

**AUDIT SERVICES REPORT**

UNIVERSITY OF LOUISVILLE

COLLEGE OF EDUCATION AND HUMAN DEVELOPMENT  
FINANCIAL AUDIT

March 4, 2009

**To:** W. Blake Haselton, Interim Dean  
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Shirley Willihnganz, EVP and Provost

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## BACKGROUND

The College of Education and Human Development is located on Belknap Campus. It houses four academic units, eight research and outreach centers, an early learning campus, and the planetarium. During the academic year 2007-2008 there were 1,346 undergraduate and 1,480 graduate students enrolled in the college<sup>1</sup>. In October 2008, the college underwent a review by NCATE, the national education accreditation organization. Preliminary results indicate the college will receive unconditional accreditation.

The college has a very large volume of financial transactions and functions. During the period audited, there were 27 departments related to CEHD on the University financial system. Within the 27 departments were 315 programs, gifts, or endowments and 135 active sponsored grants and contracts. The college is heavily dependent upon procurement cards. As of June 30, 2008, there were 48 procurement cards issued with a cumulative spending limit of \$477,500 per month.

In the fiscal year ended June 30, 2008, the college's general fund budget was \$13,939,000. Total budgeted FTE (full time equivalents) for fiscal year 2008 was 236 employees, including 150.4 faculty positions<sup>2</sup>.

## EXECUTIVE SUMMARY

Audit Services performed a financial audit of the College of Education and Human Development (CEHD) at the request of University President James R. Ramsey. President Ramsey requested a full scope financial review after disclosure of an alleged fraud committed by the former dean of the college. This audit was not a forensic analysis of the fraud and as such, individual items constituting the recent federal investigation were not part of this review. The objectives of the audit were to obtain reasonable assurance that:

- Financial transactions originated by the college are accurate, supported, and legitimate.
- Controls over financial transactions are adequate to prevent or identify questionable activity.

This audit included fiscal years between 7/1/2005 and 6/30/2008. The scope of the audit included support and controls over:

- Procurement transactions including employee travel and expense reimbursements, procurement card activity, personal service contracts, and requisitions through PeopleSoft.
- Compliance with OMB circular A-21 and University policy concerning sponsored projects.

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<sup>1</sup> 2008-2009 Board of Trustees Finance Committee Budget Workshop.

<sup>2</sup> 2008-2009 Budget approved by the Board of Trustees June 12, 2008

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- Payroll activities related to additional compensation (supplemental and x-pay).
- Compliance with the terms of endowment and gift agreements.

In addition, where the college was compliant with University practices, those practices were evaluated for effectiveness in preventing or detecting questionable activity. Although the original scope of this review was between 7/1/2002 and 6/30/2008, many departments within the college are compliant with the University's published retention schedule, which requires financial documentation to be retained for three years. The original scope was adjusted where necessary to account for this practice.

We performed this audit in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. The purpose of the Standards is to: (1) delineate basic principles that represent the practice of internal auditing as it should be; (2) provide a framework for performing and promoting a broad range of value-added internal audit activities; (3) establish the basis for the evaluation of internal audit performance; and (4) foster improved organizational processes and operations.

Based on the work performed, we conclude that:

- Financial transactions originated by the college are accurate, supported, and legitimate with few identified exceptions.
- There is **OPPORTUNITY TO IMPROVE** the controls over financial transactions that are designed to prevent or identify questionable activity.

Significant issues were also identified relative to institutional procedures and processes. These issues indicated a need for enhanced education and training in contracts, the establishment of enhanced monitoring for compliance with sponsored project regulations, and stronger communication between senior business managers and the Vice President for Finance. These issues are being addressed in the University's response to Cotton and Allen's report on research processes.

Management has developed the following action plans:

### **Contracting**

- Training in contract concepts and procedures will be developed on an institutional basis. Until the training is developed and delivered, CEHD will work with University Counsel to develop contract templates and decision trees to ensure contract practices are compliant. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen.
- Institutional Issue: Fragmented contracting processes on an Institutional level will need to be addressed. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen.

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- CEHD will comply with established contract policy regarding contract practices and will develop a centralized database to ensure college administration is aware of outstanding contracts and contract terms.
- Institutional Issue: Accounts payable processes will be enhanced to ensure payments are made on authorized contracts only. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen.

### **Financial Controls**

- Institutional Issue: The Vice President for Finance (VPF) will develop stronger lines of communication with senior business managers. In addition, the VPF will provide input in the hiring, evaluating, and training of senior business managers.
- CEHD will review and redesign business processes to reduce the incidence of one person having complete control over transactions. A 'separation of duties' matrix will be implemented to optimize controls where possible.
- CEHD will continue to use QuickBooks until an institutional solution to encumbrance accounting is developed. Staff will be trained in reconciliations and the college will use the 'separation of duties' matrix to ensure reconciliations are performed properly.
- CEHD will continue to train and monitor procurement card transactions for compliance with policy. Consideration will be made to canceling cards where continued non-compliance is identified.
- Each business manager in CEHD will be trained in cash controls, including accountability of cash receipts, recordkeeping, separation of duties and security. The practice of borrowing from cash funds will not be tolerated.
- The college will implement on-going training and monitoring of employee travel and expense reimbursements for compliance with policy.
- CEHD will continue to monitor the Planetarium financial results. Although progress has been achieved, financial viability remains a "work in progress".

