

A Financial Review of

Texas Southern University

March 2003

SAO Report No. 03-028



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Overall Conclusion

Texas Southern University (University) has improved processes for producing accurate and consistent financial information. Part of our review focused on the University's Annual Financial Report (AFR) for fiscal year 2002. We found that the AFR is supported by information recorded in the University's financial system.

It appears the Legislature and other oversight bodies can rely on the AFR. Although our review of the AFR was more limited than a full financial audit, we did not find significant inaccuracies or significant inconsistencies.

In addition, we followed up on previously identified issues involving journal vouchers. The University's financial system continued to allow unbalanced vouchers in fiscal year 2002; however, management implemented compensating controls to identify and correct those vouchers. The system also allows for the deletion of journal vouchers without creating a record of the reasons the vouchers were deleted. Management has recently begun processes to identify and record journal voucher deletions.

Conversely, in the areas we audited, which represented 17 percent of total expenditures, the University is not consistently following procedures to ensure that funds are spent in accordance with state regulations and University policies. Our tests of fiscal year 2002 expenditures (excluding payroll) revealed payments that lacked support, payments that lacked the required approvals, and payments to employees for travel and other expenses without evidence that those expenses were related to University business. Although we found errors in 24 percent of the expenditure transactions tested, those errors did not result in a significant dollar impact to the University's AFR.

Our review of outcome measure results indicated that the University has improved its reporting of performance measures. We tested three measures and found that management accurately calculated and reported two of them. University management has also implemented initiatives to continue improving outcome results.

Financial Reviews

This financial review is an extension of work begun in 2001 at the request of the Senate Finance Committee and the House Appropriations Committee. To date, the State Auditor's Office has completed financial reviews at four other universities and a number of state agencies.



Detailed Results

Chapter 1

Does Texas Southern University provide legislative budget committees and other oversight bodies with accurate and consistent financial information?

Texas Southern University (University) has improved processes for producing accurate and consistent financial information. This part of our review focused on the University's Annual Financial Report (AFR) for fiscal year 2002.

We found that the AFR is supported by information recorded in the University's financial system. We conclude that it appears the Legislature and other oversight bodies can rely on the AFR. Although our review was more limited than a full financial audit, we did not find significant inaccuracies or inconsistencies. However, we did find a need for continued improvement in the University's processes for its review of its AFR.

In June 2002, we reported that there were unbalanced journal vouchers in the financial system (see *A Follow-Up Report on Rider 5: Texas Southern University Accountability Systems*, SAO Report No. 02-055). We followed up on this issue as part of this financial review and found that the University's financial system continued to permit the recording of unbalanced journal vouchers. However, management had implemented compensating controls to identify and correct these imbalances.

Chapter 1-A

Support for the AFR Has Improved

Our review of the University's AFR for the fiscal year ended August 31, 2002, covered significant line items reported in the financial statements, as well as information in the notes to those statements. Using accounting schedules prepared by the University, we traced significant line items into the financial system. We also gathered external evidence of accuracy on several of the line items, reviewed significant journal vouchers and accompanying support, and obtained additional explanations for selected vouchers.

Compared with significant errors (in excess of 5 percent) and unsupported amounts we found in previous reviews of the University's AFRs for prior years (see SAO Reports No. 01-027 and No. 00-021), the University's AFR for fiscal year 2002 has improved.

Chapter 1-B

AFR Review Processes Could Be Improved

Despite the overall improvement, we noted several areas that—although they did not have a significant overall impact on the accuracy of the University's final, revised AFR—indicated that management should continue improving its review processes

for future AFRs to ensure that errors and inconsistencies are detected prior to AFR submissions and to ensure timely compliance with reporting guidelines. For example:

