

# Investigative Report

Legislative Joint Auditing Committee

September 10, 2013

## Review of Selected Policies, Procedures, and Transactions

University of Arkansas, Fayetteville  
Division of University Advancement

### INTRODUCTION

This report is issued in response to a request by University of Arkansas, Fayetteville (University), Chancellor G. David Gearhart for the Division of Legislative Audit (DLA) to conduct a financial review of the University's Division of University Advancement (Advancement), which had deficit cash balances for the fiscal years ended June 30, 2011 and 2012.

DLA and the University of Arkansas System Internal Audit (Internal Audit) staff determined that DLA would review selected financial records as well as internal controls, policies, and procedures at Advancement, while Internal Audit would focus on budgetary controls over Advancement's operation.

The results of DLA's review are presented in the **Results of Review section on pages 4 through 15**, with Management's Response provided in **Appendix A on pages A-1 through A-7**. The Internal Audit Report is presented in its entirety in **Appendix B on pages B-1 through B-12**.

### HIGHLIGHTS OF REPORT

- ◆ DLA review of Advancement financial records revealed **deficit cash balances of \$2.14 million and \$4.19 million** at June 30, 2011 and 2012, respectively.
- ◆ The Treasurer's Office posted Advancement **accounts receivables of \$2.1 million and \$2.5 million** at June 30, 2011 and 2012, respectively, which **partially obscured the deficits in the financial statements**.
- ◆ The Vice Chancellor for Advancement Division **did not exercise proper fiscal oversight and did not comply with University policies and procedures**.
- ◆ Advancement revenues remained relatively constant over the four-year-period reviewed, while **expenditures increased significantly** from \$7.94 million to \$13.23 million, resulting in an **overall decline in the combined Advancement and Foundation cash balance**.

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Report ID: IRHE69713

Report Date: August 22, 2013



## OBJECTIVES

The objectives of this review were to:

- Identify factors contributing to deficit cash balances in Advancement and reasons University management did not detect the deficits in their early stages.
- Identify the causes and decisions that led to deficit cash balances in Advancement and the point at which problems began.
- Determine the amount of University and University of Arkansas Foundation, Inc. (Foundation),<sup>1</sup> resources used for Advancement operations and whether funding was budgeted.
- Review selected Advancement financial records for compliance with generally accepted accounting principles.
- Determine propriety of selected Advancement disbursements and other transactions.
- Evaluate adequacy of and adherence to University internal controls and policies.

## SCOPE AND METHODOLOGY

### General

The review of Advancement financial records, internal controls, policies, and procedures was conducted primarily for the four-year period July 1, 2008 through June 30, 2012. The review consisted primarily of inquiries, observations, analysis, and selected tests of internal control policies and procedures, accounting records, and other relevant documents.

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<sup>1</sup>In this report, “the Foundation” refers only to Advancement funds held by the Foundation or transactions between Advancement and the Foundation.

To gain an understanding of Advancement and its relationship with both the University and the Foundation, appropriate personnel were interviewed. In addition, Advancement organizational charts, job descriptions, and accounts/“cost centers”<sup>2</sup> were reviewed.

Advancement records examined included bank account information, general ledger, journal entries, invoices, and routine financial reports. Selected University payroll files also were analyzed. To determine if Advancement personnel received duplicate expense reimbursements, documentation supporting Advancement personnel travel and other expense reimbursements obtained from the Foundation was compared to Advancement documents. Other Foundation records relating to Advancement that DLA staff inspected were vendor payment authorization forms and loan agreements.

References to the Foundation pertain only to Advancement transactions involving the Foundation and Advancement funds held by the Foundation.

### Access to Financial Records

DLA staff experienced difficulty obtaining Advancement financial records, which potentially limited the scope of this review. For example:

- A total of only 20 payment authorization forms were maintained by the University for fiscal years 2010 and 2011. Approximately 765 payment authorization forms located for the fiscal year ended June 30, 2012, were not maintained in any order and appeared to have been haphazardly placed into boxes. It was the University’s practice to not retain payment authorization forms.

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<sup>2</sup>“Cost centers” are general ledger fund account groups. A cost center tracks all the financial activity of a specific function (e.g., activity of the Office of University Development, activity of University Relations, etc.).

- Worksheets and files detailing all Foundation reimbursement requests prepared by Advancement Director of Budget and Human Resources (Budget Director) could not be located. According to the Vice Chancellor for Advancement Division (VCAD), the Budget Director prepared budget reports; however, none of these reports were available for review.
- When the Budget Director was relieved of her Advancement job responsibilities, the computer she used was reissued to another employee. However, this computer's hard drive contents were not "imaged" or backed-up for future review or use.

The methodology used in conducting this review was developed uniquely to address the stated objectives; therefore, this review was more limited in scope than an audit or attestation engagement performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

## BACKGROUND

### Purpose

The purpose of Advancement is to build understanding and support for higher education by enhancing the University's image, involving alumni and other constituencies in proactive functions, and raising private gift support.

### Organization

During the period of this review, the head of Advancement was VCAD Brad Choate. In addition to the VCAD, Advancement had 158 employees: 3 office staff; 42 in University Relations; 80 in University Development; 3 in Constituent Relations; 23 in Arkansas Alumni Association; and 7 in Arkansas World Trade Center.

Budget Director Joy Sharp reported directly to and prepared regular financial reports for the VCAD.

### Operations

Advancement operated with University funds; utilized the University's accounting system, Business and Administrative Strategic Information Systems (BASIS); and operated under the University's policies. Specifically, the Transaction Approval policy requires use of the online application Transaction Approval Gateway via Electronic Transmission (TARGET).

Using a predetermined formula, the University annually budgeted and provided a portion of state aid and tuition and fees to fund the operations of Advancement and other University divisions. Additional University funding sources included discretionary funds available to Vice Chancellor for Finance and Administration Don Pederson.

Advancement also received approximately \$4 million annually in operating funds from the Foundation. The funding amount was based on a percentage of a three-year rolling average of investment earnings on unrestricted endowment donations held by the Foundation. Foundation staff deposited these funds into the Advancement account quarterly.

The Foundation allowed Advancement to expend its current annual funding prior to revenue being credited to its Foundation account.

Advancement could access the Foundation funds in two ways:

- Submit requests for funding for which the Foundation would remit funds to the University's Advancement account.
- Request that the Foundation pay vendors directly on its behalf by

submitting to the Foundation both an appropriate invoice and a payment authorization form, approved by the Vice Chancellor for Finance and Administration or his assistant. After issuing the check for payment, the Foundation sent it to Advancement for mailing to the appropriate vendor.

The University's centralized budget for Advancement includes only unrestricted University funds allocated for the operation of Advancement and does not include Foundation funding. Instead, Advancement is comprised of both budgeted and unbudgeted cost center accounts. For the fiscal year ended June 30, 2012, for example, 13 cost centers were budgeted, and 68 were unbudgeted.

#### Other Events

On July 6, 2012, the Budget Director informed the VCAD that the Foundation had frozen Advancement's account and that a requested transfer of \$225,000 for the annual contribution to the Chancellor's deferred income account had been denied because the Advancement Foundation account had a deficit balance.

On July 20, 2012, the Vice Chancellor for Finance and Administration directed the Treasurer to conduct an internal review of Advancement's financial situation. The results of the Treasurer's review were issued in a report dated October 19, 2012, which is presented in **Appendix C on pages C-1 through C-4**.

On February 5, 2013, Chancellor Gearhart requested that both DLA and Internal Audit conduct an audit of Advancement.

Employment contracts for Choate and Sharp expired June 30, 2013, and were not renewed. Both of these employees were assigned other duties until their contracts expired. A new VCAD and Budget Director were hired effective April 1, 2013, and

September 3, 2012, respectively. In the interim, the Chancellor acted as VCAD, the position he held prior to assuming his role as Chancellor.

A complete timeline of events is provided in **Schedule 1 on pages 14 and 15**.

## **RESULTS OF REVIEW**

DLA review of Advancement financial records revealed deficit cash balances and incorrect journal entries for accounts receivable at June 30, 2011 and 2012. Other matters discovered were non-compliance with generally accepted accounting principles and University policies and procedures; deficiencies in internal controls; and lack of oversight by the VCAD. In addition, information contained in an internal report prepared by the Treasurer relating to Advancement was not disclosed to DLA auditors during the exit conference for the 2012 financial audit.

An analysis of Advancement's financial information is provided in **Exhibit I on page 5**.

Review results and recommendations are discussed below by topic. To assist in understanding the sequence of events, a timeline is presented in **Schedule 1 on pages 14 and 15**.

#### **Financial Trends over Four-Year Period July 1, 2008 through June 30, 2012**

An analysis of financial information for Advancement and the Foundation for the period July 1, 2008 through June 30, 2012, is presented in **Exhibit I on page 5**.

At July 1, 2008, the Advancement cash balance was \$200,214, while the Foundation cash balance was (\$348,027), resulting in a combined deficit cash balance of (\$147,813). Over the four-year period ended June 30, 2012, Advancement revenues and other

## Exhibit I

University of Arkansas, Fayetteville  
 Advancement Division - Analysis of Financial Information  
 For the Period July 1, 2008 through June 30, 2012

	For the Year Ended June 30,			
	2009	2010	2011	2012
<b>Advancement - University</b>				
Cash balance forward	\$ 200,214	\$ 19,151	\$ 545,616	\$(1,957,577)
Revenues and other sources				
Allocated revenue (Note 1)	3,992,923	3,997,408	4,093,729	4,683,948
Realized revenue (Note 2)	375,672	181,485	192,618	499,052
Reimbursements from Foundation (Note 3)	2,113,239	6,290,031	3,793,794	6,133,123
Tyson restricted donation - deposited into unrestricted Revenues and other sources				(1,355,056)
	6,481,834	10,468,924	8,080,141	9,961,067
Net transfers (Note 4)	1,276,614	892,786	1,275,242	1,417,143
Available Revenues	7,758,448	11,361,710	9,355,383	11,378,210
Expenditures				
Salaries, wages, and fringe benefits	6,767,412	7,267,659	7,660,892	8,720,527
Maintenance	868,085	658,720	932,480	1,079,236
Scholarships and other operating expenses	304,014	453,193	592,860	710,717
Subtotal	7,939,511	8,379,572	9,186,232	10,510,480
Advancement Foundation direct payments to vendors (Note 3)		2,455,673	2,672,344	2,716,571
Total Expenditures	7,939,511	10,835,245	11,858,576	13,227,051
<b>Ending Cash Balance</b>	<b>a \$ 19,151</b>	<b>\$ 545,616</b>	<b>\$(1,957,577)</b>	<b>\$(3,806,418)</b>
<b>Advancement - Foundation</b>				
Ending cash balance	\$ (853,413)	\$(1,495,687)	\$(1,439,965)	\$(1,560,677)
Fourth quarter earnings posted July 1	1,207,559	1,115,047	1,255,714	1,176,611
Adjusted ending cash balance	<b>b \$ 354,146</b>	<b>\$ (380,640)</b>	<b>\$(184,251)</b>	<b>\$(384,066)</b>
<b>Combined Advancement Cash Balance (a + b)</b>	<b>\$ 373,297</b>	<b>\$ 164,976</b>	<b>\$(2,141,828)</b>	<b>\$(4,190,484)</b>

Note 1: Includes Advancement's pro rata share of state aid and tuition and fees. These are budgeted funds.