### **Payroll Controls**

- Payroll expense transfers, often necessary because of ineffective University processes, will be appropriately documented.
- CEHD will be compliant with the University additional pay policy.

### **Sponsored Project Compliance**

- Institutional issue: Develop a central process to monitor research projects for compliance. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen.
- CEHD will develop and train all faculty members on conflict of interest policies. Procedures for ensuring compliance will be developed.
- Instructions have been issued to prohibit business managers from signing effort reports for faculty. Controls over changes to effort recorded on the effort reports will be

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implemented to ensure changes are appropriate and that needed adjustments to salary expenses are made via expense transfers.

- Consistent procedures for identifying and recording contractual revenue collected by the College will be developed and implemented. Procedures will include security over funds, monitoring due dates and at which point receivables should be recorded on the University's financial records.
- Cost share funding will be reviewed and funded. Future cost share commitments will be fully funded at the time of award.

### **Security over Sensitive Information**

- Private individual information will be kept in a secured location at all times.

The following report presents the details of this audit.

## AUDIT REPORT

### ISSUES AND ACTION PLANS

The following key issues are presented to assist administration in strengthening internal controls over financial activity. Action plans represent a team effort between administration and Audit Services in developing cost-effective approaches towards addressing each area.

#### **Contracting**

##### **Issue 1: Improve Contract Training and Practices**

The University enters into a variety of agreements that require payment to third parties in exchange for services. The terms depend upon the purpose of the agreement. For example, an agreement to perform research for a sponsor is a grant award or a contract, while PSC (personal service contract) is the term used when an individual performs a service. These agreements, regardless of the term used, are contracts that legally bind the University to pay for the service provided or to perform a service in return for funding. Because the University is a state institution, state laws allow only the Board of Trustees to enter into these agreements. The Board has delegated signature authority to a few executive level administrators, who in turn have delegated authority to specific individuals. For example, Purchasing Department buyers can sign purchase orders, and Grants Management and the Office of Industry Contracts can sign contracts related to research. These individuals have been trained in the language required by state law, and language that protects the interests of the University. The Board of Trustees has not delegated signature authority to faculty, including deans, chairs, or academic unit heads. The University can void unauthorized contracts or agreements at its discretion.

CEHD has entered into various agreements without proper authorization. These agreements are referred to by various names, such as MOA (memorandum of agreement) or educational mentor agreements and may be oral or written. A faculty member or the Assistant Dean of Finance signs most of the agreements. In one instance, authorized University officials signed a contract, but a faculty member later signed an amendment that binds the University to the laws of another state.

In addition, Audit Services determined that some informal and formal agreements do not include a detailed description of the service or deliverable covered by the contract. Without sufficient description of services, it is not possible to determine if performance has occurred and payment can be made, or if the contract has been breached and payment should be withheld.

**Action Plan (Institutional):** This has been addressed in the University response to Cotton and Allen's recommendations.

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**(Department):** Until institutional policies and training is available, CEHD will work with University Counsel to develop an appropriate process for entering into contracts that are unique to the college. **Target Action Plan: June 30, 2009**

### **Issue 2: Streamline Fragmented Contracting Processes**

The contracting function at the University has developed to meet the needs of the organization as it has grown. As a result, a fragmented process has developed among different departments, namely Purchasing, the Office of Grants Management, the Office of Industry Contracts, University Counsel, and the Vice President for Business Affairs. If the University of Louisville Foundation is a party to the contract, the Vice President for Finance is involved through his role with the Foundation. The departments must determine which process to use by evaluating the type of contract and funding source. Generally, the department, project director, or principal researcher makes the initial determination. Purchasing and Grants Management will occasionally provide guidance if there is a difference of opinion with the initial determination.

However, there may be limited communication between the processing units. For example, if a researcher determines a contract is for personal services, he will work with purchasing. If a researcher determines a sub-contract is appropriate, he will work with Grants Management or the Office of Industry Contracts. The University has not developed a formal process for purchasing and research staff to review contracts. Complicating the process is an inherent incentive for researchers to classify a contract as a sub-award. Federal regulations require institutions to charge indirect cost on the first \$25,000 of a sub-award, while institutions can charge indirect cost on 100% of a PSC. This makes more funding available for direct charges when a sub-contract is used. The lack of a common review procedure increases the risk of a researcher misclassifying a contract.

A related issue concerns amendments to contracts that have expired or are due to expire. Amendments are required to go through the same process as original contracts. However, contracts through the University of Louisville Foundation do not go through purchasing or one of the sponsored projects routes. An outside attorney retained by the Foundation reviews these contracts and an authorized Foundation official signs. It is possible for the Foundation to approve and sign an amendment to a contract that the University's Purchasing Department originally approved. In May 2008, CEHD processed two contract amendments through the Foundation approximately 11 months after the original contract expired. The University Purchasing Department originally approved the contract as a PSC. Because the amendment was not required to be processed through Purchasing, it was not compared to the original contract and was approved and executed without question.

**Action Plan (Institutional):** This has been addressed in the University response to Cotton and Allen's recommendations.

