

A Review of **_____**
**Management Controls at
the University of Houston
System**



Office of the State Auditor **_____**
Lawrence F. Alwin, CPA

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Key Points Of Report

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Key Facts and Findings

- Management at the University of Houston System generally has established management controls to fulfill the System component missions. A financial analysis of the System components provided no indications that management was expending funds inappropriately.
- Recent strategic planning activities have focused the direction of the System overall, strengthened cohesiveness among the System components, and improved internal management and fiscal processes.
- The University of Houston System could improve by strengthening monitoring and assessment activities of some functions and processes. These improvements are needed in order to effectively determine if the goals of the System and its components are being met.
- For fiscal year 1993, the combined revenues for the University of Houston System totaled \$401.7 million. State appropriations comprised the majority of these revenues at \$173.5 million (or 43.2 percent). The combined expenditures of the System for fiscal year 1993 totaled \$303 million, with academic instruction accounting for \$132.5 million (or 43.7 percent) of these expenditures.
- The University of Houston System has been experiencing declining enrollments since fall 1990, when enrollment figures peaked at 50,536. The fall 1993 enrollment total for the System was 47,916.

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Issues and Recommendations

Section 1:

Overall Management Controls Appear Adequate; Recent Strategic Planning Activities Have Benefitted The University Of Houston System

Management at the University of Houston System has generally established management controls to fulfill the System component missions. Additionally, a financial analysis of the System components provided no indications that management was expending funds inappropriately. There have been recent strategic planning activities which have focused the direction of the System overall, strengthened cohesiveness among the System components, and improved internal management and fiscal processes.

Until 1992, the University of Houston System experienced many of the symptoms of an organization lacking clear direction (i.e. high turnover in upper management, strong autonomy within the units of the System, poor controls and accountability). During 1992, the Board of Regents and the System embarked on a new strategic planning effort. The effort, referred to as "responsive reshaping," led the System to a more clearly defined and unified mission and to a direction of standardization and centralization where possible.

The System components (made up of System Administration and the University of Houston, Clear Lake, Downtown, and Victoria campuses) began extensive analyses of their operations. So far, the results of the System's "responsive reshaping" have included stability within upper management, downsizing and reorganization of departments and educational programs, profitable outsourcing of operations, enhanced recruitment efforts, centralized automated systems, and standardized policies, procedures, and

business practices. In fact, the Clear Lake campus has received a Total Quality Management grant from IBM and a "Breaking the Mold" award from the Texas Performance Review team for its reshaping efforts.

Management's Comments:

The Board of Regents recognizes that a central focus of the University of Houston System's mission is to address the complex and diverse needs of the Houston urban area. The System's goal is to make this institution the premier urban higher education system in the nation. The management strategy referred to as "responsive reshaping" is a process that integrates planning, budgeting, and performance assessment to achieve the following outcomes: alignment of component missions and goals with priority public needs; component and system-wide institutional effectiveness; and public accountability for performance results.

During 1991 and 1992, we obtained an examination of our internal control structure. As a result, we have been engaged in implementing a series of actions designed to correct internal control weaknesses and improve administrative efficiency and effectiveness. Particular emphasis has been placed upon establishing a system-wide management information system support function. Progress in accomplishing those objectives is reported to the Board of Regents on a periodic basis.

The University of Houston has defined the roles and responsibilities of key management personnel and changed the structure and reporting lines within the organization. The University of Houston changed its organizational structure so that college business managers report to both the dean and the Senior Vice President for Administration and Finance thereby setting in

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place an authority mechanism to ensure adherence to financial guidelines. Further changes in the roles and responsibilities of key personnel in the Administration and Finance Division have improved overall effectiveness significantly.

Section 2:

The University Of Houston System Needs To Strengthen The Monitoring And Assessment Activities Of Some Functions And Processes

Given the recency of the System's new strategic planning efforts, it is understandable that not all functions and processes have been assessed and adjusted. The following discussion under this section highlights specific areas for System management to direct their attention. The recommended improvements will assist management in effectively determining if goals of the System's functions and processes are being met.