- The University submitted an initial AFR to the Comptroller of Public Accounts (Comptroller) on the November 20, 2002, deadline. Subsequently, the University found errors in the Cash line item and 16 other line items, and it submitted a corrected AFR on November 26, 2002. These errors should have been detected prior to the initial submission.
- University management computed depreciation on Buildings and on Facilities and Other Improvements using a different basis for each (useful lives and salvage values) than prescribed in the Comptroller's guidelines. Although those guidelines allow for using a different basis if it is substantiated and auditable, the University did not document its basis for Buildings until months after the AFR was released. In addition, the basis for depreciating Facilities and Other Improvements remains unsubstantiated, resulting in an overstatement of \$512,000.
- Loans and Contracts of \$2.3 million were reported as current assets rather than non-current assets. Accrued Interest Payable of \$161,000 was misclassified as a non-current liability. A thorough review for consistency should have been conducted to identify these items.
- Notes to the Financial Statements (Notes) should include information to supplement a reader's understanding of the financial statements. We found several omissions in the Notes, as well as statements in the Notes that were incorrect or inconsistent with information reported elsewhere in the AFR. For example, one Note erroneously stated that the State Property Accounting system does not account for fully depreciated assets. Another Note reported \$1.3 million of short-term liability, while the financial statements reflect that amount as a long-term liability.

Recommendations

The University should:

- Enhance its AFR review procedures so that they are thorough and include reviews for consistency and errors prior to submitting the report to the Comptroller.
- Ensure that its accounting for capital assets and depreciation on those assets is in accordance with guidelines issued by the Comptroller.

Management's Response

New reporting requirements per the Governmental Accounting Standards Board (GASB 34 and 35) called for completely new formats and presentation of financial information in the financial statements and notes to the financial statements. As per SAO's recommendations, management will enhance AFR review procedures to ensure consistency with Comptroller's reporting guidelines and eliminate errors

prior to submission. Additionally, university management will ensure capital assets and depreciation will be accounted for in accordance with Comptroller guidelines.

Chapter 1-C

Journal Voucher Controls Need Enhancement

In conducting our review of the University's AFR, we found several journal vouchers that lacked adequate explanation and support (see Chapter 1-D for additional

What Are Journal Vouchers?

Journal vouchers are a type of accounting entry used to enter corrections, adjustments, and other items that do not normally occur as a result of receiving cash or spending money.

Journal vouchers are used to conduct such activities as:

- Correcting errors detected through ongoing monitoring of accounting functions.
- Adjusting budgets.
- Recording amortization and depreciation.

discussion on journal vouchers). The existence of these vouchers indicated that management had not maintained the University's general ledger in balance with its State Property Accounting system records. For example:

- Management decreased capital assets by \$21 million without sufficiently describing the reduction or the reason it was needed. The explanation on the journal voucher was "Adjust fixed assets per discussion with Maintenance & Operations." Management subsequently explained that most of the adjustment was made to write off equipment and furniture valued at less than \$5,000, as directed by the Comptroller. However, management could not provide supporting documentation for the adjustment.
- The University also recorded a journal voucher to reclassify \$13 million of capital assets without sufficient explanation on the voucher. Management subsequently explained that this reclassification entry was made to balance the University's general ledger with the State Property Accounting record due to errors made prior to fiscal year 2002. Again, management could not provide full supporting documentation to evidence the prior year errors.

Recommendations

University financial management should:

- Ensure that all journal vouchers are fully explained and supported. Journal vouchers prepared after the year-end for reporting purposes may need additional review to ensure complete explanation and support. University accounting management should not approve vouchers that lack those components.
- Maintain an accurate subsidiary record of capital assets and periodically balance that subsidiary record with the general ledger to preclude the need to make large adjustments to bring them into balance.

Management's Response

University management agrees that the General Ledger was not reconciled with the State Property Accounting System on a periodic basis; however, the General Ledger was reconciled to the State Property Accounting System as of 8/31/02. Since capital assets represent over \$134 million (56% of total assets), it was imperative that adjusting entries were made to the general ledger to ensure that our Balance Sheet

was accurate. Accounting records will be reconciled to the State Property Accounting System on a quarterly basis or more often if deemed necessary. Additionally, management will ensure that more detail is included with future journal vouchers.

Chapter 1-D

Prior Journal Voucher Issues Are Being Addressed

In addition to our three primary objectives, we followed up on previously identified issues and recommendations involving journal vouchers (see *A Follow-Up Report on Rider 5: Texas Southern University Accountability Systems*, SAO Report No. 02-055, June 2002). In our June 2002 review we found unbalanced journal voucher entries and journal vouchers that management was unable to account for.