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### **Issue 3: Comply with Contract Policy**

The University records retention policy, based on state and federal regulations, requires departments to keep contracts and supporting documents for three years after the expiration of the contract. Based on the testing performed during this audit, it is unclear whether CEHD is properly maintaining contracts. Audit Services tested 59 payments made to individuals or entities that required a contract. Only 28 contracts could be located.

CEHD relies on its component units to ensure appropriate record maintenance and retention. Most departments have delegated contract retention to the faculty members responsible for the program or project. Consequently, the Dean's Office cannot identify the number or types of contracts in the school, whether all contracts are written, are properly executed, are retained for the appropriate period, or are only paid when services have been performed and deliverables received. Lack of controls over contracts increases the risk of improper contracting practices and the risk of the University or school being committed to inappropriate contracts.

**Action Plan:** CEHD will keep original contracts at the unit level, with a copy in the Dean's Office, for the required retention period. The college will work with University Counsel's Office to develop appropriate written agreements and to develop procedures to ensure the agreements are executed in accordance with University policy. CEHD will also develop a central database of contracts to assist in tracking commitments made by the college. **Target Implementation Date: June 30, 2009**

### **Issue 4: Strengthen Accounts Payable Practices**

The University pays contracts through the PeopleSoft requisition system or a Request for Disbursement (RFD) form. Departments use RFD forms when a formal purchase order does not add value to the process. Examples of allowed uses include, but are not limited to, medical service payments, stipends, clinical trials, employee reimbursements, or subsidies/sponsorships. Policy requires departments to support the form with original receipts, invoices, or statements. However, Accounts Payable is not always provided a contract supporting a payment. Consequently, Accounts Payable may make payments based on unauthorized contracts.

The Accounts Payable staff also does not maintain a list of authorized officials who can sign various types of contracts. If Accounts Payable receives a contract with a payment request, staff may send it back to the department if there is no signature from a purchasing buyer. However, some contracts do not require a buyer's signature. For example, a lease agreement would require the signature from the Executive Vice President for Health Affairs or Vice President for Business Affairs. A sub-contract would require the signature of a Grants Management or Industry Contracts official.

**Action Plan (Institutional):** This has been addressed in the University response to Cotton and Allen's recommendations.

## Financial Controls

### **Issue 5: Enhance the Financial Manager Reporting Structure**

The financial management structure in the CEHD is the most common organization found at the University. Generally, each school has a senior business manager, with a title of assistant/associate dean for business/finance or a senior unit business manager. The staff in these positions report directly to the Dean. The University Vice President for Finance has limited authority over the financial activities of the academic unit. This organizational structure allows each academic unit the flexibility to meet unique needs. Each college and school has assessed the needed complexity of its financial structure and developed the management structure needed. However, decentralizing financial management has hampered efforts of the University to implement common and strong internal controls over financial processes. Accountability for compliance with University policies will depend upon the importance the Dean places on the activity. There are also increased risks from the influence the Dean has over the activities of the business manager. A Dean or Chair can pressure the business manager to be non-compliant with no recourse. The current reporting structure is also detrimental to training efforts. Past efforts to provide financial and policy training to staff in academic units has been hampered by an unwillingness either to pay for the training, or to give the business manager time from the unit to take the training.

**Action Plan (Institutional):** The Vice President for Finance (VPF) has begun monthly meetings with senior business managers in the University to discuss concerns and processes. In addition, the VPF will work with the Vice President for Human Resources to develop a procedure to share in the hiring decision qualified senior business managers, give input into the annual performance evaluations, and develop mandatory training. The business managers will continue to report to the Deans of respective schools and colleges.

**Target Implementation Date: June 30, 2009**

### **Issue 6: Design Processes and Job Responsibilities to Enhance or Implement Separation of Duties (Recurring from 10/2/2002 report)**

Audit Services reviewed the organization of CEHD for appropriate separation of duties. Separation of duties is a key control to prevent or detect errors or omissions timely. This control protects the institution's assets by preventing any one person from having complete control over financial transactions. To be effective, separation of duties must include rotation of duties during vacations, and accountability.

CEHD is organized around departmental or center business offices that are staffed by one or two employees, except for the Dean's Office, which is staffed with three business managers and the assistant dean of finance. The business managers are responsible for all aspects of financial transactions, including originating, recording, and reconciling. As a compensating control, the college requires transactions to be approved either by the assistant dean or, for sponsored research, the principal investigator/director of the project. Approvals occur after the transaction has been initiated, often without reviewing

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underlying documentation or justifications. The lack of separation of duties was observed in all financial aspects of the business functions of the college.

In CEHD, transactions also appear to be approved without a real understanding of the underlying financial purpose and without knowledge of the propriety of the transaction. For example, on one research grant reviewed, the researcher hired a graduate student to manage the financial aspects of the grant. When the student entered his internship, his position was reduced to .5 FTE. Because the student was given complete control over the financial aspects of the grant, he was able to reduce his time to .7 FTE instead of the .5 FTE authorized. As a result, he received overpayments totaling approximately \$11,500. This situation, while isolated, illustrates the risk of delegating approval authority to staff and faculty who approve transactions without reviewing all pertinent documentation or who do not have an in-depth understanding of the financial systems of the University. Without appropriate controls, there is no assurance that a similar situation could not reoccur or that it would be detected if it were to reoccur.

