

K-State Athletics, Inc.

**Report on Internal Controls related
to the Contracting, Travel, and
Expenditure processes.**

October 30, 2009

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Mr. John Currie
Director of Athletics
K-State Athletics, Incorporated
Bramlage Coliseum
1800 College Avenue
Manhattan, KS 66506

Dear John:

We have completed our procedures related to the internal control review of the contracting, travel and expenditure processes at K-State Athletics, Incorporated ("KSA"). Our services were performed during August and September 2009 in accordance with the terms of our engagement letter dated July 10, 2009 and the *Statement on Standards for Consulting Services* as prescribed by the American Institute of Certified Public Accountants.

The accompanying pages of our report include the following sections:

- Executive Summary
- Detailed Discussion

This report is intended solely for the information and use of management and the Board of Directors. It is not intended to be and should not be used by anyone other than these specified parties. KSA's external auditors and regulators may be provided with a copy of this report in connection with fulfilling their respective responsibilities.

Executive Summary

Project Scope

A public accounting firm was engaged to perform a process review of K-State Athletics, Incorporated's ("KSA") business processes as they relate to contracting, travel and expenses. Additionally, our scope included a review of previously missing documentation related to 13 disbursements that were referenced in Grant Thornton's *Exit Analysis Related to the Retirement of Dr. Jon Wefald, President of Kansas State University*, which was addressed to the Kansas Board of Regents and dated April 27, 2009 (hereafter referred to as "the Grant Thornton Report"), and a review of the organization's administration of their Imprest Bank Account ("Imprest Account").

We segregated the scope of this review into categories and developed an understanding of KSA's current processes and controls as they relate to the following areas:

Contract Administration

- General Contracting
- Employment and Compensation

Expense Approval and Disbursement Processing

- Disbursements with a purchase order
- Disbursements without a purchase order
- Student Host per diems
- Cash Advances
- Batch Check Processing
- Official Visits
- General Expenses
- Scholarship Payments

Imprest Account Administration Review

- Policy
- Transaction Authority
- Recent activity within the account

Review of Documentation for Transactions Referenced in the Grant Thornton Report

- Business Purpose and Authorization

In addition to understanding these processes, we also evaluated the effectiveness of the current control structure within these processes and performed limited testing of certain controls implemented since June 1, 2009 to determine if such controls were designed appropriately and operating effectively.

Summary Results and Conclusions

The process changes that have been implemented at KSA subsequent to the hiring of Mr. John Currie as Director of Athletics appear to have effectively mitigated the risk of inappropriate disbursements taking place. The KSA Board of Directors has been given specific responsibility for oversight of certain new

contracts related to compensation of head coaches or other senior level members of KSA. Additional layers of administrative approval are now required for all purchase approvals and expenditures. Use of KSA's Imprest Account for expenditures (a process that does not utilize the Kansas State University ("KSU") Controller's Office control procedures) has significantly decreased since Mr. Currie's arrival. Testing results indicate that expenses are being approved as required by the revised procedures. Overall, these factors provide a strong indication that contracts and expenses are being monitored effectively and that the control environment at KSA is improving due to the additional levels of oversight, new policies, and recently implemented procedures.

Contract Administration

Revised guidance for entering into contractual agreements has been communicated to athletic department personnel. Effective July 2, 2009, the Director of Athletics supplemented previous policies regarding contract administration and communicated that all contracts entered into by KSA must now be reviewed by the KSU Attorney prior to being approved by the Director of Athletics. Furthermore, contracts in amounts exceeding \$100,000, those that are multi-year in duration and/or those which involve compensation for Sr. Associate Athletic Directors, head coaches, or the Director of Athletics are now approved by the KSA Board of Directors.

