VIRGINIA POLYTECHNIC INSTITUTE
AND STATE UNIVERSITY
BLACKSBURG, VIRGINIA

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2002

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of Virginia Polytechnic Institute and State University for the year ended June 30, 2002, found:

- the financial statements are presented fairly, in all material respects;

- internal control matters that we consider to be reportable conditions; however, we do not consider any of these to be material weaknesses;

- instances of noncompliance required to be reported; and

- adequate corrective action of prior audit findings except for the prior year findings titled, “Status of University Initiative to Ensure Departments Follow Financial Policies and Procedures” and “Review Administration of Perkins Loan Program,” which is included in the finding entitled “Strengthen Management Oversight in the Office of Scholarships and Financial Aid” in this report.

-TABLE OF CONTENTS-

Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

October 31, 2002

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
Virginia Polytechnic Institute and
State University

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

We have audited the financial statements of **Virginia Polytechnic Institute and State University** as of and for the year ended June 30, 2002, and have issued our report thereon dated October 31, 2002. Our report on the financial statements is contained in the President's Report 2001-2002 issued by the University. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Management's Responsibility

The University's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls. Internal control is a process designed to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with generally accepted accounting principles, and the University has complied with applicable laws and regulations.

Compliance

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards. Instances of noncompliance are described in the finding entitled "Strengthen Management Oversight in the Office of Scholarships and Financial Aid" in the section titled "Internal Control and Compliance Findings and Recommendations."

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the section entitled, "Internal Control and Compliance Findings and Recommendations."

We believe none of the reportable conditions described above are material weaknesses. A material weakness is a condition in which the design or operation of one of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Status of Prior Findings

The University has taken adequate corrective action with respect to audit findings reported in the prior year except for the prior year findings entitled "Status of University Initiative to Ensure Departments Follow Financial Policies and Procedures" and "Review Administration of Perkins Loan Program." Accordingly, we included these findings in the section entitled "Internal Control and Compliance Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with management at an exit conference held on October 24, 2002. This report is intended solely for the information and use of the Governor and General Assembly, Board of Visitors, audit committee, and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR OF PUBLIC ACCOUNTS

JEG/kva
kva:82

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Status of University Initiative to Ensure Departments Follow Financial Policies and Procedures

In several previous audits, we raised significant concerns that University departments frequently do not follow financial policies and procedures. Lack of departmental compliance has hampered University plans to further decentralize payroll and finance functions. The success of decentralization efforts relies heavily on departments following established policies and procedures.

We recommended that University executive management work together to develop a stronger training, monitoring, and enforcement program with appropriate consequences. Under the leadership of the Executive Vice-President, the University established a response team that developed the framework of a comprehensive program with six broad initiatives to address our concerns. Executive management reviewed and approved the response team's initiatives. We concurred with the initiatives and have continued to monitor their implementation.

During the current audit, we continued to find problems with departments not complying with the financial policies and procedures as illustrated by the finding addressing effort reporting.

Listed below are the six initiatives, their current status, and completion timelines where known.

1. Encourage compliance with University policies and procedures.

   The University adopted the proposal to include administrative performance as an evaluation criterion for all administrators and faculty members, including academic department heads and directors. However, since the University did not have funds for salary increases for fiscal year 2002, the University chose not to communicate the criteria to deans and department heads for inclusion in the 2002 evaluation process. The University plans to communicate the criteria for use in the 2003 evaluation process.

2. Directly assist departments in achieving good business practices.

   The University has not published a formal Departmental Business Management Guide and has not hired a business practices specialist to assist departments and monitor department compliance. The University has completed drafts of several portions of the guide and is revising several other drafts to arrive at the appropriate level of detail for the guide based on initial department feedback. The University has moved the timeline for completion of the guide from January 2002 to December 31, 2002. Budget uncertainties delayed the hiring of the business practices specialist. Given the severity of recent budget reductions, the University modified its plans and is exploring the development of a business practices specialist from current financial area staffing.