The planetarium gift shop is another unit with insufficient separation of duties. One person is responsible for collection of payments from customers at the cash register, creation of the deposit sent to the Bursar, and reconciliation of the supporting documentation to PeopleSoft financials.

**Action Plan:** The business processes of the college will be reviewed and redesigned to ensure appropriate separation of duties in all business units. If necessary, reorganization of business processes should be considered. In some areas, separation of duties becomes a staffing level issue. The college will review the feasibility of centralizing all financial functions in the CEHD in order to have adequate levels of staff to allow for separation of duties and cross training. A 'separation of duties' matrix will be developed to ensure controls over transactions are optimized where possible. **Target Implementation Date: June 30, 2009**

### **Issue 7: Perform Effective General Ledger Reconciliations (Recurring from the 10/1/02 report and the 2/25/2005 Scholarship report)**

General ledger reconciliations are a key control to ensure financial transactions are accurate and that questionable transactions are identified timely. In response to an audit issue in October 2002, the college installed QuickBooks in all business units. QuickBooks was intended as a supplemental accounting (shadow) system that would allow reconciliation to occur quickly at the program or project level. Some departments are using the program effectively by entering transactions as they occur and comparing PeopleSoft to the QuickBooks reports promptly. Most business units however are not using QuickBooks effectively. Some of the ineffective practices include:

- Entering procurement card transactions from the credit card statement received from the bank. This is done at the end of the monthly billing cycle. Transactions that do not appear on the bank statement are not posted to QuickBooks. Transactions that appear on the statement, but are not in PeopleSoft are deleted from the QuickBooks record.

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- General ledger transactions are entered from the University Reports. These reports are created by the Financial Systems Administration department using Crystal Reports and PeopleSoft. By using a University Report (also known as an RDS report) to populate QuickBooks, the reconciler is reconciling PeopleSoft to itself. Any difference will be the result of a data entry error into QuickBooks.
- Transactions that occur through a PeopleSoft interface, for example, payroll entries that transfer payments from the payroll system to the financial system or that are originated by another University department such as IT, Physical Plant, or the Bursar (tuition) are not verified through the review of various reports available from those departments. If these transactions appear on the financial statements, reconcilers assume they are accurate.
- General ledger categories for assets, liabilities, and revenue, are not included in the reconciliation process. This practice is encouraged by the Controller's Office because many of these accounts are used for institutional purposes and the department would have no control over or authorization to make entries. However, this is not true for some of the balance sheet or revenue accounts. For example, it is important that business units recognize cash deficits on gift and endowment programs and grant projects. In addition, accounts such as non-grant receivables, library assets, and some liabilities are the responsibility of the business unit and if not reconciled by the unit, will not be reconciled at all.
- Business units frequently ignore expired grants. However, the projects may not be frozen by the system, particularly if there is still an unspent budget and the Controller's Office has not issued the final financial report. Without a reconciliation or at least quarterly review of these projects, inaccurate or unauthorized transactions will not be identified.

Audit Services also determined that account reconciliations are not a priority for some of the business managers who are responsible for the financial aspects of the unit. More than one person indicated that they disliked for the accounting aspects of their position, did not have time to do it, or did not have necessary resources. In addition, these individuals report to the chair, principle investigator, or director of the unit. Conflicting priorities frequently occur when the business manager's supervisor directs the manager to perform activities unrelated to financial activities.

**Action Plan:** CEHD will invest in training staff in the use of QuickBooks until the institution develops a system that can properly encumber salaries. Further, the separation of duties matrix will be used that clearly identifies the parties responsible for reconciliation.  
**Target Implementation Date: June 30, 2009**

**Issue 8: Comply with University Procurement Card Policies (Recurring from the 10/1/2002 report)**

As of June 30, 2008, the college had 48 active procurement cards. The controls over these cards should be improved to prevent or identify loss from improper use. Procurement card control weaknesses identified include:

- Failure to reconcile timely. Refer to issue 7.
- Lack of separation of duties. Refer to issue 6. The procurement cardholder is frequently the reconciler and authorizer/approver. In addition, many times we found the card to be in the possession of someone other than the official cardholder.
- Acceptance of “missing receipt” forms. The form is certifying by signature that transactions comply with policy and are not for personal purposes. If a transaction is later found non-compliant, the signer agrees to reimburse the department. Audit Services noted that the card reconciler is completing and signing these forms instead of the person who made the purchase. It is not possible for the reconciler to know what the purchase was and if it was for official or personal purposes. In addition, excessive use of a missing receipt form (more than once or twice per year) is a red flag that fraudulent activity may be taking place.
- The PeopleSoft system has a process for reallocating procurement card charges to the appropriate program or project before the charges are transferred to the general ledger. This eliminates the need for expense transfers, which increase the risk of processing errors. Because most business managers do not look at procurement card transactions until after the bank statement is received, the system reallocation process is not being used. Where the system is not being used, Audit Services identified excessive expense transfers moving procurement card charges between programs and projects or between general ledger account codes.

Security over procurement cards also needs improvement. Most individuals keep the cards in a desk drawer that is kept unlocked during the business day. Some employees keep a copy of the card (front and back) at their desk so that it is handy when they have to make a purchase.

