

AUDIT SUMMARY

Our audit of Virginia Polytechnic Institute and State University for the year ended June 30, 1999, 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;
- no material instances of noncompliance required to be reported under Government Auditing Standards; and
- adequate corrective action of prior audit findings.

SUMMARY OF SIGNIFICANT ISSUES

In the last audit, we reported significant problems with the College of Engineering equipment records. The University hired a consultant to perform a complete physical inventory of equipment and tag equipment items with bar codes to aid in the future physical inventories of equipment items. The consultant is now conducting a complete inventory. It is essential that the University adhere to sound equipment management controls to protect the University's assets and prevent a reoccurrence of these problems. An effective inventory management should include the following:

- Executive management must communicate to operating departments the importance of keeping accurate equipment records including communicating the movement, disposal, or cannibalization of equipment items to the Controller.
- The Controller should provide training and assistance to departments on equipment inventory procedures and the process for properly disposing of surplus and obsolete equipment.
- The Controller should re-examine procedures and resources committed to the surplus property program to improve the recording of surplus property sales and the cannibalization of equipment items.

The University does not have a sufficient overall fraud policy that clearly defines the responsibilities of Internal Audit, Legal Counsel, Campus Police, and the Office of Sponsored Programs in the identification, investigation, and reporting of suspected fraud. We observed confusion among the offices about their responsibilities. The University should develop a comprehensive fraud policy that clearly defines the roles and responsibilities of the above offices.

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UNIVERSITY OFFICIALS

October 27, 1999

The Honorable James S. Gilmore, III
Governor of Virginia

The Honorable Richard J. Holland
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, 1999, and have issued our report thereon dated October 27, 1999. Our report on the financial statements is contained in the President's Report 1998-99 issued by the University. We conducted our audit in accordance with generally accepted auditing standards 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 is responsible for establishing and maintaining internal control over financial reporting 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 internal control policies and procedures. The objectives of an internal control structure are 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 no instances of noncompliance that are required to be reported under Government Auditing Standards.

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 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.

Exit Conference and Report Distribution

We discussed this report with management at an exit conference held on October 25, 1999. 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

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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Strengthen Controls Over Equipment Inventory

In the last audit, we reported significant problems with the College of Engineering equipment records. These problems resulted from a breakdown in reporting disposals and surplus property sales and the movement of equipment between labs without updating the equipment records. We recommended that the Controller determine if there were similar problems in other colleges within the University.

The University hired a consultant to perform a complete inventory of equipment and tag equipment items with bar codes to aid in the future physical inventories of equipment items. The consultant is now conducting a complete inventory. After the completion of the consultant's inventory, the Controller should update the equipment records.

Next, it is essential that the University adhere to sound equipment management controls to protect the University's assets and prevent a reoccurrence of these problems. An effective equipment inventory management system should include the following:

- Executive management must communicate to operating departments the importance of keeping accurate equipment records including communicating the movement, disposal, or cannibalization of equipment items to the Controller.
- The Controller should provide training and assistance to departments on equipment inventory procedures and the process for properly disposing of surplus and obsolete equipment.
- The Controller should re-examine procedures and resources committed to the surplus property program to improve the recording of surplus property sales and the cannibalization of equipment items.

The University should provide adequate resources to perform biennial physical inventories as required by Federal regulations and to improve control over the assets. The Controller should ensure that prompt follow-up is performed on items not located in the inventory and communicate to executive management the results of future inventories. The Controller should also notify Campus Police of missing equipment items.

Develop a Comprehensive Fraud Policy

The University does not have a sufficient overall fraud policy that clearly defines the responsibilities of Internal Audit, Legal Counsel, Campus Police, and the Office of Sponsored Programs in the identification, investigation, and reporting of suspected fraud. Internal Audit has a detailed policy for the investigation and reporting of fraud and the University has other letters and memorandums that address the responsibilities of other offices in the process. However, we could not locate a comprehensive fraud policy.

We observed confusion among the offices about their responsibilities. For example, Legal Counsel failed to notify Internal Audit for several months after obtaining knowledge of a suspected fraud. There was also confusion between Internal Audit and the Office of Sponsored Programs about the responsibility to notify the grantor of a fraud involving grant funds. There is not a clear definition of which office has the

responsibility to notify the grantor, when to notify the grantor, and whether to notify the grantor for all sources of grants or just Federal grants.

The University should develop a comprehensive fraud policy that defines the roles and responsibilities of each of the above offices. The policy should clearly address who has the responsibility to notify the grantor of a fraud involving grant funds. The policy should also set forth guidelines to determine when a suspected fraud becomes a known fraud. It is our opinion that the University has a responsibility to notify the grantor of a fraud involving grant funds regardless of the source of funds.

We also encourage the University to communicate to employees their responsibility in the prevention and detection of fraud. Employee orientation is an excellent opportunity to discuss the responsibilities of employees to report suspected fraud to the State Fraud and Abuse Hotline or the Internal Audit Department.

Security Strengthen Controls over Windows NT Servers

The University does not have adequate standards for the configuration of its Windows NT servers. In our review of the security configuration of the Windows NT forms servers, we found weaknesses in password controls and a lack of adequate logging that could place the University at risk for loss of data or inappropriate system access. Specifically, we found the following:

Inadequate password controls

Windows NT administrators do not take full advantage of system security capabilities to strengthen security over passwords and protect the data from potential password attacks. System security settings do not:

- Require a minimum password length or prevent a user from reusing the same password.
- Lockout a user for repeated failed logon attempts.
- Restrict logon hours to specified times.
- Take advantage of Windows NT capabilities to define password structure such as requiring alphanumeric passwords to make passwords more secure.

Insufficient logging

Windows NT administrators do not fully take advantage of system logging capabilities. For example, monitoring tools log the use of user rights, file/object access, and user/group management, but only for failure. In certain circumstances, it is important to log successful actions. The administrators also have not enabled logging for logon/logoff or for security policy changes.

The University should develop standard security configurations for its Windows NT servers that address the above weaknesses. After we brought these matters to their attention, the Windows NT administrators took appropriate action to correct the weaknesses.

VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY

Blacksburg, Virginia

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