3. Develop incentive programs to encourage and reward good business practices.

   The University delayed the development of incentive programs due to budget reductions. Currently, there is not sufficient funding to implement all of the planned incentive programs. However, the University has completed a draft policy that will enable the development of recognition programs for staff or work teams who demonstrate administrative excellence.

4. Develop management monitoring reports to identify areas of concern.

   The University has developed and implemented reports to monitor small purchase charge card activity, potential split purchase orders, inventory, and leave reporting. The University is experiencing difficulty in developing a late termination notice monitoring report and is still working on the report.

5. Develop Training and Professional Development Programs.

   The University's training programs are ongoing. The University is working with a local community college to provide college credit classes to employees.

6. Improve communications with departmental administrators and fiscal staff.

   The Vice President for Budget and Financial Management implemented communication programs to improve information flow between deans, directors, and department heads and their fiscal officers. The programs include periodic meetings between the Vice President and fiscal officers to re-emphasize compliance with University policies and procedures.

These initiatives are a significant undertaking by the University in an attempt to change the culture of the organization. Budget reductions and uncertainties have significantly impacted the implementation of several of the initiatives. Executive management should continue their strong support of these initiatives and make departmental compliance a high priority of the University. Executive management should also carefully evaluate alternative strategies where budget reductions have prevented implementation of initiatives. We again stress that if training and incentives fail to ensure compliance, it is critical that the University implement a strong enforcement program with appropriate consequences to address repeated problems identified in its monitoring program.

<u>Develop a Formal Effort Reporting Policy</u>

The University does not have an official effort reporting policy. Although the University has issued memorandums and instructions for effort reporting, the lack of an official policy has contributed to a continual problem of departments submitting completed effort reports late. We found effort reports submitted up to six months past the due date. The University eventually obtains the effort reports, but expends a significant amount of personnel resources to track down and obtain the missing efforts reports. We are concerned that there are no consequences imposed on departments or individuals who do not submit the effort reports by the due date.

OMB Circular A-21, <u>Cost Principles for Educational Institutions</u>, requires universities to have a system to monitor the allocation of personal service costs that include an effort report from staff to adjust any estimated cost allocations. Failure to obtain effort reports could lead to significant questioned costs that could result in the University refunding unsupported amounts to the federal government.

The University should develop a formal effort reporting policy that clearly addresses the importance of effort reporting, the responsibilities of the departments involved in the process, and appropriate consequences for not complying with the policy. As part of its initiative to ensure that departments comply with policies and procedures discussed above, the University should give priority to improving the effort reporting process. The University should provide training and distribute information that increase employees' awareness of the importance of completing and submitting effort reports promptly. The University should hold each department accountable for failure to adhere to the policy and develop appropriate consequences for noncompliance. Holding departments accountable will improve efficiency in the effort reporting process and hopefully free up resources to perform other tasks.

<u>Strengthen Management Oversight in the Office of Scholarships and Financial Aid</u>

Management in the Office of Scholarships and Financial Aid does not provide adequate oversight of counselors and other administrative staff to ensure that the office complies with all federal and state regulations. During testwork of the Student Financial Aid Cluster, the University's internal auditor found pervasive control weaknesses in student financial aid processes that caused errors and non-compliance and resulted in overawards totaling $32,647. The University implemented a new financial aid system in the summer of 2000. However, management failed to design or apply effective system controls to detect and prevent errors and non-compliance. In addition, we found a lack of coordination between offices involved in the financial aid process. Details of our concerns follow:

1. There are no adequate system controls and coordination between offices to identify changes in cost of attendance and student eligibility. Exception testing found counselors awarded aid to seven students based on incorrect residency status, two graduate students based on undergraduate budgets and one ineligible Pell recipient. Overawards for these exceptions totaled $3,558.

   There is a lack of supervisory review and training for counselors who prepare manual adjustments to cost of attendance components. Files contained inadequate supporting documentation, manual adjustments did not agree to the supporting documentation in the file, and counselors made clerical errors in calculating adjustments resulting in four overawards: Two unsubsidized Direct Stafford loans for $3,972 and two state grants for $2,897.