Section 2-A:

Insufficient Monitoring And Assessment of Non-Endowment Investments Increases Risk To Principal

Non-endowment investments are not scheduled for either internal or external audits, nor does the external fund manager for these monies receive an independent performance evaluation. Some self-reports generated by the external fund manager contained typographical errors and omissions, and some portions were found to be less useful by System management. Such monitoring and assessment activities are vital to ensuring the

safety of the principal of these investments, which makes up 47 percent of the System's investment portfolio. Conversely, the external fund managers for Endowment Fund investments receive an annual audit, and 100 percent of the monies are subject to quarterly independent performance evaluations.

The University of Houston System reported \$326.6 million in cash and investments as of August 31, 1993. Of this, Endowment Fund investments accounted for 53 percent (or \$174.1 million) and non-endowment investments accounted for 47 percent (or \$152.5 million) of the total.

Recommendation:

Management should apply the similar controls in place for the Endowment Fund investments to the non-endowment investments. Internal audits or external reviews of the external non-investment fund manager would provide assurance that monies are being invested as agreed upon and performance is in line with expectations. Management could request an expansion to procedures already being performed within the annual audit and quarterly performance evaluations of the Endowment Fund monies.

Management's Response:

We plan to amend the current contract with the endowment consultant to require quarterly performance reports on the non-endowment assets. This contract amendment will be included on the agenda for the October 20, 1994, Board of Regents meeting. These quarterly reports will be presented to the Asset Management Committee of the Board of Regents. We are also considering expansion of our audit coverage in the area of internal investment accounting.

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Section 2-B:

Inadequate Support And Review Of Expenditure Transactions Could Result In Unauthorized Or Inappropriate Expenditures

Of the 60 expenditures tested at the Board of Regents' Office, almost half were not adequately reviewed and authorized as per established System procedures. Of the 265 expenditures tested at the University of Houston, approximately one-quarter were processed with inadequate (and, in some cases, missing) documentation as per established policies and procedures. (The sample tested was not statistically selected and thus results cannot be generalized to the entire population of expenditure transactions.) The individual expenditures out of compliance with established guidelines were not significant in dollar amount when compared with the overall test population.

During testwork, it was noted that policies and procedures surrounding Service Center Requisitions expenditure transactions were inconsistent. Whereas the University of Houston policies and procedures require full documentation and approval for such transactions, the departmental procedures allow for several exceptions to the campus policy, with no clear explanation as to why. The resulting transactions at the departmental level appear to be out of compliance with established campus-level controls.

Recommendation:

Management should ensure that all expenditure transactions are properly authorized and accompanied by required supporting documentation. Reviews of expenditure transactions should effectively check for compliance with policies and procedures established to prevent misuse of

funds, and policies and procedures should be in agreement within the System. Policies and procedures become ineffective as control mechanisms when active and effective monitoring for compliance does not occur.

Management's Response:

The majority of the Board of Regents expenditures are processed on Service Center Requisitions (internal procurement) for which there is a minimal risk for loss of University funds. Although properly authorized order forms were attached to the SCR's, the face of the SCR was not signed by the staff of the Board of Regents, as required by current policy. We intend to modify our SCR policy to establish documentation standards for authorization and review for each service center provider.

Of the 265 expenditures tested at the University of Houston, 59 had exceptions (23 internal procurement and 36 external procurement); 26 had missing supporting documentation and 33 were lacking purpose/benefit statements or attendee/guest lists for meetings and special events. As explained above, we plan to modify our policies for internal procurement. We also plan to clarify our documentation standards for meetings and special events.

Section 2-C:

Inconsistent Activities And Information Within System Components Could Produce Misleading Results And Noncompliance Situations

Within the University of Houston System's annual financial statements, the reporting of balances for the "Cash and Temporary Investments" funds is misstated due to the

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reporting policy adopted by the System Controller's Office. This inaccurate information is misleading to an informed reader and is out of compliance with the Comptroller of Public Accounts' requirements for financial reporting by universities.

