used to gain an understanding of the control systems in place. 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
- 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

Fieldwork was conducted from December 1996 through June 1996. We did not verify or review the accuracy of the data provided by Stephen F. Austin State University. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

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

- Hector Gonzales, CPA (Project Manager)
- Rob Bollinger, CPA
- Sean Gaven, CPA, CIA
- Ann Paul
- Nancy Raabe
- Errol Williams, CPA
- Aubrey Smart, CPA
- Pat Keith, CQA (Audit Manager)
- Craig Kinton, CPA (Audit Director)

Appendix 2:

Background Information

Appendix 2.1:

University Profile

Mission Statement

Stephen F. Austin State University is a comprehensive, state-supported university committed to excellence in undergraduate and graduate education. The faculty members of Stephen F. Austin aspire to educate students to become mature, adaptable citizens capable of meeting the challenges they confront as members of a multicultural, democratic, technological society.

The fundamental mission of the University is teaching that provides students with a substantive general education and enables students to secure both specialized and multidisciplinary knowledge. The research mission of the University complements its instructional mission by advancing knowledge and encouraging creative activity. The service mission of the University is to function as a resource to help meet the many challenges and needs of the region it serves.

Operations

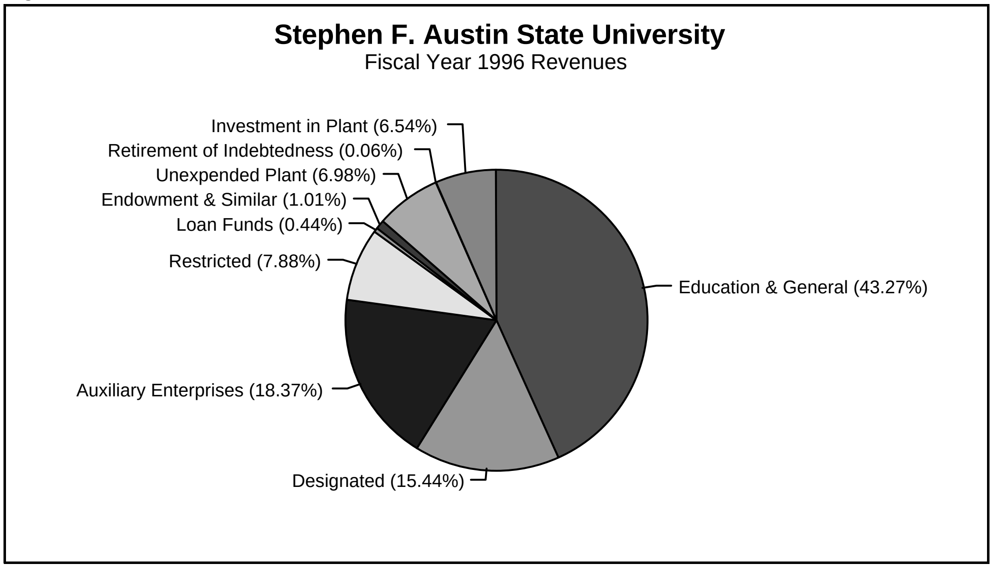
Stephen F. Austin State University is a general purpose institution serving students who are 98 percent residents of the State of Texas. It offers programs in seven undergraduate colleges (Applied Arts and Sciences, Business, Education, Fine Arts, Forestry, Liberal Arts, and Science and Mathematics) and a graduate college. It offers master's degrees in 30 disciplines, a Master of Fine Arts, and the Doctorate in Forestry. University enrollment was 11,758 (Fall 1996). Faculty headcount was 680 (Fall 1995).