   Counselors erroneously computed the Direct Loan origination fee component of cost of attendance for numerous students resulting in one overaward of $479. In addition, counselors failed to exclude summer school cost of attendance for sixteen students not officially enrolled in summer school. Three of these students received overawards totaling $5,226.

2. The processes and procedures for recognizing student financial resources from departmental and outside sources in determining need are inadequate. Resource recognition between student accounts receivable and the financial aid system is not an automated process. Internal Audit found that the "resource report" used by counselors to determine need contained untimely recognition of resources and did not match account data in several instances. It is essential that the resources recognized for financial aid purposes match resource data known by the University at large.

3. The Office does not have sufficient detailed procedures for counselors to use in reviewing the overaward report. There is also a lack of supervisory monitoring of counselors' actions in determining if an overaward occurred. The overaward report is an internally-developed tool used by counselors to identify potential overawards for follow-up. The overaward report includes the $300 overaward

tolerance allowed by the federal government. However, certain counselors did not realize that the report included this tolerance and added it back, in determining if an overaward occurred. After reviewing reported overawards, counselors used a system table to exclude certain students from appearing on future reports. However, the resources or cost of attendance subsequently changed for several of these previously reviewed students resulting in undetected overawards. Internal Audit identified six overawards in federal programs totaling $7,822 and 12 overawards of state grants totaling $8,693. In addition, Internal Audit reviewed Fall 2002 awards and identified 35 undetected potential overawards excluded from the report. The University had not disbursed aid to these 35 students and subsequently corrected the potential overawards.

4. The Office does not reconcile its emergency loans and does not have written procedures for reconciling these accounts. At June 30, 2002, there was an unidentified balance of approximately $48,000. Failure to reconcile these accounts resulted in undetected errors. Internal Audit found the following errors during their testwork:

   - Four students received duplicate checks with a total of $1,150 remaining in unbilled receivables from three loans.

   - One student received a $600 loan, but no billing for repayment.

   - One student received proceeds of $600 from a $450 loan due to an error on the check request.

5. The Office does not have an adequate process to identify students who unofficially withdraw from classes. Federal regulations require institutions to develop a mechanism to identify students who constructively withdraw and return Title IV funds, if applicable. Although 218 students received all failing grades for a semester, the Office does not have a system report to identify these students for follow-up. Receiving all failing grades is a key indicator that the student may have ceased attending classes or withdrawn without officially notifying the University.

6. Our prior report addressed our concern that the Office failed to award $235,776 in authorized Perkins funds in fiscal year 2001 and recommended that the Office offer awards to additional types of eligible students. The failure to award the entire Perkins allocation not only impacts assistance to students during the year, but also may reduce the federal contribution in future years. In fiscal year 2002, the Office failed to revise its awarding philosophy and did not award approximately $300,000 in authorized Perkins funds.

7. The Office failed to communicate a change in the matching policy for the Federal Supplemental Education Opportunity Grant program to the University bursar. As a result, the University deposited the required matching funds three months late. Federal regulations require that the University deposit the match at the time of the federal drawdown.

8. The Office has 58 workstations using Windows 95 and 98 operating systems, which are subject to security violations. There are also weaknesses in the security settings for systems rights and access on the Windows NT server. It is essential

that the Office maintain appropriate security settings to protect its confidential and critical information from unauthorized access.

Management in the Office of Scholarships and Financial Aid should re-examine the oversight that it provides to counselors and other administrative staff and ensure that all employees have adequate supervision and training. The Office should review and enhance procedures to better administer its student financial assistance programs. Management should continue to work with Internal Audit's Management Services staff to develop system and process controls that minimize the risk of overawards and other noncompliance and ensure that all workstations have adequate security settings. Finally, the Office should better coordinate its efforts with other University departments involved in the processes for the identification and recognition of student resources and cost of attendance; cash management, including matching; and identification of unofficial withdrawals.

VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY
Blacksburg, Virginia