In this current review, we found that:

- The University's financial system continued to permit the recording of unbalanced journal vouchers; however, management had implemented compensating controls to detect and correct these imbalances on a periodic basis. Most of the fiscal year 2002 vouchers appeared to correct previous unbalanced entries within fiscal year 2002.
- The financial system continues to allow management to delete journal vouchers without documenting an explanation of the deletion. We identified 5,800 potentially missing vouchers for fiscal year 2002 and 700 missing vouchers from the first quarter of fiscal year 2003, all of which management reports were deleted. In addition, most of the fiscal year 2003 journal vouchers appear to have been created by a recurring system problem that regenerates voucher entries. The University's accounting system contractor reports that this problem is now fixed. In addition, management reports that these vouchers are deleted from the suspense file without posting to the official accounting record and without affecting the AFR.

Recommendations

University accounting management should:

- Monitor the financial system to ensure that unbalanced journal vouchers do not occur.
- Ensure that all journal vouchers are accounted for and all deleted vouchers are explained.
- Confirm that the accounting system has been fixed so that it will not regenerate the same voucher entries.

Management's Response

Recurring Journal Vouchers

The vast majority of the 5800 and 700 potential missing vouchers were the result of the same 10 to 12 documents that were being generated daily. These documents were generated by the Banner System, placed in suspense, and labeled incomplete. Any items in suspense files have no financial value or impact on the accounting records. As of the date of this response, the problem of repeating journal vouchers has been eliminated.

Unbalanced Journal Vouchers

In December 2002, the University's accounting software was upgraded to prevent unbalanced journal vouchers from posting. Each month prior to closing the accounting records, the University's management generates a diagnostic report that reveals whether all transactions (including journal vouchers) are in balance. Therefore, we consider this problem to be corrected.

Is Texas Southern University spending state and local funds in accordance with state laws?

About Our Testing

We performed both judgmental and statistical sampling in order to test fiscal year 2002 expenditure transactions. Our judgmental sample contained 250 transactions that we selected because they appeared unusual or involved large dollar amounts. Our statistical sample contained 76 randomly selected transactions. Each of the 326 fiscal year 2002 transactions that we tested was recorded in one of the following seven expenditure types:

- Rentals and leases
- Communications and utilities
- Professional fees and services
- Travel
- Repairs and maintenance
- Materials and supplies
- Printing and reproduction

We did not test payroll, which made up 58 percent of the University's reported expenditures. The Comptroller audited the University's fiscal year 2001 payroll expenditures and did not find errors. In addition, we reviewed controls over the University's payroll in the previous audit and did not find significant errors in payroll transactions.

In the areas that we audited, which represented 17 percent of total expenditures, the University did not consistently ensure that funds are spent in accordance with state regulations and University policies. While the University's documented processes for paying for goods and services include most of the appropriate controls to ensure funds are spent appropriately, University employees do not consistently follow them.

Twenty four percent of the transactions in our statistical sample contained at least one error. Many of these errors involved supporting documentation for payments. We found similar errors in 24 percent of the transactions in our judgmental sample. Our results are consistent with results reported in the Comptroller of Public Accounts Post Payment Audit (Report 717-01-01, February 2002), which noted similar types of errors and an overall error rate of 41 percent.

By projecting the testing results of our statistical sample, we estimate with 95 percent confidence that expenditures totaling at least \$2.5 million for fiscal year 2002 include errors.

Maintaining Supporting Documentation for Payments Needs Improvement

Many of the errors that we noted in our transaction testing involved supporting documentation for payments.

We found payments for charges to University credit cards, a reimbursement to an employee for travel expenses, and two other reimbursements that did not include documentation clearly showing that they were related to University business.

According to **Title 34 of the Texas Administrative Code**, Section 5.51(c)(1)(B) and (D), state agencies are responsible for ensuring that expenditures comply with state laws and rules and for maintaining documentation proving that each payment resulting from the document is legal, proper, and fiscally responsible.

Section 5.51(e)(1)(B)(3) states that required documentation may include purchase orders, requisitions, contracts, invoices, and receipts.

Although the Texas Administrative Code requires that expenditures be supported by appropriate documentation (see text box), some of the University's expenditures either did not have a purchase order or had a purchase order that was not signed. The majority of these expenditures were from grant sources. We also found that some purchase requisitions were missing or unsigned.