The write-off of bad debts is handled inconsistently among the different campuses of the System. The University of Houston uses the allowance method (preferred under generally accepted accounting principles) and writes off bad debts after two years. The other three campuses (Clear Lake, Downtown, and Victoria) use the direct write-off method (discouraged under generally accepted accounting principles) and write off bad debts after one year. This inconsistent practice of accounting for bad debt within the System could lead to noncompliance with generally accepted accounting principles and Comptroller of Public Accounts' requirements should the write-off amounts for the campuses (other than University of Houston) ever be material.

Statistical employment information for the Board of Regents' Ethnic Diversity Report generated by System Administration for the campus components was not in agreement with the same information generated by the campuses themselves. The result of such discrepancies could be misinformation sent to state and federal entities. Additionally, Board and System decisions using this information could be compromised.

Recommendations:

Management should:

- Adjust reporting practices for cash and temporary investments to reflect accurate balances within the various funds.

- Adopt consistent bad debt write-off methods which comply with generally accepted accounting principles and Comptroller of Public Accounts' requirements.
- Implement controls which would prevent the dissemination of inconsistent information from the various System components.

Management's Response:

The University of Houston System has utilized a consolidated investment pool to maximize return on investment of operating funds balances for over fifteen years. Within the University of Houston System's annual financial statements, the reporting of balances associated with the investment pool have always been reported in designated funds. While the total is stated correctly, management agrees the reporting of "Cash and Temporary Investments" balances could be confusing and will report balances within each fund group on the 1994 annual financial report.

In developing procedures for reporting bad debt write-offs to the Board of Regents, the accounting officers realized that write-off policies were inconsistent between campuses. This inconsistency was disclosed in their report to the Board of Regents. We concur with your recommendation and plan to implement standardized write-off procedures for all components.

With the expansion of the institutional research and analysis functions at the System level, the potential for inconsistency in the statistical data presented to the Board of Regents has become much greater. Therefore, to ensure that in the future the System office has the opportunity to review any and all Board information for consistency and

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accuracy, administrative procedures will be instituted that will require review of that information by an appropriate System officer prior to its dissemination to the Board of Regents.

Section 3:

Objective, Scope, and Methodology

The audit objectives were: 1) to evaluate the existing management controls within the University of Houston System and identify strengths and opportunities for improvement and 2) to perform a financial analysis of the System to determine if funds are being expended as intended.

The University of Houston System was selected for review based on a statewide analysis of certain indicators and trends regarding the System's financial condition. Following a preliminary review of the System's management controls and policy environment, we narrowed our scope to: 1) a review of management controls over investments, 2) a review of the System's major fund accounts, and 3) a review of selected expenditures of the Board of Regents, System Administration, and University of Houston. Processes and controls reviewed were in place as of June 1994.

We reviewed documentation such as board meeting minutes, enabling legislation, strategic plans and component analyses, financial records, and internal and external audit reviews. We conducted interviews with top administrative personnel. Audit testing was performed for the purpose of analyzing information and comparing the results against internally or externally established criteria. This review was conducted in accordance with generally accepted government auditing standards.

Copies of this report have been distributed to the following:

Legislative Audit Committee

Honorable James E. "Pete" Laney, Speaker of the House, Chair
Honorable Bob Bullock, Lieutenant Governor, Vice Chair
Senator John Montford, Chair, Senate Finance Committee
Senator Kenneth Armbrister, Chair, Senate State Affairs Committee
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The University of Houston System

All Members of the University of Houston System Board of Regents

Dr. Alexander F. Schilt, Chancellor of the University of Houston System

Other Key Management Personnel within the University of
Houston System

Campus Presidents, Chief Financial Officers, and Provosts at Each of the
Four University Components for the University of Houston System