Appendix 2.2:

Financial Information

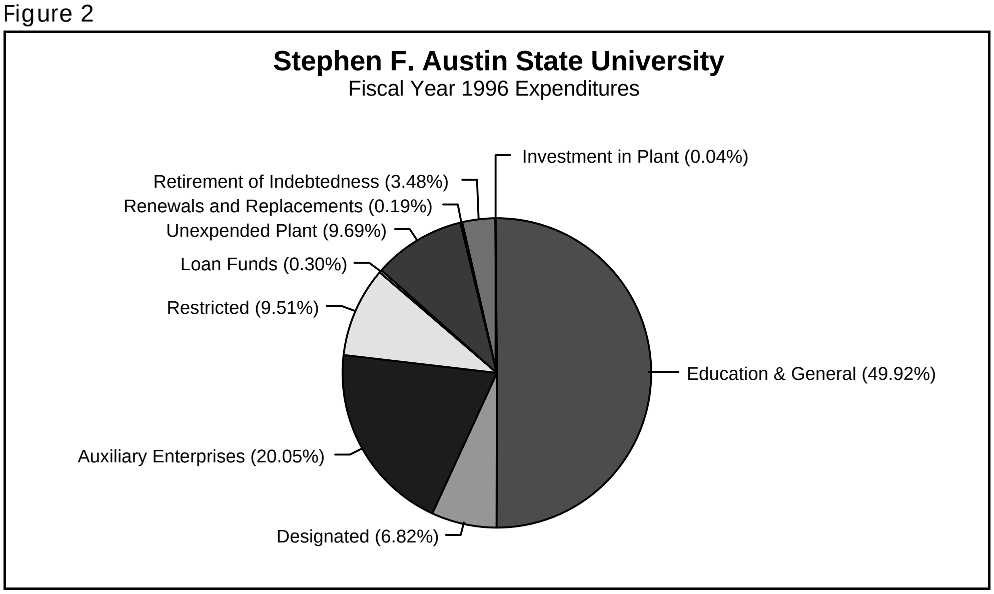
The University reported revenues and other additions of $122,037,840 and expenditures and other deductions of $108,910,308 for fiscal year 1996. The University's fund balance totaled $199,237,799 for fiscal year 1996. Reported revenues, expenditures, and fund balance were distributed as follows:

Figure 1



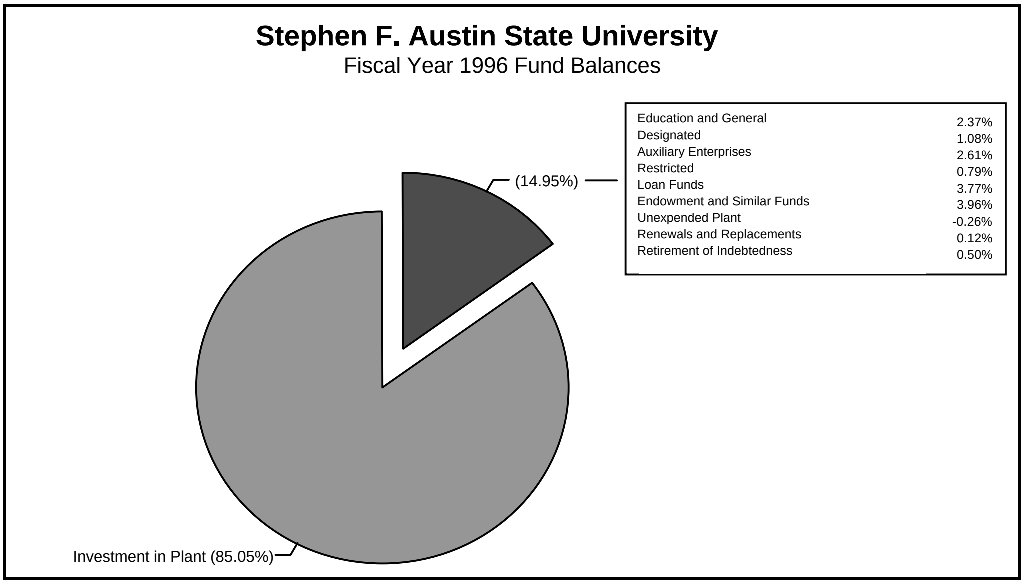
Source: 1996 Annual Financial Report

Figure 2



Source: 1996 Annual Financial Report

Figure 3



Source: 1996 Annual Financial Report

This page intentionally left blank.