



VIRGINIA STATE UNIVERSITY

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2015

Auditor of Public Accounts
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AUDIT SUMMARY

We have audited the basic financial statements of Virginia State University as of and for the year ended June 30, 2015, and issued our report thereon, dated February 24, 2016. Our report, including in the University's Financial Statements, is available at the Auditor of Public Accounts' website at www.apa.virginia.gov and at the University's website at www.vsu.edu.

Our audit of Virginia State University for the year ended June 30, 2015, found:

- the financial statements are presented fairly, in all material respects;
- internal control findings requiring management's attention; however, we do not consider them to be material weaknesses; and
- instances of noncompliance or other matters required to be reported under Government Auditing Standards.

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Financial Management over Auxiliary Enterprises *(Partial Repeat)*

Last year we recommended the University improve its financial management processes that support decision-making and highlighted concerns that focused primarily on auxiliary enterprises. Since that time, the University has improved how it budgets its auxiliary room and board so that its estimates more accurately reflect actual trends. To further improve, we recommend more in-depth analyses over auxiliary enterprises since some have financial deficits, or are projected to have deficits, and will rely on the positive cash positions of other auxiliary enterprises to operate in the near term. Improving the accuracy and nature of its financial analyses will allow both Management and the Board of Visitors to understand projected cash positions over time, enabling them to have the foresight to make informed choices. Some demands on auxiliary enterprise include:

1. Both room and board have experienced on-going budget reductions for several years. Also, room has a financial deficit from a prior year and relies on the positive cash positions of other auxiliary enterprises to cover the deficit. The University analyzed room and board estimates to support its 2016 budget and a meal plan contract renegotiation, but we found the analyses contained material errors. The University could improve its process by carefully reviewing analyses for accuracy and improve its decision making by projecting the financial outcomes under various scenarios. Making informed choices are important because the University's residence halls have large annual debt service requirements that require cash and must be self-supporting, meaning the University cannot use tuition payments or state appropriations to cover their debt service or operations.
2. The new Multi-Purpose Center is projected to operate in a deficit for at least the first three years of its operation. Last year we recommended the University analyze the sources of support for operating the Center to understand if actions are needed to offset the deficits; however, no detailed analysis from that perspective has been performed.

In addition, the Athletics auxiliary enterprise will pay increased expenses related to new office space they will occupy in the Center. No analysis has been performed to evaluate how long the Athletics auxiliary enterprises' small positive cash position can sustain these increased costs if athletic ticket sales do not generate additional revenue to the extent projected.

3. During the year, the University updated the condition assessment of its auxiliary buildings in response to our prior audit recommendation. They did not, however, prepare an adequate analysis of the amount of cash they should ideally hold in reserve to pay for future maintenance expenses, or analyze the annual contribution necessary to accumulate that reserve of cash in the future and present the analysis to the Board of Visitors. A reserve helps ensure that cash will be available to pay for future maintenance work, such as major roof or heating system replacements, for auxiliary buildings that must be self-supporting from auxiliary revenues.

The University should perform accurate analyses to share with the Board of Visitors. These analyses should show the current state of auxiliary enterprises, assumptions used for projections into the future, and their sustainability over the next few years under best, worst, and most likely case scenarios. Having these analyses will allow the University and Board to understand the amount of time at play before operational deficits deplete the positive cash positions, will promote an effective program to continually monitor progress, and will provide a basis with which to plan for other actions, such as raising cash from private gifts or additional cost cutting measures. These analyses should include and evaluate all components of auxiliary enterprises, rather than analyzing each enterprise as an individual silo, to enable Management to have a more comprehensive understanding of the competing demands. Further, although the University may choose to delay its funding of the residential maintenance reserve until financial conditions improve, it is still important that Management and the Board have knowledge of the underfunded amount, understand the risk involved in not funding it properly, and remain mindful of the need to set aside cash for these reserves as auxiliary enterprises become profitable.

In addition, Management should develop a prioritized plan of initiatives they will implement when auxiliary enterprise operations improve and share that plan with the Board of Visitors. Having a prioritized plan will ensure that any excess revenue is directed to the most important initiatives, such as repaying cash borrowed between auxiliary enterprises, offsetting the Multi-Purpose Center deficits, or placing cash in maintenance reserves to pay for future repairs or emergencies.

