University of Vermont and State Agricultural College

Internal Controls Assessment

REPORT

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Executive Summary

Scope
This assessment was performed by Deloitte & Touche LLP ("Deloitte & Touche" or "we") in response to the concerns expressed by the Board of Trustees (the "Board") of the University of Vermont and State Agricultural College (the "University") related to the circumstances and risks regarding certain unauthorized transactions identified to us by Dinse, Knapp & McAndrew, P.C., (the Board’s attorneys who retained us to perform this assessment) between July 2004 and April 2008, that were entered into without appropriate internal approvals. The objectives were to:

- Perform a root cause analysis to determine how the specified disbursements were made without proper internal approvals; and
- Identify internal control failures with respect to the unauthorized transactions and disbursements relating to them.

Our assessment focused on the central procurement process only, and references to budgets in this report relate only to those within the Division of Finance & Management. We focused on the procurement process for the Division of Finance & Administration including Administrative and facilities services, Information technology, Capital planning and management etc.

Summary of procedures
To complete this assessment, we performed the following procedures:

- Interviewed key personnel at the University and third parties;
- Performed background checks on selected individuals from publicly available records;
- Gathered and analyzed data from the FRS (Financial Record System) and PeopleSoft accounting systems in use between July 2004 and April 2008;
- Gathered documentation on the organization structure and overall control environment including contract authorization and procurement policies and procedures and other internal controls documentation;
- Assessed information and documentation related to the procurement process and set up of controls within the PeopleSoft system; and
- Evaluated additional information gathered through discussions with University personnel or documents related to the circumstances that allowed the unauthorized transactions to occur.

Deloitte & Touche’s services were performed in accordance with the Statement on Standards for Consulting Services issued by the American Institute of Certified Public Accountants ("AICPA"). Deloitte & Touche’s services did not and do not constitute an engagement to provide audit, compilation, review, or attestation services as described in the pronouncements on professional standards issued by the AICPA, and, therefore, Deloitte & Touche did not and is not expressing an opinion or any other form of assurance with respect to the University’s system of internal control over financial reporting or its compliance with laws, regulations or other matters.

Observations and findings
We note the following observations based on our assessment:

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Root cause and payment analysis results

- Three out of six contracts created with Huron Consulting Services LLC ("Huron Consulting") lack Board approval or legal counsel involvement. In addition, the total amount spent on services provided by this vendor exceeds the amounts estimated in the contracts that were signed;
- Data analysis identified several contracts with other vendors that were not entered into in accordance with the contracting and approval processes that are outlined in the University's procurement and approval authority policies;
- Control and process level break-downs exist in the procurement process including the sourcing, contracting, vendor set up, Purchase Order creation, and invoicing and payment functions; and
- Although we identified disbursements that were made without prior required internal authorizations, we did not identify any disbursements made for non-University purposes in the course of our assessment.

Other areas of potential concern

- The budget creation and reporting processes lack transparency between the Division of Finance & Administration and the Board and standard guidelines and thresholds that define reporting requirements;
- There was a lack of compliance with various University policy requirements on procurement and approval authority;
- Opportunities to make process improvements in various areas, including the procurement, budgeting, and grants and contracts accounting processes, were not implemented during the PeopleSoft implementation and continue to be under-utilized; and
- The University should re-evaluate the overall internal controls structure and environment. The recommendations provided by the National Association of College and University Business Officers (NACUBO) on improvements to the overall control environment and governance processes at colleges and universities can be used as guidance.

During the course of this assessment we also identified several areas that the Board had not specifically included within the scope of this project, but may have internal control issues or risks that warrant further analysis by the University. Some of these include the budgeting process for academic units, PeopleSoft implementation project issues, Treasury operations, and the controls around the Grants and Contracts Accounting process. We recommend that the University assess potential issues and improvements in these areas.

Key definitions and descriptions:

Internal Controls (i.e. Controls): The COSO (Committee of Sponsoring Organization of the Treadway Commission) framework defines internal control as a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Policies and procedures: According to the COSO, policies and procedures are developed for assessing and reporting on internal control monitoring activities.

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Detailed Observations and Recommendations

1) Root cause and Payment Analysis

a) Procurement process and controls

There are several opportunities for potential improvements in the control structure within the procurement process. The control break-downs identified below are a combination of inadequately designed controls as well as controls and processes that were designed adequately, but did not operate effectively.

Sourcing

The Contract Approval and Signatory Authority Policy establishes guidelines for bidding and sourcing over certain monetary thresholds. It also provides guidelines to be followed if vendors are selected based on non-competitive bids. For a substantial portion of vendors tested, there was no evidence of compliance with the bidding requirements stated in the policy in the form of Request for Proposals (RFPs). Further, a substantial number of the vendor contracts tested were entered into based on non-competitive bid forms which had not been approved by the appropriate authority according to the policy. All vendors selected by Deloitte & Touche LLP for testing exceeded the thresholds defined, for the bidding and RFP processes to be followed, per the policy.