Note 2: Represents funding collected over Advancement's share of allocated funding included in Note 1. These are budgeted funds.

Note 3: Represents annual funding from the Foundation based on a percentage of a three-year rolling average of investment earnings on unrestricted endowment donations. Advancement received one-time funds in 2010. For 2009, the amount for "Advancement Foundation direct payments to vendors" was not available, resulting in "Reimbursements from Foundation" to be understated by this same amount. Neither "Advancement Foundation direct payments to vendors" nor "Reimbursements from Foundation" were budgeted.

Note 4: Includes subsidized funding from the University's discretionary funds and funds for debt service payments.

Source: Financial information obtained from the University and Foundation (unaudited by Division of Legislative Audit)

funding sources remained relatively constant, averaging approximately \$9.96 million per year, while expenditures increased from \$7.94 million to \$13.23 million, or 67%.

As a result of flat revenues and significant increases in expenditures, the combined Advancement and Foundation cash balance, which was (\$147,813) at July 1, 2008, fluctuated over the four-year period reviewed and experienced an overall decline to (\$4,190,484) at June 30, 2012.

**Exhibit II** illustrates trends in Advancement revenues, expenditures, and ending cash balances for the review period.

Advancement was subsidized through the four-year review period with transfers from University discretionary funds authorized by the Vice Chancellor for Finance and Administration. The sources and amounts of these transfers are provided in **Exhibit III on page 7**.

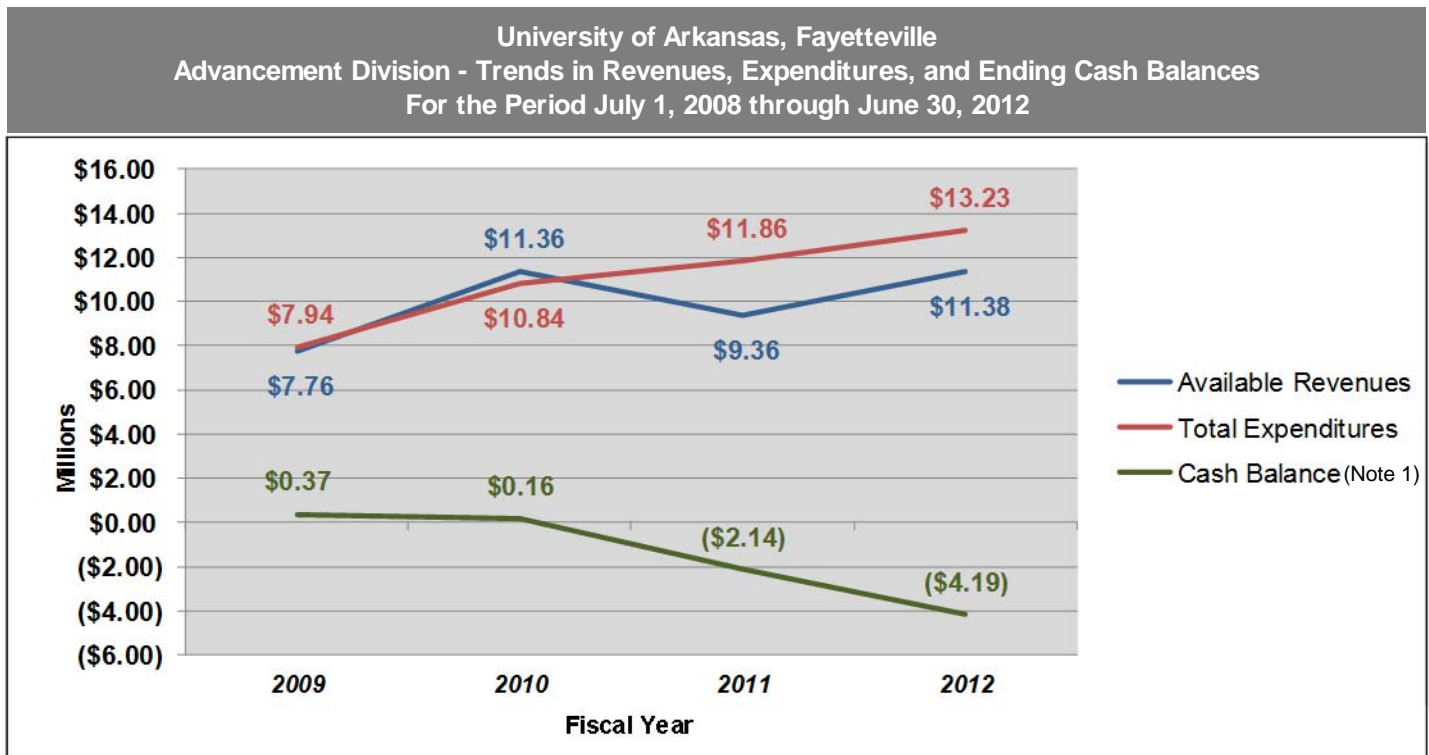
Additionally, the Foundation had three open loans to Advancement during this period. Loan repayments were made from Advancement transfers, Chancellor’s funds, and debt service payments from the University. Loan balances for each of the four years ended June 30, 2009 through 2012, are provided in **Exhibit III on page 7**.

**Internal Control Environment**

Internal control consists of five interrelated components: (1) control environment, (2) risk assessment, (3) information and communication, (4) control activities, and (5) monitoring. Management is responsible for establishing, adopting, and maintaining sound internal control policies that will ensure achievement of the entity’s objectives.

The control environment sets a division’s tone, influences employees’ control consciousness, and establishes the foundation for all other components of internal control by providing discipline and structure.

**Exhibit II**



Note 1: Cash balance refers to the respective year ending balance as of June 30.

Source: Financial information obtained from the University and Foundation (unaudited by Division of Legislative Audit)

While gaining an understanding of Advancement's internal control components and conducting this review of selected policies, procedures, and transactions, it came to DLA staff's attention that certain transactions and events, as detailed in the following sections, compromised Advancement's commitment to the five interrelated components of internal control.

### **Advancement Deficit Cash Balances**

As previously stated, **Exhibit I on page 5** provides the cash balances for each fiscal year ended June 30, 2009 through 2012. For the purposes of this report, DLA staff focused on issues regarding the combined Advancement and Foundation deficit cash balances.

#### *Primary Factors Contributing to Deficits*

DLA staff determined that several factors contributed to deficit cash balances in

Advancement as well as lack of timely detection and disclosure of the deficits:

- Lack of fiscal oversight by the VCAD.
- Inadequate and inaccurate accounting and reporting of Advancement's financial status by the Budget Director.
- Failure to appropriately budget and account for direct payments to vendors by the Foundation on behalf of Advancement.
- Increases in Advancement personnel and other operating expenditures without an increase in funding sources.
- Inaccuracies in Advancement financial statements prepared by the Treasurer's Office relating to accounts receivable.

### **Exhibit III**

#### **University of Arkansas, Fayetteville Advancement Division - Subsidy Funding and Outstanding Loans Due to Foundation For the Period July 1, 2008 through June 30, 2012**

##### **Subsidy Funding**

Source of Funds	For Year Ended June 30,				Totals
	2009	2010	2011	2012	
Discretionary funds (Note 1)	\$ 1,196,763	\$ 1,072,703	\$ 1,087,994	\$ 1,254,565	\$4,612,025
Discretionary - Debt service reserve (Note 1)			244,340	244,340	488,680
<b>Total Subsidy Funding</b>	<b>\$ 1,196,763</b>	<b>\$ 1,072,703</b>	<b>\$ 1,332,334</b>	<b>\$ 1,498,905</b>	<b>\$5,100,705</b>

Note 1: University discretionary funds authorized by the Vice Chancellor for Finance and Administration.

##### **Outstanding Loans Due to Foundation**

	For Year Ended June 30,			
	2009	2010	2011	2012
<b>Total Outstanding Loans (Note 2)</b>	<b>\$ 2,568,799</b>	<b>\$ 2,382,501</b>	<b>\$ 1,639,550</b>	<b>\$ 1,061,330</b>

Note 2: Advancement had three loans from the Foundation: Advance Software Conversion - Fayetteville, University House Renovation, and Wallace and Jama Fowler House.

**Source:** University financial records (unaudited by Division of Legislative Audit)

Each factor contributing to the Advancement deficit cash balances is discussed in detail below.

*Lack of Fiscal Oversight by the Vice Chancellor for Advancement Division*

The VCAD did not exercise proper oversight of Advancement activities or monitor the resources available to support operations, as evidenced by the following:

- The University's Code of Computing Practices states that passwords should not be shared. In violation of this policy, the VCAD gave his computer login credentials to the Budget Director, who then approved Advancement expenditures.
- The University's Transaction Approval policy dictates that a Primary Reviewer approve all transactions subject to applicable materiality thresholds. Under certain conditions, an Alternate Reviewer may be designated. In violation of this policy, the VCAD allowed the Budget Director to become an Alternate Reviewer, through the use of his computer login credentials as noted above, although policy criteria were not met. The Budget Director indicated to DLA staff that she approved all BASIS transactions from January 2010 forward.
- The VCAD relied on information and budget reports prepared by the Budget Director without implementing verification or monitoring procedures.
- The initiation of recruitment for new employee positions was verbally authorized by the VCAD, based solely on verbal assurance by the Budget Director that sufficient funds were available.
- The VCAD did not review or monitor his personal reimbursement claims,

resulting in a duplicate payment. The VCAD was reimbursed \$2,052 in September 2011 for an Advancement staff event expense that was paid directly to the vendor in August 2011. The Treasurer discovered this duplicate payment and reported it to the VCAD in June 2012. Subsequently, the VCAD reimbursed Advancement \$2,052 in October 2012.

Based on review of available documents that were tested for propriety, DLA staff noted no other duplicate payments or improper expenditures.

**DLA recommends** that computer login credentials not be shared among personnel and University policies not be overridden by the VCAD. All financial reports should be reviewed and approved by the VCAD or the Vice Chancellor for Finance and Administration. In addition, initiation of recruitment for new employee positions should be supported with written documentation and a revenue source to cover personnel costs. To avoid duplication, all expense reimbursements should be reviewed by the VCAD.

*Inadequate and Incorrect Accounting and Reporting by Advancement Budget Director*

The Budget Director processed transactions in the University's BASIS accounting system that:

- Reflected incorrect cost centers charged with expenditures.
- Included a deposit of restricted funds of \$1.35 million on May 12, 2012, that the Budget Director incorrectly coded to the unrestricted account.
- Did not combine Advancement and Foundation balances or take into account any Foundation funding available or already expended to provide an adequate accounting of Advancement's financial position.



