

**ARIZONA STATE UNIVERSITY
PUBLIC EVENTS DEPARTMENT
Report on Special Investigation
For the Period September 1989
Through June 1991**

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DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

December 9, 1992

Members of the Arizona State Legislature

The Arizona Board of Regents

We have conducted a special investigation of certain expenditures of the Arizona State University Public Events Department for the period September 1989 through June 1991. Our investigation was performed at the request of the Arizona Attorney General to determine potential violations of Arizona Revised Statutes §35-301. It also included a review of the University's internal control structure and its operation relevant to the Public Events Department's expenditures.

Our investigation consisted primarily of inquiries and the examination of selected records and other documentation. Therefore, our investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the adequacy of the financial records or the internal control structure of the University in general or the Public Events Department, nor do we ensure that all matters involving the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants or other conditions that require correction or improvement were disclosed.

The accompanying report describes our finding and recommendations as a result of the investigation. After this report is distributed to the members of the Arizona State Legislature and the Arizona Board of Regents, it becomes public record.

Douglas R. Norton
Auditor General

Attachment

cc: The Honorable Grant Woods
Attorney General
Dr. Lattie Coor, President
Arizona State University

Summary

In June 1991, due to a deficit for the Public Events Department, James O'Connell, the Executive Director of the Public Events Department, was placed on administrative leave. It was alleged that the Executive Director had advanced public monies to a local nonprofit theater company. The company was unable to repay these public monies prior to the end of the fiscal year, causing the deficit balance.

As a result of the allegation, the University obtained an independent audit of the financial statements of the Public Events Department for the year ended June 30, 1991. The audit was completed August 23, 1991, and the financial statements reported an allowance for uncollectible receivables of \$709,000 due to the estimated uncollectability of net advances in that amount made to the Musical Theatre of Arizona.

In September 1991, the Arizona Attorney General requested that the Office of the Auditor General conduct a special investigation of the Arizona State University Public Events Department for potential violations of Arizona Revised Statutes (A.R.S.) §35-301.

Our investigation included a review of University financial and administrative records related to the Public Events Department, as well as inquiries and an examination of the Public Events Department's financial statement audit report and the independent auditors' working papers.

This investigation revealed that Arizona State University, through its Public Events Department, loaned public funds to the Musical Theatre of Arizona by making advances in excess of ticket sales. As a result of these loans, at June 30, 1991, the Musical Theatre of Arizona owed approximately \$700,000 to Arizona State University. Consequently, on September 15, 1992, James O'Connell was indicted on 21 counts of misusing public funds in violation of A.R.S. §35-301.

Based on our special investigation referred to above, our finding and recommendations follow.

Finding

A Public Official Disbursed Public Monies to a Nonprofit Corporation Without Authority of Law.

As the Executive Director of the Public Events Department at Arizona State University, James O'Connell improperly disbursed and transferred public monies to the Musical Theatre of Arizona (MTA). These public monies were disbursed by Mr. O'Connell without legal authority in violation of A.R.S. §35-301.

MTA contracted, in a rental capacity, at various times with the University to provide musical productions at University theaters. These contracts permitted the University to disburse to MTA, prior to performances, monies received from ticket sales for MTA productions. The contracts between the University and MTA were executed by the Vice President of University Relations on behalf of the Arizona Board of Regents. Although Mr. O'Connell, as the Executive Director of the Public Events Department, did not have the authority to alter these contracts, he orally amended the contracts with MTA and advanced public monies to MTA in excess of ticket sales. The advances were intended to be loans; however, there were no written agreements, repayment schedules, or interest charged for these loans. In addition, Mr. O'Connell did not notify his superiors or advise the University's legal counsel or Comptroller's office of his actions.

During the period September 1989 through April 1991, Mr. O'Connell authorized 21 payments to MTA totaling \$1,455,748.12. However, because ticket sales for MTA events were not sufficient to cover any of these payments, public funds were used illegally.

MTA continued to stage the contracted musical productions during this period, and revenues generated from ticket sales were used to repay a portion of the public funds advanced to MTA. However, at June 30, 1991, the advances of public funds made by Mr. O'Connell to MTA exceeded ticket sales by approximately \$700,000.

Cause and Recommendations

As the Executive Director of the Public Events Department, James O'Connell violated A.R.S. §35-301 by ordering the payment of public monies to MTA without legal authority. Although Mr. O'Connell exceeded his authority and did not comply with University policies and procedures, because of certain weaknesses in the University's internal control structure, Mr. O'Connell was able to make illegal disbursements of public funds that were not readily detectable in the normal course of operations.

The University had a decentralized internal control structure that placed responsibility and control of public funds primarily with the colleges and departments. Furthermore, the University did not establish strong monitoring controls for the Public Events Department to offset the inherent weaknesses in such a decentralized structure. The weaknesses we noted during our special investigation of the University's internal control structure relevant to the Public Events Department and our specific findings resulting from these weaknesses are described below.

