BOARD OF REGENTS OF
THE UNIVERSITY SYSTEM OF GEORGIA

OFFICE OF INTERNAL AUDIT AND COMPLIANCE
270 WASHINGTON STREET, S.W.
ATLANTA, GEORGIA 30334

(404) 962-3025 - PHONE
(404) 962-3030 - FAX
JOHN.FUCHKO@USG.EDU

September 17, 2012

Mr. Rob Watts
Interim President
Georgia Perimeter College
3251 Panthersville Road
Decatur, GA 30034-3897

Dear Mr. Watts:

The enclosed special review report has been prepared at the conclusion of the engagement recently completed on your campus by members of the internal audit staff of the University System of Georgia (USG) and Georgia Perimeter College (GPC). The report addresses observations noted in the areas audited, and where warranted, the auditors have made recommendations based on the facts gathered during the audit. These recommendations should, in our opinion, improve procedures, improve internal controls, or ensure compliance with applicable policies, laws, or regulations.

We conducted this engagement in conformance with the *International Standards for the Professional Practice of Internal Auditing.* Our methodology included gathering various forms of evidentiary matter to meet the objectives of the review as outlined in the May 10, 2012 engagement letter. Those primary objectives were to: 1) offer an opinion on the effectiveness and accuracy related to internal communications regarding the budgeting process, financial transactions and management decisions regarding the same and 2) offer an opinion on the internal controls for budgeting and financial reporting with a focus on areas where weaknesses may have existed in processes to allow for unauthorized or fraudulent expenditures, recording or reporting.

To accomplish these objectives, we conducted interviews with former and current employees and gathered corroborating evidence to support their statements. Some of this evidence included budget workpapers from the institution, minutes of GPC executive team meetings, GPC reports submitted to the Board of Regents, published financial statements and earning records. Our procedures included examining general ledger transactions, expenditures and journal entries. We reviewed procedures for auxiliary services and activity in auxiliary accounts. We also evaluated procedures for accounts payable, payroll, human resources and financial aid in an effort to determine how and where over-expenditures occurred. We reviewed and assessed procedures for developing, allocating and monitoring the budget.

During the engagement, the former President alluded to another audit of GPC budgeting that had been conducted, but not distributed, by GPC's internal audit director. The former President may have been referring to a planned GPC internal audit of financial reporting included on the audit plan approved by the

Board of Regents Committee on Internal Audit, Risk, and Compliance in May 2011. This special review replaces that scheduled audit. No other recent internal audit engagements were completed or issued encompassing the scope of Georgia Perimeter's budget or budget process prior to the one attached. A separate internal audit engagement encompassing GPC's position management and the associated budget processes is currently being conducted by GPC's internal audit director.

During this review, Chancellor Huckaby implemented additional measures to enhance oversight and accountability for fiscal operations across the USG. These measures generally addressed budget hearings, quarterly financial reporting, interaction with external auditors, the use of reserves, and institutional assessments. A copy of the Chancellor's letter to the Presidents outlining these measures is attached to the report as Appendix V. We believe that implementation of these directives will enhance governance and internal controls over financial and budget management across the University System of Georgia.

The attached report includes responses sent to us by the institution to each observation identified in the Issues-Detail section of the audit report. The responses were all deemed satisfactory by our office.

Sincerely,

John M. Fuchko, III

John M. Fuchko, III, CIA, CCEP
Chief Audit Officer and Associate Vice Chancellor

Enclosure

cc: Members, Board of Regents of the University System of Georgia
Henry M. Huckaby, Chancellor
Dr. Steve Wrigley, Executive Vice Chancellor of Administration, BOR
Dr. Houston Davis, Chief Academic Officer and Executive Vice Chancellor, BOR
Thomas E. Daniel, Senior Vice Chancellor for External Affairs, BOR
John E. Brown, Vice Chancellor for Fiscal Affairs and Treasurer, BOR
Burns Newsome, Vice Chancellor for Legal Affairs and Secretary, BOR
Ronald B. Stark, Executive Vice-President Financial Administration, GPC
Diane Hickey, Associate Vice-President Fiscal Affairs, GPC
Jamie Fernandes, Associate Vice-President Budgets & Strategic Financial Planning, GPC
Bethaney Willis, Chief Accounting Officer, GPC
Kwabena Boakye, Director Internal Audits, GPC
Jeanne Severns, Interim Executive Director of Internal Audit, BOR

University System of Georgia (USG)

Special Review: Georgia Perimeter College (GPC)

Engagement 12-17 FINAL September 17, 2012

Overall Summary

Note: The "Overall Summary" will provide sufficient information for the users of this report to understand the issues pertaining to the management of GPC's financials. Detailed issues and appendices are intended primarily for use by GPC management in their efforts to improve the institution's financial situation. This entire report is intended for use by management and should not be used for other purposes by outside parties.

Key Conclusions

Georgia Perimeter College (GPC) faced an unprecedented fiscal shortfall in April 2012. An employee recently assigned to the college's Office of Financial and Administrative Affairs analyzed projected revenues and expenses for the remainder of Fiscal Year 2012 (July 1, 2011 – June 30, 2012). **The analysis prepared by the employee revealed that GPC's expenses were projected to exceed both projected revenue and available reserves prior to the end of FY12**.[1] While the estimated dollar amounts fluctuated, the projected shortfall required external resources in order to ensure that GPC could meet its short-term operational needs to include payroll and current expenses.

GPC's former President, as required by Board Policy, notified the University System of Georgia (USG) Vice Chancellor for Fiscal Affairs and the Chancellor of the projected shortfall. **USG administrators, at the Chancellor's direction, immediately took steps to analyze the shortfall, identify additional spending cuts, and arrange for budget re-allocations in order to ensure that GPC would meet its financial obligations**. Personnel changes at GPC resulted in the appointment of an interim President, a new Chief Business Officer, and other new fiscal affair positions. **This new team continued the work of analyzing GPC's fiscal situation and took multiple steps to address the short-term and long-term challenges faced by GPC**.[2]

[1] We also noted the existence of email discussions among staff within GPC's Office of Financial and Administrative Affairs starting in January 2012 that reference declines in auxiliary fund balances and the use of auxiliary reserves for non-auxiliary expenditures over the past several fiscal years. There was no evidence that these emails were shared outside of the Office of Financial and Administrative Affairs until several months afterwards.

[2] A new senior management team, including the president, the chief business officer, and several key fiscal management positions, was put in place near the beginning of our engagement. This new team and other current GPC staff members were professional and cooperative during our review. Additionally, GPC's former President and former Assistant Vice President for Financial and Administrative Affairs graciously provided written responses in response to OIAC queries. Finally, each member of the former fiscal leadership team (see note 3) participated in in-person and/or phone interviews with OIAC's audit team. Cooperation from all parties was essential to our engagement given the limited documentation associated with GPC's budget processes. Our engagement incorporated multiple interviews with former and current GPC employees in addition to review of GPC financial reports and data.

At the same time, the Chancellor charged the USG Office of Internal Audit and Compliance (OIAC) to review the state of affairs that led to this point. OIAC was to review governance and internal controls with respect to GPC's budgeting process in addition to analyzing the nature of GPC's fiscal challenges. Additionally, the former President alleged fraud by his former employees insofar as he believed they provided him false information about GPC's financial condition. OIAC's scope already included a consideration of fraud; however, we enhanced our procedures to address the specific fraud alleged by the former President. Our work began in May 2012 and concluded in August 2012. It involved review of financial records and business practices in addition to interviews with multiple current and former GPC employees. **We did not identify fraud during our review** (as noted in Appendix I).

We concluded that senior GPC administrators failed to perform certain key fiduciary duties. **Chief among these fiduciary duties was responsibility to understand and manage the institution's fiscal affairs**. Responsibility for the institution's management rests with the President. Board Policy 2.5 emphasizes the nature of the president's responsibility:

> The president of each USG institution shall be the executive head of the institution and of all its departments, and shall exercise such supervision and direction as will promote the efficient operation of the institution. The president shall be responsible to the Chancellor for the operation and management of the institution, and for the execution of all directives of the Board and the Chancellor. The president's discretionary powers shall be broad enough to enable him/her to discharge these responsibilities (BoR Minutes, 1972-74, pp. 69-71; 1977-78, pp. 167-168; April, 2007, pp. 76-77).

The President understandably must rely on the institution's Chief Business Officer (CBO or EVP) and the CBO's staff in the President's execution of his fiduciary duty. With respect to budget management, the CBO and the Budget Director each hold key responsibilities. In GPC's particular case, the Budget Director reported to the Assistant Vice-President for Financial and Administrative Affairs (AVP) and the AVP reported to the CBO. Collectively, we refer to these key administrators (President, CBO or EVP, AVP, and Budget Director) as GPC's former fiscal leadership team.[3]

GPC's fiscal challenges developed over time. While the institution started spending more than it earned in FY09, overall revenue was increasing from FY09 through FY12. **In point of fact, annual revenue increased from ~$139M to ~$170M or an increase of 22.3%**.[4] **Nevertheless, GPC's spending**

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[3] For purposes of this report, GPC's fiscal leadership team refers to former Georgia Perimeter College President Anthony S. Tricoli (hereafter President), former Executive Vice-President of Financial and Administrative Affairs and Chief Business Officer Ron Carruth (hereafter CBO), former Budget Director Mark Gerspacher (hereafter Budget Director and who resigned March 2012) and former Assistant Vice-President for Financial and Administrative Affairs Sheletha Champion (hereafter AVP).

[4] Revenue is presented on a GAAP basis and excludes certain transactions associated with capital assets and the $9.5M increase in FY12 revenues associated with funds redirected to GPC in order to allow GPC to meet its financial obligations.

exceeded its revenue each year. These annual shortfalls were managed through a combination of accounting entries (e.g., cancelling purchase orders and managing cash flow) and through the use of institutional reserves. At that time, all USG institutions had authorization to use auxiliary funds to cover non-auxiliary expenses as a means to cover USG-wide budget reductions (the provision allowing institutions to use auxiliary reserves for non-auxiliary expenses expired on June 30, 2012).

On one level, the fact that GPC was meetings its obligations and also increasing its revenues might allay concerns about using reserves to meet current obligations. **However, ongoing use of reserves to plug operational costs clearly is not and was not sustainable**. The ultimate result of this approach, if left unmanaged, is to impair the institution's ability to meet its obligations without outside revenue and/or painful budget cuts. This was exactly the scenario faced by GPC's current fiscal leadership team as they assumed their roles close to the end of FY12.

