

February 12, 2014

Dr. Daniel,

Internal Audit is required by UTS 142.1, *Policy on the Annual Audit Report*, Section 6, to perform an annual internal audit of the monitoring plan for financial statement certifications and validate the assertions on segregation of duties and account reconciliations. Also, Internal Audit worked under the direction of the Deloitte auditors on the Fiscal Year 2013 financial statement audit as part of our Fiscal Year 2014 audit plan.

Generally, we found that UT Dallas has a risk assessment and monitoring plan in place to properly monitor financial statement certifications and ensure an appropriate segregation of duties and account reconciliation process.

Deloitte will issue a separate report regarding the results of their work; however, we found some issues that are not considered reportable by Deloitte but that we felt should be communicated to management to strengthen the financial reporting process and minimize the risk of material misstatements going undetected in a timely manner.

Management has reviewed the recommendations and has provided responses and anticipated implementation dates. Though management is responsible for implementing the course of action outlined in the response, we will follow up on the status of implementation subsequent to the anticipated implementation dates. We appreciate the courtesies and considerations extended to us during our engagement. Please let me know if you have any questions or comments regarding this audit.



Toni Stephens  
Executive Director of Audit and Compliance

*UT Dallas Responsible Parties:*

Mr. Terry Pankratz, Vice President for Budget and Finance  
Dr. Reda Bernoussi, Director of Accounting and Financial Reporting  
Mr. Pete Bond, Assistant Vice President for Procurement Management

*Members of the UT Dallas Audit and Compliance Committee:*

Dr. Hobson Wildenthal, Executive Vice President and Provost  
Dr. Calvin Jamison, Vice President for Administration  
Mr. Terry Pankratz, Vice President for Budget and Finance  
Dr. Andrew Blanchard, Vice President for Information Resources and Chief Information Officer  
Dr. Bruce Gnade, Vice President for Research  
Dr. Darrelene Rachavong, Vice President for Student Affairs  
Dr. James Marquart, Vice Provost  
Dr. Sue Taylor, Acting Chief Information Security Officer  
Mr. Timothy Shaw, University Attorney  
Ms. Lisa Choate, Partner, Ultimate Health Resources

*The University of Texas System:*

Dr. Pedro Reyes, Executive Vice Chancellor for Academic Affairs  
Alan Marks, Attorney  
Mr. J. Michael Peppers, CIA, CRMA, CPA, FACHE, Chief Audit Executive  
Ms. Moshmee Kalamkar, CPA, CIA, Audit Manager

*State of Texas Agencies:*

Legislative Budget Board  
Governor's Office  
State Auditor's Office  
Sunset Advisory Commission

## Executive Summary

### ***Annual Financial Report, Report No. 1409***

<p><b>Audit Objective and Scope:</b> Internal Audit is required by UTS 142.1, Policy on the Annual Audit Report, Section 6, to perform an annual internal audit of the monitoring plan for financial statement certifications and validate the assertions on segregation of duties and account reconciliations. Also, Internal Audit worked under the direction of the Deloitte auditors on the Fiscal Year 2013 financial statement audit as part of our Fiscal Year 2014 audit plan.</p>	
<p><b>Audit Results:</b> The audit resulted in no recommendations considered significant to University operations; however, we offer the following recommendations to strengthen the financial reporting process.</p>	
<i>Recommendation</i>	<i>Estimated Implementation Date</i>
(1) Review Liabilities for Compensable Absences	<i>August 31, 2014</i>
(2) Review Depreciation Schedules for Acquired Assets	<i>August 31, 2014</i>
(3) Enhance Process to Record In-Service Dates for Capital Assets	<i>August 31, 2014</i>
(4) Enhance Validation Process for Items Received	<i>August 31, 2014</i>
<p><b>Conclusion:</b> Generally, we found that UT Dallas has a risk assessment and monitoring plan in place to properly monitor financial statement certifications and ensure an appropriate segregation of duties and account reconciliation process. Deloitte will issue a separate report regarding the results of their work; however, we found some issues that are not considered reportable by Deloitte but that we felt should be communicated to management to strengthen the financial reporting process and minimize the risk of material misstatements going undetected in the future.</p>	
<p><b>Responsible Vice President:</b> Mr. Terry Pankratz, Vice President for Budget and Finance</p>	<p><b>Responsible Party:</b> Dr. Reda Bernoussi, Director of Accounting and Financial Reporting; Mr. Pete Bond, Assistant Vice President for Procurement Management</p>
<p><b>Staff Assigned to Audit:</b> Dylan Becker, CPA, CIA, Senior Auditor</p>	