Continue Improving Oversight over Third-Party Service Providers *(Partial Repeat)*

In our previous year's audit, we issued the recommendation "*Improve IT Procurement Process*," which included updating current third-party outsourcing agreements with a requirement for the vendor to follow the Commonwealth's Information Security Standard, SEC 501-09 (Security Standard). Our finding also recommended that the University require, request, and evaluate independent audit reports to ensure the third-party's compliance with the Security Standard.

Despite the University having updated one of its third-party agreements for a mission critical and sensitive system, the agreement continues to omit a requirement to follow the Security Standard. Additionally, the University does not document the outcome of its evaluation of any independent audit reports of third-parties' compliance with the Security Standard. This undocumented process has resulted in the University not requesting or evaluating audit reports from certain service providers or sub-service organizations.

We identified eight weaknesses related to oversight of third-party service providers and sub-service organizations, which were communicated to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia due to the sensitivity of the descriptions.

The University's lack of a structured and documented review process prohibits the University from adequately maintaining oversight over its service providers and related sub-service organizations. The University's oversight responsibility is additionally impaired by not proactively and timely seeking the appropriate assurances from its service providers and sub-service organizations that its sensitive data is protected.

The University should develop a process for identifying service providers, including applicable sub-service organizations, and implement procedures for gaining appropriate assurance over all outsourced operations that impact the University's IT environment and sensitive data. The University should then review and revise each contract or statement of work to clearly delineate the processes, procedures, and controls assigned to each party, as well as require security controls to meet or exceed requirements outlined in the Security Standard. Finally, the University should develop and implement policies and procedures for reviewing and documenting evaluations of independent audit reports or other forms of assurance reports to ensure that the third-parties' security controls comply with the requirements described in the Security Standard. To maintain consistency and continuity, the University should develop and implement procedures for documenting final decisions and action items that come as a result of the independent audit report evaluation process.

Continue Addressing Weaknesses from Information Security Audits

The University continues to address the information security weaknesses found during scheduled fiscal year 2015 security audits over three IT systems. The University classifies these IT systems as sensitive because it is rating the data that the University stores in these IT systems as high in one or more of the following categories: confidentiality, integrity and availability.

The security audits reviewed the IT systems for compliance with the Commonwealth's Information Security Standard, SEC 501-08 (Security Standard), which was the current version at the time of the review. The review found that each system does not comply with 92 percent of applicable information system security controls. These weaknesses resulted in 13 findings. The University's management concurs with the findings and are working to address the weaknesses in accordance with the most current version of the Security Standard.

As of October 27, 2015, the University indicated that they have completed addressing four findings, extended the due date for five findings, and are working within the original time-line to address four findings. The University states that all findings will be corrected by October 31, 2016.

The University should continue to dedicate the necessary resources to ensure timely completion of its corrective action plan and becoming compliant with the Security Standard. The University should also share all future security audits with the Board of Visitors and provide periodic updates regarding the status of the University's corrective action plan.

Improve Risk Management and IT Security Audit Plan Documents

The University's risk management documentation is incomplete and inconsistent and the University's IT Security Audit Plan does not include all sensitive systems. Additionally, the University does not ensure that audits performed by external auditors are in accordance with either Generally Accepted Government Auditing Standards (GAGAS) "Yellow Book" or the Institute of Internal Auditors' Standards (IIA) "Red Book."

Specifically, the University omitted three sensitive IT systems in its IT Security Audit Plan. The Commonwealth's Information Security Audit Standard, SEC 502-02.2 (Audit Standard), Section 1.4, requires agencies to include all sensitive IT systems in its IT Security Audit Plan.

The University also did not include and evaluate one of these sensitive IT systems in its risk management documentation. The Commonwealth's Information Security Standard, SEC 501-09 (Security Standard), Sections 3.2 and 6, requires agencies to substantiate the reasoning behind classifying an IT system as sensitive. This process includes identifying the systems that support critical business processes (Business Impact Analysis, or BIA) and evaluating the risks impacting the types of data that is processed by the IT system (Risk Assessment, or RA).