University policy requires procurement cardholders to keep a log of transactions that includes the name and signature of the person who actually made the transaction, if that person is not the official cardholder. CEHD has determined that log is unnecessary and is using QuickBooks. However, as discussed above, QuickBooks entries are not made when the transaction is originated, but are updated from the bank statement. In addition, it cannot record the name and signature of individuals who “borrow” the card from the cardholder. Recent changes by the Procurement Card Department require the cardholder, PeopleSoft reconciler, and PeopleSoft approver to sign the monthly log.

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Audit Services tested over 250 transactions that occurred between July 1, 2005 and June 30, 2008. Most of these transactions were compliant with policy; however, policy exceptions were noted as follows:

### PROCUREMENT CARD TRANSACTION TESTING RESULTS

Attribute	Tested	Identified Errors	Percent Error
Transaction was within limits established for the card	257	12	5%
Original receipt was on file	257	43	17%
Entertainment was supported with a list of attendees and the business purpose for the entertainment	47	21	45%
Transaction listed on a transaction log	247	211	85%
On sponsored research, the transaction was allowable, allocable, and reasonable per OMB circular A-21	55	2	4%
Sales taxes (transaction in Kentucky) was not paid	202	19	9%
Item purchased was allowable per University policy (e.g., personal purchases, alcohol on general funds)	239	28	12%

Business units responsible for large events or purchasing quantities of medium cost equipment had a practice of splitting a transaction between multiple purchases that occurred the same or subsequent days. This circumvents the per transaction spending limit that was established by the Chair or Dean when the card was issued. Policy allows procurement cards to be used for meals during business meetings. These transactions must be documented with the names of all persons who attend and the business purpose of the meal. This documentation was missing on 45% of the transactions to restaurants or caterers that were tested. Transactions on grants must be allowable per OMB Circular A-21. Two of the purchases were for general office supplies. While allowable on a grant, office supplies are considered indirect costs and generally cannot be directly charged to a grant. Exceptions are allowed only when the office supply is directly related to the project (such as paper used to print a survey sent to participants or binders given to workshop attendees).

There were 41 questionable items purchased by or on the direction of the former dean, totaling \$2,793.55. These purchases include books (novels and U.S. history), membership in a bookstore's "preferred buyer's club", and moving supplies. In addition, over \$17,000 was charged to the Dean's Office procurement cards in fiscal year 2008 for professional journals and membership in professional organizations.

**Action Plan:** The use of procurement cards is governed by a strong University policy and procedure administered by the Purchasing Department. Staff and faculty undergo continuing training in the appropriate use of the procurement card and in policy compliance. The college will develop and perform on-going reviews and will consider

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canceling all cards except one for each department, if departments continue non-compliant practices. **Target Implementation Date: June 30, 2009**

### **Issue 9: Strengthen Controls over Cash, Checks, and Credit Card Receipts (Recurring from the 10/1/2002 report)**

Each business unit receives payments for providing services, hosting conferences or training events, or from employees for reimbursement. There is no procedure for ensuring the money received is properly accounted for or deposited with the Bursar within the 3-days required by University Policy. Cash, checks, or credit card payments should be received under dual control, checks immediately endorsed, logged and checks copied. The cash and checks should then be recorded on a transmittal and immediately deposited with the Bursar. If there is a delay, the receipts should be stored in a locked location with access limited. Each month the log should be reconciled to the general ledger by another staff member. In the CEHD units funds are not being logged as received, there is no separation of duties, and many units do not have endorsement stamps to endorse checks immediately. Consequently, there is no assurance that cash and checks are being deposited or used for the benefit of the college.

At least one department is maintaining a petty cash fund that is not recorded on the general ledger and has not been approved by the Controller's Office. This petty cash is used as a change fund and as a convenience fund for employees to use for personal meals or gas. On two days in September, employees "borrowed" from the fund and did not pay the money back. One borrower has left the University's employment and the other borrower did not leave his or her name. Security over the cash supply was inadequate with at least six different people (entire staff of the department) having access to the cash. In September 2008, over \$600 had accumulated.

Some departments purchase gift cards to compensate human subjects on sponsored projects. Gift cards are considered cash equivalents and should be subject to the same controls as cash. In addition, an inventory of the cards purchased should be maintained. The actual card stock should be agreed to the inventory log periodically. The cards are not currently controlled by the units using gift cards for human subjects.

Departments that are routinely storing cash, checks, gift cards, or other cash equivalents do not have secure storage facilities. A safe is available in the Dean's Office; however, most unit business offices do not have desks with locking drawers or do not use locking desks or filing cabinets when available.

**Action Plan:** Each business manager will be trained in cash controls. These controls include procedures necessary to maintain accountability over cash receipts, recordkeeping, separation of duties, and security controls. Finally, employees are not allowed to "borrow" from University funds and this practice will not be tolerated. **Target Implementation Date: June 30, 2009**

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### **Issue 10: Appropriately Approve and Document Employee Travel and Expense Reimbursements**

Audit Services tested 98 payments to staff and faculty as reimbursement for travel, entertainment, or petty cash purchases. These 98 payments represented 898 different expense items. There were a significant number of exceptions related to supervisory approval on travel and miscellaneous item reimbursements, and documentation on the purpose of entertainment (for example, meals associated with meetings).