We noted purchases that should have been competitively bid but that did not have documentation showing an evaluation of price quotes, written bids, or justification for an exclusive vendor or emergency purchase, even though the University's purchasing handbook requires such documentation.

Expenditure Coding Needs Improvement

During our expenditure testing, we noted that some expenditures were not recorded in the correct accounting object code. For example, lodging and meal expenses were incorrectly charged to the Rental of Motor Vehicles, Travel In-State Mileage, or Travel In-State Public Transportation accounts. Not using the proper object code may result in inaccurate expenditure amounts in the AFR or in other reports. However, the errors we found did not significantly affect the University's fiscal year 2002 AFR.

Recommendations

The University should:

- Follow state laws and its own policies and procedures for the use of state and local funds, especially for supporting documentation.
- Improve expenditure review and approval processes to ensure that all expenditures of state and local funds are charged to the proper object codes and are supported by purchase orders, requisitions, and other necessary documentation.
- Purchase goods or services with values exceeding \$2,000 through competitive bidding, in accordance with University policies.
- Develop comprehensive written policies and procedures for the use of commercial credit cards and the payment of card charges. These policies and procedures should require cardholders to submit receipts and other documentation to show that all card charges are related to University business and should require that all documentation be linked to the credit card statement and reviewed before the charges are paid.

Management's Response

Although the estimated error percentage represents only 2% of the University's total expenditures for Fiscal Year 2002, we are very concerned about the error rate. This is especially important due to the budget situation facing all state agencies. As a result, we have committed one Internal Auditor and one Compliance Officer to work exclusively on grant and other purchases.

University policy allows for credit card statement approval at the department level and returned to the accounts payable office for payment processing. The cardholder is required to submit to the approving official in his/her department, all credit card receipts, sales receipts, packing slips, and any other information related to the purchase. For audit purposes, the documentation is retained eight years by the department. Cardholders are also required to sign a statement acknowledging the usage and limitations of university issued credit cards.

As per SAO recommendations, management has enhanced our written policies and procedures governing the use of commercial credit cards, along with specific policies and procedures for payment of card charges. Internal Audit has developed purchasing tests to be performed using state-of-the-art auditing software (IDEA) to identify errors or potential errors while corrections can still be made

What is the status of the University's outcome measure results?

Although our original objective was to review outcome measure results and trends, we expanded our scope at the request of University executive management to include an audit of the accuracy of selected fiscal year 2002 measures reported to the Automated Budget and Evaluation System of Texas (ABEST), which is maintained by the Legislative Budget Board (LBB).

Two of the three performance measures we audited for accuracy were reported accurately for fiscal year 2002. Our review of reported results for six key measures indicated that the University met or exceeded targets for two measures. We noted that the University has developed initiatives to improve trends in outcome measures and that trends have been generally positive for all but one of these six measures.

Chapter 3-A

Two of Three Audited Measures Were Accurate for Fiscal Year 2002

Our audit of three key performance measures as reported for fiscal year 2002 indicated that the University accurately reported the results for the following two key measures:

- Retention Rate of First-time, Full-time, Degree-seeking Freshmen Students After One Academic Year
- Certification Rate of Teacher Education Graduates

When calculating the results for these two measures, University staff used the correct methodology and data.

For the third measure we audited, State Licensure Pass Rate of Law Graduates, the University did not use the correct methodology to calculate the result it originally submitted to ABEST. The University originally reported 41.67 percent for this measure and then recalculated the measure with a result of 53.96 percent. After communicating with the LBB analyst to confirm the definition methodology, we determined that the measure should have been reported as 42.63 percent. The 2002 target for this measure was 81.6 percent.

In addition, the University has not implemented a November 2000 audit recommendation that it formally document its process for reviewing the data it collects and the results it reports (see *An Audit Report on Performance Measures at 25 State Agencies and Educational Institutions – Phase 14*, SAO Report No. 01-007). Without formal documented review processes, there is a risk that the University will not detect errors relating to performance measure results before they are submitted to ABEST.

Recommendations

The University should:

- Coordinate with its Legislative Budget Board analyst to clarify the definitions and methodologies for computing all performance measures.
- Enhance current policies and procedures to outline the review processes associated with performance measures.

