State Auditor's Office

John Keel, CPA
State Auditor

An Audit Report on

Selected Financial Processes at Sam Houston State University

June 2010

Report No. 10-030

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Overall Conclusion

Sam Houston State University (University) should improve financial controls and oversight in areas such as asset management, investments, and financial reporting. For example:

> **Background Information**
>
> Located in Huntsville, Texas, Sam Houston State University (University) is a member institution within the Texas State University System.
>
> The University has approximately 17,000 students and is organized academically into five colleges: arts and sciences, business administration, criminal justice, education, and humanities and social sciences. The University offers bachelor's, master's, and doctoral degrees.
>
> The University reported $206,356,696 in total operating expenses as of August 31, 2009.

- The University's process for capitalizing real property assets does not comply with state property accounting requirements. As a result, the University did not report at least $5,846,691 in depreciation on its fiscal year 2009 annual financial report.
- As of August 31, 2009, $22,283,196 (42 percent) of the $53,055,228 the University had invested in a multi-strategy bond fund was held in investments with ratings that were lower than the ratings requirements in statute and the Texas State University System's investment policy.
- The University misclassified cash balances on its fiscal year 2009 annual financial report. It overstated restricted cash by $10,950,000 and understated unrestricted cash by the same amount.

In fiscal year 2009, the University had 185 grants and subrecipient contracts with awards totaling $31,020,390. Although the University has policies and procedures regarding grant management, it did not always manage grants in accordance with those policies and procedures. For example, the University did not consistently ensure that (1) the appropriate individuals approved grants before the University initiated the grants and (2) principal investigators disclosed any potential conflict of interest with the grant sponsors.

The University complied with its policy regarding the use of an indirect cost rate that was lower than the federally approved indirect cost rate for 12 (15 percent) of 80 grants tested. It did not retain approximately $453,132 in grant funds that it could have retained to cover administrative costs associated with the grants that it managed. In addition, the University did not prepare two required annual reports on its use of indirect cost funds.

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

For more information regarding this report, please contact Sandra Vice, Assistant State Auditor, or John Keel, State Auditor, at (512) 936-9500.

Auditors communicated other, less significant issues to the University's management separately in writing.

Summary of Management's Response

The University agreed with the recommendations in this report.

Summary of Information Technology Review

The University is converting from an in-house mainframe system to a commercial system called Sungard Banner Unified Digital Campus (Banner). The University plans to implement the Banner modules for student information, financial aid, finance, human resources and payroll, and enrollment management. This audit focused only on certain financial processes on which the conversion has a minimal or no impact.

Because it is converting to a new automated system, during the next two to three years the University estimates it will change its business and financial processes. Auditors performed a limited review of the information technology controls over University information systems and other automated processes used for selected financial and administrative functions. The University should strengthen passwords, periodically review user access to key financial applications, ensure that programmers do not have access to application code in the production environment, and update its disaster recovery plan (see Chapter 3).

Summary of Objectives, Scope, and Methodology

The audit objectives were to evaluate selected financial processes to determine whether the University has implemented a system of financial and administrative internal controls and consider whether:

- Accounting procedures and controls provide assurance of accurate, complete, reliable, and timely financial information.
- Security controls within the University's financial system provide assurance that critical data is protected from unauthorized alteration, loss, or improper use.
- Controls are adequate and effective in providing assurance to safeguard assets.
- The University complies with applicable laws and regulations.

The audit scope covered financial reporting, investments and endowments, cash receipts, capital assets, and grant activity between September 1, 2008, and August 31, 2009.

The audit methodology included analyzing accounting procedures and controls for grant management, investments, capital assets, cash deposits, and financial reporting; reviewing the University's access controls over financial and administration information; analyzing and testing controls over capital assets and cash; testing compliance with applicable laws, regulations, and policies; identifying and assessing automated controls over key revenue and expenditure processes; and identifying and assessing general information technology controls.

In 2009, the State Auditor's Office conducted an accreditation review of the University's fiscal year 2008 financial statements (see *Accreditation Reviews Fiscal Year 2008*, State Auditor's Office Report No 09-335, June 2009). A review is substantially less in scope than an audit. The issues discussed in the current audit report were identified as a result of conducting tests that were more extensive than the tests conducted during the 2009 review.

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Detailed Results

Chapter 1

The University Should Strengthen Controls Over Certain Key Financial Processes

Sam Houston State University (University) has not complied with state property accounting requirements regarding capitalization of real property assets. As a result, the University understated depreciation and overstated capital assets by at least $5,846,691 on its fiscal year 2009 annual financial report. The University also should strengthen the safeguarding of its assets.

In addition, as of August 31, 2009, the University held $22,283,196 in investments that were rated below the rating requirements of the Texas Government Code and the Texas State University System's investment policy. These securities represented 42 percent of the $53,055,228 the University had invested in a multi-strategy bond fund with an investment firm.

The University also misclassified its cash balances on its fiscal year 2009 annual financial report. Specifically, it overstated restricted cash by $10,950,000 and understated unrestricted cash by the same amount.

Further, the University does not consistently make cash deposits in accordance with its policies and procedures, and it does not ensure that the duties in the cash collection process are adequately segregated.

