GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL

UNIVERSITY OF THE DISTRICT OF COLUMBIA

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

FISCAL YEAR ENDED SEPTEMBER 30, 2010

CHARLES J. WILLOUGHBY
INSPECTOR GENERAL

OIG No. 11-1-13GG(a) **April 1, 2011**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General

April 1, 2011

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Kwame R. Brown
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Gray and Chairman Brown:

As part of our contract for the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2010, KPMG LLP (KPMG) submitted the enclosed final report on the University of the District of Columbia (UDC's) Internal Control Over Financial Reporting and on Compliance and Other Matters (OIG No. 11-1-13GG(a)).

This report identified deficiencies in internal control over financial reporting and compliance with investment policy considered to be material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of an entity's financial statements will not be prevented, or detected and corrected on a timely basis. This report also identified a lack of monitoring of third-party servicers and certain payroll transactions as significant deficiencies. A significant deficiency adversely affects the District's ability to initiate, authorize, record, process, and report financial data.

KPMG set forth recommendations for correcting the identified internal control weaknesses and UDC management responses are noted. In some cases, corrective action has already been taken to remedy the noted deficiencies. UDC management concurred with all findings and recommendations.

If you have questions or need additional information, please contact Ronald W. King, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

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KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
University of the District of Columbia
Washington, DC

We have audited the basic financial statements of the University of the District of Columbia (the University), a component unit of the Government of the District of Columbia, as of and for the year ended September 30, 2010, and have issued our report thereon dated January 27, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies in the University's internal control over financial reporting, which are described in the accompanying schedule of findings and responses as items 2010-01 and 2010-02 to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies, which are described in the accompanying schedule of findings and responses as items 2010-03 and 2010-04, to be significant deficiencies in internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item 2010-02.

We noted certain matters that we reported to management of the University a separate letter dated January 27, 2011.

The University's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit University's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, others within the entity, and the Government of the District of Columbia and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 27, 2011

Schedule of Findings and Responses
September 30, 2010

2010-01 Lack of Controls over the Financial Reporting Process

Condition:

During our audit, we noted that the University did not have adequate and effective internal controls in place over the financial reporting process as follows:

Preparation and management review of the financial statements

The University did not submit a complete and accurate set of financial statements for audit in accordance with the agreed-upon financial reporting timeline. Specifically, the University submitted draft financial statements for audit that did not include a statement of cash flows, as required by generally accepted accounting principles (GAAP). In addition, we noted that many of the notes to the financial statements, specifically cash and cash equivalents, accounts receivable, grants and contracts receivable, and capital assets, did not agree to the amounts on the face of the statements. Management informed us that the initial version of the financial statements submitted for audit was incomplete and subsequently provided a revised draft of the financial statements. However, we noted that certain balances included in the subsequent draft of the financial statements still did not agree to the face of the financial statements. In addition, we noted that while a statement of cash flows was provided, the cash and cash equivalents balance on the statement of net assets did not agree to the ending cash and cash equivalents balance on the statement of cash flows. In addition, we noted that although the management's discussion and analysis included the amounts and percentages of change from the prior year, it did not sufficiently describe the reasons for significant changes from the prior year in accordance with GAAP.

Inadequate account review and analysis

We noted that several accounts included amounts which could not be adequately supported by management. Specifically, we noted that management was aware that the year-end accounts receivable balance included approximately $3.4 million related to amounts that were carried over from a prior year system conversion. As this amount could not be adequately supported by management and does not represent valid future claims, it does not meet the definition of a valid receivable.

In addition, the year-end grants and contract receivable balance included approximately $384 thousand in receivables that have been outstanding for over nine years and could not be adequately supported and were not reserved for in the allowance for doubtful accounts. Management did not perform an aging analysis to determine the ongoing collectability and validity of these receivable balances.

Lastly, the year-end deferred revenue balance included approximately $133 thousand of deferred revenue that remained deferred for over nine years and could not be adequately supported. Management did not perform an analysis to ensure that the amounts were valid.