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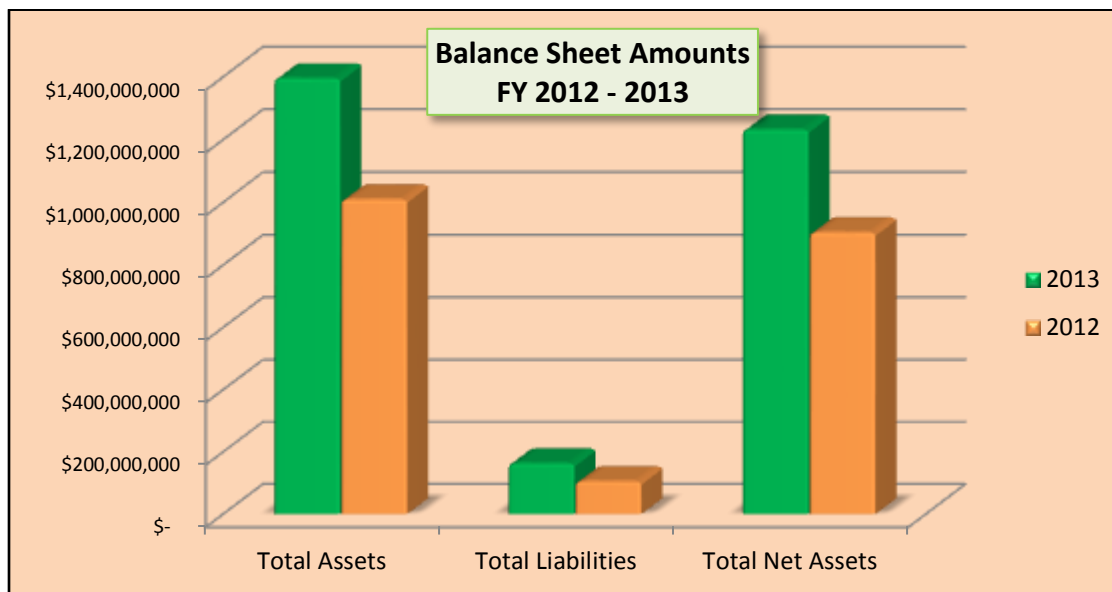
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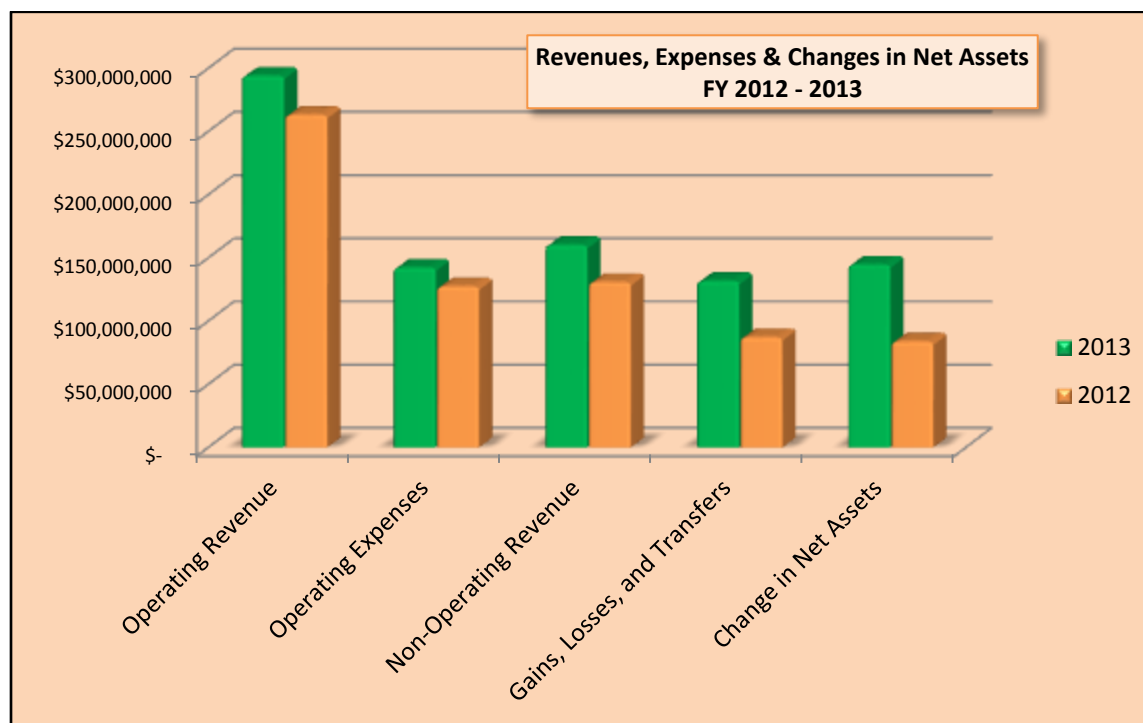
## Background