Management's Response

Management concurs with the findings and recommendations. Recent communication with Legislative Budget Board analyst has resulted in the revision of staff's methodology for calculating the measure, and the methodology has been codified. Moreover, a University representative will be invited by the LBB analyst to participate in the discussions on refining definitions for performance measures. Current policies and procedures will be revised to reflect the review process for validating performance measures.

Chapter 3-B

The University Is Working to Meet the Targets for Its Outcome Measures

A review of six of the University's nine key outcome measures showed that in fiscal year 2002, the University reported that it met or exceeded the targets for two of the measures reviewed and did not meet targets for four measures. Our review of the five-year trends for these measures indicates that the University has improved its performance toward meeting its targets in most areas (see outcome measure trends beginning on page 10). With the exception of fiscal year 2002 data for the freshmen retention rate and the state licensure pass rate of law graduates, the results are unaudited.

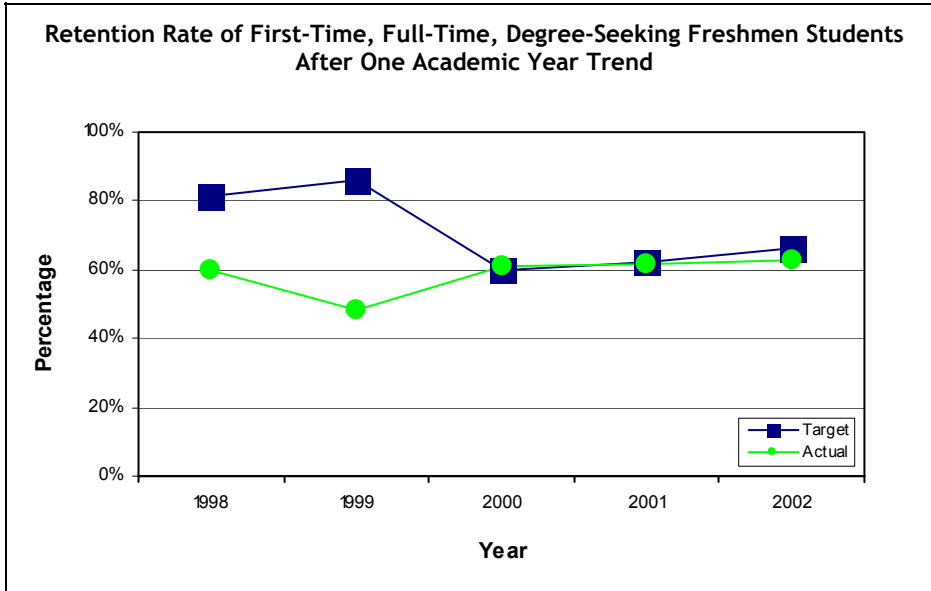
University management has conducted research with student and alumni opinion surveys and comparisons with other institutions in efforts to identify initiatives that could help attract, retain, and graduate students. Some examples of the resulting initiatives implemented by management are as follows:

- Implementing a Summer Academy and first-year academic support program for incoming freshmen to make them better prepared for their first semester in college
- Establishing additional student loan programs to help finance costs
- Revamping enrollment services to make the registration process easier
- Creating a retention coordinator position to facilitate retention initiative efforts
- Providing more student housing
- Enhancing key academic programs such as law and pharmacy
- Emphasizing maintaining or achieving accreditation status of relevant academic programs

Outcome Measure Trends

Our review of the five-year trends for the performance measure results, as self-reported by the University to ABEST, indicates that the University has improved its performance toward meeting its targets in most areas. Specific results of our review of the trends for each measure are shown below.