Supervisory signatures are required for travel reimbursements and direct payment reimbursements. In addition, if the employee's supervisor is a participant of the meal or other event, that person is not authorized to sign or approve the reimbursement request. Instead, the expense reimbursement request should go to the highest-level supervisor who was not attending the event. For example, if a department chair hosts a faculty recruitment dinner and the dean is present, the provost must approve the request for payment (when a procurement card is not used). In addition, the purpose of the meal must be documented in addition to the names of the people present.

It was observed that in some cases the receipt attached for meal reimbursement was not the detailed receipt, but was the credit card receipt. Without the detailed order receipt, it is impossible to determine if unallowable items were purchased, namely alcoholic drinks paid from state appropriations.

**Action Plan:** Faculty and staff will comply with the approval policies for these expenses. Receipts submitted to support meals will include the credit card and the detailed order receipts. This will not only allow monitoring on the propriety of the purchase, but also help ensure the employee does not receive reimbursement twice. The college will implement on-going training and reviews and will ensure these activities are incorporated in the 'separation of duties matrix' for tracking and monitoring for compliance with policy.  
**Target Implementation Date: June 30, 2009**

### **Issue 11: Monitor Planetarium Financial Results for Sustainability**

The planetarium is organized as a self-sustaining entity intended to generate enough revenue from external sources to cover operating costs. Since its inception in 2001, the planetarium has not had a sustainable business model and has not recovered all costs. It was moved from Information Technology to CEHD in 2006. Below is an analysis of the revenues and expenditures in the planetarium for the last two fiscal years with 2009 budget information obtained from the planetarium director.

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**PLANETARIUM FINANCIAL RESULTS**

	Fiscal 2007 <sup>1</sup>	Fiscal 2008 <sup>2</sup>	Year to Date Fiscal 2009 <sup>2</sup>	Fiscal 2009 Budget*
Total Revenue	158,922	142,835	45,037	147,580
** Total Expenditures	273,707	298,760	124,326	448,290
Loss for Year	-114,780	-155,924	-79,288	-300,710

<sup>1</sup>Information developed by Audit Services

<sup>2</sup>Information from University Reports: CONT-03A

\*The FY09 Budget is annualized expenditures and accounts for planned expenditure reductions

\*\*The expenditures do not include the Planetarium director's salary of \$90,320

In October of 2007, a new director was hired to change the direction of the planetarium. The new business plan includes diversifying the content of the planetarium, using the planetarium as a tool to advance the University's research mission, and facilitating University outreach. According to the director, the planetarium's position within CEHD provides unique opportunities including obtaining grants and contracts. Obtaining grants and contracts along with improving gate sales, increasing community support, and developing profitable facility rentals are key to the planetarium's success.

**Action Plan:** CEHD took on oversight of the Planetarium based on the Board of Overseer's recommendation. The issue of revenues not covering expenditures was known from the outset. CEHD agreed to accept oversight with the understanding that it would take three to five years to develop a viable business model to cover all program costs. Much progress has been achieved in that regard, but it is still a work in progress to achieve that end. **Target Implementation Date: Implemented**

**Payroll Controls**

**Issue 12: Document Payroll Expense Transfers**

Payroll expense transfers are frequently made to correct errors and to move salary onto grants and contracts when the expense was incurred before the project was established in PeopleSoft. Expense transfers are considered high risk, and should be kept to a minimum and well documented. Documentation should include the reason the transfer is necessary and the corrective action taken to ensure another transfer will not be required. University policy requires a Dean or Vice President approve transfers that occur more than 90 days from the date of the original expense. Audit Services tested a sample of 19 payroll expense transfers to determine if the transfers were appropriately documented and approved.

In the sample tested, eight of the transfers were processed more than 90 days from the date of the original transfer. These transfers were approved by the authorized employee. However, 16 of the tested transactions did not include a justification for the transfer and an indication that an error condition had been corrected.

**Action Plan:** Documentation sufficient to explain transfers that are initiated within 90 days of the transaction origination date will be documented to the same extent of "older" transfers. **Target Implementation Date: Implemented**

**Issue 13: Comply with Supplement and X-pay Policy**

Additional pay is a mechanism used by the University to compensate employees for performing work outside their normal scope of work. Supplemental payments are intended for additional duties that will be performed for an extended period and will be eligible for inclusion in benefit calculations. X-pays are for additional duties over a short interval and are not included in benefit calculations. All additional pay must be authorized by the department head and dean and include documentation on the purpose of the payment.

Audit Services tested a sample of 36 additional payments. Most of the payments were for summer salary for faculty on 10-month contracts. However, the documentation for two of the payments did not include a justification or purpose. Another employee terminated with the college effective May was paid for June through an x-pay.

Two other payments were made to circumvent University policy on the direction of the former dean. One payment for over \$11,813 was classified as a supplemental payment. The documented purpose was to compensate an employee for late enrollment in the retirement system. It is unclear as to why the employee was not enrolled in the retirement system until 6-months after the eligibility date. Regardless, University policy clearly prohibits retroactive enrollment. In addition, the payment included an amount described as the employee contribution. University policy allows employees to begin immediately contributing into the plan. Any failure to begin contributions would be the responsibility of the employee. Finally, if the University conceded liability to the employee for the late enrollment the most that would be due is approximately \$2,550, (7.5% of gross annual salary for 6-months). Under no circumstances should the employee have received a supplement. The request should not have been processed by the Payroll Department, where another breakdown in controls occurred. Any retroactive payment should have been deposited in the retirement plan. As a result, the employee received \$11,813 and an additional retirement contribution.

