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December 1997

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Key Points of Report

An Audit Report on Management Controls at the University of Houston

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Overall Conclusion

Opportunities exist for the University of Houston (University) to improve aspects of its resource and policy management control systems to make them more efficient and effective. However, in general, the University has a system of management controls that provides management with reasonable assurance that the mission will be accomplished and goals will be met.

Key Facts and Findings

- We identified four areas in which the University could improve resource management controls: improve the timeliness of tuition deposits to the State Treasury, improve the timeliness of Uniform Statewide Accounting System reconciliations, upgrade or replace the student accounting system, and periodically test the security card entrance system.
- Significant weaknesses exist in policy management. The University has approximately 125 policies that need to be updated or developed. In addition, the Federal Affirmative Action Plan has not been updated since 1984.
- The University was materially accurate in reporting formula funding information and fiscal year 1996 Education and General revenues. The University voluntarily disclosed to the Higher Education Coordinating Board a minor error in reporting semester credit hours. Had the error been reported prior to the certification of data, the University's appropriations for the 1998-1999 biennium would have been reduced by \$362,389.

Contact: Catherine A. Smock, CPA, Audit Manager, (512) 479-4700



Office of the State Auditor

Lawrence F. Alwin, CPA

This audit was conducted in accordance with Government Code, Section 321.0132 and .0133.

Executive Summary

Opportunities exist for the University of Houston (University) to improve aspects of its resource and policy management control systems to make them more efficient and effective. However, in general, the University has a system of management controls that provides management with reasonable assurance that the University's mission will be accomplished and its goals will be met.

Resource Management Procedures Should Be Improved

The lack of adequate controls over resource management creates the risk that control or operating problems might arise in the future. Examples of the kinds of problems that could emerge include loss or misuse of University resources. During the course of our audit, we identified the following four issues involving the University's resource management:

- Tuition deposits to the State Treasury are not completed in a timely manner.
- Reconciliations of Uniform Statewide Accounting System accounts are not completed in a timely manner.
- The student accounting system needs to be upgraded or replaced.
- There is no periodic testing of the security card entrance systems.

The University Should Improve Policy Management Procedures

Significant weaknesses exist in policy management. The University needs to revise or develop 125 official policies, including its Federal Affirmative Action Plan. This plan has not been updated since 1984.

The University Was Materially Accurate in Reporting Formula Funding Information for Fiscal Year 1996

The University voluntarily self-reported a minor error in semester credit hours to the Texas Higher Education Coordinating Board. Had this error been reported prior to the certification of data, the University's appropriations for the 1998-1999 biennium would have been reduced by \$362,389. The University was materially accurate in reporting fiscal year 1996 Education and General revenues.

The Board of Regent's Active Involvement in the Internal Audit Function Strengthens the University's Overall Control Environment

The University's Board of Regents (Board) is actively involved in the University's internal audit function. Among other things, the Board approves the annual audit plan and the Internal Audit Department's budget.

As a general rule, board-level involvement with an internal audit function helps create a strong control environment.

Summary of Management's Responses

Management generally concurs with the findings and recommendations in this report. The University has already begun implementing some of the recommendations.

Executive Summary

Summary of Audit Objective and Scope

Objective

The objective of this audit was to evaluate the existing management control systems within the University of Houston to identify strengths and opportunities for improvement.

Scope

The scope of the audit included consideration of the University's control environment, in addition to its policy, information, resource, and performance management systems and the key processes which support them. Additionally, we reviewed base year 1996 formula funding data and calculations.

Resource Management Procedures Should Be Improved

The lack of adequate controls over resource management creates the risk that control or operating problems might arise in the future. Examples of the kinds of problems that could emerge include loss or misuse of University resources. During the course of our audit, we identified the following four issues involving the University’s resource management:

- Tuition deposits to the State Treasury are not completed in a timely manner.
- Reconciliations of Uniform Statewide Accounting System accounts are not completed in a timely manner.
- The student accounting system needs to be upgraded or replaced.
- There is no periodic testing of the security card entrance systems.

Section 1-A:

Tuition Deposits Have Not Been Made to the State Treasury Within the Time Period Required by State Statutes

For fiscal years 1994 through 1996, the University consistently deposited deferred tuition revenues for the fall semesters an average of 30 days late. State statutes require certain local funds to be deposited in the State Treasury within seven days of collection. The University’s deposits were typically made 37 days after tuition was collected.