Each member of GPC's former fiscal leadership team claims to have been unaware of GPC's fiscal condition. The former President asserted that he was unaware of GPC's fiscal condition and that it was the CBO's duty to inform him of fiscal issues. The CBO indicated that he relied on the Budget Director and the AVP to keep him informed of fiscal deficits. The AVP indicated that she was excluded from key decision-making with respect to the budget. The Budget Director indicated that he brought some budget concerns to the attention of the CBO and AVP; however, the internal reports produced by the Budget Director did not suggest that any significant budget issues existed. Nevertheless, these internal management challenges did not absolve the former fiscal leadership team of their fiduciary duty to understand and manage GPC's fiscal affairs.

Effective execution of assigned duties would have allowed GPC's former fiscal leadership team to be aware of, and subsequently manage, GPC's fiscal affairs and, most importantly, GPC's budget. **Specifically, GPC's own annual financial reports made it clear that spending exceeded revenues, reserves were being reduced, and cash was dwindling**. For example, page v. of GPC's FY10 audited annual financial report shows that GPC had $20.7M cash on hand as of the end of FY09 and $12.4M as of the end of FY10. This amount was reduced to $4.9M by the end of FY11 as reflected on p.4 of GPC's FY11 annual financial report. GPC's financial system of record was ineffective as a budget management tool (given that budgets loaded in the system did not match Board-approved budgets and budgets were not adjusted to reflect actual financial reality); however, reliable revenue and expenditure data was available. **Members of GPC's former fiscal leadership team did not make effective use of this available information**. We consider the role of each member in turn.

Primary responsibility for GPC's management rested with GPC's President. **It is clear from our review that GPC's CBO did not provide GPC's President with timely and reliable financial information for the President's use in managing the institution**. **However, the President did not perform the necessary financial due diligence associated with his responsibilities as institution head**. Most notably, the former President did not adequately review the financial statements of the institution issued under his authority. Various copies of the institution's annual financial statements included copies of original signatures in which it appeared that the former President did sign the annual financial statements. When shown copies of these signatures, the former President indicated that some of the signatures appeared to be his but that he does not recall signing any financial statements. He indicated that he did not sign any document that he believed showed a deficit and he reported a conversation with a former staff member in his office wherein that staff member confirmed that the former President had not signed a budget report or other documents showing a deficit. The same staff member indicated to us that the signature on the annual financial statements was an original signature and that it appeared to be the former President's signature.[5] In either case, the former President indicated that he did not read the statements and that they were routed to the former CBO for handling. While the President should be able to rely on the CBO to handle ongoing financial management, the President is nevertheless responsible for the financial statements – and the financial condition – of the institution. The former President also indicated that multiple other officials (USG administrators and external and internal auditors) should have informed him that GPC was spending more than it took in through revenue.[6] Nevertheless, it does not relieve the President of the responsibility to be informed of the information in the institution's financial statements.

GPC's CBO also did not perform his assigned duties. GPC's former CBO, per his job description, is the "chief financial officer of the college, responsible to the President for providing leadership and **ensuring integrity, stability and excellence in the fiscal and administrative operations of the institution**." He is to establish a "sound, stable financial base and adequate physical resources that support the mission and scope of programs and services of the institution." Further, the CBO is to "develop and administer the college budgets, financial strategic planning, and administrative program assessment to maximize the most efficient and effective use of resources." However, **GPC's former CBO indicated that he did not review GPC's financial statements and that he essentially relied on the Budget Director and AVP to bring budget-related fiscal issues to his attention**. Fiscal issues associated with cash flow and audit shortfalls were brought to his attention; however, he indicated that he did not fully appreciate the

[5] Evidence reflects the former President's signature on FY 09, 10, and 11 draft reports. It is beyond the scope of this audit to determine whether the signatures are an original signature or a facsimile.

[6] We include this assertion by the former President in the interest of full disclosure and our inclusion of this statement does not constitute agreement with the former President's assertion. We did not formally assess this assertion insofar as it included a reference to internal auditors. However, we do note a September 28, 2010 internal audit report that includes a financial chart where total expense exceeds total revenue in Fiscal Years 2009 and 2010. This report was sent by email to the former GPC President. Additionally, the declining reserves were noted by the State Auditors in meetings and exit conferences with GPC administrators. As noted throughout this report, the former President did not attend state audit exit conferences after the Fiscal Year 2009 report.

scope or magnitude of the underlying fiscal issues when they were raised with him by both his own staff and auditors. **The former CBO cooperated fully throughout this review and acknowledged his responsibility for GPC's fiscal operations**. We agree that he was responsible for the institution's fiscal operations in the overall context of his accountability to the former President.

The former Budget Director's job description states that he is responsible for "budget planning, development and monitoring in accordance with institutional and System requirements." As noted throughout this report, fundamental budget duties were not performed. Budget reporting was inaccurate, budgets were not correctly loaded into the financial system, numerous individuals could override the flawed budgets that were loaded in the system, and budget development essentially ignored actual financial experience. In short, essentially every primary duty of the Budget Director was left unfulfilled.

The AVP's responsibilities with respect to budget management primarily consisted of providing oversight to the Budget Director. The Budget Director's failure to adequately exercise the duties of his position cannot be separated from the responsibility of the AVP to manage the Budget Director and to ensure that he exercised his assigned duties.

In summary, GPC's fiscal challenges were preventable. The shortfall in any given year leading up to FY12 was not insurmountable. Management attention to GPC's actual spending would have allowed the institution to curtail the growth in spending so as to ensure that spending remained within available resources, i.e., current revenue. Unfortunately, key leaders at every level charged with actual responsibility for GPC's fiscal management did not exercise all of their assigned duties. It appears that an emphasis on enrollment growth and program expansion took precedence over sound fiscal practice as management and leadership priorities.

Specific issues pertaining to GPC's governance and internal controls are noted below:

- Budget amendments submitted to the Board of Regents were not accurately loaded into GPC's financial system during the year.
- Budgets that were loaded were consistently overridden and up to 16 GPC personnel had authority to override financial system budget controls.
- Expenditures grew significantly between fiscal year 2009 and 2012 and exceeded revenues every fiscal year since 2009 despite significant growth in GPC's annual revenue.[7] We did not observe that significant efforts were made to reduce spending when revenues did not reach budget projections. Purchase orders were cancelled, refunds were delayed, reserves were tapped and other measures were taken to ensure that GPC met its immediate obligations; however, the

[7] Based on GAAP basis statements which include depreciation and accrued expenses not included on budget-based statements.

former fiscal leadership team at GPC did not take corrective action to structurally adjust their underlying operations so as to keep spending within available, current year revenue. Senior management indicated they were unaware of the institution's precarious financial position.

- GPC's fiscal leadership team had access to annual financial reports, cash balances, and financial system queries and reports available for use in understanding the institution's fiscal situation. Annual Financial Reports available at each fiscal year end (2009-2011) included GAAP-basis and Budgetary Compliance reports, operating results, cash flow statements, and audit issues – the reports indicated that expenses exceeded revenue and an overall decline in financial position. Additionally, analysis of the GAAP reports for these same years showed a continuing decline in unrestricted net assets. However, as noted previously, the President does not recall signing or reviewing state audit reports and indicated that those reports would have been routed to the CBO for handling. Those same reports were publicly available. The CBO indicated he had not reviewed these final financial reports developed by and for GPC. Draft financials (which included information on expenses exceeding revenues, declining unreserved net assets, and declining cash balances) were signed by the President and reviewed by financial staff.[5] The president attended the exit conference for the FY 2009 report, leadership declined a formal exit conference for FY 2010, and the President did not attend the FY 2011 exit conference.[8]
- GPC's former fiscal leadership team relied on inaccurate, internally generated spreadsheets that did not correspond to the General Ledger. Specifically, it appears that members of GPC's cabinet, to include the former President, and both the President's Council and the Strategic Budget Committee were provided incomplete and inaccurate budget presentations made by the CBO and the Budget Director at various group meetings. The CBO relied on budget spreadsheets developed by the Budget Director. We found three such presentations for FY 10, 11, and 12 and noted that presentations were not representative of GPC's financial condition.
    - **It should be noted that this budget neglect did not appear to be malicious or intentional**; rather, senior management admitted they were unaware of the institution's over expenditure and was instead focused on other activities. The result was that no one was accountable and the system in place failed. **Our testing revealed no evidence of fraud** (as noted in Appendix I).
- The budget presented to the college's executive team reflected additions and subtractions from prior year budgets without specific detail. Specifically, budgets for the upcoming year were based on prior year's budgets, rather than actual expenditures and no provisions were made for overspending that had occurred in those prior years.

[8] At the completion of every engagement, the state auditors hold an exit conference with senior financial personnel to review and discuss the engagement findings and recommendations.

- o Enrollment predictions used for budget development were unreliable while the budgeted "dollars per student" amount was less than the actual "dollars per student" received. There is no evidence that the dollar projection was based on the enrollment projection.
- ❖ The overall budget was not communicated to the stakeholders and interim budget performance was not monitored.[9] The primary tool used to monitor budget performance was a spreadsheet that did not tie to the institution's financial system of record. Average cash balances declined steeply which would indicate a need for timely corrective action by the former fiscal leadership team.
- ❖ There was neither an effective process for monitoring interim budget performance nor effective oversight by the GPC fiscal leadership team.

What Happened?

We reviewed financial results from GPC for the four years under review. The financial reports show the effects of poor governance and weak internal controls. They do not reflect the reason for what happened, but help to explain why senior management should have been aware of what was happening.

Table 1 depicts revenues and expense from financial statements prepared on the GAAP basis of accounting. Total expenses, including depreciation and accruals, exceed revenues each year.

Table 1 Financial Summary

Financial Summary				
	2009 Agreed Upon Procedures	2010 Audit	2011 Mgt. Rpt.	2012 Unaudited
Total Revenues per Published Reports	139,053,857	162,850,278	163,795,649	179,447,530*
Re-classification for comparative purposes* *	1,851,624	3,670,371	3,033,512	3,883,054
Adjusted Revenue	**140,905,481**	**166,520,649**	**166,829,161**	**183,330,584**
Total Expenses	145,908,347	168,919,939	168,480,441	183,721,505
Reclassification for comparative purposes**	1,851,624	3,670,371	3,033,512	3,883,054
Adjusted Expenses	**147,759,971**	**172,590,310**	**171,513,953**	**187,604,559**
Revenues Over (Under) Expenses	**(6,854,490)**	**(6,069,661)**	**(4,684,792)**	**(4,273,975)**

[9] A similar issue was noted by the Georgia Department of Audits and Accounts in GPC's Fiscal Year 2011 Full Disclosure Management Report. See Finding Control Number FS-571-11-02.