According to the Treasurer's internal report, the Budget Director appeared to intentionally "disguise a prior year account receivable balance that had not been cleared" by depositing a restricted donation into the unrestricted account with the "delinquent accounts receivable." However, the Budget Director indicated to DLA staff during an interview that she inadvertently deposited restricted funds in an unrestricted account.

In addition, the Budget Director assigned proxy for approval of transactions to her sister, the Assistant Director for Planned Giving. As a result, numerous transactions (a combined total of over 200 in 2011 and 2012) involved a request by the Budget Director and approval by her sister, which conflicts with sound accounting practices. The Treasurer's Office approved this proxy arrangement.

During interviews with DLA staff, the Budget Director also indicated she lacked the skills to perform her job duties.

**DLA recommends** that appropriate cost centers be used to record expenditures, restricted contributions be deposited into the proper account, and financial reports include all revenues and expenditures from both Advancement and Foundation funds held on behalf of Advancement. In addition, University personnel should not assign or authorize approval duties to a relative. Advancement should employ personnel who possess the appropriate skills to perform job responsibilities.

*Failure to Account for Direct Payments to Vendors*

Advancement can request that the Foundation pay vendors directly on its behalf by submitting both an appropriate invoice and a payment authorization form, approved by the Vice Chancellor for Finance and Administration, to the Foundation. For 2010 through 2012, these direct payments totaled \$7.84 million. Foundation direct payment totals were unavailable for 2009.

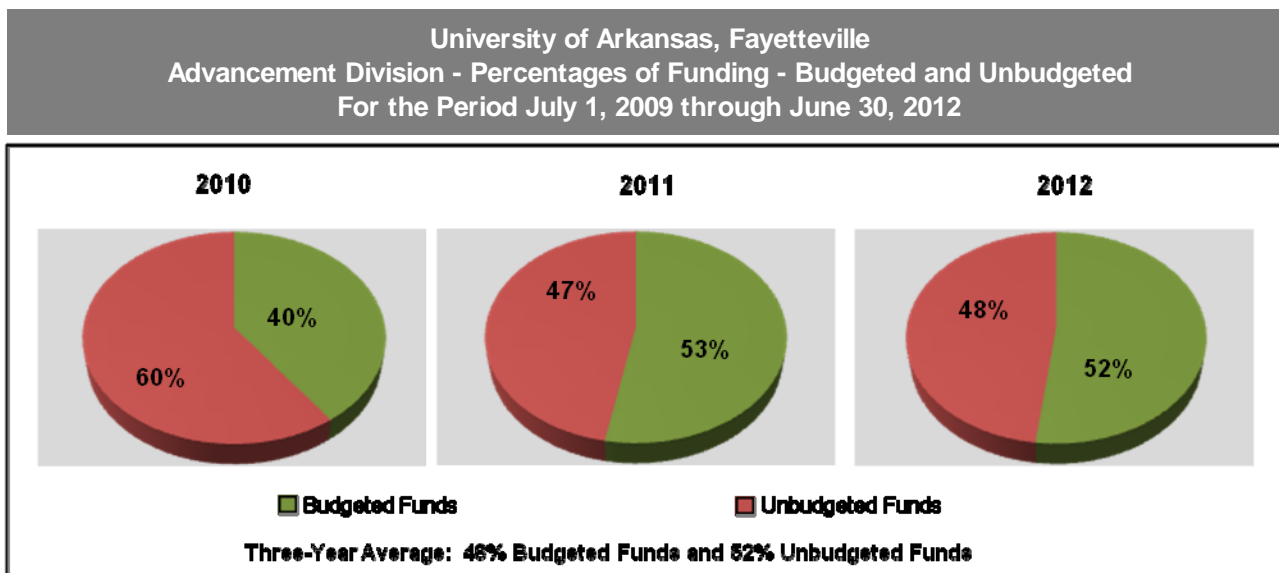
These direct payments were neither budgeted nor accounted for by Advancement but did reduce the amount of Foundation funding available to Advancement. **Exhibit IV on page 10** provides the percentages of Advancement funding that was budgeted and unbudgeted for the three fiscal years ended June 30, 2010, 2011, and 2012. The three-year average was 48% of funds subject to the University's budgeting process, with the remaining 52% of funds not budgeted. In essence, during its budgeting process for Advancement, the University included only funding sources of allocated and realized revenues and did not include University subsidy or Foundation funding. Without subjecting all revenue to the budgeting process and related budgetary controls, Advancement's financial position is not complete and transparent.

A directive issued by the Vice Chancellor for Finance and Administration on January 7, 2009, indicated that all requests for Foundation direct payments must explain why the transaction cannot be processed using the BASIS system, a University PCard, or a University TCard. This control did not function properly in that payment authorization forms did not explain why the BASIS system could not be used. In addition, it appears that Advancement processed several large transactions as Foundation direct payments that could have been processed through the University's accounting system.

The payment authorization forms were not prenumbered or otherwise accounted for, and all copies of forms and supporting documentation were not maintained by the University.

**DLA recommends** that the University budget all anticipated revenues for Advancement, including the annual Foundation funding, so that Advancement's financial position is complete and transparent. The Treasurer's Office should establish policies and procedures for

Exhibit IV



Source: Financial information obtained from the University and Foundation (unaudited by the Division of Legislative Audit)

payments to Advancement vendors. As required by University policy, these procedures should include proper approval of all payment authorization forms by the VCAD or a designee. Ideally, Foundation funding should be remitted to Advancement, budgeted, and subject to existing University expenditure policies. For Advancement expenditures incurred in fundraising activities that are not an allowed use of public funds, a percentage of annual Foundation funding could be withheld and expended by the Foundation. Payment authorization forms should also be accounted for properly and maintained by the University.

*Increases in Expenditures*

Advancement expenditures increased from \$7.94 million to \$13.23 million, or 67%, over the four-year period ended June 30, 2012, as shown in **Exhibit I on page 5**, while revenues and other funding sources remained relatively constant, averaging approximately \$9.96 million per year.

Without a constant, dedicated revenue source, Advancement increased personnel and related payroll costs by \$1.95 million, or 29%, from July 1, 2008 through June 30,

2012. Advancement began increasing staff in 2010 to assist with a capital fundraising campaign. Expenditures increased in other areas as well. From July 1, 2008 through June 30, 2012, maintenance and scholarships/other operating expenses increased \$211,151, or 24%, and \$406,703, or 134%, respectively.

**DLA recommends** that all Advancement positions be budgeted and subject to a University-approved salary structure. Increases in Advancement expenditures should be subject to the University's budgeting process and supported with a revenue source.

*Inaccuracies in Financial Statements Prepared by Treasurer's Office*

1. Accounts Receivable

The AICPA<sup>3</sup> Audit and Accounting Guide for State and Local Governments establishes the following guidelines for certain accounts receivable:

<sup>3</sup>American Institute of Certified Public Accountants, Inc.

- Donations of cash or other assets from nongovernmental entities, including individuals, are considered private donations. Private donations generally meet the definition of voluntary nonexchange transactions.<sup>4</sup>
- Under the accrual basis of accounting, governments should recognize receivables and revenues from private donations that are voluntary nonexchange transactions when all applicable eligibility requirements are met.

In noncompliance with generally accepted accounting principles, the Treasurer's Office posted the following Advancement accounts receivables, which partially obscured the deficits in the financial statements:

June 30, 2011	\$2,091,705
June 30, 2012	\$2,451,360

Both of these receivables were reversed in July, without verification that funds had been received. The Treasurer indicated to DLA staff that this is the University's typical practice to eliminate deficits on the financial statements at June 30.

Although the Treasurer deemed that the aforementioned amounts were actual receivables, DLA staff disagree with this position for the following reasons:

- The Foundation did not record corresponding accounts payables to Advancement on June 30, 2011 and 2012.
- Advancement had already expended current-year Foundation funding by June 30, 2011 and 2012.

<sup>4</sup>"Voluntary nonexchange transactions" occur when a party to an agreement willingly gives or receives value without directly giving or receiving equal value in return.

- These accounts receivables did not meet the guidelines provided in the AICPA Audit and Accounting Guide for State and Local Governments.
- The funds relating to these accounts receivable were subsequently determined not to be collectible.
- The Treasurer's internal report, dated October 19, 2012, regarding Advancement's financial position, indicated that Advancement's total operating deficit was \$4.34 million, reflecting no accounts receivable at June 30, 2012.

Subsequently, during fieldwork for the University's financial audit for fiscal year ended June 30, 2013, DLA staff ascertained that the Treasurer's Office posted an Advancement accounts receivable of \$3.2 million. However, the Foundation confirmed that it did not record a corresponding accounts payable to Advancement for this amount as of June 30, 2013.

## 2. Undisclosed Loans

The Treasurer also did not comply with generally accepted accounting principles because the University's financial statements for each of the four years ended June 30, 2009 through 2012, did not disclose two of three outstanding loans that Advancement owed the Foundation as follows:

June 30, 2009	\$1,539,346
June 30, 2010	1,484,645
June 30, 2011	885,665
June 30, 2012	382,288

The Foundation accounted for these loans in separate accounts in its general ledger.

**DLA recommends** the Treasurer review AICPA guidelines concerning accounts receivable and outstanding loan disclosure. Voluntary nonexchange transactions should not be recorded as accounts receivable unless verifiable and collectible.

## Other Issues

### *Internal Review of Advancement Deficit Cash Balances*

As presented in **Appendix C on pages C-1 through C-4**, the Treasurer prepared a report for the Vice Chancellor for Finance and Administration, dated October 19, 2012, detailing conclusions of her internal review concerning deficiencies in Advancement. All existing copies of the Treasurer's report were filed in the VCAD's and Budget Director's personnel files.

### *Issues Not Disclosed at Exit Conference*

On October 25, 2012, during the exit conference for the University's financial audit report for the fiscal year ended June 30, 2012, neither the Treasurer nor the Vice Chancellor for Finance and Administration disclosed to DLA staff information about the Treasurer's report on Advancement issued six days earlier.

The Management Representation Letter, addressed to the Legislative Joint Auditing Committee and DLA regarding the audit of the University's financial statements as of June 30, 2012, states, in part:

"We have no knowledge of any allegation of fraud or suspected fraud affecting the entity involving:

- a. Management,
- b. Employees who have significant roles in internal control, or
- c. Others where the fraud could have a material effect on the financial statements.

"We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others."

This letter, dated October 25, 2012, was signed by the Vice Chancellor for Finance and Administration.

Provided below are pertinent excerpts from the Treasurer's report, dated October 19, 2012, of her internal review of Advancement. This report is presented in its entirety in **Appendix C on pages C-1 through C-4**.

". . . Clearly the actions and specific examples outlined above provide strong evidence that the VCAD disregarded the risks inherent in delegating approval authority. These risks include over expenditure of University budgets, commitments to new fixed costs, making expenditures that are not mission-appropriate and fraudulent activity.