Tuition amounts deposited in the State Treasury in fiscal years 1994 through 1996 are shown in Figure 1.

Figure 1

	Fiscal Year 1994	Fiscal Year 1995	Fiscal Year 1996
First Tuition Deposit for Fall Semesters	\$ 7,022,177	\$10,256,674	\$11,580,864
Total Annual Tuition Deposits	\$30,377,702	\$39,295,015	\$42,275,195

By not depositing funds in the State Treasury within required time frames, the University created unnecessary control risks over \$28.9 million (total fall semester tuition deposits for fiscal years 1994, 1995, and 1996). Controls over deposits in the State Treasury minimize opportunities to use funds for purposes not authorized in the General Appropriations Act. Funds deposited in the University’s local bank account(s) can more easily be spent for purposes other than those allowed in the General Appropriations Act.

Recommendation:

University officials should closely monitor the effectiveness of newly installed procedures that were developed to ensure timely deposits of tuition to the State Treasury. If these procedures do not result in timely deposits to the State Treasury, University officials should take immediate action to develop or refine procedures to ensure tuition revenues are deposited in the State Treasury within the required seven day time period.

Management's Response:

The University identified and corrected this issue during August 1996. At that time procedures were implemented to ensure fall deferred tuition is deposited within the time period required by state statutes. Our current procedures require twice a week transfers of tuition deposits to the State Treasury. We will continue to monitor our adherence with these procedures in order to help ensure our compliance with state statutes.

Section 1-B:

Uniform Statewide Accounting System Reconciliations Have Not Been Completed on a Timely Basis

The University's Uniform Statewide Accounting System (USAS) information did not accurately reflect revenue classifications for some activities.

During our review, we discovered a \$14.5 million local fund deposit from fiscal year 1995 that had been incorrectly classified as a tuition deposit. Improper classifications like this one make it difficult for external officials, who rely on USAS data, to perform oversight and evaluation functions effectively. A timely reconciliation of the University's financial records to its USAS local fund account would have detected this error.

For fiscal years 1994 through 1996, the University did not reconcile its internal revenue accounting records to its corresponding accounts in the Uniform Statewide Accounting System on a timely basis.

Recommendation:

University personnel should reconcile the University's internal accounting records to the applicable USAS accounts on a monthly basis. However, if this is not possible, a complete reconciliation should be completed by the annual financial report deadline to ensure the accuracy of both the University's annual financial report and corresponding USAS accounts.

Management's Response:

Prior to FY 1997 our total revenue and expenditure records were reconciled to the corresponding summary records in USAS. During FY 1996 and FY 1997 the accounting offices of the University of Houston System campuses worked together to develop a comprehensive plan to modify accounting practices and automate manual processes in order to complete the reconciliation of the University's accounting system to USAS at the transaction level by FY 1998 year-end. Currently, each transmission of University accounting transactions is reconciled to the resulting detail transactions recorded in USAS. This action should help ensure that the reconciliation remains current and identify additional opportunities to further improve the process.

Section 1-C:

The Student Accounting System Should Be Upgraded or Replaced

According to a 1995 report from Arthur Andersen & Co., the University's student accounting system does not have the internal capabilities to perform some critical and fundamental accounting and reporting functions. The system cannot perform the following functions efficiently or in a timely manner:

- Determine the amounts of total student receivables.
- Determine the age of total student receivables.
- Separately account for collections and adjustments of student receivables that were previously written off as bad debts.

The lack of an effective, modern automated student accounting system makes it difficult to effectively manage significant resources involving the University's student receivables. Examples of problems that could result from an outdated student accounting system include:

- Non-collection or untimely collection of student receivables
- Inadequate audit trail for recovered bad debts
- Higher collection costs for student receivables

The total amount of student receivables as of August 31, 1996, was \$12.7 million.

Recommendation:

University officials should consider the replacement or upgrading of the student accounting system a top priority. Additionally, until the system is upgraded or replaced, University officials should develop procedures to compensate for the shortcomings of the current system.

Management's Response:

We plan to replace the student accounting system within the next three years. We are now undertaking a process re-engineering project which should result in changes to the way we currently conduct business in the areas of student accounting and other related record keeping requirements. We have already made changes to some of our applications and procedures, as recommended by Arthur Andersen & Co. in their report on the Student Accounting System, dated August 31, 1995. These changes and additional changes to be made during FY 1998 have helped and will continue to help compensate for the shortcomings in the Student Accounting System.