Internal controls governing contracting processes rely on clearly communicated authority levels, regular training and reinforcement of those policies through governance activities and the organization's ability to delegate contracting authority effectively. Accordingly, there will always be some risk of unauthorized contracting in any control environment. However, we observed that, in addition to modifying contract approval levels, the Director of Athletics has been reinforcing expectations for contracting, as evidenced through email and verbal communications to Athletic Department staff.

The requirement of KSU Attorney review, while appropriate from a governance and control standpoint, may place additional pressure on the limited University legal staff. KSA should be mindful of the review burden and take steps to be certain that any delays in review do not inadvertently encourage KSA employees to forego the necessary review in the interest of timeliness. However, it should be noted that the Director of Athletics is the final signatory on contracts and will have the opportunity to conclude whether proper legal review has taken place.

Expense Approval and Disbursement Processing

Current procedures now include several layers of administrative approval for both purchase orders and expenditures. Such approvals effectively mitigate otherwise existing weaknesses in Segregation of Duties due to excessive system access. Due to the relatively small size of KSA's accounting group within its Business Office (currently 2 full time employees supplemented with temporary and student employees), it is possible for individuals to enter transactions for processing and also approve such payments systematically. However, because individuals independent of payment processing (e.g., Senior Associate Athletic Director for Administration, Director of Athletics and KSU VP of Administration and Finance who do not have systematic capabilities to process payments) are now required to manually approve payments prior to processing, the disbursements process can detect unauthorized or inappropriate payments.

The KSU Controller's Office plays a significant role in KSA's control environment by serving as the custodian of KSA's checking account, processing disbursements and preparing bank statements on

behalf of KSA. Controller's Office personnel are directed to postpone processing of KSA checks until proper approval has been obtained from KSA, which further mitigates the risk of unsupported payments. The KSU Controller's Office also performs validation checks on payment files received from the KSA Business Office to further confirm accuracy.

However, the KSU Controllers Office's AP Clerk has the capability to modify payment batches prior to processing, thus enhancing the importance of bank reconciliations as a detective control to identify if any modification has taken place. Testing indicated that bank account reconciliations for the account maintained by the KSU Controller's Office have not been performed by KSA for the first two months (July and August) of the current Fiscal Year. Management commented that it is not unusual for these reconciliations to be delayed shortly after fiscal year end due to increased workloads as a result of the year-end financial audit of KSU and KSA. One possible solution to this constraint is the addition of an experienced accountant to the KSA Business Office who would have day to day responsibility for accounting leadership and could provide more flexibility to the team when segregating job roles as well as capacity at times when work levels increase. KSA Management noted that such a position is under consideration.

The current approval structure for Purchase Orders and Disbursements may not be cost effective or sustainable over the long term due to the significant time investments required from both the Director of Athletics and the Senior Associate Athletic Director for Administration. Currently, both individuals are approving all purchase orders prior to order placement, as well as approving all payments, expense reports, and cash advances before payment. However, a review of this activity by either of these individuals should be sufficient to prevent unauthorized payments if KSA chooses to reduce the number of required approvals. Though these reviews appear effective in compensating for the segregations of duties issues noted above, KSA may want to consider alternatives protocols to allow for scaling back of the current approval processes. One alternative includes adding a new staff member to the Business Office, who has experience in accounting and purchasing, to play the role of accounting leader. Such a position could provide flexibility in establishing a Delegation of Authorities that would allow the Director of Athletics and Senior Associate Athletic Director for Administration to concentrate their time on other priorities and focus on those disbursements that pose the most risk to the organization.

Review of Documentation for Transactions Referenced within the Grant Thornton Report

As referenced in the Grant Thornton Report, there were thirteen transactions occurring during the Fiscal Years of 2004-2006, for which supporting documentation was not located to allow for Grant Thornton to form a conclusion related to the transaction's approval and business purpose. Subsequent to the Grant Thornton Report, KSA was able to locate supporting documentation for the referenced transactions and provide it for our review. Based on the supporting documentation, and the timing and amount of the expenditure, each of the transaction's business purpose appeared reasonable. Further, although a formal approval was not associated with all of the transactions, nine of the transactions were either explicitly approved or were able to be traced to related contractual obligations requiring such disbursement. The remaining 4 transactions were related to the use of University aircraft. While the transactions were not explicitly approved, supporting documentation was sufficient to verify that the passengers appeared reasonable and the dates of travel generally coincided with known athletic competitions or duties.