Chapter 1-A

The University Should Properly Capitalize and Better Safeguard Assets

State Property Accounting Requirements for Capitalizing Real Property

Real property assets are to be capitalized when substantial completion contract documents are executed, when an asset is occupied, or when an asset is placed into service.

Source: *SPA Process User's Guide*, Office of the Comptroller of Public Accounts, page 1.29.

University Policy for Capitalizing Real Property

Real property assets are to be capitalized when all bills associated with the assets are paid.

Source: University Property Department, policy for real property construction in progress.

Asset Capitalization. The University did not capitalize (depreciate) its real property assets in accordance with the Office of the Comptroller of Public Accounts' *SPA Process User's Guide*. The University capitalizes a real property asset when it pays all bills related to that asset; however, the *SPA Process User's Guide* requires real property assets to be capitalized when they are considered operational (see text box). As a result, the University did not capitalize 7 (88 percent) of 8 real property assets tested in accordance with the *SPA Process User's Guide*, and it understated accumulated depreciation by $5,846,691 in its fiscal year 2009 annual financial report. It also overstated capital assets by the same amount.

For testing, auditors selected eight real property assets the University had acquired since 1999. The eight real property assets tested—which included six buildings, one infrastructure item, and one facilities and improvement item—represented 2 percent of the University's 496 real property assets.

Requirements for Tagging, Securing, and Conducting Inventories of Property

All property capitalized or designated as a "controlled" asset must be marked or tagged as property owned by the agency with the exception of real property.

Agencies must know at all times where all property under their control is located, should have a method for locating any inventory item on-site or off-site, and should be able to locate a given item upon request.

Property inventories should be conducted by individuals (verifiers) who are not responsible for the property being inventoried nor for accounting for it on a day-to-day basis.

Source: *SPA Process User's Guide,* Office of the Comptroller of Public Accounts, pages 2.16, 2.17, and 2.27.

Asset Safeguarding. To safeguard assets, the University affixes property tags to assets, tracks the location of assets, and conducts annual inventories (see text box for requirements in the *SPA Process User's Guide*). However, these controls do not always work as intended. Specifically:

- Nine (23 percent) of 39 assets tested were not in the location specified in the University's records. These items were not lost or stolen, but they had been moved and the University had not updated its inventory system.
- Two (5 percent) of 39 assets tested did not have a property tag, which increases the risk that these assets would not be identified as University property if they were lost or stolen.

Each University department performs an annual inventory of its assets and submits the results to the University's Property Office. However, the department heads select the staff within their departments to conduct these inventories, rather than assigning individuals who are not responsible for the assets to conduct the inventories as required by the *SPA Process User's Guide*.

To supplement the inventories the departments conduct, the University's Property Office conducts spot inventories to verify the accuracy of the inventory reports that the departments submit. In fiscal year 2009, the Property Office conducted spot inventories at 4 (3 percent) of the 133 University departments. Under this process, it would take more than 30 years for the Property Office to inventory all University departments.

Recommendations

The University should:

- Revise its policy to align with capitalization requirements in the *SPA Process User's Guide*.
- Provide training to staff to inform them of changes to the asset capitalization process.
- Develop and implement an asset inventory process based on a risk assessment of all University assets.

- Develop and implement procedures to ensure that staff who perform annual asset inventories do not have responsibility for the assets under review.

Management's Response

Recommendation: Revise its policy to align with capitalization requirements in the SPA Process User's Guide.

Response: The University agrees and will add language to the Property Office's policies and procedures to note that Real Property assets will be capitalized when substantial completion contract documents are executed, when an asset is occupied, or when an asset is placed into service.

As SHSU installs the Banner accounting system we will have the ability to track construction projects with the information available to all units within the process. So for this year end (FY10), the Property Office will work with both the Controller's Office and Construction and Planning Office to ensure items are captured at the appropriate date for depreciation in the accounting records. The manual process will be updated for FY10 with a more automated process in place after Banner "go-live" for FY11. Final completion will be August 31, 2011 and the Director of Procurement and Business Services is the responsible party.

Recommendation: Provide training to staff to inform them of changes to the asset capitalization process.

Response: The University agrees and the Procurement and Business Service Office will add to its required training for departments (once every two years) all changes to the asset capitalization process.

All three administrative departments primarily involved in asset capitalization already worked together at a recent construction accounting meeting related to the Banner installation. The VPFO attended this meeting as well to review the approach defined for the new system installation. Therefore, a portion of this is already completed with substantial completion January 2011 the Banner "go-live" date. Final completion, August 31, 2011 and the Director of Procurement and Business Services is the responsible party.

Recommendation: Develop and implement an asset inventory process based on a risk assessment of all University assets.

Response: The University agrees and the Property Office will conduct additional spot checks annually to inventory items they deem more "at risk" assets. These spot checks will be in addition to the annual departmental inventories.

The asset inventory process and policy was updated early calendar year 2010 with good results. The Property Office received all departmental inventories in a timely manner. Therefore, SHSU has responded to a portion of this audit recommendation at the same time the audit was proceeding. Final completion August 31, 2011 and the Director of Procurement and Business Services is the responsible party.

