A Financial Review of

Lamar University

June 2003

SAO Report No. 03-039

State Auditor's Office

Lawrence F. Alwin, CPA
State Auditor

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Overall Conclusion

Lamar University (University) is providing accurate and consistent financial information to the Legislature. However, the University should improve its processes to ensure that it provides accurate information to the Texas State University System (System) Board of Regents and University management.

The University relies on manual processes to manage its financial activities and does not always follow its policies and procedures for recording detailed financial information. As a result, we found several inaccuracies in the University's detailed financial information, such as expenditures charged to the incorrect object codes. For fiscal year 2002, the inaccuracies in the University's detailed information did not significantly affect the information in its Annual Financial Report (AFR) because the AFR is a summary of the University's activities. However, the inaccuracies do affect the information that the System and the University use to manage operations, and if the University does not improve its financial reporting process, similar inaccuracies could affect future AFRs. The University can make better use of features in its automated financial system to improve accuracy of financial information.

Overall, the University uses state appropriations and local funds in accordance with applicable state laws and regulations. However, it does not provide adequate guidance to staff to ensure consistent compliance in several key areas, such as the use of Higher Education Assistance Funds.

The University generally has adequate processes in place to manage contracts and grants; however, we found examples of the University reporting inaccurate contract information to the Legislative Budget Board.

Summary of Information Technology Review

Overall, the two information systems we reviewed process financial transactions reliably. Results of our tests of reconciliations and transactions processed by the systems indicated that amounts reported in the financial statements were consistent with information in these systems. Also, the University has adequate policies and procedures in place to safeguard the financial and student information data processed by these systems. The two systems we reviewed are:

- Financial Reporting System (FRS) – The University uses FRS to track all its financial activities for its budget, which is more than $75 million.

- Student Information System (SIS) – SIS tracks information for the University's approximately 9,000 currently enrolled students. The University uses SIS to record student registration and billings. This information is exported to FRS.

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This audit was conducted in accordance with Government Code, Sections 321.0131 and 321.0133.

For more information regarding this report, please contact Ron Franke, Audit Manager, at (512) 936-9500.

The University should make better use of features in its automated system. The University relies heavily on manual processes, resulting in increased coding errors and the need for management to find and correct errors (see Chapters 1 and 2). Also, University accountants must summarize data from FRS manually when preparing financial statements. This increases the chance for error. We recommend that the University enable features in FRS that would prevent the use of inappropriate expenditure codes and work to develop custom reports to summarize FRS data automatically.

Our audit focused on FRS, the student billing portion of SIS, and the Web-based payment system and did not cover any of the University's other automated systems, such as the system used to manage human resources.

Detailed Results

Chapter 1

Does Lamar University Provide Accurate and Consistent Financial Information?

Lamar University's (University) systems and procedures allow the University to report accurate financial information at a summary level to the Legislature. We focused on financial information for fiscal year 2002 and the first quarter of fiscal year 2003. Although our review was more limited than a full financial audit, we did not find significant inaccuracies or significant inconsistencies.

Although the University has an automated financial system, it relies on manual processes to prepare financial reports, which resulted in errors to certain detailed financial statements and schedules. These errors did not significantly affect the fiscal year 2002 Annual Financial Report (AFR) but do affect information that University and Texas State University System (System) management use to make decisions. The University should make better use of features in its automated system and provide additional guidance to staff to prevent future errors and to improve the efficiency of financial operations.

Chapter 1-A

The University Provided Accurate Financial Information to the Legislature

The University's AFR for fiscal year 2002 provided accurate financial information to the Legislature. New reporting standards adopted by the Governmental Accounting Standards Board (GASB) for fiscal year 2002 reduced the level of detail required in college and university financial statements. As a result, errors in some of the detailed information (see Chapter 1-B) did not have a significant effect on the accuracy of the summarized information now reported in the AFR.

The University prepared the AFR according to the guidance provided by the Comptroller of Public Accounts (Comptroller) and the System, and the information was consistent with revenue, expenditure, and budget information reported to the System. Similarly, we determined that revenue estimates included in the University's Legislative Appropriations Request were reasonable.