Contracts

The Contract Approval and Signatory Authority Policy establishes thresholds for the type of vendors that require contracts including monetary values. The requirements indicate that all vendors that exceed these thresholds should have a legal contract in place with the University. Contracts are also required to be approved by appropriate authorities within the University based on the Contract Approval and Signatory Authority Policy. This approval is obtained through the creation and authorization of a cover sheet for each contract, which is known as the “blue sheet.”

A substantial number of vendors that were selected for testing and required a contract did not have signed contracts in place. In addition, for a large percentage of vendors selected, the blue sheet had not been created and appropriate approvals in accordance with the policy did not exist.

Vendor set-up

Vendors should be entered into the PeopleSoft system based on documents that are approved by authorized personnel within the University. Currently, there is no requirement for a copy of contracts or other supporting documentation to be sent to the procurement department to set up a vendor, other than the vendor’s tax forms. In addition, the University does not have a process in place that segregates the creation and approval functions for setting up vendors in the system. These issues could increase the likelihood of having unauthorized vendors in the system and potential payments made to these unauthorized vendors, making the risks of fraud and non-optimized procurement more prevalent.

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Vendor master file

Based on our analysis of the vendor master file, it was noted that there are several instances of vendors being created with multiple vendor IDs and addresses. While we note that there may be valid business reasons for a vendor to be set up with multiple addresses, setting up multiple vendor IDs for each address could lead to breakdown of controls over the validity of the vendor master file such as, hypothetically, the processing of duplicate payments to the same vendor. In addition, the University does not have a process in place for the regular review of the vendor master file. A periodic review of the vendor master file would be intended to enable the timely identification of unauthorized vendors and potential duplicate payments.

Purchase Orders and Segregation of Duties

The Procurement or Lease of Services and Goods Policy establishes thresholds for approval requirements. These approvals are controlled through the PeopleSoft Workflow within the Accounts Payable module. The Workflow set up is inconsistent with the requirements of the University’s policy, and the current control set-up allows Purchase Orders to be created and approved by the same person. There were several instances of Purchase Orders that had been initiated by the Office of the Vice President (VP) of Finance & Administration and approved via e-mail confirmation by the same individual.

Budget check

Purchase Orders are associated with budget numbers in the accounting system. These budget numbers have amounts assigned to them based on the approved budget values. While PeopleSoft has this functionality, currently the University has not consistently designed controls (within PeopleSoft or otherwise) to prevent the creation of Purchase Orders to a vendor that exceed the overall approved budget amounts.

Invoicing and payment

The invoicing process set up for invoices above certain thresholds requires the matching of invoices against Purchase Orders. If an invoice amount exceeds the related Purchase Order amount, the current set up allows the user to change the Purchase Order amount to match the invoice. We identified numerous examples of the Procurement Department increasing these limits upon receipt of a request for payment that exceeded the limit reflected in the related Purchase Order. Thresholds are not established for the creation of these change orders.

In addition, payments made through check requests do not require a Purchase Order to be set up or approved. Therefore there are no controls set up to require check requests to be approved in compliance with the Procurement or Lease of Services and Goods Policy.

Recommendation

The University should re-design the procurement process to address the control and process break-downs identified above. The re-designed control structure should ideally include a combination of preventative and detective controls that serve as checks and balances at each step. “Preventative controls” keep undesirable events from occurring, and “detective controls” identify undesirable events after they have occurred.

In addition to this, the University should implement a process to test the operating effectiveness of these redesigned controls on a periodic basis to be able to assess compliance with the guidelines and policies established.

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A regular review of these processes is intended to help the University to identify and resolve control weaknesses on a timely basis.

b) **Huron Consulting**

Based on our analysis of available documents, the spending limit of $30.5M approved by the Board of Trustees for the PeopleSoft implementation was reached during April 2007. We noted six contracts between the University and Huron Consulting during the period of review. Three of these contracts were signed after April 2007 by the VP of Finance & Administration without evidence of Board approval. All of these contracts required Board approval based on their estimated, as well as actual, total costs, per the Contract Approval and Signatory Authority Policy.

In addition, for four out of these six contracts, it was noted that the work had begun without an executed contract being in place.

During our assessment of the Huron Consulting purchase orders, payments and contracts, we also noted that purchase orders had been increased by significant amounts after their initial creation without appropriate internal approvals. Additional controls related to budget checks and approvals for the changes to these purchase orders did not operate effectively.

For some of the contracts, the final amount invoiced significantly exceeded the initial cost estimate mentioned in the contract. There was no evidence that these increased amounts were reviewed and approved by appropriate individuals within the University.

**Recommendation**

The University should strengthen the controls around creating, approving, and monitoring projects. A process should be developed to help identify and address budget overruns on a timely basis and facilitate the timely reporting of these overruns to the President and the Board. In addition, manual as well as automated controls should be considered to prevent additional processing once the approved budget limit for a given project is reached unless appropriate approvals are obtained.