*Includes $9.5M in additional state appropriations paid back in FY 2013
**Interest expense, capital assets and other non-operating expenses
(From state audit reports FY 2009, 2010, 2011 and AFR 2012)

A review of unrestricted net assets from the year-end Statement of Net Assets shows a continuing decline from $11 million at the end of FY 2009 to negative $5 million at the end of FY 2012. The average cash balance also declined sharply during this time, from $19 million to $8 million (see Table 4).

Table 2: Net Capital (GAAP basis)

	2009	2010	2011	2012
	-	-	-	-
Invested in Capital asset, net of Debt	84,864,069	81,631,170	90,918,866	84,838,082
Restricted - nonexpendable	31,338	29,449	26,074	31,338
Restricted - expendable	451,022	354,971	(224,278)	121,906
Capital projects-Restricted	1,000,216	398,388	526,684	0
Unrestricted	11,105,026	8,968,032	(4,550,128)	(5,071,793)
Total Net Assets	97,451,671	91,382,010	86,697,218	79,919,533

(From state audit reports FY 2009, 2010, 2011 and AFR 2012)

There are many inconsistencies reflected in the budgeted and actual numbers. The budget was built on unrealistic revenue projections and not tied to enrollment figures. Revenue should have been budgeted based on the enrollment projections provided by the Office of Institutional Research and Planning. This was not the case and the result was an unrealizable budget and an unrealistic spending plan.[10]

When the expected revenue was not realized, expenses were not reduced to accommodate the drop; expenses consistently exceeded revenues while unrestricted net assets continued to decline.

It is difficult to determine exactly where the budget was overspent; the beginning budget was not allocated correctly among departments and amendments were not posted to the financial system. The fund balance amounts in the appropriations (budget ledger) and revenue ledgers did not match the budgetary amendment system as they should have.

We reviewed the minutes of the executive team meetings, summarized in Table 3, to gain an understanding of what discussions may have taken place concerning the budget throughout the year. We noticed the budget was not discussed in specific detail, i.e., planning for the following year's budget did not take the current year's performance into consideration.

[10] For example, over a 3-year period, $2,200 was budgeted for each student, but an average of $1,871 was actually received per student.

Table 3: Budget Meeting Minutes (Excerpts)

Excerpts from minutes of budget meetings include:

- *Regarding the 2013 budget:*
  - *This year $5 million was not funded. (GPC) will submit 24,500 to the Board of Regents as the final enrollment number.*
  - *It is projected that this decrease in enrollment may result in a $2 million decrease for FY2013.*
  - *Other factors which contribute to the decrease in enrollment are the tuition increase of 3% and the FY 2012 2% state reduction.*
  - *If enrollment reaches 25,500, we will be short $1 million.*
  - *If enrollment reaches 26,500, we will be in a good shape financially.*

- *Regarding the 2012 budget:*
  - *Budget reductions are expected to continue into FY2012.*
  - *Continued discussion of the downsizing of state government in reference to positions.*
  - *Formula funds for FY2012 are not being funded.*
  - *For FY2012 the reduction will increase to approximately 8.6%.*
  - *Tuition will increase approximately 5% or $1.8M for Georgia Perimeter College.*
  - *Every 1,000 students represent an additional $2.0M in revenue.*

The minutes mention budget reductions (as required across the USG) in general terms but specific plans for reducing expenditures to offset these reductions are not mentioned. For example, the minutes note that a FY 2011 budget reduction plan consists of a possible 6%, 9%, or 12% reduction. It is further noted that the college will need to identify where these reductions can be taken. The minutes do not reflect further discussion on these reductions nor any mid-year adjustments for variances in enrollment projections compared to actual enrollments.

Although steps were taken at the end of FY 2010 and 2011 to balance the budget, which indicate an awareness of a problem, spending continued to increase. One example is spending for new faculty and staff positions. Salary reports from the State Auditor's website show salary costs increased by $16 million between FY 2008 and FY 2011.

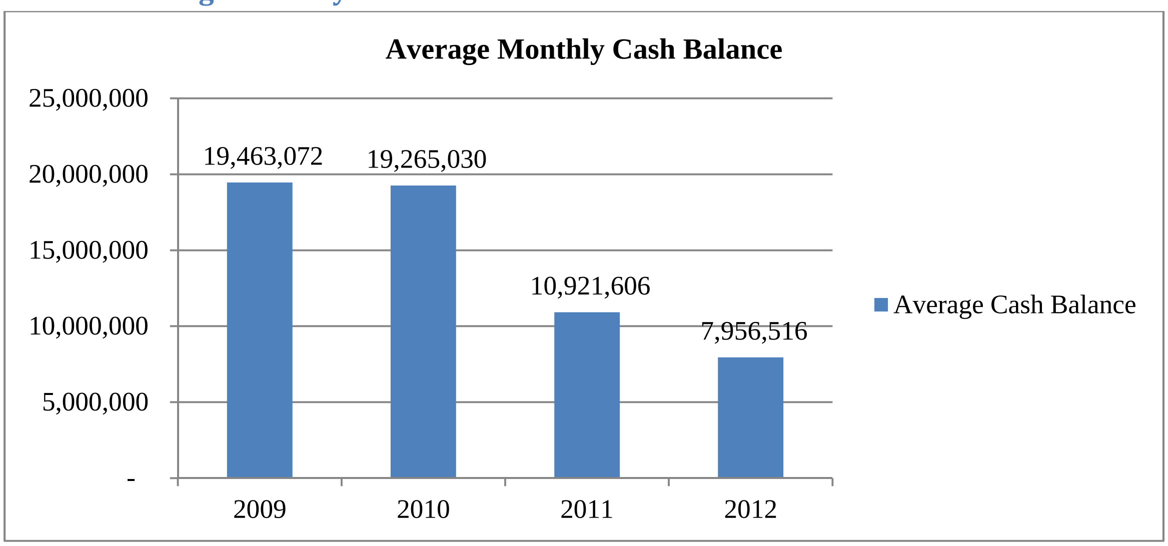
Contents

Background

This section of the report provides background information concerning GPC's financial position and is followed by a discussion concerning institutional governance and internal controls. The budgeting process is described in some detail since it is our opinion that it was central to the financial decline. Please note that fieldwork for this special review was conducted before complete, audited data for FY 2012 was available.[11]

The declining cash position of the college is reflected in the following table that indicates the average monthly cash balance dropped by more than $11 million from FY 2009 to FY 2012 (through May 31, 2012). The average balance in 2012 was $8 million - enough cash to cover approximately 15 days of operating expenses (excluding depreciation). The bank statement balance dropped to a low of $157,000 in December 2011.

Table 4: Average Monthly Cash Balance

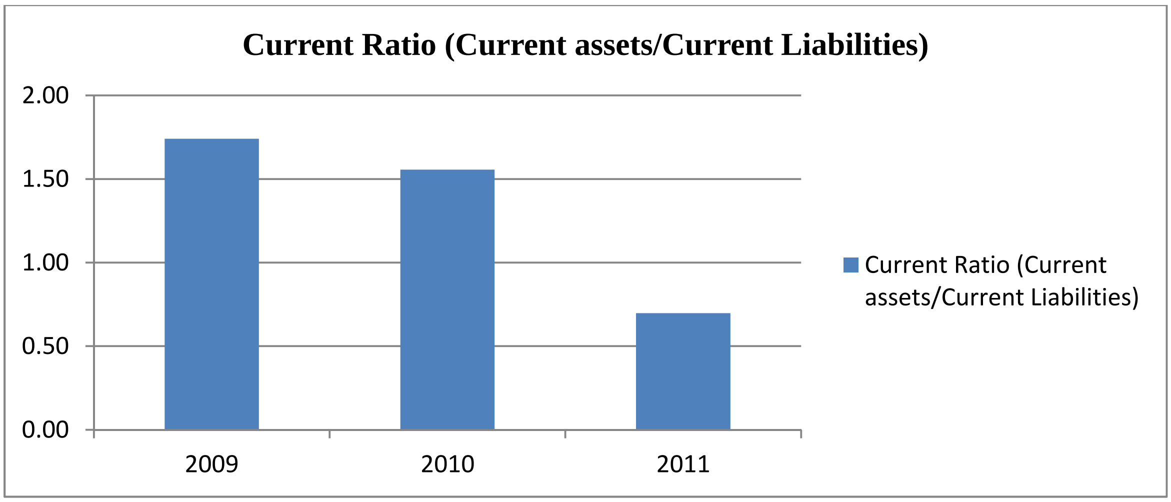


The declining cash balance was one warning sign that GPC was overspending. The consistent overspending resulted in a decline in net assets over the four years from 2009 – 2012 and more importantly a $16 million decline in unrestricted net assets from $11 million to minus $5 million (refer to Table 2: Net Assets).

[11] The Georgia Department of Audits and Accounts conducts external financial audits. Internal auditors review strategic, financial, operational, and compliance issues pertaining to overall governance, risk management, and internal controls. As such, internal auditors do not render an opinion on financial statements even though external auditors may partially rely on internal auditor's work insofar as permitted by auditing professional standards.

Current ratio is one way to measure liquidity of an organization. It is a calculation of current assets divided by current liabilities and gives an indication of the organization's ability to pay its short term obligations. A ratio of less than one indicates the institution is likely to have trouble meeting those obligations, as is the case for GPC in FY 2011 (see Table 5). The current ratio portrayed in this table includes deferred summer revenues and compensated absences. If those amounts were excluded from the calculation, the ratio would remain above one, but still have a steep decline (from 2.49 to 1.29 from the end of FY 2010 to the end of FY 2011).

Table 5: Current Ratio



(Calculated based on published financial reports FY 2009, 2010 and 2011)

Similar to the current ratio, the net working capital is another measure of liquidity. The calculation is current assets minus current liabilities. Again, calculating this amount on a GAAP basis results in a negative working capital at the end of 2011. However, excluding deferred revenues and uncompensated absences from current liabilities, the net working capital is a positive $2.3 million as compared to the prior year amount of $16 million. Again, this is a steep decline that should have been investigated by financial staff with a resultant corrective action. The above analyses indicate the financial position of the college was weakening. Assets, including cash, were declining and by 2011 were barely enough to cover liabilities. Revenues were increasing, but not as fast as spending.

What accounted for the increase in expenditures? Where was the money being spent?

Personal services, to include salaries and fringes, were consistently increasing each year (see Table 6).