Recommendation: Develop and implement procedures to ensure that staff who perform annual asset inventories do not have responsibility for the assets under review.

Response: The University agrees and the Property Office will update procedures to better document that staff having responsibility for the assets are not performing the inventory by the next annual inventory cycle. The Property Office has also invested in the Radiant RFID system to aid in completing departmental inventories. Final completion, August 31, 2011 and the Director of Procurement and Business Services is the responsible party.

Chapter 1-B

The University Should Ensure That Its Investments Comply with Statutory Requirements and the Texas State University System's Investment Policy

As of August 31, 2009, the University held $22,283,196 in investments with ratings that were below the ratings requirements of Texas Government Code, Section 2256.020, and the Texas State University System's investment policy (see text box for additional details). These securities represented 42 percent of the $53,055,228 the University had invested in a multi-strategy bond fund with an investment firm. In fiscal year 2009, the University had total investments of $167,365,195 (including $108,092,258 in TexPool).

In 2005, the Texas State University System board of regents authorized the University to invest a portion of its investments in a multi-strategy bond fund. A majority of the assets in this fund are invested in a diversified portfolio of marketable securities with ratings that range from AAA to below BBB. The fund also invests in non-rated partnerships.

Excerpt from Texas Government Code, Section 2256.020

In addition to the authorized investments permitted by this subchapter, an institution of higher education may purchase, sell, and invest its funds and funds under its control in the following:

(3) corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradations within those categories.

Excerpt from the Texas State University System's Investment Policy

Specific authority is granted to invest in the Common Fund's Multi-Strategy Equity Fund, Multi-Strategy Bond Fund, and High Quality Bond Fund. Common funds must be rated by at least one nationally recognized rating firm of not less than AAA or its equivalent.

Securities with ratings of AAA are considered to be of the best quality and carry the smallest degree of investment risk. Securities rated below BB or Ba1 and investments in non-rated partnerships have speculative elements and present a higher degree of risk of loss (see Table 1 for additional information).

Table 1

Investment Ratings Assigned by Three Rating Agencies			
Rating Agencies			
Moody's Investor Services	Standard & Poor's	Fitch Ratings Inc.	Definitions
Aaa	AAA	AAA	Prime, Maximum Safety
Aa1, Aa2, Aa3	AA +, AA, AA-	AA +, AA, AA-	High Grade Quality
A1, A2, A3	A+, A, A-	A+, A, A-	Upper Medium Grade
Baa1, Baa2, Baa3	BBB+, BBB, BBB-	BBB+, BBB, BBB-	Lower Medium Grade
Ba1	BB+	BB+	Non Investment Grade
Ba2, Ba3	BB, BB-	BB, BB-	Speculative
B1, B2, B3	B+, B, B-	B+, B, B-	Highly Speculative
Caa1	CCC+	CCC	Substantial Risk
Caa2, Caa3	CCC, CCC-	Not applicable	In Poor Standing
Ca	Not applicable	Not applicable	Extremely Speculative
C	Not applicable	Not applicable	May be in Default
Not applicable	D	DDD, DD, D	Default

Source: Information published by each rating agency.

By investing in lower-rated securities, the University exposed itself to a higher degree of financial risk than statute and the Texas State University System's investment policy allow. Table 2 provides details on the University's investments as of August 31, 2009. Auditors requested a list of specific investments holdings from the University; however, the University could not provide that list to auditors.

Table 2

University Investments as of August 31, 2009		
Security Rating	Percent Invested in the Multi-Strategy Bond Fund	Amount Invested in the Multi-Strategy Bond Fund
Investments Rated AA or Higher and Permitted by Texas Government Code, Section 2256.020		
Government Agency (AAA)	37%	$ 19,630,434.49
AAA	17%	9,019,388.82
AA	4%	2,122,209.13
Subtotals	58%	$30,772,032.44
Investments Rated A or Lower and Not Permitted by Texas Government Code, Section 2256.020		
A	9%	$ 4,774,970.55
BBB	7%	3,713,865.98
Below BBB	11%	5,836,075.12
Not rated	15%	7,958,284.25
Subtotals	42%	$22,283,195.90
Totals	**100%**	**$53,055,228.34**

Source: Unaudited information from the University.

The University also did not adequately disclose its investments in the notes to its fiscal year 2009 annual financial report. The University reported that its total investments of $59,014,879 were invested entirely in bonds. However, $5,959,651 (10 percent) of that amount was invested in stocks.

Fully complying with statute and the Texas State University System's investment policy and accurately reporting the composition of investments are important because readers rely on the University's annual financial report to make decisions that affect the University.

Recommendations

The University should:

- Review its investments in the multi-strategy bond fund to ensure that it fully complies with statutory and Texas State University System's policy requirements.
- Obtain a list of specific investment holdings from its investment firm.
- Ensure that the notes to its annual financial report accurately reflect the types of investments that the University holds.

Management's Response

Recommendation: Review its investments in the multi-strategy bond fund to ensure that it fully complies with statutory and Texas State university System's policy requirements.