Imprest Account Administration Review

Management has significantly reduced the use of KSA's Imprest Account for disbursements by implementing policies restricting the balance in the Imprest Account to \$30,000 and restricting the

maximum value of individual checks distributed from the account to \$5,000. As referenced earlier, KSA has also implemented policies placing greater responsibility on KSA employees to plan for purchases and expenses in advance, so as to reduce the usage of the Imprest Account. Our procedures indicated that inappropriate personnel do not have access to the Account, and reconciliations of the account are being performed regularly.

Detailed Discussion

We interviewed several members of KSA and KSU who play key roles within their respective organizations to obtain and develop an understanding of the Contract Administration and Expense Approval and Disbursement processes. Personnel interviewed included KSA's Business Office Clerk; KSA's Business Manager; KSA's Senior Associate Director for Administration; the Director of Athletics; KSU's Assistant Controller; Controller; Vice President of Administration and Finance as well as KSA's former Business Manager, who is a KSU Foundation employee working temporarily for KSA to assist in preparing and obtaining information that was necessary for KSA's annual financial statement audit. Interviews resulted in a deeper understanding of the types of contracts commonly entered into by KSA and approvals necessary, the types of disbursements made and the internal controls processes and governance structures currently in place. We also obtained and reviewed formal KSA policies and communications related to these processes, to confirm our understanding of the processes.

In order to validate that control changes have taken place, we performed testing of certain key controls discussed below by selecting samples of transaction activity that took place between June 1, 2009 and September 3, 2009. This date range was determined to allow for confirmation of business process performance resulting from policy and procedure changes made subsequent to the Director of Athletics' arrival.

During our testing, we were provided all supporting documentation that was requested and we are not aware of events or omissions of information that prevented us from performing our testing procedures as intended. The following sections details of our testing procedures and results.

Contract Administration

In a policy communication dated July 2, 2009, the Director of Athletics communicated that he is the only KSA Administrator with authority to sign contracts on behalf of KSA, after receiving approval from the KSU Attorney. KSA has further developed a compensation committee to review and approve contracts for individuals who are Assistant Coaches or considered Jr. Staff members (i.e. administrative personnel, sport operations staff, etc.) /Asst. Coach level or above. A new process also now requires approval from the KSA Board of Directors for any compensation related contracts for individuals such as Sr. Associate Athletic Directors, head coaches, or the Athletic Director. The Director of Athletics has also implemented the requirements that any contracts that have multi-year durations, relate to the purchase of real estate, or are valued over \$100,000 must receive KSA Board of Directors approval as well.

There are several different types of contracts into which KSA commonly enters, such as game agreements, employment/compensation agreements, Equipment/Sponsorship contracts, vendor relationship agreements, or other miscellaneous contracts. These contracts vary in terms of length, frequency into which they are entered, and form. The equipment/sponsorship contracts are typically longer in duration and require ongoing monitoring for adherence, while others, such as Game Agreements, are entered into and fulfilled in a shorter time frame. However, all contracts require Director of Athletics and University Attorney approval.

In order to validate the performance of the contracting process in accordance with the procedures referenced above, we performed testing on the following control related to contract initiation.

- 1) *All contracts are reviewed by the KSU Attorney and approved by the Director of Athletics, and, if required, the KSA Board of Directors.*

Testing: We reviewed three contracts and obtained supporting documentation of the required review and approvals of such contracts. One contract related to compensation for the Head Football Coach, and the other two were vendor agreements.