"The control environment within the Division was one where internal control activities and monitoring were devalued and circumvented. Division staff, including unit managers, was not required to participate in the management of financial activities of the Division, as evidenced by the collective lack of knowledge of the financial position of the Division and of the University's financial processes.

"Because many fraud risk factors were identified, consideration was given of the need to request an Internal Audit examination. After careful consideration, the decision to request an internal audit examination should be left ultimately to the VCFA [Vice Chancellor for Finance and Administration] and the Chancellor. The following notes are relevant to that decision:

- There is an overwhelming amount of evidence that points to lack of management oversight, non-compliance with University policies and procedures and deliberate efforts to disguise poor financial management of

the Division of Advancement resources, however no evidence of intentional acts to misappropriate resources for personal gain have been discovered. It should be noted that a review of accounting records specifically to identify misappropriated resources has not been performed and will likely be some time before staff resources are available to conduct such a review.

- The historical data suggest that the primary driver of accumulated deficit balances was the addition of staff with no permanent funding . . . .”

During the DLA financial audit exit conference, **University management should** disclose to auditors information pertinent to matters referenced in the Management Representation Letter.

#### *University Reserved Funds*

Although the Vice Chancellor for Finance and Administration indicated that Advancement’s negative financial position was immaterial due to the reserves and contingencies available to the University, reserve funds and contingencies do not alleviate the systemic financial issues revealed during DLA staff’s review.

## **SUMMARY**

DLA review of Advancement financial records revealed deficit cash balances of \$2.14 million and \$4.19 million at June 30, 2011 and 2012, respectively. The overall decline in cash balances for the four-year period

reviewed resulted from significant increases in expenditures, from \$7.94 million to \$13.23 million, without increases in revenues.

In addition, the Treasurer’s Office posted Advancement uncollectible accounts receivables of \$2.1 million and \$2.5 million at June 30, 2011 and 2012, respectively, which partially obscured the deficits in the financial statements.

The Treasurer issued a report dated October 19, 2012, of her assessment of Advancement and its numerous deficiencies. However, at the financial audit exit conference on October 25, 2012, neither the Treasurer nor the Vice Chancellor for Finance and Administration disclosed information contained in the Treasurer’s report to DLA staff.

Finally, the VCAD did not exercise proper fiscal oversight of Advancement and did not comply with University policies and procedures. The Budget Director included a deposit of restricted funds of \$1.35 million on May 12, 2012, that she incorrectly coded to the unrestricted account. In addition, the transactions processed in BASIS by the Budget Director regarding Advancement’s financial status were inadequate and inaccurate. Specifically, Advancement and Foundation balances were not combined or reflected, and Foundation funding available or already expended was not recorded.

This report has been forwarded to the Fourth Judicial District Prosecuting Attorney.

## **MANAGEMENT RESPONSE**

The University’s Management Response is available in its entirety in **Appendix A on pages A-1 through A-7**.

**University of Arkansas, Fayetteville - Division of University Advancement (Advancement)  
Timeline of Events  
For the Period June 30, 2011 through August 21, 2013**

Date	Event
June 30, 2011	The University of Arkansas, Fayetteville (University), recorded an accounts receivable of \$2.09 million to eliminate the deficit cash balance in Advancement cost centers. This receivable was subsequently determined by Associate Vice Chancellor for Financial Affairs/Treasurer (Treasurer) Jean Schook to not be supported with available Foundation funds.
July 1, 2011	The accounts receivable recorded at June 30, 2011, was reversed in the accounting records without being collected.
May 8, 2012	Advancement Director of Budget and Human Resources Joy Sharp deposited and recorded restricted funds of \$1.36 million for the Jean Tyson Child Development Center as unrestricted revenues in Advancement.
June 30, 2012	The University recorded an accounts receivable of \$2.45 million to eliminate the deficit cash balance in Advancement cost centers. As of this report dated August 22, 2013, funds relating to this receivable were determined to not be collectible by Division of Legislative Audit (DLA) staff.
July 1, 2012	The accounts receivable recorded at June 30, 2012, was reversed in the accounting records without being collected.
July 6, 2012	Sharp informed Vice Chancellor for Advancement Division (VCAD) Brad Choate that the University of Arkansas Foundation, Inc. (Foundation), had frozen Advancement's account and that the requested transfer of \$225,000 for the annual contribution to Chancellor G. David Gearhart's deferred income account had been denied.
July 20, 2012	Under the direction of Vice Chancellor for Finance and Administration Don Pederson, Schook began an internal review of Advancement's financial situation.
August 7, 2012	The University made a correcting journal entry moving the Jean Tyson Child Development Center donated funds of \$1.36 million to the proper restricted fund.
September 3, 2012	Choate demoted Sharp, and Denise Reynolds became the Director of Budget and Finance for Advancement.
October 19, 2012	Schook sent her Division of Advancement Financial Management Deficiencies report (Schook Report) to Pederson, detailing her findings concerning the deficit cash balances.
October 25, 2012	At the exit conference for the University's financial audit for the fiscal year ended June 30, 2012, neither Schook nor Pederson disclosed to DLA staff information contained in the Schook Report relating to knowledge of allegations of fraud or suspected fraud in Advancement by management or employees who had significant roles in internal control. Pederson signed the Management Representation Letter.
November 6, 2012	Gearhart informed Choate that his appointment as VCAD would not be renewed after its expiration on June 30, 2013. Gearhart assumed temporary oversight of Advancement daily operations.

## Schedule 1 (continued)

## University of Arkansas, Fayetteville - Division of University Advancement (Advancement)

## Timeline of Events

For the Period June 30, 2011 through August 21, 2013

Date	Event
February 5, 2013	Gearhart requested that an audit be conducted of Advancement by DLA and the UA System Internal Audit staff.
February 11, 2013	The <i>Arkansas Democrat-Gazette</i> sued the University over its refusal to release documentation regarding Advancement.
February 13, 2013	The University hired Chris Wyrick as the new VCAD.
February 15, 2013	The University released documentation relating to the Schook Report to the media in response to a Freedom of Information Act request.
	A settlement agreement was executed between the University and Choate regarding the terms of his employment termination, effective June 30, 2013.
April 1, 2013	DLA staff began fieldwork on the Advancement review.
June 30, 2013	Choate's and Sharp's employment at the University ended.
July 11, 2013	The University announced a significant restructuring of Advancement.
July 12, 2013	The University released additional personnel records pertaining to Choate and Sharp, along with the settlement agreement between the University and Choate.
August 21, 2013	During fieldwork for the University's financial audit for fiscal year ended June 30, 2013, DLA staff ascertained that the Treasurer's Office posted an Advancement accounts receivable of \$3.21 million. However, the Foundation confirmed that it did not record a corresponding accounts payable to Advancement for this amount.

**Source:** Information obtained from the University and Foundation (unaudited by the Division of Legislative Audit)

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# **APPENDIX A**

**University of Arkansas, Fayetteville  
Division of University Advancement  
Management Response to Report**

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## University of Arkansas Response to Division of Legislative Audit Investigative Report

As reflected in the findings and recommendations, the Division of Legislative Audit (DLA) was able to affirm the University's conclusions as to the causes that led to Advancement's overspending that ultimately resulted in a deficit balance in their accounts. Additionally, the results of their report indicated that "Based on review of available documents that were tested for propriety, DLA staff noted no other duplicate payments or improper expenditures."

While we agree with many of the recommendations and conclusions presented in the Investigative Report, there are certain findings and recommendations where we disagree. The following is detailed commentary specific to recommendations presented in the report.

### **Finding # 1 (page 8)**

#### *Lack of Fiscal Oversight by the Vice Chancellor for Advancement Division*

The VCAD did not exercise proper oversight of Advancement activities or monitor the resources available to support operations, as evidenced by the following:

The University's Code of Computing Practices states that passwords should not be shared. In violation of this policy, the VCAD gave his computer login credentials to the Budget Director, who then approved Advancement expenditures.

The University's Transaction Approval policy dictates that a Primary Reviewer approve all transactions subject to applicable materiality thresholds. Under certain conditions, an Alternate Reviewer may be designated. In violation of this policy, the VCAD allowed the Budget Director to become an Alternate Reviewer, through the use of his computer login credentials as noted above, although policy criteria were not met. The Budget Director indicated to DLA staff that she approved all BASIS transactions from January 2010 forward.

The VCAD relied on information and budget reports prepared by the Budget Director without implementing verification or monitoring procedures.

The initiation of recruitment for new employee positions was verbally authorized by the VCAD, based solely on verbal assurance by the Budget Director that sufficient funds were available.

The VCAD did not review or monitor his personal reimbursement claims, resulting in a duplicate payment. The VCAD was reimbursed \$2,052 in September 2011 for an Advancement staff event expense that was paid directly to the vendor in August 2011. The Treasurer discovered this duplicate payment and reported it to the VCAD in June 2012. Subsequently, the VCAD reimbursed Advancement \$2,052 in October 2012.

### **Recommendation #1**

**DLA recommends** that computer login credentials not be shared among personnel and University policies not be overridden by the VCAD. All financial reports should be reviewed and approved by the VCAD and/or the Vice Chancellor for Finance and Administration. In addition, initiation of recruitment for new employee positions should be supported with written documentation and a revenue source to cover personnel costs. To avoid duplication, all expense reimbursements should be reviewed by the VCAD.

### **University Response #1**

We agree. The University concluded in its October 19, 2012 report that insufficient management oversight, violation of university policy and intentional circumvention of established internal controls by the VCAD, Brad Choate, were the primary reasons that allowed overspending of available resources in the Division of Advancement. The University operates with established policies and procedures which are designed to support a strong internal control system while recognizing the flexibility required for sustaining the operations of a public research university. The VCAD and Budget Director were relieved of their duties in Advancement as a result of their deliberate actions to override existing controls, and were not retained as university employees. The University immediately began a review of the business practices and financial performance of Advancement and evaluated the functioning of the internal control system in order to identify weaknesses and implement changes as necessary to strengthen effectiveness.

## University of Arkansas Response to Division of Legislative Audit Investigative Report (continued)

The BASIS system is capable of tracking anticipated revenues and expenditures that have not previously been budgeted; however use of this feature by the campus has been optional up to this time. During FY14, campus finance officers will be instructed on how to use this BASIS feature and strongly encouraged to implement immediately. Beginning in FY15, full budget loading considering revenue from all sources will be required for all campus units. Managers responsible for hiring approval will be instructed that approval for all positions shall only be granted when the source of salary funding is entered in the BASIS system and is expected to be available.

The Division of Legislative Audit affirmed that they did not discover any improper payments other than the one duplicate payment discussed in the University's report. We believe the duplicate payment was not an intentional act by the VCAD to misappropriate or direct university resources for personal gain. Just as the VCAD was unaware of the duplicate payment that was processed, he was equally unaware of over \$7,700 in reimbursable expenses that were accumulated over two years. The University identified these expenses, which occurred from September 2010 through October 2012, during the review of Advancement financial records and determined no reimbursement claims had been processed for payment. The University subsequently reimbursed the expenses on November 7, 2012.