We found that the University properly reconciled its internal system transactions and reconciled its accounting system to the Uniform Statewide Accounting System (USAS). In addition, we reviewed bank reconciliations, payroll expenditures, wire transfers, and appropriation riders and found no errors.

Chapter 1-B

The University Relies on Manual Processes and Has Not Provided Adequate Guidance for Performing Some Financial Processes

In preparing its financial statements and processing journal entries, the University relies heavily on manual processes rather than its automated system. These manual processes are inherently less efficient and more subject to error than automated processes. In addition, the University has not provided its staff members with adequate guidance for performing several types of financial processes.

The University management regularly reviews financial reports; however, these high level reviews do not always identify errors in the detailed information. For example, we found errors in the University's reporting of encumbrances, posting of journal vouchers, and coding of expenditures.

Encumbrances. The University overstated encumbrances by $930,365 at the end of fiscal year 2002. Some of the purchase orders associated with these encumbrances should have been canceled after they were filled at less than the authorized amounts; others showed no evidence of activity. The University spent all of its state appropriations before spending its local funds, so none of the out-of-date encumbrances involved state funds. Although the University does not allow these encumbrances to increase current departmental budgets, overstating encumbrances may cause management to make inappropriate decisions because it does not have accurate information about the amount of money available to cover obligations.

Because of new GASB reporting requirements (see text box), the University did not have to report encumbrances in its fiscal year 2002 AFR. However, the System required encumbrance information in a separate, detailed section of the AFR. As a result, there is a risk that someone who reads the AFR may use inaccurate encumbrance information to make decisions.

New GASB Reporting Requirements

Under new GASB reporting requirements, AFRs now contain less detail. Previous reporting requirements called for more detailed information for each fund type. However, the new format requires only summary information.

The University took steps to reduce similar encumbrances at the end of fiscal year 2001. However, it did not follow through in canceling all old purchase orders and did not take these steps at the end of fiscal year 2002. It also did not establish procedures to regularly identify and eliminate purchase orders that no longer represent valid encumbrances.

Financial Reporting. The reports from the University's automated accounting system do not adequately summarize data for preparing financial statements. As a result, the accountants manually enter data into electronic spreadsheets to prepare statements such as the AFR. This process is time-consuming and increases the possibility of errors. Management's review of reports may detect significant errors; however, it is unlikely that management would detect all smaller errors.

Also, the University has not documented how individual accounts should be classified in the statements. Without a list of account classifications, University accountants classify accounts based on their knowledge and on what was done in the past. There is a risk that each accountant will classify accounts differently, making the information inconsistent. For example, in a monthly report to the System's Board of Regents, $1,350 was listed as accrued liabilities when it should have been listed as deposits payable, and $4,112 was listed as accrued liabilities when it should have been listed as deferred revenue. However, because all these accounts are in the broad category of liabilities, the errors did not affect total liabilities in the financial statements. The lack of account classifications may also affect the accuracy of financial statements because different University accountants prepare different parts of the financial statements.

Journal Entries. The University's process for creating and approving journal entries is manual and lacks the steps needed to ensure that all approved journal entries are posted to the financial system. Many organizations have an automated journal entry process that tracks the entries from creation to posting. When an organization prepares its journal entries manually, it typically starts with a numbered and logged set of blank entries. It is important to number all the entries to ensure that all approved adjustments to financial information are processed and to prevent unapproved adjustments. Accounting staff members prepare entries and have them approved, and then the entries are posted to an account. If a journal entry is recorded on the log but not posted, accounting staff know that it is missing.

> **What Is a Journal Entry?**
>
> Journal entries are a powerful 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 entries are used to conduct activities such as correcting errors detected through ongoing monitoring of accounting functions and adjusting budgets.

However, the University does not start with a numbered set of journal entries. Accounting staff create entries and have them approved, and then data entry personnel number, log, and enter them into the system. Because the entries are not numbered until after they are approved, an entry could be created and approved but never entered. There would be no record of it, and it could result in errors in the financial statement. In fact, we found one journal entry with a small dollar value that was prepared and approved but never entered.