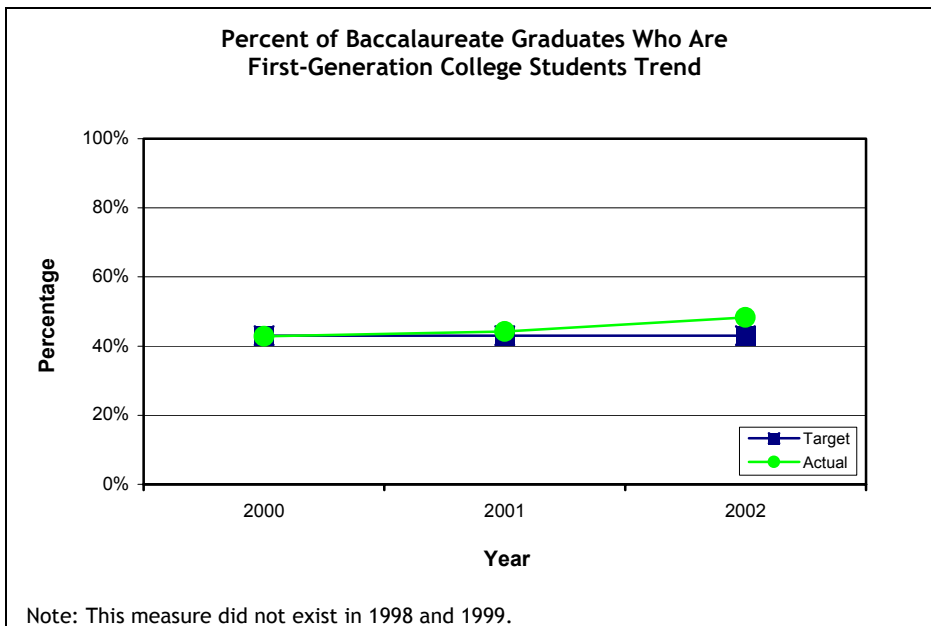
Figure 1



The Retention Rate of First-Time, Full-Time, Degree-Seeking Freshmen Students After One Academic Year was below target in 1998 and 1999 but increased in 2000 (see Figure 1). For fiscal year 2002, the University reported the results for this measure as 63 percent, while the target is 66 percent.

Source: ABEST

Figure 2

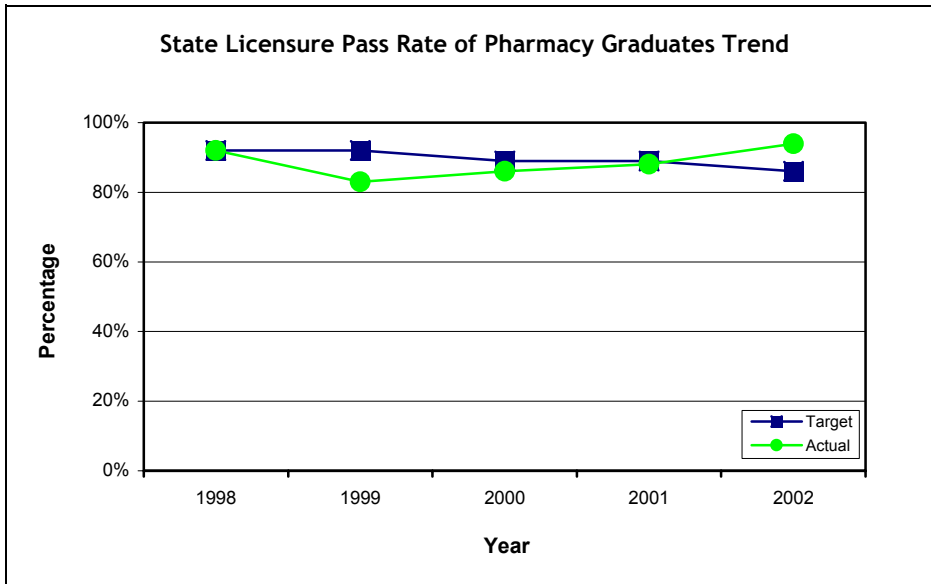


Note: This measure did not exist in 1998 and 1999.

Source: ABEST

The percentage of first-generation college graduates has steadily increased over the past three years (see Figure 2). The University has met or exceeded the target each year. In fiscal year 2002, the results of this measure were reported as 48.3 percent, with a target of 43 percent.

