



**Report to the Board of Regents of
Kentucky State University
University Financial Controls
July 28, 2000**

EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS
www.kyauditor.net

**144 CAPITOL ANNEX
FRANKFORT, KY 40601
TELE. (502) 564-5841
FAX (502) 564-2912**

Report to the Board of Regents of Kentucky State University

By Auditor of Public Accounts Edward B. Hatchett, Jr.

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Background

The annual financial statement audits of Kentucky State University (University) have for several years noted deficiencies in the University's internal financial controls. The 1998 annual audit identified 26 deficiencies in internal controls. The 1998 auditors, PricewaterhouseCoopers, created a *Financial Controls Handbook* to address the risks arising from the absence of proper controls.

The Auditor of Public Accounts (APA) and the University executed a Memorandum of Understanding on January 28, 2000, under which the APA consults with and assists the University in implementing internal controls and periodically reports his findings, recommendations, and project status.

Work Performed by the Auditor of Public Accounts

The APA conducted a Regents Workshop on January 28, 2000, addressing University fiscal health, budgeting, and accountability.

The APA, through a series of meetings, consulted with the University Regents on developing and adopting more informational financial report formats.

The APA conducted on-campus interviews of more than 75 KSU employees to gain an understanding of the University's fiscal processes, practices, and financial controls. The handling and record keeping of each University financial transaction has been noted, mapped, and analyzed. The following information results:

1. The University does not have a Financial Operations Manual.

We were informed that no copies of the University's Financial Operations Manual could be located, and that prior editions were archaic and had fallen into disuse.

To assure that University staff know what is expected of them and how to carry out assigned duties, a new Financial Operations Manual, with detailed policies and procedures governing financial transactions, is needed.

Actions taken to date:

APA and University Chief Financial Officer (CFO) and Comptroller are creating a new Financial Operations Manual, which is 60% complete.

Recommendations:

The University President should establish a task force to implement internal controls contained in the Financial Operations Manual. The task force should include fiscal officers from all areas of the University and be chaired by the CFO.

APA should act as advisor to the task force.

2. University performance is not benchmarked to fiscal measures resulting from strategic planning.

A series of critical fiscal performance benchmarks should be drawn from the University's strategic plan, detailing the expectations of the Board of Regents. Ratios such as the following should demonstrate how well the University is meeting expectations:

- current revenues to current expenditures
- educational expenditures per student
- endowment per student
- available funds to educational and general expenditures and mandatory transfers
- instruction and academic support to total educational and general expenditures less restricted scholarships

Actions taken to date:

New Regents were oriented to the existing University strategic plan on July 27, 2000.

Recommendation:

The Board of Regents should select critical fiscal performance benchmarks and evaluate University performance accordingly.

3. The University does not have an independent internal audit function.

The University's internal audit function is ineffective. The internal audit job description is inadequate, other duties masquerade as internal auditing, and the existing chain of reporting weakens independence.

Actions taken to date:

A search is currently underway to fill the University's vacant internal auditor position.

Recommendations:

The Board of Regents should better define the job description of internal auditor and require that the internal auditor report directly to the Board of Regents. The Board should hire a credentialed, experienced internal auditor.

4. The University's decentralized invoicing, receipting, accounts payable management, and travel expense reimbursement lack consistency and escape accountability.

Current University practices promote inconsistent and unaccountable handling of funds. Too much unilateral authority invested in the Office of Finance and Administration violates the principle of segregation of duties, subjecting University fiscal resources to unacceptable risks.

Actions taken to date:

The position of CFO was recently created by the President upon the recommendation of the APA. The position was divested of any duty to oversee non-financial operations.

Recommendation:

The President should centralize University invoicing, receipting, accounts payable management, and travel expense reimbursement.

5. Minimum requirements for education and experience are not observed in recruiting for University financial operations positions. Adequate permanent staffing levels are not maintained.