Response: The University agrees that we should review our investments in the multi-strategy bond fund to ensure that we fully comply with the Public Funds Investment Act and TSUS Rules and Regulations. The University will work with the TSUS office to implement this finding and will be completed by August 31, 2010. The responsible party is Vice President for Finance and Operations.

Recommendation: Obtain a list of specific investment holdings from its investment firm.

Response: The University agrees with this finding. A list of holdings at a detail level consistent with FAS 157 requirements for commingled funds has been received and will be requested quarterly. Implementation of this finding is immediate and the responsible party is Vice President for Finance and Operations.

Recommendation: Ensure that the notes to its annual financial report accurately reflect the types of investments that the University holds.

Response: The University agrees. A more detailed review of the notes to the AFR will be completed to ensure there are no classification errors. Final completion, August 31, 2010, financial statements due fall 2010. The Controller is responsible for implementation.

Chapter 1-C

The University Should Classify Cash Balances Accurately on Its Annual Financial Report

In its fiscal year 2009 annual financial report, the University reported $15,189,857 as Cash in Bank - Restricted Assets. However, $10,950,000 (72 percent) of that amount represented funds set aside for construction projects that did not meet the definition of restricted assets and should have been reported as Cash in Bank - Current Assets. Because the funds set aside for the construction projects were not legally subject to constraints (for example, through construction agreements or law), those funds did not meet the Governmental Accounting Standards Board's (GASB) definition of restricted assets (see text box for that definition).

Restricted Assets

Restricted assets are assets whose use is subject to constraints that are either (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

Source: Governmental Accounting Standards Board Statement No. 34.

If the University had properly classified the $10,950,000 amount discussed above as Cash in Bank - Current Assets, it would have reported a total of $2,777,201 as Cash in Bank – Current Assets. However, because of its misclassification of the $10,950,000 amount, in its fiscal year 2009 annual financial report, the University incorrectly reported a negative $8,172,799 as Cash in Bank - Current Assets.

TexPool

TexPool is a local government investment pool created on behalf of Texas entities whose investment objectives are preservation and safety of principal, liquidity, and yield consistent with the Public Funds Investment Act.

Source: www.texpool.com.

In an attempt to show that it had $10,950,000 designated for construction projects and because it did not withdraw funds from TexPool in a timely manner to cover the checks it had issued, the University misreported its cash balances (see text box for details on TexPool). (To earn interest on funds collected, the University uses a cash management process that allows it to invest funds deposited in its local bank into TexPool. The University makes periodic withdrawals from TexPool and deposits those funds into its local bank account to pay for its expenditures.)

As a result of these errors, the University overstated the Cash in Bank - Restricted Assets line item by $10,950,000 and underreported the Cash in Bank - Current Assets line by the same amount in its fiscal year 2009 annual financial report (see Table 3).

Table 3

University Misclassification of Cash Balances Reported on Its Fiscal Year 2009 Annual Financial Report

Line Item	Amount the University Reported	Amount the University Should Have Reported
Cash in Bank - Restricted Assets	$15,189,857	$ 4,239,857
Cash in Bank – Current Assets	(8,172,799)	2,777,201
Totals	**$7,017,058**	**$7,017,058**

Source: The University's fiscal year 2009 annual financial report and auditor analysis.

Although the net effect of these errors on the total assets in the annual financial report was zero, these line items did not present an accurate description of cash as of August 31, 2009.

Recommendations

The University should:

- Implement controls to ensure that it classifies restricted assets accurately and in accordance with GASB definitions.
- Not report negative cash balances as assets when funds are available to cover checks issued from the local bank for transfer to the State Treasury.

Management's Response

Recommendation: Implement controls to ensure that it classifies restricted assets accurately and in accordance with GASB definitions.

Response: The University agrees that controls should be in place to ensure that restricted assets are classified accurately and in accordance with GASB definitions. SHSU believes we are obligated for the use of assets submitted for construction projects to the Texas Higher Education Coordinating Board. Overall, we will improve our monitoring of this area for compliance. Implementation will be done immediately for FY10 year end and the responsible party is the Controller.

Recommendation: Not report negative cash balances as assets when funds are available to cover checks issued from the local bank for transfer to the State Treasury.

Response: The University agrees that presenting all cash account lines as positive at the financial statement date is a better presentation format. The University waits until the latest point possible to transfer its cash balances to optimize the interest earnings on $9-10 million. SHSU will review each August 31 whether the transfer can be made in a manner that allows us to optimize interest earnings as well as present all cash account lines in a positive manner. Implementation will be done immediately for FY10 year end. The responsible party is the Controller.

Chapter 1-D

The University Should Improve Controls Over Cash Receipts and Deposits

Auditors tested fiscal year 2009 cash receipts totaling $4,265,837 and determined that University departments deposited $3,940,636 (92 percent) of those receipts within one working day of receipt as required by University policy. However, University departments deposited $325,200 (8 percent of the $4,265,837) an average of <u>three</u> days after receipt. This increases the risk that the cash could be lost or stolen, increases the risk that checks may not be negotiable, and reduces the amount of interest that could be earned. The University's internal audit department previously reported that deposits of cash were not always done in a timely manner.

Additionally, at all five University departments that auditors tested, a single individual received, recorded, and deposited cash and also performed cash-related financial reconciliations. Although all cash tested was accounted for, not segregating these duties increases the risk of loss, theft, or fraud.