### Finding #2 (pages 8-9)

#### *Inadequate and Incorrect Accounting and Reporting by Advancement Budget Director*

The Budget Director processed transactions in the University's BASIS accounting system that:

Reflected incorrect cost centers charged with expenditures.

Included a deposit of restricted funds of \$1.36 million on May 12, 2012, that the Budget Director incorrectly coded to the unrestricted account.

Did not combine Advancement and Foundation balances or take into account any Foundation funding available or already expended to provide an adequate accounting of Advancement's financial position.

In addition, the Budget Director assigned proxy for approval of transactions to her sister, the Assistant Director for Planned Giving. As a result, numerous transactions (a combined total of over 200 in 2011 and 2012) involved only a request by the Budget Director and approval by her sister, which conflicts with sound accounting practices. The Treasurer's Office approved this proxy arrangement.

### Recommendation #2

**DLA recommends** that appropriate cost centers be used to record expenditures, restricted contributions be deposited into the proper account, and financial reports include all revenues and expenditures from both Advancement and Foundation funds held on behalf of Advancement. In addition, University personnel should not assign or authorize approval duties to a relative. Advancement should employ personnel who possess the appropriate skills to perform job responsibilities.

### University Response #2

We agree. DLA has confirmed our conclusion that the Budget Officer, Joy Sharp, lacked the financial management expertise necessary to perform her duties. As stated in the October 19, 2012 report, "immediate steps were taken to address the lack of management oversight and lack of financial management expertise of Advancement staff." Budget Director, Joy Sharp was relieved of all responsibility for financial management and reassigned to another position within the Division of Advancement on September 1, 2012. The Vice Chancellor for Finance and Administration appointed an Advancement Finance Officer who possessed the necessary skills and demonstrated experience to perform the duties required, with direct reporting to the VCFA. The Finance Officer began preparing financial reports for Advancement that included all revenue and expenditures, including resources available at the University of Arkansas Foundation, Inc (Foundation).

## University of Arkansas Response to Division of Legislative Audit Investigative Report (continued)

The University has revised the process for depositing reimbursements from the Foundation by requiring that reimbursement checks be sent directly to the Treasurer's office for deposit and entry into the accounting system, thus eliminating departmental handling of reimbursements from the Foundation.

Additional processes are currently being developed to improve oversight of unit financial performance by Finance and Administration with the establishment of a formal reporting structure for campus financial officers and full budget loading in BASIS. The University is also currently developing a financial report to be used by all campus units that will provide comprehensive reporting of financial position monthly, which is expected to be introduced by December 2013. As an interim step, academic units began submitting monthly financial reports to the Provost and VCFA beginning in January 2013.

### Finding #3 (pages 9-10)

#### *Failure to Account for Direct Payments to Vendors*

Advancement can request that the Foundation pay vendors directly on its behalf by submitting both an appropriate invoice and a payment authorization form, approved by the Vice Chancellor for Finance and Administration, to the Foundation. For 2010 through 2012, these direct payments totaled \$7.84 million. Foundation direct payment totals were unavailable for 2009.

These direct payments were neither budgeted nor accounted for by Advancement but did reduce the amount of Foundation funding available to Advancement. Exhibit IV on page 10 provides the percentages of Advancement funding that was budgeted and unbudgeted for the three fiscal years ended June 30, 2010, 2011, and 2012. The three-year average was 48% of funds subject to the University's budgeting process, with the remaining 52% of funds not budgeted. In essence, during its budgeting process for Advancement, the University included only funding sources of allocated and realized revenues and did not include University subsidy or Foundation funding. Without subjecting all revenue to the budgeting process and related budgetary controls, Advancement's financial position is not complete and transparent.

A directive issued by the Vice Chancellor for Finance and Administration on January 7, 2009, indicated that all requests for Foundation direct payments must explain why the transaction cannot be processed using the BASIS system, a University PCard, or a University TCard. This control did not function properly in that payment authorization forms did not indicate an explanation as to why the BASIS system could not be used. In addition, it appears that Advancement processed several large transactions as Foundation direct payments that could have been processed through the University's accounting system.

The payment authorization forms were not prenumbered or otherwise accounted for, and all copies of forms and supporting documentation were not maintained by the University.

### Recommendation #3

**DLA recommends** that the University budget all anticipated revenues for Advancement, including the annual Foundation funding, so that Advancement's financial position is complete and transparent. The Treasurer's Office should establish policies and procedures for payments to Advancement vendors. As required by University policy, these procedures should include proper approval of all payment authorization forms by the VCAD or a designee. Ideally, Foundation funding should be remitted to Advancement, budgeted, and subject to existing University expenditure policies. For Advancement expenditures incurred in fundraising activities that are not an allowed use of public funds, a percentage of annual Foundation funding could be withheld and expended by the Foundation. Payment authorization forms should also be accounted for properly and maintained by the University.

### University Response #3

We agree except as noted. As stated in our response to findings #1 and #2, steps are being taken to include all funds in both budgeting and reporting and unit financial position.

The Division of Advancement operates, as do all campus units, under the established University policies and procedures for procurement activities, including vendor payments. Processes and accounting structure are in place to support procurement activities intended for reimbursement from private funding sources on deposit at the Foundation. The VCFA in early 2009 directed the campus to process in the University's BASIS system all procurement activities intended to be funded with private resources that met State and university compliance requirements. The Budget Director did not comply with the directive of the VCFA. The VCFA will closely monitor campus Payment Authorization requests for direct payments to vendors and return to campus units those requests that can be processed in the BASIS system

## University of Arkansas Response to Division of Legislative Audit Investigative Report (continued)

The Payment Authorization Form is a document developed by the Foundation to accumulate supporting documentation for their payments. The form is routed through various approval points on campus to support appropriate management review as well as due diligence for compliance with donor restrictions, tax compliance and compensation. The University disagrees that these forms should be retained as they are not supporting documentation for university payments. Campus units with funds on deposit at the Foundation have access to the Foundation's accounting system and can prepare reports necessary to track direct payments to vendors. Revised budget and financial reports in BASIS will provide university management with the information necessary to track direct spending from the Foundation.

### Finding #4 (page 10)

#### *Increases in Expenditures*

Advancement expenditures increased from \$7.94 million to \$13.23 million, or 67%, over the four-year period ended June 30, 2012, as shown in Exhibit I on page 5, while revenues and other funding sources remained relatively constant, averaging approximately \$9.96 million per year.

Without a constant, dedicated revenue source, Advancement increased personnel and related payroll costs by \$1.95 million, or 29%, from July 1, 2008 through June 30, 2012. Advancement began increasing staff in 2010 to assist with a capital fund raising campaign. Expenditures increased in other areas as well. From July 1, 2008 through June 30, 2012, maintenance and scholarships/other operating expenses increased \$211,151, or 24%, and \$406,703, or 134%, respectively.

### Recommendation #4

**DLA recommends** that all Advancement positions be budgeted and subject to a University-approved salary structure. Increases in Advancement expenditures should be subject to the University's budgeting process and supported with a revenue source.

### University Response #4

We agree with the exception noted. The University stated in its October 19, 2012 report "historical data suggests that the primary driver of accumulated deficit balances was the addition of staff with no permanent funding." The Division of Legislative Audit has validated that conclusion, although it is not clear in their finding. Total expenditures increased 67%, or \$5.29 million, over the four-year period. DLA concludes that \$1.95 million of that increase is attributable to payroll costs in FY12 alone, \$.21 million attributed to maintenance, and \$.41 attributed to scholarships and other operating expenses, leaving a unidentified increase of \$2.72 million which represents unfunded salaries over multiple years that was not considered by DLA as a contributor to the cumulative deficit. For example an unfunded position added in FY10 impacts deficit amounts each year for a total of three years unfunded expenses. Clearly, when the cumulative effect of unfunded positions held over multiple years is considered, the significant driver of the accumulated deficit was overspending of payroll costs that were not supported by budget or private funding. We disagree that increases in scholarship spending impacted the cumulative deficit amount in any way. Scholarships awarded are based on gifts received and are thus fully funded.

The salary structure for all university positions complies with State regulations for classification and compensation, regardless of the source of funding. As we have responded to previous recommendations, the University is taking steps to implement processes that will identify in BASIS the funding source for all positions.

### Finding #5 (page 11)

#### *Inaccuracies in Financial Statements Prepared by Treasurer's Office*

##### 1. Accounts Receivable

The AICPA' Audit and Accounting Guide for State and Local Governments establishes the following guidelines for certain accounts receivable:

**University of Arkansas**  
**Response to Division of Legislative Audit Investigative Report (continued)**

- Donations of cash or other assets from nongovernmental entities, including individuals, are considered private donations. Private donations generally meet the definition of voluntary nonexchange transactions
- Under the accrual basis of accounting, governments should recognize receivables and revenues from private donations that are voluntary nonexchange transactions when all applicable eligibility requirements are met.

In noncompliance with generally accepted accounting principles, the Treasurer's Office posted the following Advancement accounts receivable, which partially obscured the deficit in the financial statements:

June 30, 2011	\$2,091,705
June 30, 2012	\$2,451,360

Both of these receivables were reversed in July, without verification that funds had been received. The Treasurer indicated to DLA staff that this is the University's typical practice to eliminate deficits on the financial statements at June 30.

Although the Treasurer deemed that the aforementioned amounts were actual receivables, DLA staff disagrees with this position for the following reasons:

- The Foundation did not record a corresponding accounts payable to Advancement on June 30, 2011 and 2012.
- Advancement had already expended current year Foundation funding by June 30, 2011 and 2012.
- These accounts receivable did not meet the guidelines provided in the AICPA Audit and Accounting Guide for State and Local Governments.
- The funds relating to these accounts receivable were subsequently determined not to be collectible.
- The Treasurer's internal report dated October 19, 2012, regarding Advancement's financial position, indicated that Advancement total operating deficit was \$4.34 million, reflecting no accounts receivable at June 30, 2012.
- Subsequently, during audit fieldwork for the University's financial audit for fiscal year ended June 30, 2013, DLA staff ascertained that the Treasurer's Office posted an Advancement accounts receivable of \$3.2 million. However, the Foundation confirmed that it did not record a corresponding account payable to Advancement for this amount as of June 30, 2013.

**2. Undisclosed Loans**

The Treasurer again did not comply with generally accepted accounting principles because the University's financial statements for each of the four years ended June 30, 2009 through 2012, did not disclose two of three outstanding loans that Advancement owed the Foundation as follows:

June 30, 2009	\$1,539,346
June 30, 2010	\$1,484,645
June 30, 2011	\$ 885,665
June 30, 2012	\$ 383,288

The Foundation accounted for these loans in separate accounts in its general ledger.

**Recommendation #5**

**DLA recommends** the Treasurer review AICPA guidelines concerning accounts receivable and outstanding loan disclosure. Voluntary nonexchange transactions should not be recorded as accounts receivable unless verifiable and collectible.