Table 6: Audited Expenditures for Personal Services and Non-Personal Expenses (GAAP basis)

	2009 (Agreed Upon Procedures)	2010 (Audited)	2011 (Mgt Rpt)	2012 (Unaudited)
Personal Services				
Faculty	31,614,776	36,097,093	39,180,027	40,240,138
Staff	39,923,513	42,423,420	45,463,745	48,103,631
Benefits	16,786,783	19,191,796	21,972,942	23,541,787
Other	337,547	524,777	739,064	536,958
	88,662,619	**98,237,086**	**107,355,778**	**112,422,514**
Non-personal				
Travel	562,652	691,261	840,775	832,666
Utilities	3,544,319	3,324,257	3,673,397	3,803,994
Supplies*	27,952,942	28,328,147	13,706,148	22,738,088
Non-personal excluding scholarships and depreciation	**32,059,913**	**32,343,665**	**18,220,320**	**27,374,748**
Scholarships	18,530,748	32,178,792	35,612,521	36,439,609
Depreciation	6,655,067	6,160,396	7,291,822	7,484,634
Total Operating Expenses per GAAP statements	**145,908,347**	**168,919,939**	**168,480,441**	**183,721,505**
Non-Operating Expenses				
Interest Expense (Capital Assets)	1,851,624	3,670,371	3,033,512	3,883,054
Other Non-Operating expenses	0	287,737	0	0
Total Expenses	**147,759,971**	**172,878,047**	**171,513,953**	**187,604,559**

(Published Financial Reports FY 2009, 2010, 2011 and AFR 2012)

*Note: The decline in supplies expense in FY 2011 is a result of an $11 million error in the manner in which assets were capitalized from prior years. Refer to Issue 2 "What Did We Observe" for additional details.

Personal services increased significantly: $16.8 million or 23% between 2009 and 2012.[12] Non-personal services other than scholarships and depreciation actually decreased over the same time period. (We have excluded scholarship expense as this is an offset of scholarship revenue and depreciation is a non-cash expense.)

[12] In the interest of full disclosure, it should be noted that the GPC internal audit department added a position in February 2012 at an annual salary of $78,500.

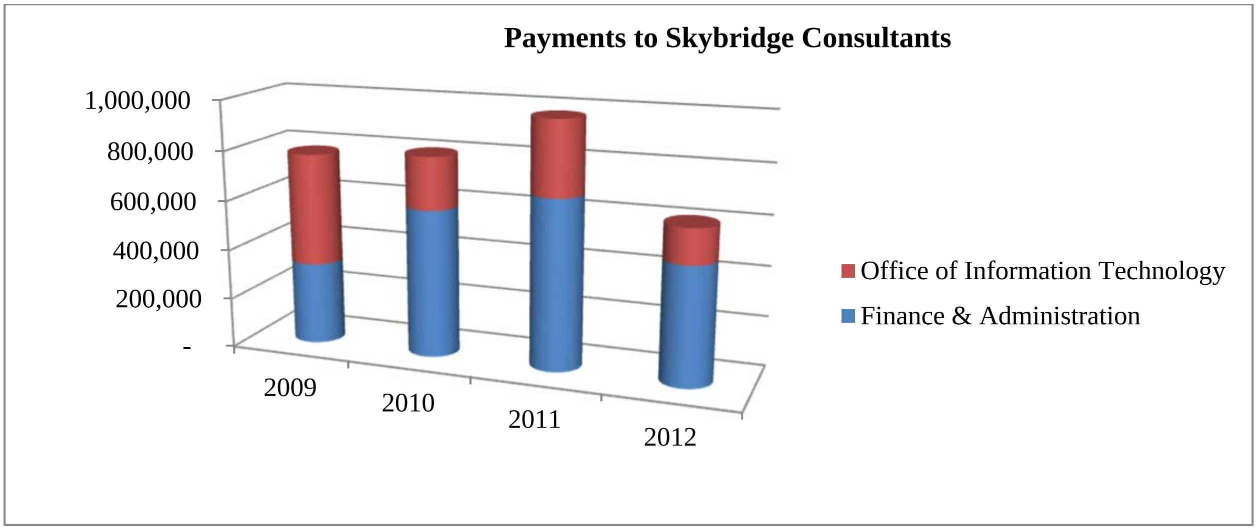
Even though we can tell salaries increased, poor management of position control by the former budget director makes it impossible to know how many new positions were added during the time period. This lack of control manifested itself in many ways: individual departments could not manage their personal services because employees were attached administratively to one department, yet were funded by another. A departmental budget may have included people from other departments while excluding some of its own people. Budget managers had inaccurate data but were told by the budget director not to worry about it. Because of lack of position control, no one knew how much it cost to fund a position in a specific department. An internal audit of GPC's position control by GPC's internal audit director was underway prior to the start of our engagement and will be addressed in detail in that report.

A significant inaccuracy regarding personal services was budgeting of fringe benefits. GPC understated the fringe benefits that corresponded with each employee on the payroll. This understatement has been estimated at $6.7 million. Understating fringe benefits allowed other budget areas to be overstated. When funds were spent against the overstated areas, deficit spending occurred.

Other significant, consistent expenses include payments to a consulting firm for various information technology and financial services. Some of these consultants were hired on a long-term basis. Notably, GPC paid Skybridge Consultants $1.6 million for a consultant to help with general ledger and other accounting duties from October 2005 through February 2012, and $964,000 to another consultant to assist with payroll during the same time period. (See Table 7 on p.15.)

Also, several new initiatives were introduced at the college during this time. The budget impact of these initiatives was relatively small. The total amount spent on these initiatives in 2012, according to the GPC General Ledger department accounts, was approximately $570,000. Nonetheless, there was no stated requirement for a new initiative to be self-sustaining (self-funding) after the first year. However, we found no documented evidence showing which GPC budget areas were cut to fund these initiatives; rather vice-presidents from responsible areas were expected to allocate their resources to absorb any additional spending.

Table 7: Payments to Consultants



(GPC Financial Records FY 2009, 2010, 2011, 2012)

Another expenditure to note is the spending of fees that were collected for debt service on seven public-private venture (PPV) projects on four campuses. The college began collecting fees for this construction before debt service began. The fees, which were allowed to accumulate as part of auxiliary reserves instead of student activities, were liquidated along with other auxiliary reserves as the college overspent available funds.

(At that time, there was no requirement that the institution maintain reserves for PPVs as the PPV debt is held by a third-party. GPC has made the required rental payments to the third-party. The debt service on the seven projects has been paid timely by the third party and is not in arrears.)

To summarize, it cannot be determined where the budget was overspent because it was not allocated correctly and contained errors and omissions.

Issues - Detail

Issue #1 - Institutional Governance

Background

Governance in the University System of Georgia is primarily exercised at the institutional level by the institution's president. *Board Policy 2.5.1 Executive Head of Institution* states:

> The president of each USG institution shall be the executive head of the institution and of all its departments, and shall exercise such supervision and direction as will promote the efficient operation of the institution. The president shall be responsible to the Chancellor for the operation and management of the institution, and for the execution of all directives of the Board and the Chancellor. The president's discretionary powers shall be broad enough to enable him/her to discharge these responsibilities (BoR Minutes, 1972-74, pp. 69-71; 1977-78, pp. 167-168; April, 2007, pp. 76-77).

There are additional definitions of governance. Most governance definitions reference achieving objectives, overseeing and monitoring operations, and ensuring compliance with laws and accountability for behavior. Broader governance themes include leadership, guidance, and a tone at the top that encourages legal and ethical behavior, societal well-being and a focus on action. Fiscal management is a fundamental governance component.

GPC employees with critical fiscal/budget management responsibilities included the Executive Vice President for Financial and Administrative Affairs or Chief Business Officer (CBO), the Budget Director, and the Assistant Vice President for Financial and Administrative Affairs (AVP). Of these three employees with critical fiscal/budget management, the CBO reported directly to the President. The President held overall responsibility for the institution's performance as further detailed in GPC's organizational chart (see Appendix II for GPC's organizational chart and Appendix III for selected position descriptions). Collectively, this report refers to GPC's former fiscal leadership team when referencing these four positions. Additionally, institutional vice presidents hold budget responsibilities for their respective functional areas.

Board Policy 7.1.2.2 Deficits further defines the President's responsibilities:

> When any situation develops that would create a deficit at an institution, the president shall take the appropriate corrective action. If the president determines that he/she cannot take adequate corrective action to eliminate the deficit, he/she shall inform the Chancellor and/or the USG chief fiscal officer immediately.

What issue did we observe?

Fiscal and budget management was ineffective within the overall context of institutional governance. Original budgets submitted to and approved by the Board of Regents for the fiscal years reviewed (2009, 2010, 2011 and 2012) were not properly allocated in the financial system. Mid-year adjustments were not loaded into the system. Budget overrides during this period were standard practice making any budget to actual comparisons meaningless; original budgets were consistently overspent and expenses exceeded revenues. The budget would be brought into balance at year end by moving expenditures to funds where balances might be available. Over several years, this approach resulted in depleted reserves and an overall structural deficit.

GPC's former fiscal leadership team did not remedy the institution's precarious financial position.[13] The former President has stated that he was unaware of the college's financial straits and that he relied on the former CBO for accurate financial and budget information. Similarly, the former CBO stated he was not aware of the college's actual financial condition (as reflected in the audited financial reports) and that it would have been the former AVP's and former budget director's responsibility to notify him. The former AVP asserted that she was excluded from many of the discussions and much of the decision-making with respect to budget matters, even though the budget director reported directly to her. Consequently, she possessed limited knowledge of the decisions made with respect to GPC's budget, including whether or not budget reductions should be implemented.

We do not know why the former fiscal leadership team was not aware of GPC's fiscal situation. Sufficient, publicly available financial information was available to alert the fiscal leadership team to GPC's declining financial position and to the fact that the prepared budget was not sustainable. Specifically, GPC's fiscal leadership team had access to annual financial reports, cash balances, and financial system queries and reports available for use in understanding the institution's fiscal situation.

Annual Financial Reports were available at each fiscal year end: FY 2009, 2010, and 2011. These statements included operating results, cash flow statements, and audit issues – all indicating expenses exceeding revenue, declines in unrestricted net assets and an overall weakening in financial performance. These statements are subject to some level of review by state auditors ranging from a full external audit to an agreed-upon procedures engagement. At the completion of each engagement, the state auditors hold an exit conference or close-out meeting with senior financial personnel to review and discuss the engagement findings and recommendations. Such meetings were held for the years under review, so there is no reason to believe the fiscal leadership team would not have been aware of the deficiencies. (In 2010, GPC's CBO declined a formal exit conference, but there is evidence of an end of engagement meeting between the state auditors and the CBO regarding the FY 2010 audit report.) Additionally, management actually prepares the financial statements that are subsequently audited by the external auditors. Final draft versions of these audited statements (which included information on actual deficits) of the financials were signed by institutional officers and reviewed by financial staff.