Recommendations

The University should:

- Provide training and oversight to ensure that departments comply with its cash deposit policy.
- Segregate the duties of receiving, recording, and depositing cash, as well as duties associated with performing cash-related financial reconciliations.

Management's Response

Recommendation: Provide training and oversight to ensure that departments comply with its cash deposit policy.

Response: The University agrees and recognizes that some departmental cash deposits are not processed in a timely nature as prescribed by the University Policy "Cash Deposits and Receipts - FO-10". Currently, departments receive informal training on cash receipting/deposits.

It is also recognized that formal training is not offered in regards to cash receipting/deposits. A formal training session for departments was in the process of development but placed on hold once it was decided that the University would convert from its legacy system to Banner and a third party cashiering system. As a part of the implementation of Banner, procedures and policies are under review and training will be developed upon completion of this process.

Departments accepting cash will be trained on the procedures/processes of Banner and/ or a third party cashiering system. The recommended third party provider will improve the University's ability to monitor cash deposits from the moment of receipt at the departmental level through transmission of a finalized feed into the financial system. Formalization of training and use of a cashiering system that allows supervisors to monitor users (cashiers) should improve adherence of cash deposit policy. Final completion will be August 31, 2011. The Controller is the responsible party.

Recommendation: Segregate the duties of receiving, recording, and depositing cash, as well as duties associated with performing cash-related financial reconciliations.

Response: The University agrees and will continue to monitor and improve the segregation of duties related to the duties associated with cash. One additional control will be available as SHSU migrates from our legacy system to a third party cashiering system with our Banner ERP implementation. Final completion will be by August 31, 2011. The Controller is responsible for oversight of cash policies and procedures.

Chapter 2

The University Should Consistently Manage Grants in Accordance with Its Policies and Procedures

The University does not consistently manage grants in accordance with its policies and procedures. Specifically:

- The University did not consistently ensure that (1) the appropriate individuals approved grants before the University initiated the grants and (2) principal investigators disclosed any potential conflict of interest with the grant sponsors.
- The University generally recorded grant expenditures properly, and those expenditures were within budget, adequately documented, and properly coded in the financial system. However, auditors identified errors totaling $2,638 in a sample of 42 grant invoices totaling $24,185. In addition, one grant subrecipient did not submit required supporting documentation for expenditures totaling $218,325.
- The University complied with its policy regarding the use of an indirect cost rate that was lower than the federally approved indirect cost rate for 12 (15 percent) of 80 grants tested.
- In fiscal year 2009, the University did not retain approximately $453,132 in grant funds that it could have retained to cover administrative costs associated with the grants that it managed.
- The University did not prepare two required annual reports on its use of indirect cost funds.

In fiscal year 2009, the University had 185 grants and subrecipient contracts with awards totaling $31,020,390. The University's Office of Research Administration and Technology Commercialization (Research Administration) is responsible for overseeing the grant management process, and principal investigators are responsible for the day-to-day management of the individual grants.

Chapter 2-A

The University Should Strengthen Controls Over Grant Initiation

Research Administration did not consistently ensure that the appropriate individuals approved grants before it initiated the grants. Ensuring grants receive the proper approvals allows management to make informed decisions about accepting the terms and conditions of these grants and the use of University resources to match them.

Two (40 percent) of five grants tested were not approved as required. Specifically:

- One $882,027 grant the University awarded for supporting new and expanded anti-gang enforcement and prevention efforts was not approved by the president before the grant was initiated. University policy requires the president to approve grants that exceed $750,000.

- One $215,910 matching grant the University awarded to promote the pursuit of a higher education degree for at-risk population groups was not approved by the vice president of academic affairs. University policy requires the vice president of academic affairs to approve matching grants.

The University's Office of Research and Sponsored Programs also did not consistently ensure compliance with the University's policy requiring principal investigators to disclose any potential conflict of interest with the grant sponsors. The University did not have the proper disclosure statements for 3 (60 percent) of 5 grants tested. Disclosing potential conflicts of interests is important in protecting against fraud, waste, and abuse.

Recommendations

The University should:

- Initiate grants only after it receives required approvals.

- Obtain all conflict of interest forms prior to approving grants.

Management's Response

Recommendation: Initiate grants only after it receives required approvals.

Response: The University agrees with the recommendations and will ensure that grants are initiated only after the required approvals are obtained. The recommendation to be implemented immediately and the responsible party is Associate Vice President for Research Administration and Technology Commercialization.

Recommendation: Obtain all conflict of interest forms prior to approving grants.

Response: The University agrees with the recommendation and will ensure that all conflict of interest forms have been obtained prior to approving grants. The recommendation to be implemented immediately and the responsible party is Associate Vice President for Research Administration and Technology Commercialization.

Chapter 2-B

The University Should Strengthen Controls Over Grant Monitoring

The University generally recorded grant expenditures properly, and those expenditures were within budget, adequately documented, and properly coded in the financial system. However, auditors identified errors totaling $2,638 in a sample of 42 fiscal year 2009 invoices totaling $24,185. These errors included the following:

- In January 2009, the University used grant funds to pay a principal investigator $1,260, but the principal investigator did not submit the required time and effort report. Research Administration asked the principal investigator to submit the time and effort report after auditors requested it in March 2010.
- The University used grant funds to pay a principal investigator's travel expenses of $1,378 without obtaining the approval of Research Administration as required by the University's policy.