Section 1-D:

Security Card Entrance Systems Should Be Tested Periodically

During the course of our review, we determined the University does not require periodic testing of security card entrance systems on campus. The University is in the process of installing a one-card system throughout the campus. The system will be used as a transaction/debit card for various financial transactions within the University and will eventually be used to grant and track entrance and exit to several areas.

Without periodic testing to make sure the systems are functioning correctly, there is no assurance that University police will be able to identify and interview those persons having access to secured areas in the event of lost, stolen, or damaged property. As a result, some University assets are not being adequately safeguarded from theft, loss, or abuse.

Recommendation:

University officials should assign a department the responsibility of periodically testing the security card entrance systems and documenting the results and testing schedule.

Management's Response:

The University's key issuance policy will be modified to address electronic access systems. These modifications will address the protocol for installing and maintaining electronic access systems.

Section 2: POLICY MANAGEMENT

The University Should Improve Policy Management Procedures

The University should improve policy management procedures to eliminate the large backlog of procedures that need to be revised or developed. In addition, the University needs to ensure all required Affirmative Action reports are updated as required by federal regulations.

Current policies and procedures are essential to ensure the University has enforceable policies and procedures to safeguard its resources from loss, theft, or abuse; to ensure accomplishment of its mission and goals; and to provide guidance for operating and administering the multitude of different areas encompassing the University.

Section 2-A:

Numerous Policies Need Revisions or Development

Various policies in the areas of parking, information technology, funding issues, facilities management, and budgets are not current. Presently, there are over 125 University policies and procedures needing development or revision.

Additionally, only 21 of the 40 sections in the University's *Manual of Administrative Policies and Procedures* actually contain fully-written policies and procedures. The remaining 19 sections consist only of a title.

A cause of the backlog appears to be under-staffing of the unit responsible for the development and revision of the University's policies and procedures. Presently, only one person has responsibility for this function, which is very time consuming due to the extensive coordination and approval process currently in use. However, the University of Houston System is in the process of merging many of its functions into the University of Houston's main campus operations. Part of this process will be the formation of a small unit to formulate policies and procedures.

Without current policies and procedures available to University faculty, staff, and students, the University is at risk of not being able to enforce and take necessary punitive actions against anyone not adhering to the policies and procedures.

Recommendation:

University officials should restructure the process used to develop and revise policies and procedures to ensure timely implementation of new and revised policies and procedures.

Management's Response:

We plan to revise our process for developing and revising university policies and procedures. These revisions should help ensure that the needed policies are promulgated and that revisions to existing policies are made in a timely manner. We expect to establish estimated policy completion/revision dates for all policies in the process of development or revision by August 31, 1998.

Section 2-B:

The University's Federal Affirmative Action Plan Should Be Updated

The Affirmative Action Plan required to be maintained for the Office of Federal Contract Compliance Programs has not been updated since 1984. This plan is required to be updated and available for review by federal auditors on a yearly basis. Failure to abide by federal regulations could put the University's Sponsored Research programs at risk of delays in cost reimbursements or loss of future research grant funding.

Recommendation:

University officials should develop procedures to ensure timely updates to their Federal Affirmative Action Plan.

Management's Response:

The recommendation has already been implemented. The database from which the update is drawn was completed and the plan will be in place at the end of October 1997. Mechanisms for continuous updating are incorporated so that a current plan can be produced at any time.

Section 3: FORMULA FUNDING

The University Was Materially Accurate in Reporting Formula Funding Information for the 1996 Base Year

Section 3-A:

The University Identified Corrections to Semester Credit Hour Data That Resulted in Overfunding of \$362,389 for the 1998-1999 Biennium

The University voluntarily identified and disclosed corrections (instances of noncompliance and unreported items) to the certified semester credit hour data reported to the Texas Higher Education Coordinating Board (Coordinating Board). Had the errors been reported prior to the certification of the data, these corrections would have resulted in a net decrease in appropriations by \$362,389 for the 1998-1999 biennium. All corrections disclosed were misclassification of doctoral and master's students.