[13] Note that references to the financial team, President, CBO, AVP and budget director of the institution refer to the former employees, unless otherwise noted.

However, the former President stated he never received the state auditors' reports and the former CBO indicated that he had not reviewed the final financial reports developed by and for GPC.[14] Nevertheless, these reports were signed by the former President or signed on his behalf and made available to the CBO, AVP, and others.[15] The AVP stated she was not aware of the possibility of any budget over-expenditures until late in June 2011 when a consultant informed her of the possibility. Even after she was made aware of this possibility, the problem was not remedied.

The financial reports also included these audit issues:

- Budget reflected over-expenditures in special funding initiative $152,440.21 (agreed upon procedures FY 2009)
- Inadequate Accounting Procedures (FY 2010)
- Inadequate Accounting Procedures over Budget Preparation and Execution (FY 2011)
- Errors Noted in Financial Statement Preparation (FY 2011).

Bank balances were available daily. Bank statements were also available and bank reconciliations were prepared monthly. The CBO and AVP should have been aware of the declining bank balances. The AVP was apprised by her staff on several occasions of challenges associated with cash balances. However, when we inquired as to whether or not she was aware of the deficit, the AVP's response was that she was informed by a consultant on July 1, 2011 that the college had a low bank balance and was overspending its budget. The AVP indicated she informed the CBO the next day, but the CBO took no action. The CBO subsequently related to us that he did have a conversation regarding the bank balance with the AVP. However, he did not feel that she had relayed the seriousness of her concerns to him. Their conversation did not address overspending the budget.

The AVP said she then met with the budget director and demanded certain deliverables from him to help her learn more about the issue, but the budget director failed to act.

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[14] The former President was present at the exit conference for the FY 09 audit. The former CBO declined a formal conference for FY 10; however, the state auditors met with him on 12/10/2010 regarding the FY 10 audit report. The former CBO was present at the FY 11 conference but the former President did not attend. Audit reports are sent to the president of each audited institution and the president and CBO are required to sign the reports. Reports bearing signatures purportedly belonging to GPC's former President and former CBO were returned to the Georgia Department of Audits and Accounts.

[15] Financial reports can also be viewed online at www.audits.ga.gov. As noted previously, the former president indicated that he does not recall signing the financial statements and the reports were routed to others for handling. See Note 5.

Finally, ongoing and persistent state budget challenges across the USG were highlighted by the University System Office, the news media, and others. Budget updates frequently were included on the agenda at USG presidents' meetings. Budget topics also were discussed in GPC executive meetings.

It appears that the information the executive team relied on was inaccurate. Specifically, members of GPC's cabinet received and likely relied on budget presentations made by the former CBO and former budget director at the executive team meetings. We found three such presentations for FY 10, 11, and 12 and have summarized the presented information in Table 8.

Table 8: Budget Summaries Presented to Executive Team

Fiscal Year	**FY 10 Budget**	**FY 11 Budget**	**FY 12 Budget**[16]
Date presented	4/17/09	(not dated)	4/1/2011 and 4/29/11
Budgeted Revenue - prior year	112,824,010	115,965,793	118,614,264
Budgeted Expenditure - prior year	(112,824,010)	(115,965,793)	(118,614,264)
Anticipated Revenue Current Year/Funds Available *sic: Additional Revenue*	15,968,444	6,300,000	(12,182,966)
Budget Request for Current Year *sic: Fiscal Year(These amounts were presented as additional funds available)*	14,440,066	10,160,276	11,948,360

(From budget summaries prepared by GPC financial personnel in FY 2009, 2010 and 2011)

These budget presentations were not representative of GPC's financial condition. The information presented does not agree with the audited financial statements nor the budget submitted for Board approval. The budget was based on incorrect numbers for prior years with additions and subtractions from those numbers. **However, the audited and publicly available financial statements prepared by the institution did accurately reflect the institution's financial status.** Review of the institution's own financial statements would have alerted senior management to the institution's true financial state.

Meanwhile, the former budget director stated that he knew of no one who was looking at the overall budget. It seems apparent that he should have had the responsibility for doing so since his job description included responsibility for budget planning, development and monitoring in accordance with institutional and system requirements. He indicated he had conversations with the former CBO and the former AVP to notify them they were overspending, but no actions were ever taken to curtail the

[16] The executive team meeting minutes dated May 9, 2011 reference approval of the FY 2012 Budget. We did not find reference to budget approvals in other meeting minutes that were available to us.

spending. (We did not find documented evidence to support the existence of the conversations referenced by the former budget director.) He also stated in an affidavit signed for former President Tricoli that he did not believe there were any budget deficits and that he never brought concerns about budget deficits to the attention of the former President.[17] He went on to say if it appeared that a particular budget item in the general fund was going to exceed the amount budgeted, he would ask the accounting department to move that expense to an alternate funding source. He further states "these charges appeared in the budget reports for those alternative accounts but because there were sufficient funds in the accounts to cover the charges, the budget reports did not reflect deficits."

It should be noted that expenses were charged against auxiliary services, technology fees and student activities fees. If funds must be moved to cover expenses, the correct way is to transfer funds from budget line items where funding exists to budget line items that have a deficit balance via a "non-mandatory transfer." It is not appropriate to move expenses out of deficit line items to other funded lines.

In summary, neither the former President, nor the former CBO, nor the former Budget Director, nor the former AVP exercised full responsibility for or ownership of the budget. Each relied on or expected someone else to be accountable. The former President specifically stated that he never directly received or knew about the State Auditor's report and that he was never informed of the budget deficit. The President also cited GPC's policy that the CBO inform the President of any expenditure trends that may affect the College's ability to live within its budget, yet the CBO never apprised him of any budget deficits.[18] The CBO also stated that he had not reviewed the audited financial statements. He relied on his staff to prepare the Annual Financial Reports. He acknowledged that as CBO, he should have been aware of the deficit, but also expressed the opinion that the system office or others should have notified him of the problem.

This budget neglect did not appear to be malicious or intentional; rather, senior management seemingly was unaware of the institution's budget deficits and was instead focused on other activities. The result was that no one was accountable and the system in place failed.

<u>What steps should be taken to address this issue and its associated risks?</u>

On April 25, 2012, it became apparent to the school's former leadership that there would not be cash available to pay its upcoming expenses nor reserves available to cover its deficits at year end. The former president immediately notified the Chief Financial Officer of the USG.

[17] The affidavit is not dated. Most likely it was signed in either May or June of 2012.

[18] GPC Policies can be found at: http://depts.gpc.edu/governance/policies/New300/302.pdf.

Subsequently, senior personnel changes were made resulting in the appointment of an interim president, an EVP for Finance and Administration (CBO) and an Associate Vice-President for Fiscal Affairs. The budget manager had resigned shortly before the deficit was reported and an Assistant Vice President for Budgets and Strategic Financial Planning was appointed in his stead. The new financial leadership team took immediate steps to address the deficit in the short term and to prevent its recurrence:

- State appropriations in the form of institutional loans were increased $9.5 million (paid back in FY 2013)
- $1.4 million of purchase orders were closed
- $4.7 million in summer 2012 revenue was moved from FY 2013 to FY 2012
- A reduction in force was implemented
- $400,000 savings from implementation of other short term strategies

Two hundred eighty two staff members (215 full-time and 67 part-time) were laid off, which GPC projects will result in financial savings of $7.5 million in FY 2013 and $9.4 million in 2014. This number includes 215 full-time and 67 part-time employees.

Additional spending cuts were made in an effort to balance the budget. This June 29, 2012 message from Interim President Rob Watts to GPC Faculty and Staff Colleagues describes these cuts:

> *I have been asked several times about the internal institutes and centers we had to close for budget reasons. There are five: The Atlanta Center for Civic Engagement and Service Learning, the Southeastern Institute of Sustainability, the Southern Academy for Literary Arts and Scholarship, the Center for International Education, and the Center for Organizational Development. These centers did good work, but the college is not able to continue these initiatives in their current form, given its fiscal constraints.*
>
> *The college will, though, continue some reduced portion of these activities in other ways. For example, the theme of our Quality Enhancement Program for SACS is engaged learning. Over the next five years, we must implement the QEP and report the results to SACS. In addition, I would not want anyone to think that the thirty-plus-year-old Chattahoochee Review is going away. I have just read the spring issue and look forward to the next. And study abroad opportunities will not be eliminated. I studied abroad as a sophomore, and it was a life-changing experience. We will need to find another avenue to maintain these opportunities for students.*

The current administration has taken necessary steps to address the shortfall and help the institution fulfill its mission.

To address the root cause of the shortfall, we recommend that:

1.1 GPC leadership foster a culture of senior management accountability for fiscal performance – this includes ongoing review of revenues, expenses and cash flow, accurate budget reporting, remediation of financial audit issues, and careful financial planning at the senior level.

1.2 GPC leadership use information from the USG's official financial reporting system (PeopleSoft). This includes using available analytic tools such as running budget to actual financial reports and holding managers accountable to their budgets.

1.3 GPC develop a transparent and open budget process to include regularly held budget meetings throughout the year with financial, academic and operational stakeholders. These meetings should include, at a minimum, the current state of the budget and action steps to adjust operations and spending to align with the actual financial position of the college.

Other specific issues to address are detailed in Issue #2 – Internal Controls.

Management Response (Provided by Ronald B. Stark, Executive Vice President, Financial and Administrative Affairs, Georgia Perimeter College)

Recommendation #1.1:

GPC leadership foster a culture of senior management accountability for fiscal performance – this includes ongoing review of revenues, expenses and cash flow, accurate budget reporting, remediation of financial audit issues, and careful financial planning at the senior level.

Management response:

We agree with this recommendation. In fact, the new leadership team began immediate action to change the culture and improve accountability the first week of its appointment. The current GPC leadership team recognizes the immediate need for implementing strong fiscal controls surrounding accounting, reporting and budgeting at the College.

Actions already taken to date include:

- GPC's Budget Office reports directly to the Chief Business Officer instead of the AVP for Financial Affairs. This change highlights the importance to senior management that the budget issues at the College are corrected.
- The FY2013 budget was both reduced and recast to more accurately reflect available resources.
- New purchasing procedures were communicated to College staff outlining requirements for obligating funds by purchase order/requisition. This includes prior approval for all purchases at the Director or Dean level, with the exception of emergency purchases.
- The AVP for Financial Affairs and Chief Accounting Officer/Controller completed all required statutory reporting for FY2012 and met the prescribed due dates. The financial reporting submissions are currently under audit by the Department of Audits and Accounts.