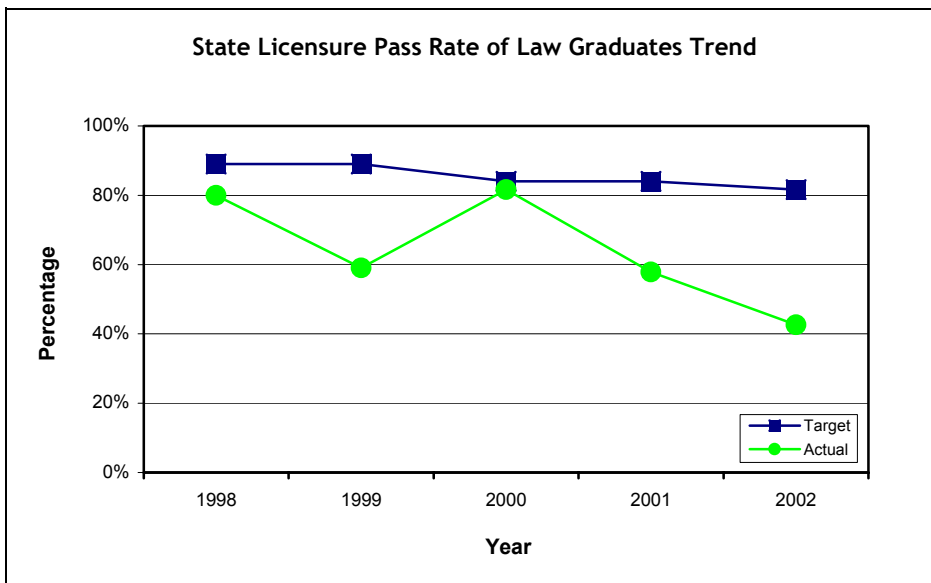
Figure 3



Source: ABEST

The State Licensure Pass Rate of Pharmacy Graduates has increased since 1999 and exceeded the target in 2002 with reported results of 94 percent, while the target is 86 percent (see Figure 3).

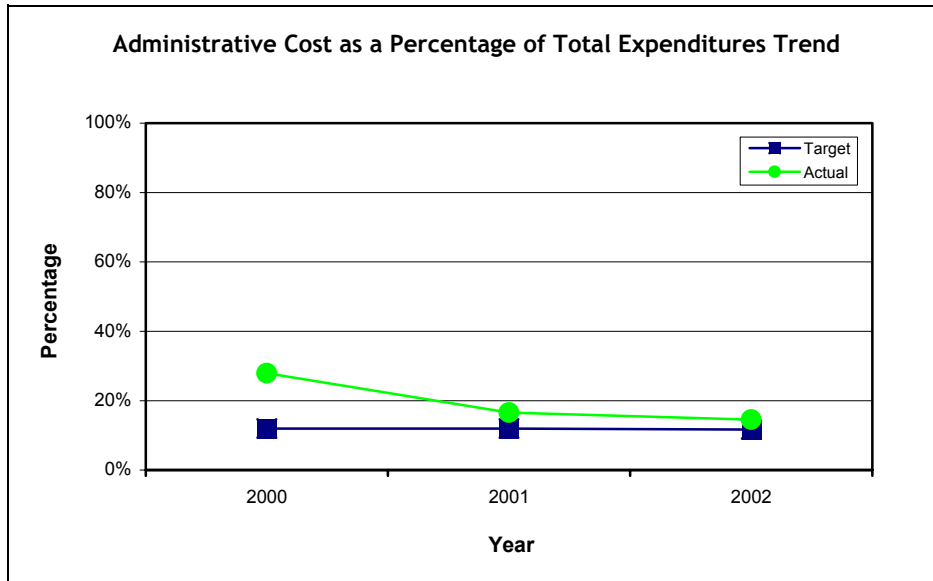
Figure 4



Source: ABEST

The State Licensures Pass Rate of Law Graduates has been below target since 1998 and has shown a steady decline since 2000 (see Figure 4). For 2002, the University achieved 42.6 percent, while the target is 81.6 percent.