Figure 2

Self-Reported Corrections by Attribute and Semester							
University	Attribute	Summer	Fall	Spring	Number of Corrections	Number of Unique Students	(Over-) or Under funding for all Attributes Resulting from Self-Reported Corrections
University of Houston	TASP	\$0.00	\$0.00	\$0.00	0	0	\$0.00
	Student Classification	(\$104,940.27)	(\$184,827.80)	(\$72,620.73)	199	54	(\$362,388.80)
	Tuition Collection	\$0.00	\$0.00	\$0.00	0	0	\$0.00
	Class Size	\$0.00	\$0.00	\$0.00	0	0	0

The University did not accurately report the classification of all students reported to the Coordinating Board for funding purposes. According to the University, verification of assertions made by 54 students were not available at the time of reporting. To be eligible for doctoral-level funding, a student must have 30 hours of graduate work or a master's degree. Procedures implemented in Summer 1996 by the University to address misclassification of master's and doctoral students have begun to improve reporting.

Recommendation:

We recommend the University continue to improve procedures to ensure that students are classified and reported as doctoral and master's students only when they meet criteria established by the Coordinating Board.

Management's Response:

The University will continue to implement the student classification verification procedure started in Summer 1996. The University believes the current verification process will safeguard against misclassifying students in state reports.

Section 3-B:

The University's Procedures for Payment of Tuition and Fees by Installment Plan Did Not Require That Students Sign the Documentation Necessary to Sanction Students for Nonpayment

The University's procedures for the payment of tuition and fees by installment did not require students to sign a form acknowledging that nonpayment can lead to sanctions.

Statutes state that no sanctions may be imposed upon students for nonpayment unless the institution had the student sign a promissory note containing the required language.

Without this documentation the University is not able to comply with the Legislature's intent. On the one hand, if the University imposes sanctions against students for nonpayment, then it has not complied with the statute. On the other hand, if the University does not impose sanctions, it receives state monies under formula funding procedures for a student who may not meet the financial obligations anticipated.

Recommendation:

We recommend the University develop an effective mechanism to ensure (1) that students using the tuition installment option acknowledge the consequences of not paying the remainder of their installment payments, and (2) that the University be able to collect.

Management's Response:

We will include instructions on the student fee bills which indicate that if the student elects to pay the tuition and fees under the installment plan that the student is acknowledging that non-payment can lead to certain sanctions.

Section 3-C:

Fiscal Year 1996 Education and General Revenues Were Materially Accurate

A review of the reported actual fiscal year 1996 educational and general revenues noted that the amounts are materially accurate. These amounts were also used to request appropriations for the 1998-1999 biennium. Amounts reported as actual were based on good estimates rather than final account balances. Final account balances were presented to the Legislative Budget Board prior to the final appropriations decisions. The objective was to audit the accuracy of Education and General revenues included in the University's Legislative Appropriations Request.

Section 4: CONTROL ENVIRONMENT

Board of Regent Involvement in the Internal Audit Function Strengthens the University's Overall Control Environment

The Board of Regents (Board) for the University of Houston System is actively involved in the University's internal audit function. The involvement of the Board is evidenced by the following:

- It approves the internal audit charter.

- It approves the annual internal audit plan and any changes to the plan.
- It has input into which areas should be audited.
- It approves the budget for the Internal Audit Department and any personnel actions involving the Internal Audit Director.
- It receives copies of all internal audit reports, along with periodic status reports on internal audit activities.
- It has frequent communication with the Internal Audit Director and meets with him privately to discuss pertinent University information.

All of these factors, along with the Board's commitment to an independent and professional Internal Audit Department, contribute to a stronger overall control environment for the University.

Objectives, Scope, and Methodology

Objectives

Our audit objectives were to evaluate the management control systems within the University of Houston, including its management of resources, and to identify strengths and opportunities for improvement. We evaluated whether the control systems provide reasonable assurance that the University's goals and objectives will be accomplished. The audit evaluated control systems in place during fiscal years 1994 through 1996.

Management controls are policies, procedures, and processes used to carry out an organization's objectives. They should provide reasonable assurance that:

- Goals are met.
- Assets are safeguarded and efficiently used.
- Reliable data is reported.
- Laws and regulations are complied with.

Management controls, no matter how well designed and implemented, can only provide reasonable assurance that objectives will be achieved. Breakdowns can occur because of human failure, circumvention of control by collusion, and the ability of management to override control systems.

Scope

The scope of this audit included consideration of the University's overall management control systems: policy management, information management, resource management, and performance management.