Results: The compensation contract was reviewed by the KSU Attorney and approved by the Director of Athletics and KSA Board of Directors. The vendor contracts were reviewed by the University Attorney and approved by the Director of Athletics. Accordingly, each of the contracts was executed in a manner consistent with organizational policy and contained the necessary approvals.

The contracting process, as currently designed, appears reasonable for an organization like KSA. It was noted that the new process appears to be followed for contracts that have been executed since these procedures were established. The only potential weakness to the efficiency of the process involves the review of the KSU Attorney. The KSU Attorney's office currently has limited staff capacity which, at some point, could slow the contract review process. KSA should monitor its contracting volume and make sure that a slowing review process does not encourage individuals to circumvent the critical KSU Attorney review process in the interest of timeliness. However, in the event that such review is circumvented, Mr. Currie's review of contracts should include verification of review by the KSU Attorney's Office, which would detect if the KSU Attorney's Office has not been properly consulted.

Expense Approval and Disbursement Processing

Prior to the hiring of the current Director of Athletics, expenses processed for KSA needed only approval from the responsible associate athletic director with oversight of the sport or operational area (i.e. facilities), as well as the KSA Business Manager. Additional layers of administrative approval for all expenses became a requirement subsequent to Mr. Currie's commencement as Director of Athletics, and are contained in an email communication from Mr. Currie to KSA personnel on July 2, 2009, in which Mr. Currie established his authority to review all disbursements. Through our interviews with KSA and KSU personnel, we obtained an understanding of the different types of disbursements pertaining to KSA, as well as an understanding of the various tasks performed by KSA and KSU personnel to understand if any policies, procedures, roles or responsibilities pose potential control weaknesses.

Based on these interviews, we identified several key controls associated with the Expense Approval and Disbursement processes that are necessary to prevent and/or detect unauthorized payments from being processed. Based on such procedures, we identified and tested the following controls due to their significance to the disbursement process. Italic text indicates a KSA or KSU control that is relied upon in the disbursement Expense Approval and/or Disbursement processes:

- 1) *Purchase orders are approved prior to ordering. Invoices are approved and the associated good/service provided/rendered is validated prior to being processed for payment*

This control was determined to be key for preventing payments for invalid or unauthorized expenses. The requirement of Purchase Order approval helps prevent unauthorized and/or inappropriate purchases from being made, and also allows management to have greater awareness and oversight of expenditures. Furthermore, it is essential for the Business Office to verify with the appropriate Athletic Department contact that the invoiced good/service was appropriately received/rendered prior to submission for payment to prevent payments for goods or services that were not received,.

Testing: From a listing of all purchase orders processed in the current fiscal year, we selected ten purchase orders and verified each had been approved by the Associate Athletic Director for the respective sport, the Senior Associate Athletic Director for Administration, and the Director of Athletics prior to ordering. We also reviewed associated documentation (i.e. invoice, email files, etc.) to verify that receipt of goods or services was verified prior to payment authorization.

Conclusion: All selections were approved by appropriate personnel and were properly validated prior to authorizing payment.

2) *All disbursements are approved by the following personnel, prior to payment:*

- *Head Coach/Supervisor*
- *Associate Athletic Director (responsible for the originating sport or department)*
- *Senior Associate Athletic Director for Administration*
- *Director of Athletics*
- *KSU Vice President of Administration and Finance*

We determined the effectiveness of approvals by personnel independent of transaction processing to be a significant control in the disbursement process, given the segregation of duties concerns discussed in the Executive Summary.

Each of the six Associate Athletic Directors has oversight responsibility for a number of sports and/or operations at KSA and is responsible for approving expenses relating to those sports and/or operations. Additionally, the Senior Associate Athletic Director for Administration and the Director of Athletics have the responsibility of approving all purchase orders and disbursements prior to payment. The requirement for approval from the Senior Associate Athletic Director for Administration and the Director of Athletics for all disbursements became organizational policy when Mr. Currie was hired as Director of Athletics. As discussed in the executive summary, both individuals are approving all purchase orders prior to order placement, as well as approving all payments, expense reports, and cash advances before payment. However, a review of this activity by either of these individuals should be sufficient to prevent unauthorized payments if KSA chooses to reduce the number of required approvals.