The University had adequate expenditure documentation for three of four subrecipient grants tested, but auditors identified errors for the fourth subrecipient. Specifically, the fourth subrecipient did not submit required supporting documentation for 51 expenditures totaling $218,325 in fiscal year 2009; however, both the principal investigator and Research Administration approved those expenditures. In addition, the subrecipient exceeded the total amount awarded by $30,641 in fiscal year 2009. This occurred because of a system limitation and because of weaknesses in monitoring grant expenditures and budgeted amounts. The subrecipient also exceeded the budgeted amounts for "Other Expenses" by $4,997 in fiscal year 2008. This occurred because the grant's principal investigator miscoded vouchers, and Research Administration did not correct this error before entering the information into the accounting system.

Recommendations

The University should:

- Verify that invoices associated with grants are for valid expenditures and include supporting documentation prior to paying grant-related invoices.
- Monitor grant budgets to prevent paying invoices in excess of the amounts budgeted for each expense category and each budget year.

Management's Response

The University agrees with the recommendations. The University will verify that invoices associated with grants are for valid expenditures and will *include supporting documentation prior to paying grant-related invoices. Additionally, we will monitor grant budgets to prevent paying invoices in excess of the amounts budgeted for each expense category and each budget year. The implementation of the Banner ERP provides an improved ability to use automated controls versus just the current manual process. The recommendations will be implemented immediately, and the responsible party is Associate Vice President for Research Administration and Technology Commercialization.*

Chapter 2-C

The University Should Consistently Follow Its Policy Regarding the Use of Indirect Costs Rates

Indirect Cost

The term indirect cost refers to those costs that cannot be charged to a grant or contract as a direct cost. These costs include but are not limited to:

a. Depreciation and use allowances.
b. General administration and general expenses.
c. Sponsor project's administration expenses.
d. Operation and maintenance expenses.
e. Library expenses, departmental administrative expenses, and student administrative expenses.

Source: University Academic Policy Statement No. 950818.

The University did not consistently follow its policy regarding the use of indirect cost rates that are lower than the federally approved indirect cost rates. Higher education institutions retain a certain percentage of grant funds to cover the administrative costs associated with a grant (see text box for additional details). The percentage retained is the indirect cost. According to Research Administration's policy, to use an indirect cost rate that is lower than the federally approved indirect cost rate before the grant becomes effective, either (1) Research Administration must approve a waiver or (2) the grant's principal investigator must submit to Research Administration written program guidelines that specify that it is acceptable to use indirect cost rates that are lower than the federally approved rate.

Of the 80 grants tested that required a waiver or submission of guidelines to use an indirect cost rate that was lower than the federally approved indirect cost rate, the University complied with its policy in this area for 12 (15 percent) of these grants before the grants were approved. When the University uses an indirect cost rate that is lower than the federally approved rate, it uses a relatively larger amount of appropriated and local education and general funds to pay the administrative costs associated with the grant, and it reduces the amounts of funds available for other research.

Recommendation

The University should ensure that it consistently complies with its policy regarding the use of an indirect cost rate that is lower than the federally approved indirect cost rate.

Management's Response

The University agrees with the recommendation and will ensure compliance with established policies. Current administration is focused on this area and IDC revenues are increasing this fiscal year. This recommendation will be implemented immediately and the responsible party is Associate Vice President for Research Administration and Technology Commercialization.

Chapter 2-D

The University Should Ensure That It Consistently Retains the Appropriate Amount of Grant Funds to Cover Indirect Costs

In fiscal year 2009, the University did not retain approximately $453,132 in grant funds to cover administrative costs associated with the grants that it managed. Auditors tested 122 grants and determined that for 74 (61 percent), the University (1) correctly used the federally approved indirect cost rate, (2) properly approved waivers to use an indirect cost rate that was less than the federally approved indirect cost rate, or (3) was not permitted to retain grant funds to cover administrative costs. However, for 48 (39 percent) of the 122 grants tested, the University:

- Retained a lower amount of grant funds than it could have retained to cover administrative costs for 19 grants.
- Retained no grant funds to cover administrative costs for 29 grants.

Auditors determined that the University could have retained, but did not retain, approximately $453,132 to cover the administrative costs associated with these 48 grants.

Research Administration is responsible for overseeing the proper application of indirect cost rates to grants. However, in some cases, principal investigators used an indirect cost rate that was lower than the federally approved indirect cost rate without notifying Research Administration. Principal investigators did this to be able to provide more funds to a subrecipient or to retain more funds within their own departments. Auditors also identified one instance in which the University's ability to draw down grant funds to cover indirect costs was delayed because of these issues.

Recommendation

The University should ensure that it uses the federally approved indirect cost rate or that it follows University policy regarding the use of a lower indirect cost rate.

Management's Response

The University agrees with the recommendation and will ensure compliance with established policies. This recommendation will be implemented immediately and the responsible party is Associate Vice President for Research Administration and Technology Commercialization.