**University Response #5**

Accounts Receivable:

The recording of the receivable was based on the University's interpretation of guidance contained in the Governmental Accounting and Financial Reporting Standards (GAFRS) section N50.117 and 118. We believe that applicable eligibility requirements were met and reimbursements due were collectible. The University did not establish a receivable as an effort to obscure a deficit balance, and we disagree that it is our typical practice to eliminate deficits in this way. Accounts receivable from the Foundation are only established for reimbursements due that have not been received at year-end.

**University of Arkansas**  
**Response to Division of Legislative Audit Investigative Report (continued)**

DLA examined the journal entry and supporting documentation establishing the Advancement account receivable in both FY11 and FY12 during their audit fieldwork for the financial statement audits. In both instances the University provided supporting documentation and answered all inquiries of the audit staff. There were no additional follow-up questions from field audit staff regarding documentation provided, audit managers did not raise any issue resulting from their review of audit documentation and the topic was not included in formal or informal communications with university management or the audit committee. Thus, the University believed that their interpretation of the accounting authoritative literature was accurate. DLA did not explain the inconsistency in their conclusions by reporting an exception in this Investigative Report.

There is no automated mechanism in BASIS to eliminate revenue or expenses accrued in a prior period. Accrual entries are always reversed in the next reporting period so that revenue or expenses are not recognized twice.

The internal report presented the cumulative amount of overspending as of June 30, 2012, including the deposit error credited to unrestricted funds identified subsequent to the accounting close. It was intended for management's use in evaluating Advancement financial performance and was never represented to be prepared in accordance with external reporting requirements.

The University recognizes a difference in professional opinion regarding the appropriateness of recording the Advancement receivable. Accordingly, we will defer to the opinion of DLA and eliminate the entry from the account receivable balance recorded for FY13 and restate comparative amounts reported for FY12.

**Internal Loans:**

The University did not identify a reporting requirement in the Governmental Accounting and Financial Reporting Standards that was applicable to internal financing arrangements where all transactions occurred and were recorded entirely in a separate entities accounting system. For the two loans not disclosed, we determined that the terms described the source of funds for repayment as unrestricted private funds. All payment activity associated with these two arrangements was accomplished using unrestricted private funds that were received and on deposit in Foundation accounts. Payments were made by transfers from one Foundation account to another. At no time did the University provide any funds for either of these internal financing arrangements, nor did any transactions occur that were recorded in the BASIS system. Accordingly, there was no activity associated with these internal financing arrangements to report or disclose in our financial report.

**Other Issues (pages 12-13)**

*Issues Not Disclosed at Exit Conference*

On October 25, 2012, during the exit conference for the University's financial audit report for the fiscal year ended June 30, 2012, neither the Treasurer nor the Vice Chancellor for Finance and Administration disclosed information about the Treasurer's report on Advancement issued six days earlier.

The Management Representation Letter, addressed to the Legislative Joint Auditing Committee and DLA regarding the audit of the University's financial statements as of June 30, 2012, states, in part:

"We have no knowledge of any allegation of fraud or suspected fraud affecting the entity involving:

- a. Management,
- b. Employees who have significant roles in internal control, or
- c. Others where the fraud could have a material effect on the financial statements.

"We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others."

This letter, dated October 25, 2012, was signed by the Vice Chancellor for Finance and Administration.



## **University of Arkansas**

### **Response to Division of Legislative Audit Investigative Report (continued)**

During the financial audit exit conference, University management should disclose to auditors information pertinent to matters referenced in the Management Representation Letter.

#### **University Response**

We disagree that there were any pertinent matters referenced in the Management Representation Letter that were not disclosed. No allegation of fraud or suspected fraud was communicated to the Treasurer or the Vice Chancellor for Finance and Administration at any time. The Treasurer's report stated "no evidence of intentional acts to misappropriate resources for personal gain have been discovered." DLA contends that the university should make representations that they had knowledge of fraud or suspected fraud, when management did not have such knowledge.

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# **APPENDIX B**

**University of Arkansas, Fayetteville  
Division of University Advancement  
Internal Audit Report**

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UNIVERSITY OF ARKANSAS SYSTEM

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## **Internal Audit Report**

### **University of Arkansas, Fayetteville Budget Controls**

2404 North University Avenue / Little Rock, Arkansas 72207-3608 / 501-686-2901 or Toll-free 1-877-233-8520 / Fax 501-686-2919

University of Arkansas, Fayetteville / University of Arkansas at Little Rock / University of Arkansas at Pine Bluff  
University of Arkansas for Medical Sciences / University of Arkansas at Monticello / Division of Agriculture / Criminal Justice Institute  
Arkansas Archeological Survey / Phillips Community College of the University of Arkansas / University of Arkansas Community College at Hope  
University of Arkansas Community College at Batesville / Cosatot Community College of the University of Arkansas  
University of Arkansas Community College at Morrilton / University of Arkansas at Fort Smith  
Arkansas School for Mathematics, Sciences and the Arts / University of Arkansas Clinton School of Public Service

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## *Background*

The Chancellor of the University of Arkansas, Fayetteville requested an audit of the Division of University Advancement (Advancement Division) by the Division of Legislative Audit and Internal Audit on February 5, 2013. Prior to the start of this internal audit, the Vice Chancellor for Advancement and the Advancement Division's Director of Budget and Human Resources separated employment from the University effective June 30, 2013. A new Vice Chancellor for Advancement was hired effective April 1, 2013. A new Director of Budget and Finance for the Advancement Division was hired effective September 3, 2012. On July 2, 2013 this position title changed to the Assistant Vice Chancellor for Advancement and is now a direct report to the Vice Chancellor for Finance and Administration and an indirect report to the Vice Chancellor for Advancement. A budget was developed for all budgetary units within the Advancement Division and was presented to the Vice Chancellor for Finance and Administration with a zero-based budget proposal for fiscal year 2014. A human resources organizational study was also conducted to evaluate the Advancement Division. Training has been held for support staff in the use of the University BASIS software. Additional training is planned for TARGET reviewers, People Admin, ARS, pcard, teard, Purchasing Plus, Advance, and Blackbaud.

The Advancement Division receives operating funds from The University of Arkansas Foundation, Inc. (Foundation). Funding comes from earnings on investments in the Foundation as well as unrestricted gifts and self generated departmental charges for services rendered and funds are deposited quarterly into University accounts. For the audit period fiscal year 2010 through fiscal year 2012, the earnings available to the Advancement Division ranged from a low of \$944,221 to a high of \$1,490,873 for each quarter.

Advancement Division funds are maintained in the following Foundation accounts as listed in the VCAD Financial Position schedule dated April 24, 2013.

<u>Account Number</u>	<u>Account Description</u>
30003026	University Relations
30003126	Advancement Budget
30003650	Annual Fund-Development
30003651	Annual Fund-Expenses
30007028	Development Planned Gifts
30009987	Crisis Funds
30010116	Advance Software Conversion-Fay
30010453	Arkansas World Trade Center
30010480	UREL Special Projects
30011179	VCAD-Sustainability Consortium

The Foundation funds are not included in the University's centralized budget for the Advancement Division.

The Advancement Division also receives operating funds from the University. The University maintains the following University cost center accounts per the BASIS Cost Center Balances Report as of June 30, 2012.

<u>Company</u>	<u>Description</u>	<u># of Cost Centers</u>
0102	Fayetteville – General	7
0112	Dedicated Funds – General	3
0372	Fayetteville - Gifts and Grants	1
0392	Fayetteville - U of A Foundation Support	<u>57</u>
	Total Cost Centers	68

Of the 68 Cost Centers, 13 had budgets in BASIS which together totaled \$5,216,354. We were provided with the Arkansas Division of Legislative Audit Analysis of Financial Information/Advancement Division for the period July 1, 2008 through June 30, 2012. We observed expenditures ranged from \$7,939,511 to \$13,227,051 in the Analysis. A budget gap of approximately \$8 million existed between the BASIS budgets for the Advancement Division for fiscal year 2012 when compared to the Arkansas Division of Legislative Audit Analysis.

### *Scope*

We performed an audit of the Advancement Division at the University for the time period ending June 30, 2012 and other time periods deemed necessary to achieve the objectives of the audit. The purpose of this audit was to 1) examine and evaluate adequacy and effectiveness of the established internal control structure over the Advancement Division’s budgetary process 2) verify accuracy of selected financial and managerial reporting information and 3) determine compliance with existing State regulations, Board of Trustees policies and University’s policies and procedures.

Our audit was conducted in accordance with generally accepted auditing standards, Government Auditing Standards issued by the Comptroller of the United States, and International Standards for the Professional Practice of Internal Auditing issued by The Institute of Internal Auditors. Those standards require that we plan and perform our audit to obtain reasonable assurance that the University’s internal control system is adequate in safeguarding assets, ensuring that the University’s records and reports are accurate and reliable, and ensuring compliance with applicable regulations, policies and procedures. We believe our audit provides a reasonable basis for the conclusion stated in this report.



## *Findings and Recommendations*

### **Internal Control**

As part of our audit, we made a study and evaluation of management's established internal control structure to the extent we considered necessary as required by generally accepted auditing standards. For the purpose of this report, we have outlined the significant internal control areas to be the University's decentralized budget controls related to the Advancement Division and the University's centralized budget controls.

Management is responsible for establishing and maintaining a system of internal control over each of these operations. In fulfilling that responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of the control procedures. The objectives of the system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss and that transactions are executed in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection on any evaluation of the system to future periods is subject to risk that procedures may become inadequate because of changes in condition, or that the degree of compliance with procedures may deteriorate.

### **The University's Decentralized Budget Controls over the Advancement Division**

During the audit, management was responsive to our interviews and inquiries. However, from the interviews, inquiries and other observations, we determined that financial documentation was not sufficiently available to audit the decentralized budgeting controls within the Advancement Division in accordance with generally accepted auditing standards. We requested the Advancement Division's decentralized budget reports from the new Assistant Vice Chancellor for Advancement, the former Director of Budget and Human Resources, the former Vice Chancellor for Advancement and the Vice Chancellor for Advancement's current executive assistant; however we never received any budget files for the Advancement Division. The new Assistant Vice Chancellor for Advancement stated she also did not receive any such documents upon assuming budget responsibilities. We did locate certain files related to the budget process within the University's IT system that ended at fiscal year 2009.

On March 6, 2013, we received the VCAD Financial Position report dated October 19, 2012 from the Vice Chancellor for Finance and Administration. On March 7, 2013, the new Assistant Vice Chancellor for Advancement stated she did not have any financial files left by the former Director of Budget and Human Resources except what was retained on the University's IT system.

In an interview of the Vice Chancellor for Finance and Administration on May 8, 2013 we were informed that the Associate Vice Chancellor for Financial Affairs' original VCAD Financial Position schedule was not exact, but the report's conclusions had not changed. On May 19, 2013, we received an updated VCAD Financial Position schedule, dated April 24, 2013, from the Vice Chancellor for Finance and Administration.