Testing: We selected 15 disbursement transactions from bank account detail provided by the KSU Controller's Office and requested supporting documentation (i.e., appropriate invoices, purchase orders, and/or expense reimbursement forms) for each of the selected transactions. For the time period under review, all KSA disbursements were distributed through one of KSU's two bank accounts. We confirmed through review of bank statements that no payments were processed through the Imprest Account during the months of July or August. We selected two disbursements from September Imprest Account activity and obtained supporting documentation for these transactions to validate appropriate approvals occurred prior to disbursement.

Conclusion: All 15 selected disbursements were approved by each required individual prior to disbursement and each of the three Imprest Account transactions were also approved by the appropriate personnel prior to being disbursed.

3) *The Controller's Office Accounts Payable Clerk ("AP Clerk") reviews manual copies of batch reports to ensure the batch was approved by the following individuals, prior to check processing:*

- *Business Office Manager*

- Senior Associate Athletic Director for Administration
- Director of Athletics
- KSU Vice President of Administration and Finance

The AP Clerk further verifies the electronic batch distributed for payment agrees in dollar value to the manual copy of the batch, which contains the relevant approvals.

It is critical for the KSU AP Clerk to verify that the appropriate approvals have been obtained, prior to processing the batch for payment. The KSA Business Manager produces a batch file of all pending payments in need of approval. A manual copy of this batch file is distributed for review and then forwarded to the KSU Controller's Office once the necessary approvals have been obtained. At the KSU Controller's Office, the AP Clerk verifies that the appropriate approvals are present and then instructs the KSA Business Manager to create an FTP file containing payment details necessary for the KSU Controller's Office to process disbursements. The KSA Business Manager has the capability to both create and approve batches for payment.

Prior to the FTP file being transmitted to the KSU Controller's Office for payment, the KSA Business Manager has the capability to make modifications to the file, after the batch has been approved. As such, the Controller's Office agreeing the dollar totals of the manual, approved copy of the batch file with the batch payment report is a key control to validate that only approved expenses are processed and that no modification has occurred. The KSU Controller's Office AP Clerk, who uploads the FTP file received from the Business Manager for payment processing, also has the capability to modify the batch prior to processing the checks. Because of this capability, it is important that the KSA Business Office performs the monthly bank reconciliations for the Controller's Office bank account to detect any unauthorized modifications to the submitted batch file.

Testing: Five payment batches were selected from the bank statement provided by the KSU Controller's Office. Documentation related to the original approved batches were obtained from the KSU Controller's Office and inspected to confirm that the appropriate approvals were present. We further agreed the total amount processed per the bank account detail to the amount processed as detailed on the manual batch copy to validate that no additional payments were entered into the batch payment process.

Conclusion: Each of the five selected batches was approved by all appropriate personnel and the total dollars of payments per the approved batch copy agreed with the actual amount of dollars processed for payment via the bank account detail.

- 4) *Bank Account Reconciliations for the Controller's Office Account and the Imprest Account are performed by the KSA Business Manager on a monthly basis. Reconciliations are subsequently reviewed by another staff member.*

Bank reconciliations were determined to be a key control, due to their importance for detecting unauthorized transactions. KSA processes transactions through two bank accounts; one that is under control of the KSU Controller's Office, and an Imprest Account, which is under the direct control of KSA. Furthermore, as noted above in the details of the control tested previously, with the KSU Controller's Office AP Clerk possessing the capability to modify batches received from the KSA Business Office prior to processing for payment, failure to perform bank reconciliations in an effective manner could limit KSA's ability to detect errors in financial reporting and/or inappropriate use of cash.