Staffing levels in financial operations are well below what prudent management requires. Critical functions have often been assigned to temporary workers. Many full-time positions are filled with employees lacking adequate experience and/or education. Promotions often eliminate appropriate segregation of duties, thereby increasing risk to University resources.

Actions taken to date:

The University is recruiting for many of the vacant positions.

Recommendations:

The President should ensure that the best available candidates possessing necessary education and/or experience are hired.

The CFO and the internal auditor should continually assess segregation of duties, focusing particularly upon the impact of promotions and transfers.

6. The University's accounts are not successfully reconciled periodically.

Reconciliations of University general ledger accounts are performed sporadically, and many are months behind. The reconciliation of the Student Information System (SIS) to the Financial Reporting System (FRS) reveals an \$850,000 discrepancy. A reconciliation of the Human Resource System (HRS) has not been performed successfully in several months. Many reconciliations for FYE June 30, 1999 remain incomplete.

Actions taken to date:

The University has contracted with the public accounting firm of Crowe, Chizek and Company to assist in completing the outstanding reconciliations both for FYE June 30, 1999 audit and for FYE June 30, 2000 audit.

The University has also consulted with the APA and SCT, the general ledger application software provider. It has been determined that several downloads from SIS to FRS were not identified in time to be properly processed. The resulting outage has not been accurately determined as of July 15, 2000.

Recommendations:

The CFO, the Comptroller, and key University staff should work with Crowe, Chizek and Company on the reconciliation project, assuring that University staff gain adequate training and experience for future reconciliations.

The Comptroller should perform all reconciliations on time.

7. The University's financial statements are not adjusted immediately upon recommendation by the auditors.

Auditor adjustments are not posted to the University's financial statements in a timely manner. Numerous adjustments for 1995, 1996, and 1997 were not posted until May 1999. Proposed adjustments for FYE 1999 have not been posted. Furthermore, adjustments often have been posted incorrectly.

Actions taken to date:

Numerous correcting entries to the June 30, 1999 University balances have been posted over the past few months. Other correcting entries suggested by former auditors remain unmade.

Recommendation:

The CFO should assure that all auditor-recommended adjustments are posted accurately and in a timely manner.

8. The University lacks effective information systems security.

Inappropriate information systems authority is granted to staff. Some are invested with the authority to both approve transactions and access the SIS, HRS, and FRS systems. Upper management has the authority to alter data in any of the systems. Computer security access codes have been turned off. No employee, whether management or staff, should have the unilateral authority to initiate, approve, record, and report transactions.

Actions taken to date:

Some management access has been modified.

Recommendations:

The internal auditor should perform regular system security assessments to ensure

- Access of each position is appropriate to the job position/description
- Access rights parameters of all positions are restricted in order to minimize risk of loss
- All security codes are activated
- All security codes are changed every 30 days
- Any deviation from defined access levels is recommended in writing by a supervisor and the Comptroller and approved in writing by the CFO
- All personnel actions consisting of terminations, resignations, or transfers are immediately communicated to the information systems manager, and that subject access rights are immediately terminated.

The CFO and the information systems manager should quickly correct all deficiencies.

9. The University's financial reporting system does not keep responsible parties properly informed.

The reporting function is tainted. Because the Financial Reporting System (FRS) is out of balance, the Comptroller maintains, in an Excel spreadsheet, a second set of books to

track the University's financial statements and adjustments. The proper flow of accurate financial information from staff to supervisor to department head to vice president to President to Board of Regents cannot be assured. The financial directives of the Board of Regents are not always communicated to the staff and employees of the University.

Actions taken to date:

The Board of Regents adopted the APA's format and content recommendations for Board reporting during the April 2000 Board meeting. Several of the report formats have been implemented.

Recommendations:

The Board of Regents should insist on strict adherence to appropriate reporting standards and formats and that only one set of University books be maintained.

10. The University's disbursements are not adequately controlled.

Checks written for amounts less than \$10,000 do not receive proper review or verification. An inordinate number of checks are requested and prepared manually each month, thereby escaping the scant automated system controls that exist.