The UT System is composed of nine academic and six health-related institutions of higher education as well as UT System Administration. Annual Financial Reports (AFRs) and related footnote information are prepared by the financial reporting officers at each UT institution and UT System Administration in accordance with accounting and financial reporting requirements promulgated by UT System policy and the Texas Comptroller of Public Accounts to be included in the UT System Consolidated AFR. The Office of the Controller at UT System Administration consolidates AFRs from all UT institutions and UT System Administration and prepares footnotes and other related disclosures so that the UT System Consolidated AFR is prepared in accordance with generally accepted accounting principles. The information included in the University of Texas—Dallas (UT Dallas AFR) and related footnote information are the responsibility of UTD management.

The UT System Board of Regents approved the hiring of Deloitte to conduct an independent audit of the Consolidated AFR of the UT System. Deloitte is responsible for auditing the Consolidated AFR, which includes the balance sheet as of August 31, 2013 and the related statement of revenues, expenses, and changes in net assets and cash flows for the year then ended. As part of the external financial audit, internal audit assisted Deloitte under their direction in the performance of financial audit procedures. Deloitte will prepare a separate audit report detailing the results of their audit.

Summarized UT Dallas AFR Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flow information is listed below.





<b>Cash Flows</b>	<b>2013</b>	<b>2012</b>
Net Cash Provided (Used) by Operating Activities	\$ 82,435,770	\$92,943,372
Net Cash Provided (Used) by Noncapital Financial Activities	\$155,497,478	\$154,574,629
Net Cash Provided (Used) by Capital and Related Financing Activities	\$ 28,843,133	\$43,448,709
Net Cash Provided (Used) by Investing Activities	\$ 29,812,350	\$16,858,084
Net Increase (Decrease) in Cash	14,406,224	\$1,324,464
Cash & Cash Equivalents at Beginning of Year	\$78,134,051	\$37,004,438
Cash & Cash Equivalents at End of Year	\$92,540,275	\$38,328,901

UTS 142.1, *Policy on the Annual Financial Report*<sup>1</sup>, provides for “financial reporting requirements and duties related to those responsible for financial reporting, the approval of accounting records and responsibilities for establishing internal controls to ensure that funds are expended and recorded appropriately, and procedures for obtaining services by an external audit firm.” The policy designates a Financial Reporting Officer who is responsible for the integrity of the financial statements. These responsibilities include assuring efficient and effective internal controls over the preparation of the financial statements, identifying sources of the financial data, and evaluating material impacts of the sources of financial data.