Management believes that fiscal controls and accountability are well in process and will be completely in place before the end of fiscal 2013. Due to the depth and breadth of financial issues at GPC, however, management anticipates that the College will not be free from budget reductions that occurred as a result of the FY2012 budget shortfall until fiscal 2015.

Additionally, management believes that accountability is necessary to ensure proper budget management and oversight. In order to ensure accountability at GPC, the Budget Office, with the cooperation of the Executive Team, has implemented the following:

- All budget managers are now at the Dean or Director level. Budget managers are to be held accountable for their budget vs. actuals via performance management.
- The Executive Vice President for Financial Affairs and the AVP for Budgets and Strategic Financial Planning will review the college-wide budget vs. actuals on a monthly basis.
- The Executive Vice President of Financial Affairs and the AVP for Budgets and Strategic Financial Planning will update the Executive Team monthly on the state of the budget vs. actuals.
- The AVP for Budget and Strategic Financial Planning will meet quarterly with the Vice Presidents to review their responsible programs. If necessary this review will include the budget managers to address any issues.

<u>Recommendation #1.2</u>:

GPC leadership use information from the USG's official financial reporting system (PeopleSoft). This includes using available analytic tools such as running budget to actual financial reports and holding managers accountable to their budgets.

Management response:

The current GPC financial leadership team agrees that PeopleSoft is the system of record for the College's budgeted and actual revenues and expenses. As such, PeopleSoft will be the source for interim reporting, as well as annual external reporting.

Actions already taken to date include:

- Fiscal 2013 budget was loaded and correctly allocated in PeopleSoft during July, 2012.
- Budget override access was eliminated from sixteen or more employees to four.
- The number of budgeted cost centers was streamlined from approximately 900 to 600, making budget maintenance more manageable.

Department managers have access to PeopleSoft budget progress reports to monitor their department performance against budget. In addition, the College will be implementing iStrategy, which is a reporting tool that pulls data from PeopleSoft, to provide a more user friendly alternative to PeopleSoft delivered reports. Training for iStrategy as well as overall budget principles will begin in mid-October. As a result of these efforts, management considers this recommendation already implemented.

Recommendation #1.3:

GPC develop a transparent and open budget process to include regularly held budget meetings throughout the year with financial, academic and operational stakeholders. These meetings should include, at a minimum, the current state of the budget and action steps to adjust operations and spending to align with the actual financial position of the college.

Management response:

The current GPC leadership team agrees that the appropriate stakeholders must be aware of the College's performance against budget so that adequate planning can take place to prioritize and optimize limited resources.

GPC's financial leadership will formalize periodic budget reporting to senior management, which will be evidenced in meeting minutes. This will occur no less than quarterly, beginning with the end of the first quarter of fiscal 2013.

Communication and transparency are vital to ensure proper budget oversight and management. To ensure proper transparency the Budget Office will initiate the following communication strategies and tools:

- Budget Website
  - The Budget Office will maintain its independent website. The website will contain pertinent information for all budget managers including:
    - How to Complete a Budget Transfer
    - Policies and procedures for Travel
    - List of Budget managers and their chartfield strings
    - The Budget Principles
    - Roles and Responsibilities for Budget Managers
    - Budget Office contact information
    - Revenue Projections
- Budget Managers' List Serve

    - Periodically it is necessary to communicate information to the Budget Managers. The Budget Managers' List Serve is the fastest method of communication. The List Serve is managed by the AVP for Budget and Strategic Planning.
- Office Hours and Accessibility
    - The Budget Office will be open daily to assist Budget Managers with any questions or concerns. The AVP for Budgets and Strategic Financial Planning will return all communication in the order in which it is received. The AVP will remain available for individual meetings as needed to review spending plans, budget concerns, or any issues as they arise.

The Budget Office will not make any adjustments to a departmental budget without the expressed consent from the Budget Manager or the responsible Vice President.

Issue #2 – Internal Controls

Background

Internal controls are required in order to effectively manage fiscal operations. The USG Ethics Policy states in its Code of Conduct #3 Explanatory Notes and References:

> 3. Perform assigned duties and professional responsibilities in such a manner so as to further the USG mission.
>
> All members of the USG community are expected to conduct themselves in accordance with the highest standards of scholarship, public service and integrity. This requirement encompasses both a responsibility to understand and to further organizational missions and goals. Individuals in positions of greater authority bear a greater responsibility for achieving organizational missions and goals in an effective and efficient manner. However, all members of the USG community should contribute to the success of the USG in a manner consistent with their duties and responsibilities.
>
> **Effective internal controls are one method that can be employed to assist the USG in achieving its mission. Internal controls are the processes employed at all levels to help ensure that USG business is carried out in accordance with BOR policies and procedures, institutional policies and procedures, applicable laws and regulations and sound business practices. Good internal controls promote efficient operations, accurate financial reporting, safeguarding of assets and responsible fiscal management.**[19]

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) primary objectives of an internal control system are to "ensure (1) efficient and effective operations, (2) accurate financial reporting, and (3) compliance with laws and regulations."[20]

Examples of internal controls in a budgetary context include processes and procedures designed to:

- Assign responsibility for budget development and execution;
- Monitor budget performance;
- Ensure that resources are available to meet planned expenses;
- Validate and approve expenditures against a valid budget;
- Ensure that budgets submitted to the Board of Regents are congruent with the financial resources of the college and that they are properly reflected in the financial system; and,
- Provide early warning of financial or other risks as reflected in budget performance.

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[19] http://www.usg.edu/audit/compliance/ethics (emphasis above added)

[20] Appendix IV describes the COSO model in more detail. Also please see http://www.coso.org/audit_shop.htm.

What issue did we observe?

Internal controls over budget management were non-existent, overridden, or ineffectively executed. Specific practices that resulted in an overall failure of internal controls generally fell into the categories of **Budget Development**, **Budget Execution**, and **Budget Monitoring** and include:

1. **Budget Development**: The budget that was presented to the college's executive team, the President's Council, and the Strategic Budget Committee reflected additions and subtractions from prior year budgets without specific detail as noted in Table 8. Specifically, budgets for the upcoming year were based on prior year's budgets, rather than actual expenditures and no provisions were made for overspending that had occurred in those prior years.

   Enrollment predictions and related revenue calculations used for budget development were unreliable.

2. **Budget Execution**: Internal controls over the administration of the budget were ineffective; budgets were not properly allocated, forcing constant budget overrides.
   a. It was standard practice to overspend and then <u>override budget controls</u>. Departmental budgets were not properly allocated or loaded into the financial accounting system. Therefore, many departments incorrectly reflected a zero budget. The system rejected otherwise authorized expenditures attempted against these budgets because the system showed no budget available. The only way to allow the expenditure to be made, other than correcting the budget in the accounting system (which was not done), was to override the warning. As many as 16 employees had access to override the budget.
   b. There was <u>no documented risk assessment</u> that listed potential risks associated with the budget process and how the institution would manage those risks.
   c. <u>Auxiliary and other reserves</u> were used in 2010 and 2011 to cover shortages. Table 9 shows these adjustments were, respectively, \$3.2 and \$13.2 million.[21] Additionally, at the end of FY 2011, \$1.3 million of purchase orders were closed and the related expenditures were rolled into following years. We believe these transactions indicate some financial personnel at the institution had an awareness of deficits in 2010 and 2011 and that awareness should have carried over into 2012.

[21] It should be noted it was an allowable practice to use auxiliary funds for operating expenses at the time these adjustments were made at GPC. This temporary measure used to address USG-wide budget concerns expired at the end of FY 2012.

Table 9: Expenditures Moved to Balance Budget

	FY 2011		FY 2010	
	From	To	From	To
State Appropriation	(12,519,803)		(1,907,421)	
Tuition	(731,213)		(1,345,838)	
Other General		7,256,731		
Auxiliary Stores and Shops		3,035,348		
Auxiliary Other		359,574		1,907,421
Student Activities		588,002		
Indirect Cost		296,903		
Technology Fees		1,714,458		1,345,838
	(13,251,016)	13,251,016	(3,253,259)	3,253,259

(From GPC financial records FY 2010 and 2011)

d. A review of select journal level detail of building and facilities improvement additions revealed $11.1 million in reported FY 11 asset additions that were expended in prior years. Over $9 million of these additions were posted on or after June 30, 2011. This may have been an attempt to manage the FY11 reported decrease in total net assets and should have been treated as an adjustment to beginning balances (this would not have affected current year expenses as exemplified in Table 6).

e. Despite job descriptions describing budget responsibilities, no individual accepted responsibility or took ownership of the budget process. The institution did not have an established or reliable budget process to inform responsible persons (including the President, the executive team, and the budget managers) the status of the budget; neither did the budget office maintain control of the budget.

3. **Budget Monitoring**: The overall budget was not communicated to the stakeholders and interim budget performance was not monitored. The primary tool used to monitor budget performance was a spreadsheet that did not tie to the institution's financial system of record.

   a. Some steps for monitoring performance might have included analytical reviews. Had these or other analyses been performed on readily available data, the deteriorating financial position of the institution would have been apparent. For example, in FY 2009 and FY 2010 current assets exceeded current liabilities by $13.7 and $9.5 million respectively. By FY 2011, current liabilities exceeded current revenues by $4 million. As noted in Table 4, average cash balances were in a steep decline which would indicate a need for timely corrective action.

b. There was neither an effective process for monitoring interim budget performance nor actual oversight by the GPC fiscal leadership team. References to the budget in executive team meetings were in general terms such as "if enrollment reaches 26,500 we will be in good shape financially" and "budget reductions are expected to continue." As noted in Issue #1, the former president, former CBO, and former AVP stated they were not aware of the deficits even though they were presented in published financial statements. The total budget was discussed annually, but unfortunately the presentations contained insufficient and incomplete information.

c. During the years reviewed, spreadsheets supposedly reflecting the current state of the budget were prepared by the former budget director and provided to the former CBO. The former CBO apparently did not verify the accuracy or reasonableness of these spreadsheets. These **spreadsheet reports were not accurate** and routinely showed budget surpluses when in fact the college was running a deficit. Procedures for reconciling these subsidiary worksheets to totals generated from the official accounting records were not in place and therefore were not performed.

d. The declining cash position was mentioned in several e-mails between the former AVP and accounting staff. These e-mails are evidence of awareness, but not understanding, of the implications of a declining cash balance. The response was to monitor the disbursements on a daily basis. We do not see evidence that the root cause of overspending was addressed.