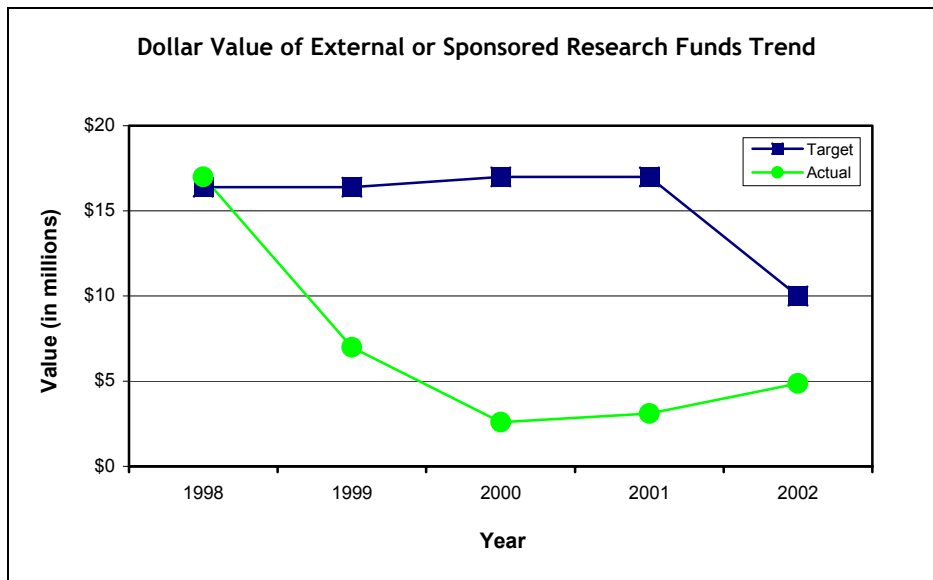
Figure 5



Source: ABEST

The University has not met the target for Administrative Cost as a Percentage of Total Expenditures for the three years we reviewed: fiscal years 2000, 2001, and 2002 (see Figure 5). However, the University continued to decrease its percentage of administrative costs (14.58 percent reported, with a target of 11.7 percent) in fiscal year 2002.

Figure 6



Source: ABEST

The reported results for the Dollar Value of External or Sponsored Research Funds declined below target in 1999, 2000, and 2001 and then increased in 2002 to \$4.86 million, with a target of \$10 million (see Figure 6).

Management's Response



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March 27, 2003

Mr. Lawrence F. Alwin, CPA
State Auditor
Robert E. Johnson Bldg., Suite 4.224
1500 N. Congress Ave.
Austin, Texas 78701

Dear Mr. Alwin:

We appreciate the State Auditor's acknowledgement of the continued progress Texas Southern University has made towards improving processes for producing accurate and consistent financial information.

Enclosed is management's response to the State Auditor's Financial Review of Texas Southern University. In regard to the issues noted in the report, the University has begun implementation of all of the recommendations. We respectfully acknowledge the assistance from the State Auditor's Office and will continue to make the necessary improvements. If you have questions, or require additional information, please call me at (713) 313-7035.

Sincerely,

A handwritten signature in black ink, appearing to read "Priscilla Slade".

Priscilla Slade, Ph.D.
President

Enclosure (1)

AN EQUAL EDUCATIONAL OPPORTUNITY INSTITUTION

Other Information

Objectives, Scope, and Methodology

Objectives

The project objectives were to:

- Determine whether Texas Southern University (University) provides legislative budget committees and University management with accurate and consistent financial information.
- Determine whether the University is using state appropriations and local funds in accordance with applicable state laws and regulations.
- Review the results of outcome performance measures.
- Follow up on prior journal voucher issues.

Scope

The scope of this review included the University's accounting records and transactions for fiscal year 2002, journal vouchers for fiscal year 2003, and performance measure results reported for 2002.

Methodology

To achieve these objectives, we reviewed the University's latest Annual Financial Report, tested expenditures for fiscal year 2002, audited the accuracy of selected performance measures, interviewed University managers, reviewed policies and procedures, and followed up on prior journal voucher issues.

Project Information

We conducted fieldwork between January and March 2003. This review was conducted in accordance with standards applicable to performance audits contained in generally accepted government auditing standards.

The following members of the State Auditor's staff conducted the review:

- Kelton M. Green, CPA, CFE (Project Manager)
- Jacqueline M. Shelby (Assistant Project Manager)
- Rob Bollinger, CPA
- Sharon L. Brantley
- Carmelita S. Lacar, Ph.D.
- Chuck Dunlap, CPA (Quality Control Reviewer)
- Ron Franke (Audit Manager)
- Frank N. Vito, CPA (Audit Director)

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