Coding Errors. The University does not provide sufficient guidance to staff who initially code expenditure transactions. In addition, it does not make use of a feature in its automated system that would limit the available code choices used to pay for the expenditure based on the account. As a result, University staff assigned the wrong purchase codes to numerous expenditures. Our test of nonpayroll expenditures found that 20 percent of the randomly selected sample of transactions contained errors in object codes. For example, staff coded travel expenditures as consumables and a purchase of raw materials as equipment. These types of miscodings caused the University to report incorrect expenditure information to the Comptroller in the Matrix of Operating Expenses. The matrix shows expenditures by type rather than by department or account.

These errors did not affect total expenditures reported or expenditures reported by function. We did not find coding errors in payroll, depreciation, or scholarship expenditures.

The University attempts to identify and correct coding errors, particularly when they relate to capital assets. However, this effort is time-consuming and an inefficient use of staff members' time. It also does not eliminate the possibility that coding errors will go undetected and result in inaccurate internal reports that University management uses to make management or budget decisions.

Recommendations

The University should:

- Establish and implement policies and procedures for canceling purchase orders that are no longer valid.
- Maximize the use of automation by developing automated reports that summarize accounting data for financial statements.
- Develop a list that details how accountants should classify accounts when preparing the financial statements.
- Begin using an automated system for creating, routing, and posting journal entries or improve its tracking of hard-copy journal entries.
- Provide staff members with guidance for coding expenditures, and use the feature in the automated system that prevents account managers from using codes that are not appropriate for their accounts.
- Provide training and ongoing documentation resources to staff who initiate financial transactions.

Management's Response

Management concurs and provides the following comments:

- *Management has already canceled more than $423,000 of outstanding purchase orders. We are implementing policy and procedure changes which will be incorporated in the Lamar University Finance Policy and Procedures Manual by August 31, 2003.*
- *We are evaluating a new financial system. Selection should occur by December 31, 2004.*
- *The Assistant Vice President for Finance and the Director of Accounting will develop a list that details how accountants are to classify accounts when preparing the financial statements. The list will be completed by August 31, 2003.*
- *Tracking of journal entries will be enhanced. The Assistant Vice President for Finance will consider an automated system for journal entries when evaluating a new financial system. Selection should occur by December 31, 2004.*
- *The Director of Purchasing will establish guidelines for coding expenditures.*
- *The Director of Purchasing will provide training and ongoing resources to staff who initiate financial transactions. The Director of Purchasing will provide training to assist account managers in correctly coding financial transactions.*

Chapter 2

Is the University Using State Appropriations and Local Funds in Accordance with Applicable State Laws and Regulations?

Although the University generally uses state appropriations and local funds in accordance with applicable state laws and regulations, it does not provide adequate guidance to staff to ensure consistent compliance in several key areas. We found examples of the University either not having adequate and documented procedures or not consistently following procedures for Higher Education Assistance Fund (HEAF) expenditures, cash handling, and asset management.

HEAF Expenditures. The University has not developed procedures for staff to follow when spending HEAF appropriations. As a result, the University purchased items that did not meet guidelines (see text box) such as hanging baskets and hooks for plants and movie video gift sets.

> **Higher Education Assistance Funds (HEAF)**
>
> These funds for educational and general activities may be used to acquire land, capital equipment, and library books and to construct, equip, repair, or rehabilitate buildings.
>
> Source: Texas Constitution, Art. VII, Section 17

HEAF appropriations are a limited state resource designed to be used for specific purposes. By using these funds inappropriately, the University risks not complying with state laws. In addition, improper use of these funds could cause the University to reimburse some of its HEAF appropriations with other state-appropriated or local funds budgeted for other uses.

In fiscal year 2002 and the first quarter of fiscal year 2003, the University received approximately $4.7 million in state HEAF money. We tested a random sample of HEAF expenditures totaling $417,595 and found $11,531 (2.8 percent) in purchases that did not clearly meet HEAF guidelines. In addition, the University did not provide any justification that these expenditures were specifically for educational and general purposes.

