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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
University of the District of Columbia
Washington, D.C. 20008

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 basic financial statements of the University of the District of Columbia (the University), a component unit of the Government of the District of Columbia, which comprise the statement of net position as of September 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, and have issued our report thereon dated February 3, 2015.

Internal Control over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 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. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2014-01, 2014-02, 2014-03, and 2014-04 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's basic financial statements are free from 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 an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as item 2014-03.

The University's Response to Findings

The University's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. The University's response was not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on the response.

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 University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

February 3, 2015

Schedule of Findings and Responses

2014-01 Lack of Controls over the Implementation of the Banner System

During fiscal year 2011, the University implemented a new financial system, Banner. While improvements were made over general information technology controls related to Banner, we noted the following weaknesses continued to exist during our fiscal year (FY) 2014 audit:

Banner (and Supporting Infrastructure) Generic Accounts

During our FY 2013 audit, it was determined that generic accounts with update or greater access within the environment did not have controls in place to either (a) log and monitor the activities taken under these accounts or (b) rotate the passwords on a periodic basis. Additionally, 13 accounts at the database/application layer and four at the operating system layer were no longer required to be active within the environment.

During our FY 2014 audit, we noted that on September 15, 2014 access was revoked to all but one of the accounts noted as exceptions in FY 2013. Additionally, on August 1, 2014, a policy entitled the *Application System Account Password Change Policy* was implemented to require a semi-annual rotation of the passwords to generic/system accounts for which password expiration could not be enforced. However, as operating system accounts were not in-scope for this policy, passwords were not rotated consistently for the generic/system accounts at this layer. As a result, this deficiency was not fully remediated as of the end of FY 2014.

Segregation of Duties – Banner Developers

During our FY 2012 audit, it was determined the two University developers served as the primary system administrators for the UDC production database supporting the Banner application. Management implemented a procedure requiring that the individual responsible for developing the change not to be the same individual responsible for migrating the change into production. However, the two developers retained access to migrate changes to production through administrative privileges on both the operating system and database supporting the Banner application. As a result, these developers were able to circumvent this procedure without detective controls to identify if such instances were to occur.

During our FY 2014 audit, per inquiry of management, we noted that the extent of in-house development was minimal as the majority of changes applied to the application were provided as patches by the Banner vendor, SunGard. However, the combination of responsibilities and levels of access to the Banner environment held by these two individuals remained the same, and as such, the deficiency was not remediated as of the end of FY 2014.

Banner Application Periodic Access Review

During our FY 2013 audit, we noted that the periodic review of access process for Banner was not performed timely for certain Banner systems. One department completed the first review five months after the start of the process. The review was never completed for all other departments.

During our FY 2014 audit, we noted that a revised procedure document was implemented to require that an annual periodic review of access be performed. This review was completed in September 2014. However, upon reviewing the documentation in support of this review, it was determined that there were a significant number of changes requested as part of the review. Based on the volume of changes identified, an annual review cycle was determined to be insufficient to address the risk that access is commensurate with job responsibilities, whether due to changes in responsibilities or misconfigurations of access.

Criteria

As part of our financial statement audit methodology, we executed tests of General Information Technology (GITC) controls in the areas of access to programs and data, program changes, program development, and computer operations. Our internal framework for identifying and testing GITCs can be mapped to several commonly accepted information technology risk and control frameworks including those published by the National Institute of Standards and Technology (NIST), Information Systems Audit and Control Association (ISACA), and the International Standards Organization (ISO). For purposes of our reporting of findings for the University, we have provided relevant criteria below.

- NIST Special Publication (SP) 800-53, Revision 3, Recommended Security Controls for Federal Information Systems and Organizations, August 2009, section Access Control (AC-2)
- NIST SP 800-53, Revision 3, Recommended Security Controls for Federal Information Systems and Organizations, August 2009, section Access Control (AC-5)
- NIST SP 800-12, Revision 3, An Introduction to Computer Security: The NIST Handbook, October 1995

Cause

Banner (and Supporting Infrastructure) Generic Accounts

Until September 2014, management's periodic access review did not include an evaluation of the necessity of active generic accounts managed by IT. As a result, the accounts that were no longer required to be active were not disabled.

Additionally, due to lack of policy requirements to require password rotation for accounts at the operating system layer supporting Banner, rotation for the accounts noted in the condition did not occur during FY 2014.

Segregation of Duties – Banner Developers

Management has implemented a process to procedurally segregate the responsibilities for development and implementation into production for changes made to the database supporting the Banner application. However, due to resource constraints, management has not allocated the resources required to develop and implement change management controls that fully mitigate the risks associated with the condition including, but not limited to, the segregation of program development roles from production system administration roles among different individuals.

Banner Application Periodic Access Review

Due to resource constraints and management's perception of the risk, management did not prioritize resources to perform a more effective periodic review of access. Additionally, the volume of changes requested as part of the review indicates potential flaws in the processes to revoke access from individuals at the time of termination or transfer.

Effect

Without the existence of proper controls to either restrict access to the passwords of generic accounts (including password rotation) or to log, approve, and monitor the activities under these accounts, the risk is increased that changes to application programs and data in the production environment may be applied in a manner that has an adverse impact on the availability or processing/data integrity of the application without management's awareness or approval.

The lack of segregation of program development roles from production system administration roles increases the risk of changes to application programs and data and the configuration of the underlying database.