Specific Internal Control Structure Weaknesses and Related Findings

1. With limited external oversight, the Executive Director of the Public Events Department controlled the disbursement of public funds with a Request for Check (RFC) form. RFCs were intended to be used for specific types of procurements such as those of the Public Events Department, and were not processed through the University's independent purchasing system. Once approved by the designated department employee, the RFCs for the Public Events Department went directly to the Comptroller's Office to be processed for payment. Because RFC forms used throughout the University were processed in a similar manner, this lack of external oversight for RFCs may not be limited to the Public Events Department. The reasons for this lack of external oversight involving the Public Events Department that we noted follow.
 - a. The Business Manager and the other employees authorized to approve RFC forms for the Public Events Department reported to the Executive Director of Public Events. Therefore, the Executive Director was able to override any objections of the Business Manager and other authorized signers to ensure the ultimate authorization and disbursement of the advances of public funds to MTA. These employees did not inform any ASU employees outside the Public Events Department of their concerns.
 - b. The authorizing signer of an RFC form was responsible for ensuring adherence to University policies and procedures. Therefore, the authorizing signature on the RFC form indicated to the University Comptroller's Office that the disbursement was in accordance with

the University's policies and procedures. Because of this decentralized control, only a minimum level of supporting documentation was required from the Public Events Department by the Comptroller's Office to process an RFC form. The Comptroller's Office relied on the signature on the RFC form as authorization for processing and did not always require sufficient documentation to determine the propriety of the expenditure.

- c. The Comptroller's Office Policy and Procedure Manual, Number 1-10.1, required that all checks for more than \$10,000 be manually signed by a second authorized signer; and for checks of \$50,000 or more, the second check signer must have initialed the RFC form or invoice to indicate that the supporting documentation was reviewed and that all amounts agreed. However, the Policy and Procedure Manual did not specify what the review should entail. A designated Comptroller's Office employee acted as the second authorized signer, but the Comptroller's Office employee was not required to determine if the expenditure was proper.

As a result of the weaknesses in the University's internal control structure cited above, the Comptroller's Office processed the 21 illegal payments made to MTA during the period September 1989 through April 1991, without adequate supporting documentation to determine the propriety of the expenditure.

In addition, for one of the 21 checks of more than \$10,000, only one signature had been obtained, and for five of 18 checks of \$50,000 or more, there was no indication that the supporting documentation had been reviewed by the second signer.

2. An independent review, outside the Department, of the financial statements to note and investigate unusual or unexpected line items, ending balances, or variances was not required.

There was no documentation to indicate that the Public Events Department's financial statements for this period were reviewed by an employee outside the Public Events Department.

3. The University did not have formal procedures regarding the processing of emergency checks.

The Public Events Department requested emergency checks for 17 of the 21 payments made to MTA during the period September 1989 through April 1991.

Recommendations

The University should revise its internal control structure policies and procedures to the extent necessary so that its public funds are adequately safeguarded from misuse or misappropriation. Specifically, the controls over disbursements made using an RFC form should require that the Comptroller's Office evaluate the supporting documentation for adequacy and propriety commensurate with the amount and purpose of the disbursement. Also, the Policy and Procedure Manual should require that for RFC's, large dollar disbursements be approved, not just reviewed, by an authorized check signer in the Comptroller's Office. Of course the Comptroller's Office must be empowered with the authority to execute these controls, and specific investigative follow-up procedures should be adopted for disbursements rejected by the Comptroller's Office.

In addition, the University should implement stronger monitoring controls to mitigate the inherent weaknesses in a decentralized internal control structure. This should include written policies requiring that system-generated reports be reviewed by a knowledgeable employee outside the college or department. Furthermore, specific criteria for monitoring the reports and reviewing the financial statements should be developed for each area, and the results of such follow up should be adequately documented and reviewed by management.

In addition, the University should adopt formal written policies and procedures to more effectively control and limit the issuance of emergency checks.

University Reported Internal Control Structure Policy and Procedure Changes Subsequent to June 1991

The weaknesses we noted in the University's internal control structure described above existed prior to June 1991. The University indicated that since June 1991, it has adopted or changed certain internal control structure policies and procedures to help prevent any further misappropriations of public monies. We have not, however, verified these changes. The following policy changes specifically relate to the operations of the Public Events Department.

- Advances in excess of actual ticket sales are now prohibited, and ticket sales reports must accompany all advance requests.
- The Public Events Department is required to perform a complete reconciliation of the ticketing system to the deferred income general ledger balance biannually, and the Comptroller's Office is required to review this reconciliation.
- The Public Events Department may not amend contracts signed by the Vice President of the University Relations Office without the approval of the Vice President.

- All payments made before a contract is signed must be accompanied by a confirmation letter from the payee outlining the terms of agreement relating to the payment.
- The University is reinstating the position of the Public Events Department Business Manager, which had been eliminated in February 1991. The new Business Manager is to report to both the Director of Public Events and the Director of Financial Operations of University Relations.

In addition to these policy changes in the Public Events Department, the University indicated that it has adopted the following policies that affect all University activities.

- A Director of Financial Operations has been appointed to oversee all University Relations activities. The Director of Financial Operations is responsible for financial oversight of University Relations departments, including Public Events, from budgeting to final financial reporting. Also, financial reports generated specifically for each department are reviewed monthly for unusual activity or trends. All other Vice President's Offices have a similar position.
- The former title of the balance sheet account "prepaid artists' fees" has been changed to "deferred artists' fees", to avoid any misconception that artists' fees are paid prior to an event.
- The University has established an internal audit unit to supplement the Board of Regents' internal auditors. The purpose of this internal audit unit is to strengthen the University's internal control structure, especially at the departmental level.
- The University has adopted a policy of providing guidance to the business office personnel in each college or department when questions arise involving a specific transaction. The new University policy instructs the business office personnel to contact the appropriate person within the Comptroller's Office or the Office of the Vice President for Administrative Services about any concerns that they might have.
- Emergency checks now require a written memorandum as to why an emergency check is required.