Cash Handling. The University Cashier's Office does not have detailed procedures for handling cash. As a result, current processes put cash at risk of theft and increase the risk that the University will not detect shortages or overages.

For example, the University currently does not require that two cashiers be present when cash is removed from the safe or when deposits are prepared. We observed checks and credit card slips that were not kept in the cash drawer. In addition, all cashiers and assigned custodians have a key and the alarm code for the cashier's office, and all cashiers have the combination for the safe.

We confirmed that $261 was missing from the approximately $7,000 kept in the cashier's safe and that it had not been reported as a shortage. This shortage occurred during a 10-week period when staff did not count the money in the safe, and it was not reported as a shortage in the University's accounting system for two weeks after it was initially detected. Staff members were not able to determine the exact cause of the shortage. It was eventually resolved by recording the $261 as a shortage.

Asset Management. The University does not consistently follow procedures to verify inventory or manage its property and equipment. As a result, University assets are at risk of misuse or theft. In addition, according to the State Property Accounting

(SPA) system, any agency that fails to keep accurate records as required may lose access to state warrants and electronic transfers of funds.

When asset management staff verified the departments' individual inventories, their judgmental sample of six items excluded those items worth less than $60,000 and was too small to represent the total inventory. As a result, this test was not adequate to confirm the accuracy of the total equipment inventory worth $31 million.

We tested a larger sample that was representative of the population (37 items totaling approximately $1 million in value). Although we were eventually able to locate all items, we found that 10 of the 37 items were not in the location listed in the inventory system. Two of the 37 items were not properly labeled as state property.

In addition, we found a $50,000 microscope, reported as a gift, that was not labeled as state property or included in inventory records. Failure to include gift items in the inventory can lead to inaccurate reporting in the SPA system and the University's AFR.

Recommendations

The University should:

- Document and follow procedures for and provide training regarding the appropriate use and justification of HEAF expenditures.

- Document and follow procedures to safeguard cash, restrict access to the Cashier's Office and vault, monitor and reconcile Cashier's Office funds in a timely manner, and account for shortages and overages immediately.

- Strengthen controls over property to provide better monitoring of University assets. Specifically, ensure accurate documentation of inventory recorded by departments, perform annual inventory verifications following SPA guidelines, and accurately account for gifts received in inventory records.

Management's Response

Management concurs and provides the following information:

- *Management has already drafted guidelines for expenditures of HEAF to be effective August 1, 2003. The Director of Purchasing will provide training to the account managers regarding the appropriate use and justification of HEAF expenditures. The purchases of $11,531 from HEAF were all for Educational and General purposes, but because of the nature of these purchases, the University will reimburse HEAF from other appropriated Educational and General Funds.*

- *Management has implemented and improved cash handling and accounting procedures.*

- *Management agrees to better monitor and improve controls over university assets.*

Chapter 3

Does the University Have Effective Controls over Contract and Grant Management?

The University generally has adequate processes in place to manage contracts and grants; however, we found examples of the University reporting inaccurate contract information to the Legislative Budget Board (LBB). Reporting inaccurate contract information to the LBB increases the risk that the State will not have appropriate information for decision-making. We reviewed five of the University's contracts and found the following:

- The University reported $9 million of contracts to the LBB, overstating the total by $252,902. A $222,902 construction contract was reported twice to the LBB because two departments submitted the same contract information.
- The University incorrectly reported a $30,000 grant designated as a stipend for a faculty member on leave without pay as a consulting contract.

Texas Government Code, Section 2254, requires state agencies and universities to report consulting, professional, and construction services contracts worth more than $14,000 to the LBB so that the LBB can provide this information to the Legislature and the public.

Recommendation

The University should institute procedures to ensure that staff members appropriately classify contracts and accurately report contracts to the LBB.

Management's Response

Management concurs. Management will coordinate university report submissions.

Did the University Meet Its Performance Measures for Fiscal Year 2002?