Consideration of the University's policy management systems included a review of:

- Processes used to create, monitor, and evaluate University strategic and operating plans
- Processes used to create, monitor, and revise University budgets
- Processes used to create, implement, evaluate, and revise University policies and procedures

Consideration of the University's information management systems included a review of:

- Processes for identifying, collecting, classifying, evaluating, maintaining, and updating information

- Existing management reports
- Timeliness, accuracy, and availability of information

Consideration of the University's resource management systems included a review of:

- Processes used to select, train, and evaluate University employees
- Processes used to control the University's cash
- Investment policies and practices at the University
- Processes used to ensure proper acquisition, storage, security, and management of inventory assets
- Processes used to ensure that fixed assets and infrastructure are economically purchased and used and adequately protected against waste and abuse
- Processes used to identify and collect revenue
- Protection of computers and computer applications

Consideration of the University's performance management system included a review of processes used to develop, track, and use performance measures.

A review of each of the control areas revealed some specific issues that were examined further.

Methodology

The audit methodology consisted of gaining an understanding of each control system. In select areas, tests were then performed to determine if the control systems were operating as described. Finally, the results were evaluated against established criteria to determine the adequacy of the system and to identify opportunities for improvement.

An understanding of the control systems was gained through interviews with the Board of Regents, management, faculty, and staff. Written questionnaires and reviews of University documents were also used to gain an understanding of the control systems in place. Control system testing was conducted by comparing the described and actual processes. The testing methods primarily consisted of document analysis, process and resource observation, and employee interviews.

The following criteria were used to evaluate the control systems:

- Statutory requirements
- University policies and procedures

- General and specific criteria developed by the State Auditor's Office Inventory of Accountability Systems Project
- State Auditor's Office Project Manual System: The Methodology
- State Auditor's Office Project Manual System: The HUB
- Other standards and criteria developed through secondary research sources, both prior to and during fieldwork

Fieldwork was conducted from April 1997 through August 1997. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

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

- Terry Holderman, MBA (Project Manager)
- Dale Kincaid, MBA
- Barbette Mayes
- Errol Williams
- Michelle Jaubert-Esquivel, CPA
- Carlita Joseph, MPA
- Catherine A. Smock, CPA (Audit Manager)
- Craig Kinton, CPA (Audit Director)

Background Information

Appendix 2.1:

University Profile

Mission Statement

The University of Houston is a state-supported institution whose mission is to:

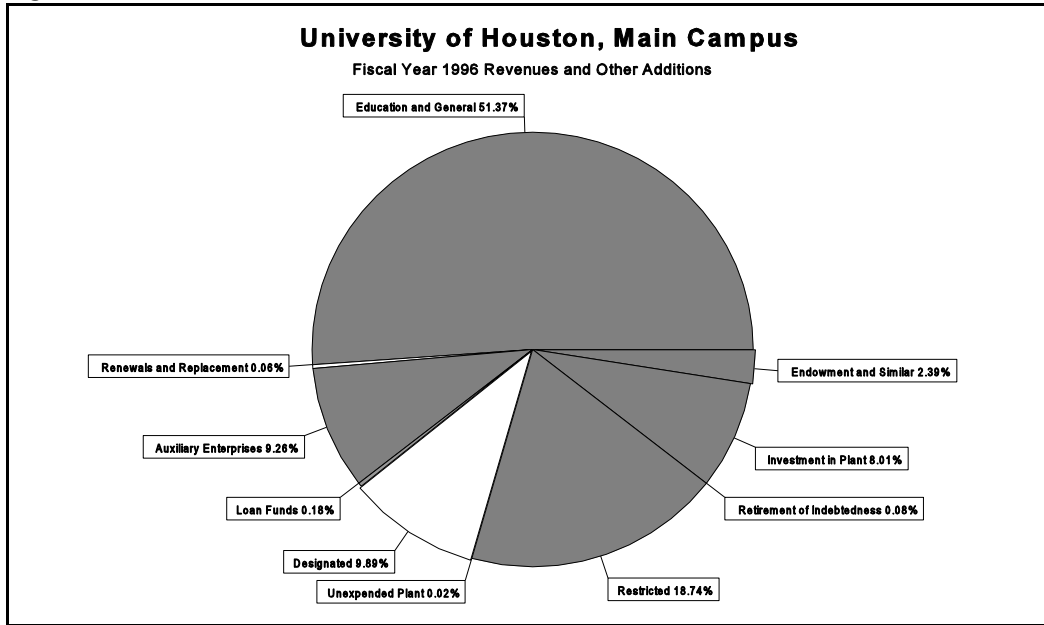
- Provide a range of educational programs that foster an intellectually and culturally diverse environment that enhances individual growth and development
- Prepare a broad community of students (undergraduate, graduate, professional, and non-degree seeking) to make lifelong learning commitments that result in personal, social, economic, and community contributions to an increasingly globally interdependent world
- Create, discover, disseminate, and preserve knowledge and understanding by engaging in basic and applied research, scholarly and artistic activities that benefit students, scholars, and external constituencies
- Serve as a major resource for local, state, national, and global communities by applying scholarly analysis and experience to community problems
- Recognize its special responsibility to the Houston metropolitan area by making the knowledge base and other resources of the institution readily accessible to its citizens.