In addition, the Financial Reporting Officer establishes controls over the annual closing of the accounting records, including the correct timing to ensure inclusion of material financial data, the validity of the adjusting entries, and the reconciliation of sub-accounts into the general ledger.

UTS 142.1 also states that each university must have a monitoring plan for account reconciliation and segregation of duties. The Risk Assessment and Monitoring Plan, (RAMP), tested annually by Internal Audit, is risk-based and updated annually. The Financial Reporting Officer has certified that the financial accounts are presented fairly with no misrepresentations and abides by the Financial Code of Ethics.

## **Audit Objective**

Internal Audit is required by UTS 142.1, Policy on the Annual Audit Report, Section 6, to perform an annual internal audit of the monitoring plan for financial statement certifications and validate the assertions on segregation of duties and account reconciliations. Also, Internal Audit worked under the direction of the Deloitte auditors as part of the financial statement audit.

## **Scope and Methodology**

The scope of this audit was fiscal year 2013, and our fieldwork concluded on January 14, 2014. To satisfy our objectives, we performed the following:

- Reviewed the Risk Assessment and Monitoring Plan
- Tested supporting documentation related to account reconciliations and segregation of duties for expenditures and journal entries.
- Verified the certification process was complete.
- Confirmed a sample of returned letters for completeness.

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<sup>1</sup> <http://www.utsystem.edu/bor/procedures/policy/policies/uts142.html>

We conducted the financial statement audit work under the direction and guidance of Deloitte. Where applicable, we conducted our examination in accordance with the guidelines set forth in The Institute of Internal Auditor's *International Standards for the Professional Practice of Internal Auditing*. The *Standards* set criteria for internal audit departments in the areas of independence, professional proficiency, scope and performance or audit work, and management of the internal auditing department.

## **Audit Results and Management's Responses**

Generally, we found that UT Dallas has a risk assessment and monitoring plan in place to properly monitor financial statement certifications and ensure an appropriate segregation of duties and account reconciliation process. Deloitte will issue a separate report regarding the results of their work; however, we found some issues that are not considered reportable by Deloitte but that we felt should be communicated to management to strengthen the financial reporting process and minimize the risk of material misstatements going undetected in the future.

A significant recommendation is defined as one that may be material to operations, financial reporting, or legal compliance. This would include an internal control weakness that does not reduce the risk of irregularities, illegal acts, errors, inefficiencies, waste, ineffectiveness, or conflicts of interest to a reasonable low level. We have **no significant recommendations** resulting from this audit; however, the following recommendations will help enhance the financial reporting process and minimize the risk of material misstatements going undetected in a timely manner.

### ***Audit Recommendations***

#### **(1) Review Liabilities for Compensable Absences**

Employee compensable leave liabilities are separately reported as both *current* and *noncurrent* on the Balance Sheet and totaled \$4,017,221 and \$3,646,098, respectively, as of August 31, 2013. These amounts represent the vacation leave that would have to be paid to terminating employees as of August 31, 2013.

[GASB 16](#), *Accounting for Compensated Absences*, paragraph 10, states: "The compensated absences liability should be calculated based on the pay or salary rates in effect at the balance sheet date." In calculating the amount reported on the Balance Sheet, the wage rates for Fiscal Year 2014 were used in the calculations rather than the wage rates as of August 31, 2013.