In fiscal year 2002, the University failed to meet three of nine key performance measure outcomes by more than 5 percent (see Table 1) according to data the University submitted to the Automated Budget and Evaluation System of Texas (ABEST). The three performance measures not met were:

- Administrative Cost as a Percent of Total Expenditures.
- Percent of Lower Division Courses Taught by Tenured Faculty.
- State Licensure Pass Rate of Engineering Graduates.

Table 1

The University Failed to Meet Three Key Measures by More than 5 Percent in Fiscal Year 2002			
Measure	**Target**	**Actual**	**Percentage of Target**
Administrative Cost as a Percent of Total Expenditures	11.60%	14.06%	121.00%
Percent of Lower Division Courses Taught by Tenured Faculty	63.70%	59.98%	94.00%
State Licensure Pass Rate of Engineering Graduates	95.00%	86.95%	92.00%
The University Nearly Met One Key Measure in Fiscal Year 2002			
Certification Rate of Teacher Education Graduates	79.20%	78.70%	99.00%
The University Met or Exceeded Five Key Measures in Fiscal Year 2002			
Percent of First-time, Full-time, Degree-seeking Freshmen Who Earn a Baccalaureate Degree Within Six Academic Years	23.50%	26.44%	113.00%
Retention Rate of First-time, Full-time, Degree-seeking Freshmen Students after One Academic Year	69.30%	69.32%	100.00%
Percent of Baccalaureate Graduates Who Are First Generation College Graduates	40.90%	42.43%	104.00%
State Licensure Pass Rate of Nursing Graduates	92.70%	93.24%	101.00%
Dollar Value of External or Sponsored Research Funds (in millions)	$1.50	$1.65	110.00%
Note: Unlike agencies, universities' expenditures and outcomes do not correlate to specific strategies but instead with their state appropriations for Educational and General State Support. Therefore, we looked at Lamar University's performance measures for Educational and General State Support.			

Source: Data the University reported to ABEST

The University provided the following explanations and initiatives to meet the three performance measures, which we did not verify:

- "Administrative cost increased mainly due to increases in salaries for security and police positions and in the cost of benefits that the University currently does not allocate to non-administrative costs. The University reports that it will look for ways to operate more efficiently and a method to allocate these benefit costs to determine a more accurate cost for administration."

- "The actual number of tenured and tenure-track faculty increased from fiscal year 2001 to fiscal year 2002; however, due to the University's enrollment growth, it hired a larger number of non-tenure track faculty to address the demand for lower-division courses. The University has conducted searches for tenured and tenure-track faculty during fiscal year 2002 and 2003, and new faculty numbers should bring the University closer to the target."
- "The engineering license review course has been revised with positive results."

Recommendation

The University should continue working on its initiatives to meet performance measures in the future.

Management's Response

Management concurs. The university will strive to meet all performance measures in the future.

Other Information

Objectives, Scope, and Methodology

Objectives

The project objectives were to:

- Determine whether Lamar 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.
- Determine whether the University has effective controls over contract and grant management.
- Determine whether the University is meeting performance measures

Scope

The scope of this review included the University's accounting records and transactions, contracts and grants, and journal vouchers for fiscal year 2002 through the first quarter of fiscal year 2003, as well as performance measure results reported for 2002.

Methodology

To achieve these objectives, we reviewed information systems used to collect and report financial and performance measure information; reviewed the University's latest Annual Financial Report; tested expenditures, contracts, and grants for fiscal year 2002 through the first quarter of fiscal year 2003; audited the accuracy of selected performance measures; interviewed University managers; reviewed policies and procedures; and followed up on prior audit issues.

Project Information

We conducted fieldwork between March and May 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:

- Paige Buechley, MBA, MPubAff (Project Manager)
- Agnes Barnes, CPA (Assistant Project Manager)
- Rodney Almaraz, MBA, CPA, CISA
- David Dowden
- Vicki Durham, MBA
- Natasha Kelly, MBA
- Sarah Slaughter
- Chuck Dunlap, CPA (Quality Control Reviewer)
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