Lack of Controls over Accounting for Capital Assets

During our testing of capital assets, we noted certain individually significant items that were not properly capitalized. As a result, management performed an analysis over the operating expense and capital asset accounts and noted an additional $14 million that were erroneously recorded as operating expenses. In addition, during our testing of capital assets, we noted $2.4 million of capital assets with fiscal year 2009 in-service dates that were included as fiscal year 2010 capital asset additions. These errors represented 16.3% of the fiscal year 2010 capital additions of $14.7 million.

Calculation of the allowance for doubtful accounts

During our year-end testing of the methodology and calculation of the allowance for doubtful accounts related to student accounts receivable, we noted that the calculation did not use the correct accounts receivable balance as of September 30, 2010. Specifically, management erroneously used the amount of $15,838,793 instead of the correct amount of $12,302,951, resulting in an overstatement in the calculation for the allowance for doubtful accounts.

Criteria:

In order to ensure financial information is useful in decision-making and evaluating managerial and organizational performance, as well as demonstrating accountability and stewardship, there must be adequate controls over financial reporting to ensure accounting and financial information is fairly stated in accordance with GAAP.

Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities- an amendment of GASB No. 34*, prescribes the appropriate format for the University's basic financial statements. In addition, GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraph 11 (c) states that the analysis "should include *reasons* for significant changes from the prior year, not simply the amounts or percentages of change. In addition, important economic factors, such as changes in the tax or employment bases, that significantly affected operating results for the year should be discussed."

Cause:

The agreed-upon time frame was unnecessarily aggressive to produce a complete and accurate set of GAAP financial statements. Sufficient policies and procedures are not in place over the review of financial information and reporting. Specifically, there are not sufficient policies and procedures over the review of draft financial statements; the review and analysis of account balances to ensure balances represent valid activity; and the review and analysis of the coding, tracking and recording of expenditures related to the procurement of capital assets.

Effect:

Inadequate controls over the financial reporting process and the lack of procedures to adequately review and analyze account balance information initially resulted in material misstatements of financial statement amounts that were not prevented, or detected and corrected by management on a timely basis.

Recommendation:

We recommend that management implement policies and procedures to require the following:

- thorough review of financial statements prior to submission for audit;
- thorough review and analysis of account detail and balances;
- performance of routine aging analysis of outstanding receivables to assess collectability;
- review and analysis of expenses to ensure the appropriate accounting treatment (i.e., capitalized or expensed) and to ensure capital assets are recorded in the proper fiscal year; and
- thorough review and approval over the calculation of the allowance for doubtful accounts.

Views of Responsible Officials:

Preparation and management review of the financial statements

Management concurs with this finding.

Management understands the composition of the three basic financial statements as required by generally accepted accounting principles (GAAP). However, in order to meet the CAFR submission deadline that was established by the University and agreed to by all parties (12/22/2010), UDC management submitted "the Balance sheet" and "Statement of Revenue, Expenses and Changes in Net Assets", while still working on "the Statement of Cash flows" and updating "Foot notes". Management embarked on this strategy to speed up the audit and give the auditors a head start in order to meet the established deadline.

In order to prevent such inconsistent submission of the Financial Statement in the future, management will work closely with its auditors to set timelines that both meet the City's CAFR deadline and also provide enough time for audit work.

Inadequate account review and analysis

Management concurs with this finding.

UDC has set-up sufficient amount as allowance for doubtful accounts to allow for possible write-off in the event that any receivable is deemed uncollectible. Also, management will conduct routine aging analysis to determine probability of collections.

Lack of controls over Accounting for Capital Assets

Management concurs with this finding

Prior to FY10, all capital related transactions were handled by the DC Department of Real Estate for all District agencies including UDC. Fiscal year 2010 is the first year that UDC procurement and real estate division assumed the management of capital assets. Because this has been a new function for UDC procurement division, it was not captured in the Fixed Asset Module. However, all these capital expenditures stays as expenditures in the income statement.