Additionally, the University relied on one external report to fulfill its sensitive IT system audit requirement; however, this report was not performed in accordance with the auditing standards accepted by the Commonwealth. Two other external audit reports did not state an attestation that the audit was performed in accordance with the auditing standards accepted by the Commonwealth. However, during our review, the external auditor revised their report to include the appropriate attestation. The Audit Standard, Sections 1.4 and 2.5.4, requires that sensitive IT System audits follow either GAGAS or IIA and includes an audit standard attestation, respectively.

The University is increasing the risk for system vulnerabilities and threats to go undetected and not be remediated by not including all sensitive IT systems in its IT Security Audit Plan and Risk Management documentation.

The inconsistencies identified in the IT Security Audit Plan occurred because the University does not have up-to-date Risk Management documentation and does not ensure that the IT Security Audit Plan includes all sensitive IT systems.

The University should evaluate and update the BIA and Sensitivity Classifications to identify and classify all IT systems for mission criticality and sensitivity. Additionally, the University should use the information gathered from the BIA and Sensitivity Classifications to conduct an RA for each sensitive IT system. Furthermore, the University should use the information gathered from the BIA and RA to ensure that the IT Security Audit Plan includes all sensitive systems. Lastly, the University should ensure that all IT security audits performed are in accordance with the GAGAS Yellow Book or IIA Red Book standards and attested in the final audit reports.

Improve Policies, Procedures, and Physical Documentation over Inventory

The University performed a capital asset physical inventory between fiscal year 2014 and fiscal year 2015 and we found the following areas that need improvement:

- 21 out of 21 (100 percent) sampled assets identified as surplus in the physical inventory master list did not have surplus property form documentation from the responsible department;
- 9 out of 13 (69 percent) sampled disposed capital assets did not have surplus property disposal form documentation from the responsible department;
- 3 out of 25 (12 percent) sampled located capital assets were not updated as inventoried in the Fixed Asset Accounting System (FAACS); and
- Several inventoried department sheets did not document the individual who performed the inventory, or the date the physical inventory was conducted.

The Commonwealth Accounting Policies and Procedures Manual (CAPP Manual) contains procedures and requirements over physical inventory, surplus property management, and disposal management. These requirements include changing the master file record when an assets status changes and notifying proper individuals when an asset is surplus or disposed. Although the University's surplus property disposal policy is consistent with the CAPP Manual, departments did not consistently follow the policy by submitting a surplus property form to Administrative Support Services.

The University should improve controls and communication with departments to ensure they are following policies and procedures related to surplus and disposal of assets. The University's Fixed Asset Department should improve documentation to show who performed the inventory, and the date each department's physical inventory was conducted. In addition, the University's Fixed Asset Department should update FAACS with any missed assets from the previous inventory, and the inventoried date information to assist with identifying when to perform the next inventory.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

February 24, 2016

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
Vice-Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Virginia State University

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, the financial statements of the business-type activities and aggregate discretely presented component units of **Virginia State University** as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the University's basic financial statements and have issued our report thereon dated February 24, 2016. Our report includes a reference to other auditors. We did not consider internal controls over financial reporting or test compliance with certain provisions of laws, regulations, contracts, and grant agreements for the financial statements of the component units of the University, which were audited by other auditors in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. We did identify certain deficiencies in internal control over financial reporting entitled "Improve Financial Management over Auxiliary Enterprises," "Continue Improving Oversight over Third-Party Service Providers," "Continue Addressing Weaknesses from Information Security Audits," "Improve Risk Management and IT Security Audit Plan Documents," and "Improve Policies, Procedures, and Physical Documentation over Inventory," which are described in the section titled "Internal Control and Compliance Findings and Recommendations," that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the section titled "Internal Control and Compliance Findings and Recommendations" in the findings entitled "Continue Improving Oversight over Third-Party Service Providers," "Continue Addressing Weaknesses from Information Security Audits," "Improve Risk Management and IT Security Audit Plan Documents" and "Improve Policies, Procedures, and Physical Documentation over Inventory."