Chapter 2-E

The University Should Prepare Required Annual Reports on Its Use of Indirect Cost Funds

The University has not prepared two required annual reports describing how it used funds for indirect costs. The University's policy requires its Office of Research and Sponsor Programs to prepare the following annual reports:

- An annual written report to the associate vice president for research and sponsored programs that describes how the University used indirect cost funds and how this benefited research at the University.
- An annual written report to the University community describing how all recovered indirect cost funds were used to support research activities. The purpose of this report is to highlight the research activities of the faculty at the University.

University staff responsible for preparing these reports were unaware of these requirements until auditors brought the requirements to their attention. Preparing these reports is important in demonstrating to individuals both within the University and outside of the University how indirect cost funds are used.

Recommendations

The University should:

- Comply with its policy to prepare an annual report describing how indirect cost funds were used.
- Comply with its policy to prepare an annual report describing how recovered indirect cost funds were used to support research activities.

Management's Response

The University agrees with the recommendations. The request for a report on use of IDC funds during FY2010 will be distributed to IDC recipients in September 2010. Based on the response, a written annual report will be distributed to the University community describing how all recovered indirect *cost funds were used to support research activities. The responsible party is Associate Vice President for Research Administration and Technology Commercialization with a completion date of October 2010.*

Chapter 3

The University Is Converting to a New Information System

The University is converting from an in-house mainframe system to a commercial system called Sungard Banner Unified Digital Campus (Banner). The University plans to implement the Banner modules for student information, financial aid, finance, human resources and payroll, and enrollment management. The University has implemented the financial aid module and will phase in the additional modules over the next two years.

The University also will purchase additional software products that interface with Banner. Project cost estimates are $10,592,348 over a four-year period starting in fiscal year 2009. The project will be funded by revenue from an increase in computer fees and designated tuition, as well as funds from the Higher Education Assistance Fund and the Higher Education Performance Incentive Fund.

Because it is converting to a new system, the University estimates it will change its business and financial processes during the next two to three years. As a result, this audit focused only on certain financial processes on which the conversion has a minimal or no impact.

Auditors' limited review of general controls over information technology identified the following issues:

- The University should strengthen network password settings.
- The University should perform a periodic review of user access to key financial applications. However, auditors did not identify any evidence of unauthorized access.
- University programmers have access to application code in the production environment. This is the result of a limitation of the University's mainframe system and was noted in a previous audit. The University asserts that an April 2010 hardware upgrade enabled it to properly segregate access between the development and production environments.
- The University has not updated its disaster recovery plan since 2005.

Recommendations

The University should:

- Strengthen network password settings.
- Perform a periodic review of user access to key financial applications.

- Ensure that its programmers do not have access to application code in the production environment.
- Update its disaster recovery plan on a regular basis.
- Ensure that it considers the issues identified in this audit report during the design, development, and implementation of the new automated system.

Management's Response

Recommendation: Strengthen network password settings.

Response: The University agrees that strengthening passwords is always important. SHSU continues to monitor the balance between risk and convenience especially as we consider the move from our legacy ERP to the Banner ERP. Implementation is immediate and ongoing with a final review related to the new ERP implementation to be done by August 31, 2011. The responsible party is the Associate Vice President for Information Resources.

Recommendation: Perform a periodic review of user access to key financial applications.

Response: The University agrees with this recommendation and has developed a policy to address these concerns with the Banner ERP implementation. This policy will be applied to our existing legacy system. SHSU will formalize the DRAFT policy it has developed, and add to the official University policies by July 1, 2010. SHSU will ensure that all designated owners have confirmed a review of access and made any corrections necessary by July 1, 2010. The responsible party is the Associate Vice President for Information Resources.

Recommendation: Ensure that its programmers do not have access to application code in the production environment.

Response: The University agrees with this recommendation and has plans underway to address this item. SHSU's legacy ERP was on a single server, and as such the resources were not available to properly segregate access. SHSU was already planning the installation of a legacy ERP server upgrade in May 2010 that provides two servers and will restrict production code access to the quality control group. Segregation will be in place by July 1, 2010. SHSU is progressively installing a new Banner ERP server environment, with full implementation by September 2011. The responsible party is Associate Vice President for Information Resources.

Recommendation: Update its disaster recovery plan on a regular basis.

Response: The University agrees that the overall disaster recovery (DR) plan book is out of date. Critical individual documents have been updated and are available to the appropriate staff. SHSU will ensure all individual DR plan documents are updated and available by August 1, 2010. SHSU will have a fully updated disaster recovery plan book available by October 1, 2010. The responsible party is Associate Vice President for Information Resources.

Recommendation: Ensure that it considers the issues indentified in this audit report during the design, development, and implementation of the new automated system.

Response: The University agrees with this recommendation. SHSU will provide a copy of these recommendations to ERP Project management, implementation team leads, Information Resources staff and Steering committee by June 1, 2010. SHSU will discuss the underlying concept and concerns of these issues with ERP Project management, implementation team leads, Information Resources staff and Steering committee by June 1, 2010. The responsible party is Associate Vice President for Information Resources.