In a meeting on May 24, 2013, the former Advancement Division's Director of Budget and Human Resources confirmed to us the accuracy of a letter to the Chancellor, dated November 2, 2012, that acknowledged that she did not provide budget reports to the Vice Chancellor for Advancement and unit heads in a timely and appropriate manner due to her workload. She did not monitor the revenue correctly; nor did she adjust her projections accordingly when the revenue decreased. We also confirmed that she assigned proxy responsibility to her sister for approval of transactions in violation of UA Board Policy 410.1 Nepotism. We were unable to obtain any budget reports from her for our audit.

In a meeting on May 31, 2013, the former Vice Chancellor for Advancement stated there were budget meetings and budget reports. However, he was not able to provide us with any of these reports to audit. In the meeting, he confirmed two of the units in the Advancement Division did not have a budget. He also confirmed that he had provided his BASIS ID and password to the former Advancement Division's Director of Budget and Human Resources which violated UAF Policy 330.1 Transaction Approval, but stated his belief that this action had not resulted in any loss to the Advancement Division.

We interviewed the Associate Vice Chancellor for Financial Affairs on June 11, 2013, and she stated there were very few accounting records and no organized historical records for the Advancement Division since the former Vice Chancellor for Advancement was hired. We asked for the supporting documentation for the Associate Vice Chancellor for Financial Affairs' VCAD Financial Position report dated October 19, 2012. The documentation the Associate Vice Chancellor for Financial Affairs provided included the VCAD Financial Position Schedule dated October 14, 2012, a TARGET report showing TARGET transactions reviewed by Selected Users, a duplicate reimbursement and a list of the Advancement Division's staff.

***Recommendation: 1) Advancement Division management should retain timely and complete supporting documentation for budget reporting.***

*Management Response: 1) We agree. The VCAD Financial Position report dated October 19, 2012 was fully documented by being tied back to BASIS. This report was “not exact” due to the process of discovering transactions in BASIS that were added to the original report (at all times tied back to BASIS) and fully accounting for transactions that affect overall Advancement expenditures but do not flow through BASIS (i.e., third party Foundation payments from total available Foundation funds expected by Advancement.) Budget control reporting will be encouraged in FY14 and required in FY15. Supporting documentation relating to budget control will be implemented along with budget control reporting.*

### **The University’s Centralized Budget Controls**

The University budgets unrestricted revenues, otherwise known as “company 0102”, through incremental based budgeting, where the budget base from the preceding year is increased by the percentage increase approved by the Executive Committee. We were informed there were no written procedures governing the budget process for the University and that the University does not budget all available funds campus-wide. Other available funds could include realized revenue, balance forward, university endowment distribution, non-university endowment realized revenues, Foundation funds, and grants.

We were further informed by the University’s Budget Director and Payroll Director that there is no link between the budget and salaries in the University’s BASIS administrative software. Colleges and divisions can hire part-time/hourly positions and enter the positions into the University’s administrative software system (BASIS) without a budgeted position number. The BASIS software does not contain preventative controls to ensure these positions have sufficient funding prior to hiring. Management stated it is the responsibility of the colleges and divisions to verify they have funding to pay the part-time/hourly positions.

We noted Finance and Administration has not provided written instructions on how to effectively monitor the budgetary process to the colleges and divisions. As a result, the process used to monitor budgets varies from MS Excel spreadsheets to Business Objects System-Crystal Reporting or SAS and Brio. The process also varies from sole reliance on the division’s budget director for monitoring the budget, as was the practice in the Advancement Division, to more formalized meetings with various college and division heads.

We were informed by the Controller that Finance and Administration did not monitor college and division accounts in a deficit position until May of each year (eleven months into the fiscal year). The process in place during the audit period was to send inquiries about deficit balances to the colleges and divisions in May and request their plans for covering any deficits.

The Vice Chancellor for Finance and Administration also informed us that unappropriated reserves are not budgeted. Requests for funding from the reserves are made by the college or division's management to the Vice Chancellor for Finance and Administration. The Vice Chancellor for Finance and Administration makes final decisions on fund transfers from unrestricted reserves. However, requests are approved in consultation with the Chancellor for any questionable items. We observed that there was no consistent documentation when requests were not approved.

The University's current centralized budget process creates an audit risk environment (related to impact and likelihood) that adverse transactions may occur and not be detected on a timely basis.

***Recommendations: 2) Management should develop written procedures to promote effective and consistent budgetary monitoring by the colleges and divisions. 3) Management should budget all funds available to the University. 4) Management should monitor and resolve significant deficit spending issues monthly or quarterly rather than waiting until year end. 5) All payroll positions should be budgeted. 6) The BASIS software should be updated to include preventative controls (edit checks) that prevent entry of new hires into the payroll system which do not have sufficient funding prior to hiring.***

*Management Response: 2) We agree. Formal, written budget procedures will be developed with a final draft completed by June 30, 2014. Upon completion of the initial draft, the Associate Vice Chancellor for Budget and Financial Planning (new position currently being filled) will be responsible for updating the document as necessary.*

*Management Response: 4) We agree. The Associate Vice Chancellor for Budget and Financial Planning will directly assist the campus financial officers by establishing ongoing communication regarding actual results of operations, projections of annual results, variances from budgets, new or discontinued activities or any other financial concerns.*

*Formal, written procedures will be developed to ensure consistent and timely reporting of unit financial position. A BASIS report is currently in development that will provide for full budget, expected revenue from all sources, expenditure and future expected commitments reporting on a monthly basis. This report will provide for more rigorous budgetary monitoring by the office of the Vice Chancellor and the ability to proactively address any budget variances as they become known rather than resolution as part of the year-end closing process. It is expected that the report will be in the beta test phase by the end of the first quarter of FY14 and fully implemented by June 30, 2014.*

*Management Responses: 3), 5), and 6) We agree. The BASIS system is capable of tracking anticipated revenues and expenditures that are not formally budgeted; however use of this feature by the campus has been optional up to this time. During FY14, campus finance officers*

*will be instructed on how to use this BASIS feature and strongly encouraged to implement immediately. Beginning in FY15, full budget loading will be required for all campus units. Managers responsible for hiring approval will be instructed that approval for all positions and hourly wage rates shall only be granted when the source of salary funding is entered in the BASIS system and is expected to be available. We will examine the feasibility of implementing edit checks in the BASIS system to validate that sufficient funding is in place prior to entry of new hire in the payroll module. Feasibility will be determined by June 30, 2014.*

#### **Other Observations**

In response to an inquiry, Internal Audit was informed by the Vice Chancellor for Finance and Administration by an email dated May 30, 2013 that the University had other divisions with deficit balances. These deficits differed from the Advancement Division's deficit in that the University's administration was aware of the deficit balances. The Vice Chancellor for Finance and Administration has developed accounting and monitoring controls to track the University's progress in addressing the deficit balances.

We were provided schedules by the Vice Chancellor for Finance and Administration; two significant deficit balances were being carried forward. One deficit balance being carried forward related to a prior implementation of network and data systems from fiscal year 2001. According to the schedules the highest deficit balance existed at the end of fiscal year 2010 in the amount of \$15,272,639, and the deficit balance has been reduced to \$8,083,560 as of May 28, 2013.

Garvan Woodland Gardens has also carried forward a deficit balance for a number of fiscal years. In the 2004 School of Architecture Internal Audit, we were provided a written response for a plan to address the deficit. We reviewed the deficit in BASIS for the past five years and observed that the deficit balance had increased from \$2,885,324 at June 30, 2008 to \$5,992,987 at March 31, 2013. This is an increase in the deficit of \$3,107,664. The University's management transferred \$100,000 in fiscal year 2012 and \$200,000 in fiscal year 2013 into the Garvan Woodland Gardens account.

We were informed by the Vice Chancellor for Finance and Administration that a written plan approved by the Chancellor and Board of Trustees to address the deficits does not exist. The Vice Chancellor for Finance and Administration subsequently stated that these deficits would be better accounted for as internal loans from the University's reserves. We could not locate a University policy on establishing internal loans.

After the completion of our audit fieldwork prior to closing the general ledger, the University's Vice Chancellor for Finance and Administration provided us with a schedule of University reserve accounts, representing the portion of unrestricted E&G reserves available for use at the discretion of the Vice Chancellor for Finance and Administration and the Chancellor. The cost centers in the schedule totaled \$36,790,320, which included unappropriated reserves of \$19,070,298 as of June 30, 2013. The University maintains these operating reserves and they are essential to funding growth, maintaining liquidity and providing additional support as needed to the colleges and divisions.

***Recommendations: 7) Management should create a documented budget plan to resolve deficits on an annual basis. Deficits too large to resolve on an annual basis should be brought forward to the Board of Trustees for review and approval of a multiyear resolution. 8) Should the University decide to reclassify the deficits as internal loans, a Board of Trustees policy should be developed approving the establishment of internal loans. In addition, campus accounting procedures and approved loan repayment schedules should be developed, along with inclusion of the annual loan payments in the University's budget.***

*Management Response: 7) We disagree that this recommendation addresses the scope stated on page 3, specifically that this finding has anything to do with the Advancement deficit or a material risk to the University. The examples cited are not related to the Advancement deficit and are distinguished from the Advancement deficit in several critical ways including being known to both internal and legislative audit for a number of years with no finding or recommendation that would have guided the campus to handle them differently. The Garvan Woodland Garden deficit was approximately \$1.5 million when information was sought about it in 2004 by Internal Audit. The campus response to Internal Audit's question about a "plan to cover this deficit" at the time was "The campus is not going to write off the deficit but intends to carry it to see if the Gardens can become self supporting sufficiently to pay it off." and is the same response given in interviews during FY13. The response to Internal Audit is provided here:*

Date: Mon, 19 Jul 2004 11:48:40 -0500  
To: "Kathy M. Ward" <kward@uark.edu>  
From: Don Pederson <dop@mail.uark.edu>  
Subject: Re: Garvan Woodland Gardens  
Cc: jeff.hannon, karen.seller, whitmire  
Bcc:  
X-Attachments:

Don,

We are performing an audit of the College of Architecture and there is a piece of information I am hoping you can provide.

A review of the 0112 company cost centers for Garvan Woodland Gardens reveals a deficit close to \$1.5 million at the end of fiscal year 2004. Is there a plan to cover this deficit outside of the College of Architecture?