**Action Plan:** The College will continue to comply with University policies concerning additional payments. The employee overpaid through the efforts of the former dean has left the Universities employ and further collection efforts are not feasible. CEHD will continue to review processes in-house and strengthen controls by ensuring there is appropriate approvals and separation of duties. **Target Implementation Date:** **Implemented**

### **Sponsored Project Compliance**

**Issue 14: Enhance Sponsored Project Compliance**

The University has historically given PIs (principal investigators) and PDs (project directors) the responsibility for monitoring compliance with research regulations. The PIs often hire administrative staff with varying levels of expertise to help with the administrative and compliance functions. Central administrative units will provide some monitoring functions.

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There is no dedicated compliance monitoring function over sponsored projects, except for specialized regulations over human subjects, animal welfare, student financial aid, or biological/chemical/nuclear substances. The Controller's Office is responsible for monitoring for completed effort reports and sub-award audits. The Office of Grants Management monitors projects to ensure researchers are not paid 100% from sponsored projects. Research Integrity maintains research conflict of interest information. These relatively small departments are responsible for a very large volume of sponsored contracts. For example, in addition to monitoring functions for effort reports and sub-contractors, the Controller's Office is responsible for operational activities such as billing and collections. To perform critical operational responsibilities, many departments limit compliance monitoring to the minimum required. For example, OMB Circular A-133 requires certain entities that accept federal grant money to have independent audits verifying compliance with regulations. The requirement for these A-133 audits is incorporated into sub-awards by contract and regulation. The Controller's Office only monitors sub-contractors for external A-133 audits if the original sponsored project is coded federal on PeopleSoft and the department has accurately posted a payment to a monitored general ledger expense account. Audit Services identified one sub-contractor who was not being monitored because the payments were posted to the incorrect general ledger account. Another non-federal sponsor was required to have A-133 audits on file through contract language. There is no process to ensure a sponsor is complying with contract requirements.

There is also no on-going review of expenditures for compliance with OMB Circular A-21. While the Controller's Office may question expenses at the time of grant closeout, this could be a year or more after the expense was incurred and paid. A researcher is responsible for complying with sponsor regulations; however, there should be an independent monitoring program to protect the researcher and University from errors in interpretation or knowledge gaps. A central independent authority would also help ensure consistent application of the various government regulations.

**Action Plan (Institutional):** This has been addressed in the University response to Cotton and Allen's recommendations.

### **Issue 15: Monitor Conflicts of Interest and Comply with Current Policy**

Financial conflicts of interest in research are governed by a policy adopted by the University as of April 4, 2004, revised May 3, 2007, that says in part:

**“Covered Individuals:** At least annually, each *covered individual* (and/or his/her spouse and dependent children) must complete a *Disclosure of Significant Financial Interests* under the provisions of this policy or sanctions may be imposed. In the event of changes, the covered individual (and/or his/her spouse and dependent children) must complete a Disclosure of Significant Financial Interest within 30 days after any significant change in the individual's (and/or his/her spouse and dependent children) *significant financial interests*; or to reflect the emergence of other circumstances that might cause research the individual is conducting to be affected by significant financial interests. . .

(4) **“Covered individual”** includes any faculty member (whether fully-, partially-, or non-salaried), staff member, student, fellow, trainee, administrator or other employee who, under the aegis of the University, is involved in research, or pursuant to the review and approval of the University's Institutional Review Board (IRB), conducts research involving human subjects, or is otherwise identified as involved in research by a principal investigator, chair or unit head, or other University administrative officer responsible for research activities. ”

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In practice, the University has allowed each academic unit's Dean of Research to determine who is a covered individual in that unit. At CEHD, covered individuals did not include instructors, graduate research assistants, or students working with faculty on sponsored research. It is the Dean's responsibility to ensure the timely filing of financial conflict of interest disclosures. Finally, there is no procedure to ensure the disclosures are completed correctly. At CEHD, three researchers incorrectly completed the disclosure stating they were not involved in research.

Conflicts of interest unrelated to research are governed by personnel policy PER 1.03, which requires conflicts to be reported to the University as soon as identified. Two potential conflicts of interest were identified in the CEHD. In one situation, a faculty member hired her daughter to work on a research project on which the faculty member was the principal investigator. In addition to being a potential conflict of interest by employing her daughter, this was a probable violation of the University's nepotism policy, which prohibits employees from being involved with the terms of employment of a family member. In another situation, a researcher hired a close family member as a contractor for computer programming. In addition to being a violation of University policy, this payment was an apparent violation of Kentucky statute (KRS.45A.455). This statute says in part: "(1) It shall be a breach of ethical standards for any employee with procurement authority to participate directly in any proceeding or application; request for ruling or other determination; claim or controversy; or other particular matter pertaining to any contract, or subcontract, and any solicitation or proposal therefore, in which to his knowledge:

(a) He, or any member of his immediate family has a financial interest therein; . . ."