Appendix 2.2:

Financial Information

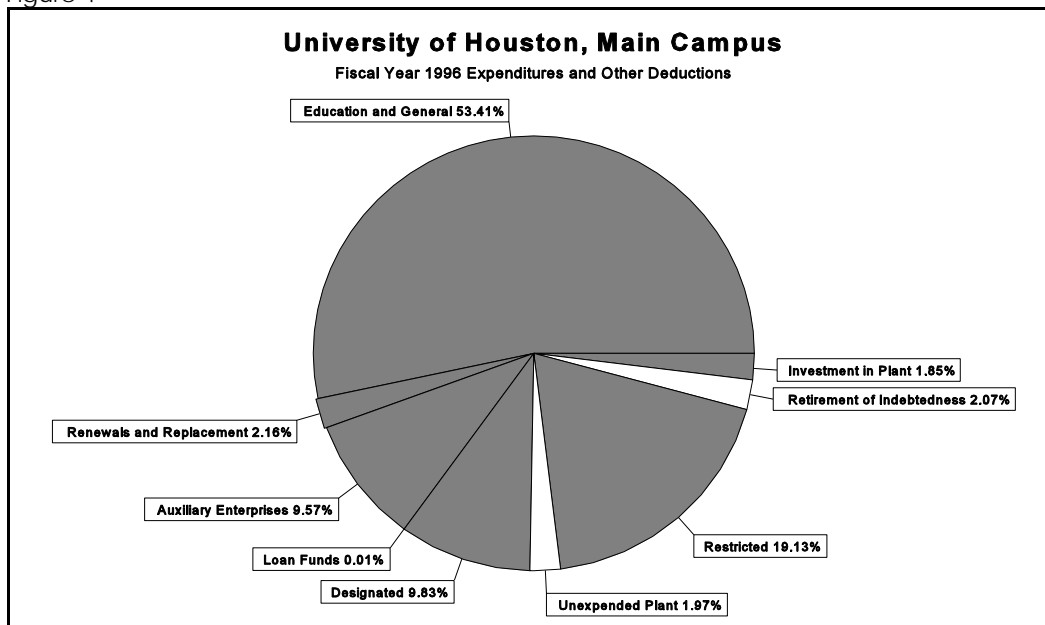
The University of Houston reported total revenues and other additions of \$368,968,278 and total expenditures and other deductions of \$358,726,063 in fiscal year 1996. The University's fund balance totaled \$687,989,914 for fiscal year 1996. See Figures 3, 4, and 5 on pages 16 and 17 for the distribution of reported revenues, expenditures, and fund balance for fiscal year 1996.