<u>What steps should be taken to address this issue and its associated risks?</u>

2.1 At a broad level, those charged with responsibility for financial management should design, document, and monitor an effective budget process. For the controls to be effective, the budget requires continuous monitoring of actual results compared to budgeted projections followed by decisive action to correct variances. Fundamentally, effective budgeting ensures that the institution can meet its most important objectives while spending only its available resources. In an era of constrained budgets, effective budgeting may mean deciding not to pursue programs and activities.

Specific budgetary controls should be documented in written procedures. We recommend that GPC:

2.2 Follow the steps mandated in the June 6, 2012 correspondence from Chancellor Huckaby to the USG Presidents as outlined in Appendix V regarding budget hearings, quarterly financial reports and external audits.

2.3 Use conservative and consistent enrollment projections when developing its budget. Enrollment projections should take into account the impact of changes in Federal financial aid such as the availability of Pell Grants for summer classes, new rules regarding admission of Learning Support students and other current trends.

2.4 Ensure that current and relative budgets are properly loaded in the financial system and that only a limited number of individuals are authorized to override the budget and only with proper authorization.

2.5 The budget process should be transparent and inclusive of key stakeholders. Consider the establishment of a budget committee that includes executive leadership and department heads from all functional areas. The committee's purpose would be to develop an annual budget that is ultimately recommended to the President. At a minimum, ensure that those managers charged with budget responsibility are given the necessary information to understand the budget allocated to their department and their progress in adhering to that budget.

2.6 Design and implement procedures for continual monitoring of performance with explanations of variances. Variances in both revenues and expenditures should be explained and adjustments made as required to maintain a balanced budget. Responsibility for performance monitoring should be assigned to functional budget managers. Responsibility for adjustments and re-allocation of resources should be assigned to the budget department.

2.7 Establish a calendar for regularly held budget meetings throughout the year. Incorporate budget performance monitoring and reallocate resources as indicated to ensure the continued effective use of resources. Minutes of the meeting should be recorded.

2.8 Guidelines for preparing, recommending and adopting the budget with special attention to the strategic allocation of resources to align with the institutions goals. These guidelines should address responsibility for calculating realistic revenue projections with procedures for adjusting the budget as revenue projections fluctuate.

Management Response (Provided by Ronald B. Stark, Executive Vice President, Financial and Administrative Affairs, Georgia Perimeter College)

Recommendation #2.1:

At a broad level, those charged with responsibility for financial management should design, document, and monitor an effective budget process. For the controls to be effective, the budget requires continuous monitoring of actual results compared to budgeted projections followed by decisive action to correct variances.

Management response:

The current GPC financial leadership team agrees GPC should design, document, and monitor an effective budget process.

Actions already taken to date include:

We are in the process of adopting and implementing Budgeting Principles, which is a document outlining objectives and goals for revenue projections and review of revenues and expenses by the GPC Budget Office. These principles will continue to be refined as needed during fiscal 2013. The principles as currently defined include:

The Budget Office will provide thoughtful and accurate projections for all unique sources of revenue. In order to ensure a sound budget the projections must be in line with the actual revenue received. In an effort to ensure accurate projections, the budget office will provide the following:

- Tuition and fee projections to build the next fiscal year budget in April.
    - Given GPC's student population, which often applies and registers as the semester opens, this is a difficult process. With the help of the Office of Institutional Research and the Enrollment Management Committee the Budget Office will use a sound enrollment figure in the projection model.
- Revised tuition and fee projections in July as the new fiscal year budget rolls out.
    - As the Fiscal Year opens the Budget Office will use the revised enrollment figure to adjust the budget if necessary prior to opening the period. Any revised estimates will be reflected in GPC's amendment #1 to the USG Budget Office.
- Review Revenue on a monthly basis
    - The Budget Office will monitor revenue on a monthly basis and track trends
- Adjust revenue projections on a quarterly basis
    - The revenue projections will be reevaluated and adjusted on a quarterly basis to ensure GPC's budget remains in line with estimated revenue. All adjustments will be made in the USG budget amendment system as well as in PeopleSoft.
    - In the event of an adjustment to the projections, the Budget Office will communicate the change with the Executive Team, consisting of the President and Vice Presidents, to make any adjustments to the budget and spending plans.

We will be developing a budget model to ensure accurate projections; the model will include the following:

- Enrollment projections from the Office of Institutional Research and the Enrollment Management Committee
- Actual enrollment figures
- Projected then actual credit hours
- Review of withdrawals at 50% & 60% of the semester and monitor refunds
- Review unofficial withdrawal at the end of the semester for those students that may qualify for a refund.
- Online students vs. on-campus students
- Tuition Waivers

Recommendation #2.2:

Follow the steps mandated in the June 6, 2012 correspondence from Chancellor Huckaby to the USG Presidents as outlined in Appendix V regarding budget hearings, quarterly financial reports and external audits.

Management response:

The current GPC leadership team will comply with Chancellor Huckaby's June 6, 2012, correspondence. We have drafted a cash flow model and are currently testing it.

Recommendation #2.3:

Use conservative and consistent enrollment projections when developing its budget. Enrollment projections should take into account the impact of changes in Federal financial aid such as the availability of Pell Grants for summer classes, new rules regarding admission of Learning Support students and other current trends.

Management response:

The current GPC financial leadership team agrees that a solid process is needed for enrollment projections. The Budgeting Principles draft previously mentioned addresses projections, their frequency and the items that will be considered.

As mentioned above, GPC will also develop a revenue model by December, 2012, that will include enrollment projections and other variables affecting revenue. This will enable GPC to conduct "what if" analyses that will put GPC in a better position to anticipate and therefore plan for the impact of one or more changes.

Recommendation #2.4:

Ensure that current and relative budgets are properly loaded in the financial system and that only a limited number of individuals are authorized to override the budget and only with proper authorization.

Management response:

The current GPC leadership team agrees that only a select few individuals should have the capability to override budgetary controls in PeopleSoft. As discussed above, this change has already been implemented, with only four employees possessing budgetary override access. The Chief Business Officer is the only position that may approve budget override access.

Also, as indicated above, the fiscal 2013 budget was loaded into PeopleSoft in July. As a result of these efforts, management considers this recommendation implemented.

Recommendation #2.5:

The budget process should be transparent and inclusive of key stakeholders. Consider the establishment of a budget committee that includes executive leadership and department heads from all functional areas. The committee's purpose would be to develop an annual budget that is ultimately recommended to the President. At a minimum, ensure that those managers charged with budget responsibility are given the necessary information to understand the budget allocated to their department and their progress in adhering to that budget.

Management response:

See response to Institutional Governance recommendation #1.3 above.

While input from all functional areas is an important part of the budget process, management believes that developing an annual budget by committee would be difficult at best. We will involve the appropriate college leadership in the budget process and in the final budget recommendation made to the president.

Recommendations #2.6, 2.7 and 2.8:

- Design and implement procedures for continual monitoring of performance with explanations of variances. Variances in both revenues and expenditures should be explained and adjustments made as required to maintain a balanced budget. Responsibility for performance monitoring should be assigned to functional budget managers. Responsibility for adjustments and re-allocation of resources should be assigned to the budget department.

- Establish a calendar for regularly held budget meetings throughout the year. Incorporate budget performance monitoring and reallocate resources as indicated to ensure the continued effective use of resources. Minutes of the meeting should be recorded.
- Guidelines for preparing, recommending and adopting the budget with special attention to the strategic allocation of resources to align with the institutions goals. These guidelines should address responsibility for calculating realistic revenue projections with procedures for adjusting the budget as revenue projections fluctuate.

Management response:

GPC's current leadership team agrees with the collective internal control recommendations related to the budgeting process. As indicated above, many of these items have been either completed or are in process. These controls will be completely implemented by December, 2012.

Appendix I: Additional Comments

We did consider the possibility of fraud when performing this engagement. We were particularly mindful of the statements of the former GPC President who alleged fraud by members of his team.[22] Our procedures were designed to identify potential fraud with a particular focus on the actions of those with responsibility for the institution's financial management. However, the audit did not constitute a detailed review of all financial transactions during the four fiscal years under consideration. Therefore, it is possible that errors, irregularities and/or illegal acts, including fraud or malfeasance, went undetected.

As noted above, we found a general lack of controls. **However, we did not find indicators that fraud was present**. Bank reconciliations were performed and reconciled to the general ledger. Financial audits or similar engagements were performed annually.

We performed a Benford analysis[23] to detect if unusual transactions had occurred, but the analysis ended in a normal distribution. We reviewed expenditures for several years looking for unusual payments. We did identify payments that had been made on weekends, but further inquiry revealed this had been done with proper approval.

We interviewed/questioned nearly 20 persons in various positions at the college - the president, vice presidents, accounting staff, administrative assistants and others. We know that it has been reported that persons who are aware of fraud may not report it simply because they were never asked. With that in mind, we posed the following questions to each person we interviewed:

1. Do you know of anyone who is stealing from the institution?
2. Do you suspect that anyone is stealing from the institution?
3. Do you know of anyone in the institution who is manipulating the accounts or records?