Actions taken to date:

The interim CFO has taken steps to significantly reduce the number of manual checks written.

Recommendation:

The internal auditor should be assigned the duty of assessing and reporting regularly the status of check production.

11. The preparation of the University's annual budget is not an appropriately structured, collaborative enterprise, inviting participation of all interested University parties.

The Vice President for Finance and Administration did not develop the preliminary budget based on prior year's activities or according to parameters established by the Regents Finance

Committee and/or the Board of Regents. Department heads should have the opportunity to review, request changes in their preliminary budgets, and address the Finance Committee. Departmental hearings about the budget were not held during FYE June 30, 2001 budget preparation.

Actions taken to date:

None noted.

Recommendation:

The Regents Finance Committee, the CFO, the Comptroller, and department heads should be directly involved in developing the University budget.

12. The University does not assure the security of cash and records.

General records maintenance procedures are deficient. Cash assets are at risk. Vaults and safes are open and unmonitored in the Cashiers' Office. Vital reports are stacked in piles in offices in the various departments. There does not appear to be a centralized filing system in any department. Employees take an inordinate amount of time to obtain information that should be readily available. The security of vital and personal information cannot be assured.

Actions taken to date:

An August meeting with the Department of Libraries and Archives has been scheduled.

Recommendation:

The President should appoint and empower a records manager for the University. The University should adhere to archival standards established by Kentucky's Department for Libraries and Archives, including establishing appropriate off-site back-up storage for electronic records.

13. The University does not effectively manage its student loan receivables.

Among Kentucky's public universities, KSU has the highest default rate for Perkins loans. It is not eligible to receive new federal Perkins funding because the default rate exceeds federal restrictions. Until collections improve, funds for future Perkins borrowers therefore depend entirely upon repayments by prior borrowers.

Actions taken to date:

None noted.

Recommendations:

The CFO should improve the management of student loan collections. Effective incentives should be devised for loan repayment.

14. The University does not effectively manage the time and attendance of its employees.

The timekeeping function for University employees is inadequate. As a result, many manual checks must be issued each pay period to correct errors or accommodate timesheets submitted late. These manual checks are rarely posted to HRS or FRS.

Actions taken to date:

There has been no action to ensure that time and attendance are reported accurately nor to post and reconcile manual checks to HRS or FRS.

Recommendations:

The President should analyze the potential benefits of outsourcing the payroll function.

Each University employee should sign the timesheet once it has been completed by the timekeeper to ensure that time and attendance have been recorded accurately.

Time clocks should be installed in all departments to ensure appropriate timekeeping for each employee. Manual payroll checks should become an infrequent exception to normal practice.

15. The University bookstore lacks adequate financial controls.

The bookstore has a decentralized system of purchasing and inventory. The purchasing function is not reviewed by anyone in the Accounting Department or in the Purchasing Department.

The bookstore has a manual system for taking inventory. There is no system for reconciliation to ensure that revenue and expenditures are posted correctly. The current voucher system for purchasing books on account is not efficient.

Action taken to date:

None noted.

Recommendations:

The President should analyze and report to the Board of Regents the potential benefits of outsourcing the bookstore operations to a private contractor.

The CFO should implement a computerized system of inventory and accounting for the bookstore. A point-of-sale system would improve efficiency when tracking inventory and sales information, as well as allow the bookstore to connect the cash registers to the voucher accounts for automatic posting to students' accounts.

16. The University does not observe equitable salary scales for its employees.

Salary levels are often not commensurate with the duties of the positions or the employees' experience and education. Duties and responsibilities have been stripped from positions with no corresponding reduction in salaries.

Actions taken to date:

None noted.

Recommendation:

The President should conduct a salary survey of all University functions and positions, comparing salaries to peer institutions and community standards, and realigning salaries according to the duties, responsibilities, and experience/education required by each position.