Appendix

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to evaluate selected financial processes to determine whether Sam Houston State University (University) has implemented a system of financial and administrative internal controls and consider whether:

- Accounting procedures and controls provide assurance of accurate, complete, reliable, and timely financial information.
- Security controls within the University's financial system provide assurance that critical data is protected from unauthorized alteration, loss, or improper use.
- Controls are adequate and effective in providing assurance to safeguard assets.
- The University complies with applicable laws and regulations.

Scope

The scope of this audit covered financial reporting, investments and endowments, cash receipts, capital assets, and grant activity between September 1, 2008, and August 31, 2009.

Methodology

The audit methodology included:

- Analyzing accounting procedures and controls for grant management, investments, capital assets, cash deposits, and financial reporting to provide assurance of the accuracy, completeness, and reliability.
- Reviewing the University's access controls over financial and administrative information to verify whether critical data is protected from unauthorized alteration, loss, or improper use.
- Analyzing and testing the effectiveness of controls to safeguard capital assets and cash receipts.
- Identifying and testing compliance with applicable laws, regulations, and policies related to grant management, investments, capital assets, and cash deposits.

- Identifying and assessing automated controls over key revenue and expenditure processes.

- Identifying and assessing general information technology controls designed, implemented, and monitored by the University's Information Resources Department.

Information collected and reviewed included the following:

- University annual financial report for the fiscal years ended August 31, 2008, and August 31, 2009.

- *Fiscal Management Post-Payment Audit Report Summary Sam Houston State University Fiscal 2008 Second Quarter*, Office of the Comptroller of Public Accounts.

- University internal audit reports.

- Monthly statements, quarterly reports, and investment reports from investment funds.

- Selected University receipts, sales books, and deposit slips.

- Hard copy files of selected grant information, including grant agreements, budgets, and voucher information.

- Program codes for key financial processes.

- Reports the University uses to monitor and reconcile key financial transactions.

- University disaster recovery plan.

- List of all University real and personal property assets.

- Hard copy files for selected capital assets, including property tag sheets, voucher information, reconciliations, and University inventories.

Procedures and tests conducted included the following:

- Interviewed University executive management and staff.

- Reviewed and analyzed University investments for compliance with Texas State University System investment policies.

- Determined whether the University received and reconciled monthly statements from investment fund managers.

- Traced the financial records in the University's accounting system to the University's annual financial report for fiscal year 2009 for accuracy.

- Reconciled the University's annual financial report for fiscal year 2009 to information in the Uniform Statewide Accounting System.
- Analyzed the timeliness and accuracy of the University's deposits of cash.
- Observed selected University departments' cash handling procedures.
- Analyzed the University's capital asset system to determine whether it contained accurate records of personal and real property.
- Verified whether selected University property existed and whether the University properly tagged that property.
- Reconciled information in the University's capital asset system to information in the State Property Accounting system.
- Reviewed and analyzed the University's capital asset inventory process for effectiveness.
- Reviewed and analyzed selected grant applications for proper approval and disclosure of potential conflicts of interest.
- Reviewed and analyzed selected grant expenditures for allowability and proper documentation.
- Reviewed and analyzed grant indirect cost rate waivers for proper approval and applicability.
- Ran billing and purchasing transactions through the University's test system to verify accuracy.
- Input and retired a capital asset in the University's test system to verify system integrity.
- Observed batch payroll processes and procedures, including the preparation of summary reports used to verify transactional integrity.
- Tested key general information technology controls, including controls over documentation, change management, and process monitoring.

Criteria used included the following:

- Texas Government Code, Chapter 2256 (Public Funds Investment Act).
- Texas Education Code, Chapter 145 (Overhead Cost Recovery).
- Texas State University System investment policies.
- University policies and procedures for grants and capitalization.

- University Academic Policy Statement 950818, Distribution of Recovered Indirect Cost Policy.
- University Finance and Operations Policy FO-10, Cash Deposits and Receipt Policy.
- *SPA Process User's Guide*, Office of the Comptroller of Public Accounts, February 2008.
- Texas Higher Education System Generic Building Componentization Guidelines, Office of the Comptroller of Public Accounts.
- Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.
- Best Practice Guide for Securing Active Directory Installations and Day-to-Day Operations, Microsoft.
- Title 1, Texas Administrative Code, Section 202.74(a)(4).

Project Information

Audit fieldwork was conducted from February 2010 through March 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- Amadou N'gaide, MBA, CFE, CIDA (Project Manager)
- Jeffrey Grymkoski, MA (Assistant Project Manager)
- Ishani Baxi
- Robert Burg, MPA
- Joseph Kozak, CPA, CISA
- Dana Musgrave, MBA (Quality Control Reviewer)
- Sandra Vice, CIA, CGAP, CISA (Assistant State Auditor)

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas "Tommy" Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Rene Oliveira, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Texas State University System

Members of the Texas State University System Board of Regents
- Mr. Ron Blatchley, Chair
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- Mr. David Montagne
- Ms. Trisha S. Pollard
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- Mr. Christopher Covo, Student Regent

Dr. Brian McCall, Chancellor

Sam Houston State University

Dr. James F. Gaertner, President