Other than as noted, the responses indicated no one knew of any fraud at the institution nor did anyone suspect that anyone was stealing. The former President indicated he was no longer in his position before he could discover if anyone stole from the institution or before he could gather the evidence to suspect that anyone was or was not stealing from the institution. He has alleged the former CBO, former AVP and former Budget Director engaged in a pattern of fraudulent behavior for the purpose of concealing

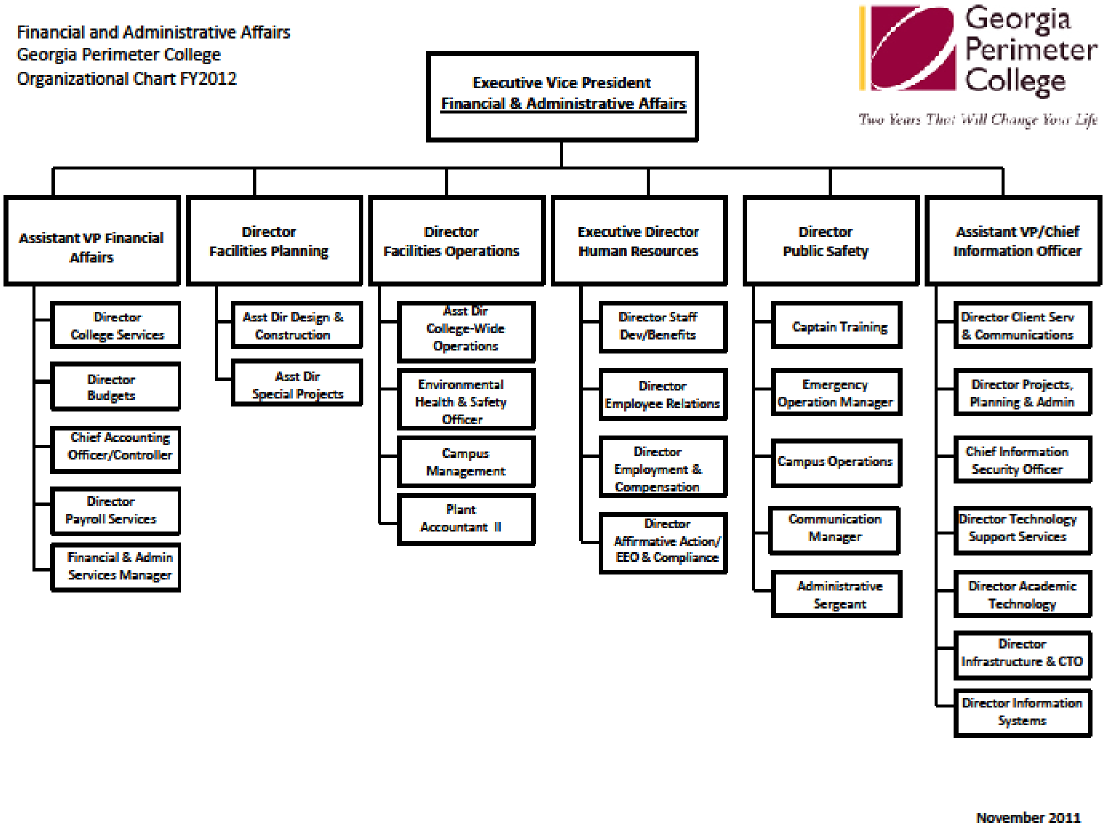
[22] No evidence of fraud was provided in connection with this allegation but it was referred to the Attorney General's Office for consideration. OIAC was asked by the Attorney General's Office to review for potential fraud in its audit procedures and to refer any potential fraud to that office for further action.

[23] Briefly, Benford's law states that in lists of numbers from many real-life sources of data, the leading digit is distributed in a specific, non-uniform way. Benford's law also gives the expected distribution for digits beyond the first, which approach a uniform distribution as the digit place goes to the right.

financial improprieties from the former President and the Board of Regents. The former AVP indicated it appeared the former Budget Director was manipulating the accounts.

We certainly agree with an assessment of inaccurate internal financials; however, we did not find evidence to substantiate that this was an intentional attempt to mislead or derive personal gain.

Appendix II: Organizational Chart



Appendix III: Position Descriptions

President

Board of Regents Policy Manual Section 2.5.1 Executive Head of Institution

Board of Regents Policy Manual Section 7.1.2.2 Deficits

CBO and Executive Vice-President

(Partial job description) The Vice President for Financial & Administrative Affairs is the chief financial officer of the college, responsible to the President for providing leadership and ensuring integrity, stability and excellence in the fiscal and administrative operations of the institution. The service areas of direct responsibility include Finance and Business Operations, Budgets and Strategic Financial Planning, Facilities Operations and Planning, and Information Technology. The Vice President is a representative of the College Executive Team responsible for creative leadership and innovation in achieving the mission and vision of the college. Establish a sound, stable financial base and adequate physical resources that support the mission and scope of programs and services of the institution.

Develop and administer the college budgets, financial strategic planning, and administrative program assessment to maximize the most efficient and effective use of resources.

Provide leadership and oversight for the development and implementation of college policies, procedures, or standards in all service areas, ensuring adequate internal controls and compliance with state and federal statutes.
Supervise relations with state auditors, coordinate state appropriation requests, and develop information requests required from state agencies and the legislature.

Negotiate or approve contracts and agreements with vendors, federal and state agencies, or other organizational entities.

Act as the college liaison to the USG Fiscal Affairs.

Director of Budgets

The Director of Budgets is responsible for budget planning, development and monitoring in accordance with institutional and System requirements. The position provides leadership in developing and implementing business policies and procedures.

Assistant Vice President for Finance (AVP)

(Partial job description) The Assistant Vice President for Financial Affairs is the senior financial operations manager that provides financial and administrative leadership for a broad range of financial, business, support operations, and planning areas to include: accounting services, financial reporting, budgets, student financial aid, student accounts, payroll, purchasing, risk management, fixed assets, campus card services, printing operations, and contracted bookstore/ food service operations.

Manage and coordinate the fiscal operations of the college. Provide leadership to a professional staff in the development, implementation and administration of policies and procedures that maintain and enhance the fiscal integrity of the college.

Maintain the integrity of the annual budget process.

- Oversees preparation of annual budget by reviewing the work of the Director of Budgets/Budget Office.
- Ensure interaction, accurate information and timeliness and assistance in the preparation of budget proposals at all stages of the process.
- Ensure the development of the annual budget calendar and format of College budget process.
- Ensure the establishment of guidelines and timelines for annual budgeting process to be approved by the Executive Team.
- Reviews and analyzes the process and implement improvement as necessary.

Appendix IV: COSO Model for Internal Controls

COSO is the Committee on Sponsoring Organizations of the Treadway Commission. It is charged with providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence. COSO expects to issue an updated *Internal Control-Integrated Framework* and related supporting documents during the First Quarter of 2013. Our report refers to the COSO cube and integrated framework which has been in effect since 1992. The basic tenets of internal control will not be altered in the updated framework. The interested reader can find details at **www.coso.org**.

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO, Appendix IV) primary objectives of an internal control system are to ensure (1) efficient and effective operations, (2) accurate financial reporting, and (3) compliance with laws and regulations. To be effective, the system must contain the following five components:

1. The **control environment**, which establishes the foundation for the internal control system by providing fundamental discipline and structure.

2. **Risk assessment,** which involves the identification and analysis by management of relevant risks to achieving predetermined objectives.

3. **Control activities,** or the policies, procedures, and practices that ensure management objectives are achieved and risk mitigation strategies are carried out.

4. **Information and communication,** which support all other control components by communicating control responsibilities to employees and by providing information in a form and time frame that allows people to carry out their duties.

5. **Monitoring,** this covers the external oversight of internal controls by management or other parties outside the process; or the application of independent methodologies, like customized procedures or standard checklists, by employees within a process.

Appendix V: Effective Monitoring of Financial Oversight

CHANCELLOR HENRY M. HUCKABY PHONE: (404) 656-2202 270 WASHINGTON STREET, S.W. FAX: (404) 657-6979 ATLANTA, GEORGIA 30334 EMAIL: CHANCELLOR@USG.EDU

"Creating A More Educated Georgia" www.usg.edu

June 5, 2012
Presidents of the
University System of Georgia
270 Washington Street
Atlanta, Georgia 30334

SENT VIA EMAIL

Dear Presidents:
Effective oversight of fiscal operations is a shared responsibility among our presidents, our chief business officers, and the University System Office. Our external and internal auditors are partners in this endeavor as they fulfill their associated roles, respectively, of rendering an opinion on our financial statements and in performing internal audits. In an effort to strengthen our fiscal operations, the System Office will be implementing enhanced review of each institution's financials. Accordingly, I am implementing the following procedures. These procedures will be formalized shortly; however, please implement these at your respective institutions as follows:

1) Budget Hearings: We will continue the practice of conducting in-person budget hearings for each institution. In addition to proposed budgets, institution presidents and chief business officers must be prepared to discuss their financial resources/reserves as well as current financial performance as compared to their current year budget. The System Office also will be implementing more detailed monitoring of cash flows and budget to actuals on a quarterly basis. This review will require submission of additional data by your business office; details will be provided by the Office of Fiscal Affairs.

2) Quarterly Financial Reports: Effective July 1, 2012, institutions will be required to submit quarterly financial statements, including a report of financial actions, designed to reveal the presence of any serious cash flow problems and to provide early warning of significant problems with the current year budget, a summary balance sheet, and a summary statement of revenues and expenditures. This quarterly report also will include a certification form that requires the signature of both the president and the chief business officer, attesting to the accuracy of the information contained in the report. The format for these statements will be provided by the Office of Fiscal Affairs.

3) External Audits: I expect institutional presidents and chief business officers to attend external audit exit conferences to ensure that they are fully aware of audit issues. Please make this a high priority when planning your schedules. Representatives from the Office of Fiscal Affairs and the internal audit function also will be invited to these exit conferences in order to ensure that relevant information pertaining to findings and financial performance are shared within the System Office.

4) Use of Reserves: Please also note that the use of auxiliary reserves to fund non-auxiliary operations will no longer be allowed effective fiscal year 2013. The use of auxiliary reserves for general operating purposes was a temporary measure that is scheduled to sunset as outlined in the Business Procedures Manual. Any planned expenditure of non-auxiliary reserves on projects not related to the source of the reserves must be reported

immediately to the Office of Fiscal Affairs. The Office of Fiscal Affairs will subsequently notify the appropriate offices within the System Office and the appropriate Board of Regents' Committees, including the Committee on Finance and Business Operations and the Committee on Internal Audit, Risk, and Compliance.

5) Institution Visits: The Office of Fiscal Affairs will conduct visits to selected institutions to review accounting records and related financial information. If deficiencies are noted, the Office of Internal Audit and Compliance will be asked to investigate these deficiencies. At the conclusion of the internal audit engagement, the Office of Fiscal Affairs will assist the institution by providing guidance to use in correcting any issues noted.

I appreciate the essential role each of you has in ensuring our financial position is properly reported, carefully monitored and remains strong.

Sincerely,
Henry M. Huckaby
Chancellor

HMH/jf

cc: Members, Board of Regents
Dr. Steve Wrigley, Executive Vice Chancellor of Administration
Dr. Houston Davis, Executive Vice Chancellor for Academic Affairs
Tom Daniel, Senior Vice Chancellor for External Affairs
J. Burns Newsome, Vice Chancellor for Legal Affairs
John Brown, Vice Chancellor for Fiscal Affairs and Treasurer
Shelley Nickel, Associate Vice Chancellor, Planning and Implementation
John Fuchko, Chief Audit Officer and Associate Vice Chancellor
Ben M. Riden, Jr., Associate Vice Chancellor, Fiscal Affairs
Tracey Cook, Assistant Vice Chancellor, Fiscal Affairs
Vikki L. Williamson, Assistant Vice Chancellor, Fiscal Affairs
Chief Business Officers, University System of Georgia
Chief Academic Officers, University System of Georgia
Chief Institutional Auditors, University System of Georgia
Claire M. Arnold, Director, Education Audit Division, DOAA