Testing: We requested bank account reconciliations for the KSU Controller's Office Account and the Imprest Account for the months of July and August and inspected the reconciliations to determine whether they appeared to be adequately completed and reviewed.

Conclusion: The KSU Controller's Office account reconciliations had not been performed for either month; however, KSA management commented that it is not unusual for these reconciliations to be delayed shortly after fiscal year end due to increased workloads as a result of the year-end financial audit of KSU and KSA.

Account reconciliations for the Imprest Account were adequately performed for both months; however, an independent review of the reconciliation was not performed. An independent review of the reconciliation should be performed due to the segregation of duties concerns resulting from the Business Manager's capability for transaction entry into the G/L.

The addition of an experienced accountant to the KSA Business Office to provide day to day accounting leadership could provide more flexibility to the team when segregating job roles as well as add capacity at times, such as year end, when work levels increase. KSA Management shared that such a position is under consideration.

Review of documentation for Transactions Referenced in the Grant Thornton Report

As part of our scope, we were asked to review thirteen transactions referenced in the Grant Thornton Report for which no documentation available. Subsequent to the issuance of the Grant Thornton Report, KSA was able to locate supporting documentation for the referenced transactions and provide it for our review.

Testing: We obtained a detailed listing of the referenced transactions and supporting documentation from KSA Management. We validated that the thirteen transactions for which KSA provided documentation were indeed the transactions referenced in the Grant Thornton Report by obtaining and reviewing a letter from Grant Thornton to the Board of Regents detailing the specific transactions. For each of the transactions, we reviewed the supporting documentation provided by KSA to ascertain whether the disbursements were appropriately approved and if a valid business purpose for the disbursement was evident from the documentation provided.

Conclusion: Our review of the transactions in question indicated that there were appropriate approvals documented or the purpose of the expenditure appeared reasonable based on the timing and amount of the expenditure. Although formal approvals were not associated with all of the transactions, nine of the transactions were either explicitly approved or were able to traced to related contractual obligations requiring such disbursement. The remaining 4 transactions related to the use of University aircraft. These transactions were not explicitly approved, although supporting documentation was sufficient to verify that the passengers appeared reasonable and the dates of travel generally coincided with known athletic competitions or duties. KSA should consider revising its aircraft policy to better describe the authority levels necessary to authorize travel.

Imprest Account Administration Review

The Imprest Account's original intended use was for reimbursement of travel related expenses or expenses for which payment was required in less than 10 days. However, as indicated in the Grant Thornton Report, prior to the hiring of Mr. Currie, there was significant activity in this account that did not pertain to these original purposes. In response, the Director of Athletics has implemented revised policy guidelines regarding Imprest Account usage. According to a policy from the Director of Athletics, and approved by the KSA Board of Directors on June 29, 2009, the balance of the Imprest Account will not exceed \$30,000 and the account is only to be used for "travel advances, purchases that may not be made with a purchase order or departmental corporate credit card, and for other instances when expediency is clearly in the best interest of KSA." Further, any one transaction in the Imprest Account cannot exceed \$5,000.

Based upon the nature of the Account, and guidelines specified within the revised policy, we determined the following control to be critical for proper administration of the Account.

1) Access to the Imprest Account is restricted to appropriate personnel

Restricting authority for transactions to only those with a business need can help reduce the likelihood of unauthorized activity occurring.

Testing: From the bank which administers KSA's Imprest Account, we obtained a listing of all authorized signatories for the account.

Conclusion: A review of the access listing noted access appears to be appropriate. Three Associate Athletic Directors, as well as the Director of Athletics, have the ability to sign checks against the account.

It should also be noted that the Account's balance for the months reviewed was below the \$30,000 limit referenced in the June 29, 2009 policy revision. Furthermore, refer to testing on bank account reconciliations detailed above in the *Expense Approval and Disbursements* section for testing of the Imprest Account bank reconciliations.