As a result, the liability reported on the Annual Financial Statements for Fiscal Year 2013 was overstated by approximately 5.5%, or \$408,083. The chart below details the differences between the reported and actual liability:

NACUBO Function	Liability Reported (FY14 Pay Rate * Vacation Hours)	Actual Liability (FY13 Pay Rate * Vacation Hours)	Difference
Academic Support	\$ 1,676,977.15	\$ 1,585,239.00	\$ (91,738.14)
Auxiliary	\$ 482,784.74	\$ 457,324.26	\$ (25,460.49)
Institutional Support	\$ 2,128,369.60	\$ 2,012,429.27	\$ (115,940.33)
Instruction	\$ 1,371,135.79	\$ 1,300,177.63	\$ (70,677.31)
Operation and Maintenance of Plant	\$ 453,226.19	\$ 433,748.45	\$ (19,477.74)
Public Service	\$ 132,586.86	\$ 123,737.40	\$ (8,849.46)
Research	\$ 858,215.18	\$ 817,785.51	\$ (40,429.67)
Student Services	\$ 560,023.34	\$ 524,513.96	\$ (35,509.38)
<b>Grand Total</b>	<b>\$ 7,663,318.84</b>	<b>\$ 7,254,955.47</b>	<b>\$ (408,082.52)</b>

**Recommendation:** Management should review the query and data sets used in financial reporting to ensure the salary rates are accurate and comply with GASB 16.

**Management's Response:** *Management will review the data used in estimating the liability for compensable absences and will make sure the appropriate rates are used based on GASB 16 requirements.*

**Estimated Date of Implementation:** *August 31, 2014*

**Person Responsible for Implementation:** *Randy Rikel, Associate VP and Controller*

(2) **Review Depreciation Schedules for Acquired Assets**

UT Dallas acquired the Waterview Apartment Complex during July 2013. The complex consisted of four phases (I-IV) and each phase was assessed a value based on the square footage of the phase compared to the total square footage of all four phases. Accounting further segregated the cost of each phase into components, such as HVAC, fixed equipment, and plumbing based on the estimated percentage of costs of the components compared to the total value of the phase. The purpose of segregating the estimated costs of the components for each phase was to establish a realistic depreciation schedule for the acquired assets.



The expected life, however, of the componentized assets does not appear to be reasonable. The expected useful life used in the depreciation schedules relied on a Generic Building Table<sup>2</sup> provided by the Texas Comptroller of Public Accounts. Accounting treated the assets as if they were newly constructed even though the actual age of the acquired assets was approximately 26 years old on the date of acquisition. Property guidelines provided by the Texas Comptroller of Public Accounts state that “If your institutional experience indicates another useful life is more appropriate, you may use that useful life.” The graph below details the total expected useful life of the assets for Phase I:

Asset ID	Description of Componentized Asset	Amount Capitalized	PeopleSoft Useful Life (Yrs)	Actual Age (Yrs)	Total Expected Life of Asset
WVAI01	Waterview Apt 1 - Bldg Shell	\$ 5,639,610.27	30	26	56
WVAI02	Waterview Apt 1 - elec + light	\$ 1,590,659.31	20	26	46
WVAI03	Waterview APT I - Plumbing	\$ 867,632.35	20	26	46
WVAI04	Waterview Apt 1 - Fire Prot	\$ 289,210.78	10	26	36
WVAI05	Waterview Apt 1 - fixed Equip	\$ 289,210.78	20	26	46
WVAI06	Waterview Apt 1 - HVAC	\$ 2,458,291.66	15	26	41
WVAI07	Waterview Apt 1 - Misc Cons	\$ 289,210.78	15	26	41
WVAI08	Waterview Apt 1 - Floor	\$ 1,735,264.70	15	26	41
WVAI09	Waterview Apt 1 - Interior	\$ 867,632.35	15	26	41
WVAI10	Waterview Apt 1 - Roof	\$ 433,816.17	10	26	36

As a result, there is an enhanced likelihood UTD will recognize additional expenses since it is likely the assets will be impaired, or need to be replaced before reaching their expected useful life as entered in PeopleSoft.

**Recommendation:** Management should review the depreciation schedules for acquired assets to ensure they represent a reasonable useful life.