Figure 3



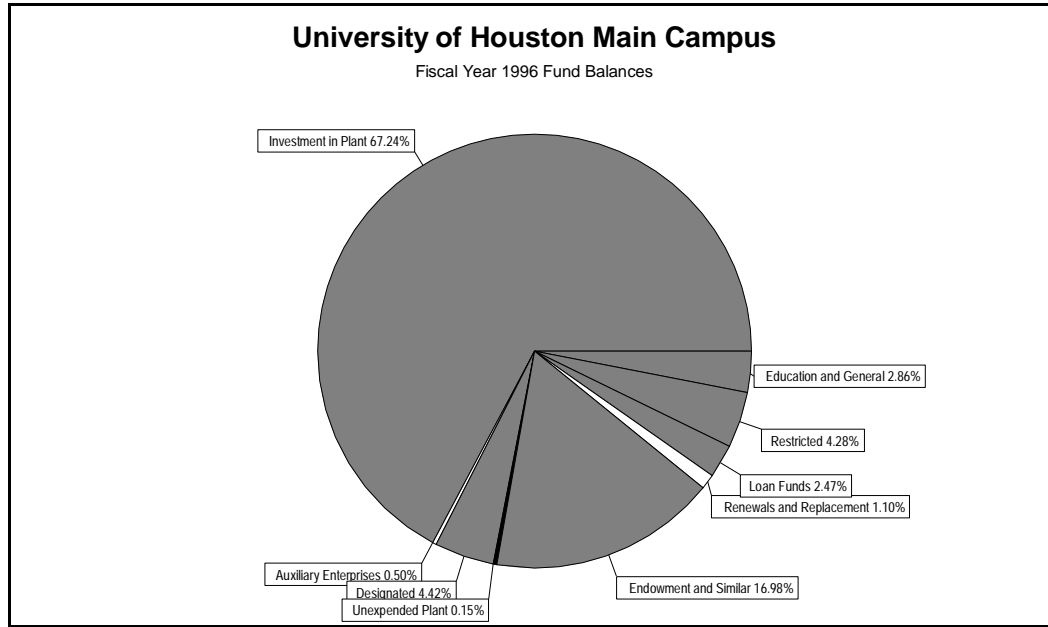
Source: 1996 Annual Financial Report

Figure 4



Source: 1996 Annual Financial Report

Figure 5



Source: 1996 Annual Financial Report

Formula Funding Objectives, Scope, and Methodology

Formula Funding Objectives

The primary objectives of a formula funding audit are to:

- Audit the accuracy of the variables in selected formulas used in calculating formula funding appropriations.
- Report differences between University records and data submitted by the University to the Coordinating Board.
- Determine the accuracy of fiscal year Education and General revenues reported in the University's requests for legislative appropriations.

Formula Funding Scope

The scope of formula testing focuses on the accuracy of variables of selected funding formulas. Funding formulas are used to allocate appropriations to the University. There are four funding formulas, each driven by variable data reported by universities. Two formulas were selected for the audit: instructions and operations formula and teaching experience supplement. Statewide, these two formulas account for 78.40 percent of the \$2.9 billion funding by formulas during the 1998-1999 biennium. At the University of Houston these two formulas account for 80.77 percent of the \$240,539,284 funding by formulas during the 1998-1999 biennium.

Semester credit hours is the only variable for each selected formula and is reported to the Coordinating Board in the CBM-004 Class Report and CBM-001 Student Report. All 35 universities receiving semester credit hour formula funding appropriations are subject to audit for compliance with state statutes, General Appropriations Act riders, and the Coordinating Board's rules and regulations. Audit procedures concentrate on testing accuracy of student classification, collection of tuition, compliance with the Texas Academic Skills Program (TASP) requirements, and class size reporting. Test work is concentrated on the base period semesters used to calculate funding for the 1998-1999 biennium, which includes the Summer 1996, Fall 1996, and Spring 1997 sessions.

Formula Funding Methodology

The formula funding audit methodology includes:

- Using attribute sampling methodology to test the accuracy of the semester credit hours used in calculating appropriations.

- Reviewing self-reported corrections provided by the University and calculating the dollar impact on appropriations.
- Reviewing the University's documentation supporting amounts included in its request for legislative appropriations.

University Self-Reported Corrections - Since the audit sample is drawn from certified data and there is no other means for the universities to make corrections to enrollment data after the Coordinating Board certifies the data, universities are encouraged to self-report corrections prior to audit testing. This self-reporting process compensates for known exceptions in certified data. Dollar amounts based on the effective funding rate for the specific item reported increases or decreases any over or under-funding from compliance testing.

Prior to any audit testing, the University of Houston was encouraged to disclose any known instances of noncompliance in the enrollment data reports. Disclosing known instances of noncompliance is usually to the University's benefit. The dollar amount associated with each self-reported item is based on the appropriations the University received for reporting the semester credit hours. On the other hand, instances of noncompliance identified through the audit sampling result in a greater dollar impact since they are projected to the entire population of appropriation dollars generated by semester credit hours.

Review of Educational and General Amounts - A review was conducted of the Educational and General revenue amounts in Schedule 1 of each university's request for legislative appropriations. This review consisted of analytical procedures and included tracing amounts to the University's annual financial reports, performing trend analyses of net tuition and indirect costs, and evaluating procedures for estimating revenues for future fiscal years.

Review of Teaching Experience Supplement Procedures - A review was conducted of the policies and procedures related to tracking and reporting Teacher Experience Supplement formula variables. This review consisted of interviews and analysis of written procedures.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards.

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