2) **Other Areas of potential concern**

a) **Automated controls in PeopleSoft**

The University has invested a considerable amount of time and resources in the implementation of the PeopleSoft system. A key benefit from the installation of an integrated ERP application is the ability to design and implement effective and efficient automated controls within the system. Currently, various control settings within the Accounts Payable module of the ERP are not being used effectively by the University. For example, the Purchase Order approval set up that is currently in place requires purchases over $50,000 to obtain one level of approval. This is inconsistent with the University’s policy requirements which define additional levels of approvals for expenses exceeding $250,000. In addition, PeopleSoft could be configured to facilitate multiple layers of approval. If appropriately designed, controls within the application can be used to monitor compliance with the approval authority stated in the University’s various policies.

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Recommendation

The University should perform an assessment of the automated controls and settings that are available within PeopleSoft and implement appropriate controls reflecting the University’s policies through the use of automated and/or configured checks and controls within the ERP application.

b) Compliance with policies

The University has published the relevant and applicable policies on websites that are accessible to University employees. Updates to these policies are made online. We observed through our discussions and tests of transactions that employees are not complying with published policies and in many cases are not aware of all the policies and updates to policies. In addition, compliance with policies is not monitored on a regular basis.

Recommendation

The University should train employees on existing policies on a periodic basis. The University should also determine whether policy creation, change, and communication are performed in a standardized manner. In addition to this, University management should design and implement procedures to assess compliance with policies on a regular basis.

c) Governance

Potential improvements could be made in the overall internal control environment (including systematic controls and monitoring controls), as well as in management oversight at the VP of Finance & Administration level. It is typically the responsibility of a VP of Finance & Administration, or an equivalent’s role, to implement policies, procedures, and standards which facilitate an effective control environment. The person in this role should also communicate weaknesses or improvement areas to executive management, the Audit Committee, and the Board of Directors. During our engagement, we were not informed of or provided with documentation evidencing a formal reporting mechanism to communicate important, relevant, and timely information to the Board.

Recommendation

The University should evaluate its current structure in an effort to achieve effective corporate governance. Going forward, the role of the VP of Finance & Administration should be to design and implement a system of internal controls. The University may want to consider revisiting the National Association of College and University Business Officers (NACUBO) report which outlines a series of recommendations for Higher Education institutions related to the Sarbanes-Oxley Act of 2002. The report focuses on three main areas: independent auditors, senior management, and audit committees. The University should undertake an evaluation to understand best practice guidance and areas of improvement. A specific area of focus should be to create a more robust reporting mechanism to executive management and the Board.

d) Role of Internal Audit

Based on comparison to the Institute of Internal Auditors (IIA) standards and the Global Audit Information Network (GAiN) benchmarking reports provided by the IIA, the Internal Audit Department at the University of Vermont does not have sufficient authority, staff, or independence to be effective in supporting the University in its objectives. A typical Internal Audit Department in a comparable university utilizes a risk-based approach to

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provide reliable assessments of financial reporting, deter and investigate fraud, safeguard assets, and assess compliance with laws and regulations. Additionally, it is an emerging best practice for an internal audit department to be organizationally independent from management (in order to enable an objective evaluation of management activities and personnel) and report to the audit committee of the University. At the time of the unauthorized transactions, the Internal Audit Department of the University reported to the VP of Finance & Administration. The current department does not appear to have utilized a risk assessment to scope its activities and is understaffed based on our benchmarks.

**Recommendation**

The University should evaluate the resources and support provided to its Internal Audit function in order to meet the expectations of the Audit Committee. The Internal Audit Department should be organizationally independent from management to enable an objective evaluation of management activities and personnel. The University should determine whether the Internal Audit Department has unrestricted access to the Audit Committee. The University should consider staffing according to industry benchmarks with personnel who are experienced in helping an organization as complex as the University transform its internal controls to a more effective state. The department's efforts should be performed utilizing a meaningful risk assessment and be executed in accordance with the IIA standards.

e) **Budgeting process**

We analyzed the portions of the budgeting process that were relevant to the unauthorized transactions within our scope and noted several issues in this process that contributed to the unauthorized spending. These include the ability to re-allocate un-spent budgets to departments at the end of a year, lack of adequate and transparent reporting between the VP of Finance & Administration and the Budgeting and Finance Committee, as well as the judgmental adjustments involved in the report that is currently presented to the Board and Budgeting and Finance Committee. A combination of these issues contributed to the ability to move funds between accounts and reappropriate budget amounts to projects without obtaining explicit approvals. As a result the VP of Finance & Administration had the ability to utilize re-allocated funds to compensate for unbudgeted Huron related University spending.

**Recommendation**

The University should create a more standardized and transparent process of compiling budget balances and reporting them to the Budgeting and Finance Committee. Additional guidelines on the creation and presentation of the balance on contingency funds should be created.

The control environment and processes at the University should be analyzed to determine appropriate areas of improvement to potentially enhance the processing and monitoring of contracts and payments that are subject to internal approvals in accordance with University policy.

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