The University's Response to Findings

We discussed this report with management at an exit conference held on February 29, 2016. The University's response to the findings identified in our audit is described in the accompanying section titled "University Response." The University's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Status of Prior Findings

The University has not taken adequate corrective action with respect certain aspects of previously reported findings entitled “Improve Financial Management” and “Improve IT Procurement Process” included within this year’s findings entitled “Improve Financial Management over Auxiliary Enterprises” and “Continue Improving Oversight over Third-Party Service Providers.” Accordingly, we included these findings in the section entitled “Internal Control and Compliance Findings and Recommendations.” The University has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Audit Standards in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

AUDITOR OF PUBLIC ACCOUNTS

KKH/alh



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Kevin W. Davenport
Vice President for Administration and
Chief Financial Officer

February 29, 2016

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Ms. Martha Mavredes
Auditor of Public Accounts
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Richmond, Virginia 23218-11295

Dear Ms. Mavredes:

Virginia State University (VSU) has reviewed the Financial Internal Control and Compliance Findings and Recommendations provided by the Auditor of Public Accounts for the year ended June 30, 2015. The University acknowledges and is in agreement, in principle, with the following findings and recommendations:

Improve Financial Management over Auxiliary Enterprises (Partial Repeat)

Management will perform an in-depth analysis of its' auxiliary enterprises to include projected cash balances for room and board, the new Multi-purpose Center, athletics and auxiliary maintenance reserves. The analysis will show the sustainability of auxiliary enterprises over the next few years under best, worst, and most likely case scenarios. The analysis will also include a prioritized plan of initiatives. Management will present the analysis to the Board of Visitors in March 2016.

Continue Improving Oversight over third-Party Service Providers (Partial Repeat)

On February 21, 2016, the Commonwealth's IT Security & Risk Office released and posted a proposed Hosted Environment Information Security Standard (SEC525-01) for review and comment by state agencies and higher education institutions. The review period expired on February 21, 2016. Once this standard is finalized and published, the University will develop a process for certifying the effectiveness of internal and security controls surrounding its application hosting services and environments, as well as, clear delineation of processes, procedures, and controls assigned to each party of the agreement. The University will ensure that contracts for external IT service providers are required to provide a Service Organization Control (SOC 2), Type II report.

Continue Addressing Weaknesses from Information Security Audits

The University has recently hired a Chief Information Security Officer. We will hire dedicated IT Security personnel to support the IT Security Program and satisfy all the requirements in the Commonwealth's IT Security Standards (SEC 501-09).

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An Equal Opportunity Employer/Equal Access Institution*

Improve Risk Management and IT Security Audit Plan Documents

The University has successfully performed its annual review of the Business Impact Analysis (BIA) reports which is used as a primary input document into the Sensitivity Classification of IT systems, Risk Assessments (RA), IT Contingency Operating Plan (COOP), IT Security Audit Plan, and Disaster Recovery Plan (DRP). These documents are reviewed and updated in accordance with the Commonwealth's IT Security Standard (SEC 501-09) and IT Security Audit Standard (SEC 502-02.2). VSU will continue to ensure IT Security Audits are conducted in accordance with either the auditing standards of the Institute of Internal Audit (IIA) or the Generally Acceptable Government Auditing Standards (GAGAS).

Improve Policies, Procedures, and Physical Documentation over Inventory

Management will improve its documentation over inventory by ensuring surplus capital assets have the proper documentation and inventoried department sheets show who performed the inventory and the date each department's physical inventory was conducted. Management will update FAACS with any missed assets from the previous inventory and include the inventoried date information. Additionally, management recently engaged a firm to assist it in improving inventory controls and communications to departments.

The University would like to express our sincere appreciation for accommodating our request to meet the compressed financial audit timeline. On behalf of the administration and staff at Virginia State University, please extend my gratitude to your staff for their commitment and professionalism.

Sincerely,



Kevin Davenport
Vice President for Administration
and Chief Financial Officer

cc: Dr. Makola M. Abdullah, President
The Honorable Anne Holton, Secretary of Education
Mr. David Von Moll, State Comptroller
Mr. Daniel Timberlake, Director of Planning and Budgeting

VIRGINIA STATE UNIVERSITY

Petersburg, Virginia

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