**Management’s Response:** *Management will review the depreciation schedules of recently acquired assets and where possible evaluate whether the current useful lives are appropriate and reasonable. If the recently acquired assets are deemed to be impaired or in need to be replaced, Management will use Generally Accepted Accounting Principles to capitalize any substantial improvements and subsequently expense the appropriate depreciation expense based on the determined useful life.*

**Estimated Date of Implementation:** *August 31, 2014*

<sup>2</sup> <https://fmx.cpa.state.tx.us/fmx/spa/building/fpp-q001.pdf>

**Person Responsible for Implementation:** *Randy Rikel, Associate VP and Controller*

(3) **Enhance Process to Record In-Service Dates for Capital Assets**

The in-service dates used for capital assets acquired during Fiscal Year 2013 were based on the first payment date and not when they were actually placed into service, ready to be placed into service, or acquired. To pay an invoice there must be a three way match in PeopleSoft which includes the purchase order, invoice, and receipt. When vendors required up-front, or partial payments prior to shipment the items were received regardless if they had actually arrived on campus. GASB 34, Paragraph 19 states, "Capital Assets includes land, improvements to land, easements, buildings... and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period."

As a result, assets were capitalized and depreciated in the fixed assets module in PeopleSoft before they had arrived on campus, or were ready to be placed into service. Additionally, if assets required partial payments then each payment was capitalized separately as payments were made regardless if payments dates crossed into a new accounting period.

**Recommendation:** Management should review the process used to capitalize assets to determine the best way to ensure only assets that are on campus are reflected on the Balance Sheet, and minimize the risk of capitalizing the same asset in different accounting periods.

**Management's Response:** *Management will review the receiving and partial payment processes in order to ensure information used for capitalizing assets is complete and accurate.*

**Estimated Date of Implementation:** *August 31, 2014*

**Person Responsible for Implementation:** *Bob Fishbein, Assistant VP for Auxiliary Services and Randy Rikel, Associate VP and Controller*

(4) **Enhance Validation Process for Items Received**

For items not processed by Central Receiving, complete reliance is placed on email communications between Accounts Payable, departments, and Central Receiving to validate items have actually been received and are on-campus. The emails are stored within eProcurement by the buyers and are maintained under the history of the Purchase Order. During the review, we noted that email communications did not always ask if the item has been received and instances were found where the only question to the department was if the invoice was ok to be paid.

Best practices suggest additional procedures, beyond email communications, be used in conjunction with email communications to validate an item has actually arrived on campus.

**Recommendation:** For items not received by Central Receiving, management should determine the best way to validate and document that an item has actually arrived on campus.

**Management's Response:** *Management will review the receiving process in order to ensure items received by departments are validated and documented.*

**Estimated Date of Implementation:** *August 31, 2014*

**Person Responsible for Implementation:** *Pete Bond, Assistant VP for Procurement and Randy Rikel, Associate VP and Controller*

## Status of Prior Audit Recommendations

The following is the status of implementation of the recommendations resulting from Internal Audit Report No. 1329, *Financial Statement Certifications*, dated August 29, 2013

Recommendation	Implemented?
Consideration should be given to formalizing the process of communication to the Vice President for Budget and Finance by providing a summary report indicating the completion rate of reconciliations and also detailing accounts where reconciling differences have been identified.	Yes
Management should ensure that processes that have been put in place for reconciling the two systems continue to work as designated throughout the year.	Yes
A materiality threshold should be formally documented and added to the Letters of Representation process document.	Yes

## **Conclusion**

Based on the audit work performed, we found that UT Dallas has a risk assessment and monitoring plan in place to properly monitor financial statement certifications and ensure an appropriate segregation of duties and account reconciliation process. Deloitte will issue a separate report regarding the results of their work; however, we found some issues that are not considered reportable by Deloitte but that we felt should be communicated to management to strengthen the financial reporting process and minimize the risk of material misstatements going undetected in the future.

We appreciate the courtesy and cooperation received from the management and staff of the Office of the Vice President for Budget and Finance during this audit.