To ensure that all capital assets are timely and properly identified and capitalized, the new Banner financial system that was implemented in FY 2011, will allow UDC to set up construction project correctly in the proper asset class as they are processed.

Calculation of the allowance for doubtful accounts

Management concurs with this finding

Management has added a second level approval path that will be conducted by the controller and will also serve as a quality control measure. This will ensure that this situation does not recur.

2010-02 Lack of Controls over Compliance with Investment Policy

Condition:

During our testing of mutual fund investments in, we noted that the University's mutual fund investment in Bernstein International Value II portfolio (SIMTX) had an overall two-star rating from Morningstar during fiscal year 2010 which is not in compliance with the *University of the District of Columbia Endowment Fund Investment and Spending Policy* (Investment Policy). Per the Investment Policy, all mutual funds must maintain at least a three-star rating from Morningstar. The market value of SIMTX is $3.2 million or 9.2% of the total investment portfolio of $35 million as of September 30, 2010.

Criteria:

Per section VI of the *University of the District of Columbia Endowment Fund Investment and Spending Policy* (Investment Policy), "Mutual funds must have at least a three-year record of performance and at least a three-star rating from Morningstar."

Cause:

As purchase and sale decisions are initiated autonomously by the respective fund managers, compliance can only be ensured after the fact. The University provides the investment policy to its fund managers and requests that fund managers remain in compliance with the policy; however appropriate follow-up and monitoring procedures are not performed by the University to ensure compliance.

Effect:

Non-compliance with the Investment Policy can subject the University to undue financial risk, tarnished public reputation, and legislative sanction.

Recommendation:

We recommend that management periodically review its investment portfolio, including the fund managers' purchase decisions to ensure compliance with all Investment Policy requirements.

Views of Responsible Officials:

Management concurs with this finding.

UDC and the Office of Finance and Treasury (OFT) staff will be engaging in a RFP in FY11 to replace underperforming managers and managers not meeting mutual fund ratings. UDC and OFT staff will also engage a third party investment consultant to assist in investment reviews and portfolio compliance during the fiscal year. At this stage management is comfortable with the existing exposure to the Bernstein fund and will document the policy violation to the Investment Advisory Board.

2010-03 Lack of Monitoring of Third-Party Servicers

Condition:

Management does not obtain and review reports performed in accordance with Statement on Auditing Standards No. 70, *Service Organizations* (SAS No. 70 reports) or perform alternative procedures over the controls in place at third-party service providers that impact the University's financial reporting. Specifically, the SAS No. 70 reports of investment fund managers (Stanford Bernstein & JPMorgan) are not reviewed to ensure that controls which impact the processing of University's investment transactions are properly designed and operating effectively.

In addition, there are not sufficient procedures in place to ensure that transactions processed by Tuition Management Systems (TMS), a third-party service provider are complete and accurate. TMS collects and remits tuition payments to the University on the behalf of the University's students who are on a payment plan. TMS does not have a SAS No. 70 review performed. The University does not perform alternative procedures to ensure that controls at TMS which impact the processing of tuition payment transactions are properly designed and operating effectively.

Schedule of Findings and Responses
September 30, 2010

Criteria:

In order to ensure financial information is useful in decision-making and evaluating managerial and organizational performance, as well as demonstrating accountability and stewardship, controls must be properly designed and operating effectively to ensure that the University's accounting and financial information is fairly stated in accordance with GAAP. As part of this requirement, adequate controls should be in place over the processing of transactions recorded in the University's financial statements, including those processed by the third party service providers.

Cause:

Policies and procedures are not in place that require the review of third-party service providers' SAS No. 70 reports. In addition, sufficient policies and procedures are not in place requiring the performance of alternative procedures to ensure that controls are properly designed and operating effectively for those providers that do not obtain a SAS No. 70 review.