**Action Plan:** The College has informed and trained all faculty members on the requirements of the University's conflict of interest policy. Training and reports have been monitored and the faculty's participation documented and reported to the dean. All faculty in the college are required to report conflicts of interest, faculty who receive external funding are required to obtain fiscal responsibility training, and faculty that participate in research and student committees are required to register and complete training for research ethics. Records show that all faculty members are now in compliance with these requirements. Quarterly reports have been developed that will provide staff in the college information necessary to notify staff of training expiration dates. **Target Implementation Date: Implemented**

### **Issue 16: Accurately Complete Time and Effort Reports**

Staff and faculty complete time and effort reports semi-annually. Reports are due in January to monitor the salary charged to federal and federal flow-through grants, and in July to certify the accuracy of salary charges. Federal regulation requires a researcher or someone with knowledge of the actual effort expended on a project to certify the effort.

Audit Services tested a sample of 22 effort reports certifying salary charges as of June 30, 2008. The project director or someone knowledgeable of the actual effort expended did not sign three reports. Instead, the project director instructed the business manager to sign the director's name certifying the accuracy of the reports. The business manager had no knowledge of the work performed and did not know if the people paid on the grant were

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actual UofL employees. Allowing subordinate staff to sign a supervisor's signature increases the risk of theft or embezzlement. The practice was a potential violation of federal regulations because a person with direct knowledge of the work performed did not certify the effort.

**Action Plan:** All unit business managers have been assigned the task of disseminating the effort reports for affected personnel. The completed reports will be reviewed in the Dean's Office for accuracy and adherence to procedures for appropriate completion. Business managers have been instructed that at no time are they to sign the effort report for the PI and they are to report to the CEHD research office if they are asked to do so. Changes in effort are reviewed and processed in the Dean's Office. At the time of award implementation, salary changes are reviewed by the PI, the department representative, and the Research Office. The Research Office will provide to the Dean's Office personnel the appropriate charges and the department representative will monitor the monthly reports to verify the charges are correct. **Target Implementation Date: Implemented**

### **Issue 17: Monitor Billing and Collections Activity**

CEHD is involved with various programs that require the college to perform billing and collections activity. For example, the Kentucky Autism Training Center (KATC) provides training to parents, schools, and school districts. In 2008, KATC collected over \$98,000 from this activity. The National Research Center on Career and Technical Education (NRCCTE) provides a 3-tiered program to school districts across the country. Non-grant revenue in 2008 was approximately \$242,000. Education Counseling and Psychology (ECPY) sells protocols to students that are used during student practicum activities. Each of these activities requires the unit to track contracts, billings, and collections. None of the units record accounts receivable on the general ledger although some receivable balances can be significant. There are various tracking mechanisms used to ensure the receivables are collected. NRCCTE has started a spreadsheet of contracts with receivable information. KATC keeps a spreadsheet of scheduled training, but does not update or reconcile to payments received. ECPY does not maintain an inventory of available protocols or reconcile funds received to inventory. Lack of formalized procedures and controls over contract or non-grant receivables increases the risk of losses through non-collection or from theft of funds coming into the University.

**Action Plan:** The College will develop procedures for handling contract and other miscellaneous revenues. Procedures should include the controls that units are expected to implement to protect funds coming into the University, the amount at which units must record receivables on the general ledger, and receivable monitoring processes. **Target Implementation Date: June 30, 2009**

### **Issue 18: Fund Committed Cost Share Budgets**

Cost share is sometimes required by project sponsors and is sometimes committed by faculty who are competing for grants. Cost share is accounted for by the University using a 3-pronged process: budget establishment, budget funding, and cost allocation. When cost

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share is committed or required the Office of Grants Management establishes a budget on PeopleSoft in a specific fund. As the researcher or project director spends the budget, the expenses are posted to the cost share fund. Unless the budget is funded, the cost share fund will develop a cash deficit. As of June 30, 2008, the cash deficit report for CEHD included 29 sponsored projects. Of these 29 project deficits, 6 were partially the result of unfunded cost share, and one was entirely the result of unfunded cost share. Only one of the grants with a cash deficit that had required cost share had partially funded the cost share fund. The amount of the unfunded cost share that contributed to the cash deficits was \$185,000.

**Action Plan:** All current cost share commitments are under review and the funding is in process. For future commitments, cost share will be funded at the time the award is made.

**Target Implementation Date: Implemented**

### Security over Sensitive Information

**Issue 19: Implement Security over Social Security Numbers and Credit Card Numbers**

Audit Services observed employee and vendor social security numbers on various payment support documents and file labels. While the information is not readily available to students or individuals outside the college, it is available to staff and faculty. Unsecured access to social security numbers increases the risk of identity theft to faculty, staff, and business partners.

Credit card numbers are also considered sensitive data that should be protected through enhanced security. Credit cards are accepted for various activities sponsored by the CEHD, such as workshops and purchases through the gift shop. Where credit card numbers are obtained manually, it is critical that the documents be stored in a location that is secured (locked) at all times, with limited accessibility. The entire credit card number should not remain legible, with all but the last four-digits redacted as soon as possible.

Protecting sensitive data is the responsibility of the college and helps protect faculty, staff, contractors, and customers.

**Action Plan:** Social Security numbers have been removed from all file folders. All credit card transactions and documentation is kept in a secured location at all times. All information involving the credit card numbers is disposed of according to the policies and procedures set forth by the University. **Target Implementation Date: Implemented**



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