The campus is not going to write off the deficit but intends to carry it to see if the Gardens can become self supporting sufficiently to pay it off. - dop.  
thanks,  
kathy

*That plan was sufficient for Internal Audit in 2004. Both deficits have been clearly segregated in separate reserve accounts with the large negative balances for transparency and would have been easily seen during previous audits. Specifically these large negative balances were seen or reviewed by Legislative Audit in past audits. More importantly, the large negative balances were carried forward to hold the units accountable for funding not only their annual budget but the cumulative deficit as well. The absence of findings in numerous previous audits implies acceptance of the stated or implied process. Furthermore, these deficits were previously communicated to President Sugg before Chancellor Gearhart took office as chancellor. A plan was in place to continue the deficits as negative reserves until related revenues were available to offset the initial investments. The plan was opportunistic and not prescriptive since the payoffs could not be predicted due to constraints and unpredictability of revenues. It is the Vice Chancellor for Finance and Administration's responsibility to develop a budget plan for university operations on an annual basis. When activities are identified for which there is not sufficient resources to fully fund necessary expenditures and it is determined the activities are vital to the mission of the university, the Vice Chancellor in consultation with the Chancellor and the Executive Committee will develop an action plan to resolve any material variances in required resources and available resources. There is no Board policy guiding the campus in reporting such management issues. Nor do generally accepted accounting procedures prohibit management creating negative reserves to accomplish institutional mission.*

*Management Response: 8) We agree. At such time that a formal internal loan process is developed on the campus, a policy will be recommended to the Board of Trustees that will allow the establishment of internal loans. In addition, campus accounting procedures and approved loan repayment schedules would be developed, along with inclusion of the annual loan payments in the University's budget. Feasibility and need will be assessed during FY14.*

We observed during the audit that the campus policies governing foundation activities 222.1 UA Foundation Expenditure Guidelines, 222.2 UA Foundation Payments, 222.3 UA Foundation and Razorback Foundation Equipment Purchases and 222.4 UA Foundation Payments to Travel Agencies were no longer accessible on the campus website. According to the website, the policies are currently being revised. The policies were removed from the website on November 8, 2012.

***Recommendation: 9) Management should establish an implementation date for the updates to the campus policies.***

*Management Response: 9) We agree. The policies will be updated by December 15, 2013 and posted to the University website.*

We were informed that the only external report issued by the Advancement Division relates to the amounts of funds raised in a given year. We observed that the press release is issued through the Advancement Division without coordination through the Vice Chancellor for Finance and Administration.

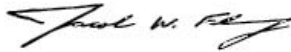
***Recommendation: 10) Disclosure of campus fundraising activity by the Advancement Division should be reviewed by the office of the Vice Chancellor for Finance and Administration prior to release for consistency and accuracy.***

*Management Response: 10) We agree. Disclosure of campus fundraising activity by the Advancement Division will be reviewed by the office of the Vice Chancellor for Finance and Administration prior to release for consistency and accuracy beginning with FY14 disclosures.*

### ***Conclusion***

The University of Arkansas, Fayetteville's established system of internal control over the budgeting and financial reporting processes needs to be strengthened in the above documented areas in order to enhance the adequacy for safeguarding assets, ensuring that the University's financial records and reports are accurate and reliable, and ensuring compliance with applicable University policies and procedures.

Written By:



Jacob Flournoy  
CPA, CIA, CGMA, CISA, CFE  
Internal Audit Director

August 28, 2013  
Date

Assigned to the Audit:  
Gerry Harris, ACDA  
Senior Internal Auditor

Also Assisting on the Audit:  
Kathy Ward, CPA, ACDA  
Regional Audit Manager



# **APPENDIX C**

**University of Arkansas, Fayetteville  
Division of University Advancement  
Associate Vice Chancellor for Financial Affairs/Treasurer Report**

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# UNIVERSITY OF ARKANSAS

Office of Financial Affairs

**CONFIDENTIAL**

October 19, 2012

To: Donald O. Pederson, Vice Chancellor for Finance and Administration

From: Jean E. Schook, Associate Vice Chancellor for Financial Affairs *Jean E. Schook*

Re: Division of Advancement Financial Management Deficiencies

Deficit balances at year-end in University accounts with no ability to reimburse cost centers used for private funds spending, along with actions taken by University of Arkansas Foundation, Inc., alerted Finance and Administration that serious financial management issues were present within the Division of Advancement.

An assessment of financial position revealed significant deficit balances in both the Division's University and Foundation accounts at June 30, 2012 in the amounts of \$2,451,360 and \$1,889,559, respectively, for a total Advancement operating deficit of \$4,340,920. Also, projected resources available for fiscal year 2013 will not be sufficient to fund commitments for salaries/ fringe benefits and provide sufficient resources for operating (maintenance) expenses, thus resulting in additional accumulation of Advancement total deficit of \$3,593,042 based on reasonable expectations of revenues from all sources as of today.

Initial conclusions based on a review of both university and foundation accounting records and other supporting documentation, as well as interviews with key personnel, revealed the Vice Chancellor for Advancement, Brad Choate, (VCAD) provided inadequate and essentially no oversight of the financial activities of the Division. Advancement staff were unable to explain the circumstances that led to the deficit balances, were not aware of the magnitude of the deficits in both University and Foundation accounts, and could not propose curative steps to achieve a sound financial position.

When the severity of this situation was determined, immediate steps were taken to address the lack of management oversight and lack of financial management expertise of Advancement staff. An Advancement Fiscal Officer was appointed September 1, 2012 with direct reporting to both the Vice Chancellor for Finance and Administration, Don Pederson, (VCFA) and the VCAD. Duties of the Advancement/Development Director of Budget and Human Resources, Joy Sharp, (the Director) were reconfigured to remove all responsibility for financial management, focusing only on human resources matters for the Division.

In order to gain a better understanding of the underlying causes for the financial crisis within the Division, the Associate Vice Chancellor for Financial Affairs and the newly appointed Advancement Fiscal

Officer, under the direction of the VCFA compiled a multi-year summary of funds available to support operations, funds expended to support operations and remaining resources. The following items were noted during the review of accounting records and other supporting documentation when preparing the multi-year summary discussed above:

1. The VCAD provided his log-in credentials to the Director in direct violation of Fayetteville Policies and Procedures 330.1 Transaction Approval and the Code of Computing Practices. This was an intentional act that circumvented the internal controls established with the Transaction Approval policy. Upon arrival at the campus in 2008, the VCAD requested that the Director be named as his alternate reviewer for transactions routed through the TARGET approval process. This request was denied by the Vice Chancellor for Finance and Administration, Don Pederson, because the Director was not in a position appropriate for material transaction review. The VCAD strongly disagreed with the decision and made it known that the policy was overly restrictive and burdensome to him and proceeded to ignore strict policy.

Sharing credentials circumvented internal controls considered foundational to the university as well as internal and external auditors in assuring proper segregation of duties and appropriate approval procedures.

2. The VCAD did not exercise proper oversight over the activities of the Division, nor monitor the resources available to support operations as evidenced by: his delegation to the Director all responsibility for transaction review and approval for all Division transactions processed through the University BASIS system and for those processed directly from Foundation accounts; his complete reliance on information and reports prepared by the Director with no effort to validate or question unexpected results; and failure to consider the likelihood of conflict of interest violations or observe that the conflict did indeed occur with the Director and a family member also employed in the Division.

Specific examples evidencing the above assertions are:

- A review of TARGET transaction review history revealed many transactions that only involved the Director and a family member of the Director also working in the Division, with many of them seemingly unrelated to the duties assigned to the family member. When examples of these transactions were presented to the VCAD, he could not explain why only those two staff members were involved in transactions that did not appear to be within duty scope of the family member.
- The VCAD did not review or monitor his own personal reimbursement claims as evidenced by a duplicate payment in the amount of \$2,051.87 for an Advancement staff event paid directly to Fayetteville Country Club on 8/22/11 and included on a VCAD personal reimbursement claim paid 9/21/11. The duplicate payment was not discovered until June 2012 by the VCFA who immediately requested the Director obtain reimbursement. The VCFA's request was not acted upon by the Director and was

ultimately resolved October 2012 when the Advancement Fiscal Officer presented supporting documentation to the VCAD.

- The VCAD indicated that the Director provided him with budget reports from time to time, but he did not retain any of these reports in either electronic or hard copy format. When asked to review a budget worksheet that appeared to be prepared by the Director, the VCAD asserted that was exactly the type of reports he had received. The example reviewed indicated available budget of over \$11 million. A cursory review by the VCAD should have detected the unreasonableness of the information contained within the worksheet. It was clear that neither the VCAD nor the Director could provide reasonable answers to budget or expenditure questions as the magnitude of the problem was being ascertained.
- The VCAD did not monitor spending of Foundation funds and did not monitor cost center balances for University cost centers used to process expenditures made with private funds (Company 0392). Reimbursements due to these cost centers were not made timely. The Director became more and more delinquent in processing reimbursements, despite direct requests to do so by Financial Affairs staff. Often very large funds transactions occurred on the last day of the fiscal year to attempt settlement of these amounts due. Beginning in FY 2011, it became necessary to accrue an account receivable from the Foundation because reimbursements were not processed in a timely fashion nor, as determined after the fact, supported by available Foundation funds.
- In what appeared to be an intentional effort to disguise a prior year account receivable balance that had not been cleared, the Director deposited restricted funds (a gift for capital purposes) totaling \$1.3 million dollars, in May 2012, into the same unrestricted general operating account with the delinquent account receivable balance. Upon discovery of the deposit error in July 2012, the VCFA immediately moved the restricted funds to the proper account. This event was facilitated by the general practice of having all checks returned directly to the Director exacerbating the lack of fiscal control. The misdirection of the funds occurred in spite of the purpose of the funds being clearly described on the face of the check.
- For the fiscal years 2008 through 2012, the VCAD authorized an overall increase of 20 positions, or 18% of total FTE, without determining if sufficient budget or other resources were available for permanent funding. The VCAD indicated that he relied completely on the Director's assertion that funds were available.
- Units within Advancement did not have sufficient information about unit budgets to manage individually and were forced to rely entirely on the Director's authorization for expenditures. Expenditures authorized by the Director were not made in the unit of the activity nor were all appointments in the assigned unit, all compounding a lack of transparency in budget and expenditure management.

Clearly the actions and specific examples outlined above provide strong evidence that the VCAD disregarded the risks inherent in delegating approval authority. These risks include over expenditure of

**University budgets, commitments to new fixed costs, making expenditures that are not mission-appropriate and fraudulent activity.**

**The control environment within the Division was one where internal control activities and monitoring were devalued and circumvented. Division staff, including unit managers, was not required to participate in the management of financial activities of the Division, as evidenced by the collective lack of knowledge of the financial position of the Division and of the University's financial processes.**

**Because many fraud risk factors were identified, consideration was given of the need to request an internal audit examination. After careful consideration, the decision to request an internal audit examination should be left ultimately to the VCFA and the Chancellor. The following notes are relevant to that decision:**

- There is an overwhelming amount of evidence that points to lack of management oversight, non-compliance with University policies and procedures and deliberate efforts to disguise poor financial management of the Division of Advancement resources, however no evidence of intentional acts to misappropriate resources for personal gain have been discovered. It should be noted that a review of accounting records specifically to identify misappropriated resources has not been performed and will likely be some time before staff resources are available to conduct such a review.**
- The historical data suggests that the primary driver of accumulated deficit balances was the addition of staff with no permanent funding.**
- An internal audit examination would be limited to university accounts and accordingly would provide no additional insight into activity of Foundation accounts that form an integral part of the revenue base for the Division. The results of such an examination would highlight the violations of university policy and lack of management oversight that have already been identified.**

**CC: G. David Gearhart, Chancellor**

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