Effect:

Control failures at third-party service providers which impact the processing of the University's transactions may go undetected. In addition, SAS No. 70 reports outline certain controls which must be properly designed and operating effectively at the user organization (i.e., the University) in order for the controls at the third-party servicer to operate effectively. Without obtaining and reviewing the SAS No. 70 reports of its third-party servicers, University financial managers may not be made aware of user control deficiencies, and therefore will not be able to ensure the proper processing of its transactions.

Recommendation:

We recommend that the University review the SAS No. 70 report of its investment fund managers, JPMorgan and Stanford Bernstein to ensure that controls which impact the processing of the processing of investment transactions are properly designed and operating effectively and that user controls are appropriately identified.

We also recommend that the University perform alternative procedures, such as testing controls in place at TMS or requiring TMS to obtain a review in accordance with SAS No. 70 to ensure that management can properly monitor the design and operating effectiveness of controls over the processing of tuition payment transactions.

Views of Responsible Officials:

Management concurs with this finding.

UDC and the Office of Finance and Treasury (OFT) staff will look to engage a third party investment consultant to assist in the review and oversight of external investment managers. This engagement will include policy compliance, as well as review of SAS 70 for managers.

In addition, management will review and document the consultant's work to make sure it is in compliance with SAS 70.

2010-04 Lack of Controls Over Certain Payroll Transactions

Condition:

During our testing of payroll expense, we noted one payroll transaction amounting to $43,915 of the ninety-eight payroll transactions selected that was incorrectly charged to the University's payroll register.

Specifically, we noted that the transaction related to an employee who retired from the Office of Chief Financial Officer (OCFO) in October 2009. Upon retirement, the employee received a retirement incentive award payment in the amount of $15,000, and was also entitled to a severance payment of twenty-six weeks of regular pay. The retirement incentive award payment was contingent upon the employee not being employed by the Government of the District of Columbia for a period of five years. As the employee was hired into an adjunct faculty position by the University in January 2010, the employee properly repaid the award amount. The credit for the repayment was erroneously recorded in the University's payroll register instead the appropriate agency (OCFO). The employee received the remainder of his OCFO severance payment in the amount of $43,915.35 in February 2010. The credit for the severance payment was also erroneously recorded in the University's payroll register.

In addition, during our testing of the time and attendance (T&A) process, we noted that for three of the sixteen non-salaried employees selected, the T&A forms were not properly signed by the employee and for one of the sixteen non-salaried employees selected, the T&A form was not properly signed by the authorizing supervisor.

Criteria:

In order to ensure financial information is useful in decision-making and evaluating managerial and organizational performance, as well as demonstrating accountability and stewardship, controls must be properly designed and operating effectively to ensure that the University's accounting and financial information is fairly stated in accordance with GAAP.

As part of this requirement, adequate controls should be in place over the processing of transactions recorded in the University's financial statements.

Cause:

Controls are not in place over the processing and monitoring of payroll transactions to prevent or detect invalid accounting transactions. Existing policies are not consistently followed or monitored.

Effect:

A lack of controls over payroll transaction processing and monitoring could result in material invalid transactions being recorded.

Schedule of Findings and Responses
September 30, 2010

Recommendation:

We recommend management implement controls to ensure amounts included in the University's payroll expense represent true and valid expenses of the University.

In addition, we recommend that the University ensure all T&A forms for non-salary employees are signed by both the employee and the supervisor in accordance with the University's existing policy.

Views of Responsible Officials:

Management concurs with this finding.

Management has instituted the following controls to eliminate such oversight:

Budget Analyst assigned to specific program will conduct bi-weekly review of the University's 485 Payroll Report. This will include analysis of payroll charges by program and employees receiving payments. This process will also enable the analysts to identify excessive payments that did not receive prior approval by UDC finance department prior to payment.

A second level review will be conducted by Specific Program owners, to identify legitimate program employee charges. This will ascertain that only current employees working within that program are getting paid.

The final and third level review will be conducted by the Budget Director, who will sign off on all 485 Reports, to make sure the above reviews are properly conducted, and all adjustments, if needed are made within a reasonable time frame.