Lastly, by not performing a review of user accounts on a regular basis, the risk exists that:

- Employees may have access to the system that does not correspond with their current job responsibilities and/or may present a conflict of interest. This access could allow a person to advertently or inadvertently use various functions to alter the integrity of application data in an unauthorized manner.
- A separated person (or another person with knowledge of this active user account) with an active user account present within the application, may be able to use this account to alter the integrity of application data in an unauthorized manner.

Recommendation

We recommend that management implement the following actions:

Banner (and Supporting Infrastructure) Generic Accounts

- Ensure that the periodic review of access is performed in a consistent and timely manner to ensure that the access of generic/system accounts is revoked when no longer required.
- Apply the Application System Account Password Change Policy, which requires semi-annual rotation of passwords, to accounts with administrative access at the operating system level supporting the Banner system.

Segregation of Duties – Banner Developers

- Develop and implement one or more of the following activities into existing change management processes and controls:
  - Logical segregation of program development roles from production system administration roles among different individuals; or,
  - Implementation of monitoring controls over the activities of the developers (and other individuals) with administrative access. The monitoring should be performed by an individual without production database administrative access and based on a system-generated listing of changes applied to the Banner application. Documentation of these monitoring controls should be maintained and include a signature approval of the review as well as notations of the appropriateness of the actions taken by the developers within the database. Further, any suspicious activity, such as modifications to functionality or data without corresponding change request approvals, should be researched and include a documented resolution, as necessary.
- Provide and discuss procedures with control performers. Monitor control performer adherence to the procedure on a periodic basis.

Banner Application Periodic Access Review

- Establish a quarterly or semi-annual process to review access rights that are deemed critical by management to ensure that inappropriate access is detected and remediated in a timely manner.
- Monitor to ensure that controls for revoking access from individuals that separate from the entity or transfer to other job functions are designed and operating effectively.

View of Responsible Officials

Management concurs with this finding.

2014-02 Lack of Controls over the Financial Reporting Process

During our audit, we noted that the University did not have adequate and effective internal controls in place and operating effectively over the financial reporting process as follows:

Untimely Cash Reconciliation

During our testwork over the University's bank reconciliation, we noted that the reconciliation was not performed during the period of November 2013 through March 2014. The control is designed to be performed on a monthly basis.

Lack of Documented Standard Operating Procedures

The University does not have documented standard operating procedures (SOPs) in support of its operations, organization and controls. Lack of documented SOPs has resulted in changes in accounting methodologies, a lack of adherence to prudent internal control procedures, and numerous reversals of accounting transactions during FY 2014.

Lack of Controls over Grants

The University receives various reimbursement basis grants. As such, the University records a receivable and corresponding revenue once expenditures related to a grant are incurred. The grantor will not provide reimbursement for expenditures in excess of the grant award amount. During our audit, we noted that in the prior year, the University erroneously recorded receivables and corresponding revenue for one transaction in excess of the grant award amount by $537,898. In order to remove the erroneous receivable balance, the University recorded bad debt expense in the current year to write off the uncollectible balance.

Alternative Investment Valuation

During our audit of the University's investment balances as of September 30, 2014, we noted that investments in certain limited partnerships, as confirmed by the investment manager, was $271,564 greater than the investment balance recorded in the general ledger. The monthly investment statements from the fund manager report the fair market value of limited partnership investments on a one month lag. As the University's general ledger balance is based on the September 2014 investment statements, the amount recorded in the general ledger reports the fair market value of the investments as of August 31, 2014, as opposed to the September 30, 2014 balance. The September 30, 2014 balance was available at the time the financial statements were prepared.

Inadequate Preparation and Review of Manual Journal Entries

During testwork in various process areas, we noted inadequate preparation and review of manual journal entries, as follows:

- During testwork over tuition revenue, we noted an incorrect manual journal entry reversal of the September 30, 2013 deferred revenue entry, resulting in $2,437,585 being incorrectly recognized in an incorrect general ledger account. As these accounts are included in the same financial statement line item, there is no financial statement impact.

- During testwork over grant expenses, we noted that for one of 68 expenses tested, management incorrectly recorded various expenses (telecommunication supplies, vehicle lease and rental, etc.) of $2,761 as contractual services. As these accounts are included in the same financial statement line item, there is no financial statement impact.

- During testwork over other operating revenue, we noted:

  - For one of five entries tested, the University identified $779,781 of unrealized gains which should have been recorded in the prior period. The University created a journal entry to record $779,781 in investments and other operating revenue. This resulted in an overstatement of other operating revenue of $779,781.

  - For two of five entries tested, totaling $496,293, the entries recognized revenue related to the write-off of unearned revenue for grants that had expired in the prior period. Management could not provide evidence that the unused funds associated with the awards are not required to be returned to the respective grantor. This resulted in an overstatement of revenue of $496,293.

  - For two of five entries tested, totaling $301,800, the entries recognized revenue related to the write-off of a credit balance for grant receivables for grants that expired in a prior period. Management could not provide evidence that the unused funds associated with the awards are not required to be returned to the respective grantor. This resulted in an overstatement of revenue of $301,800.

- During testwork over manual journal entries, we noted the following:

  - For two of 40 entries tested, we noted the approver of the entry was not an authorized journal entry approver.

  - For one of 40 entries tested, we noted management improperly recorded grant revenue related to an expired grant in the amount of $1,365. Additionally, management improperly transferred $35,369 from other operating revenue to capital appropriations revenue. This resulted in other operating revenue being understated by $34,004, grant revenue being understated by $1,365, and capital appropriations being overstated by $35,369.

  - For one of 40 entries tested, we noted management improperly wrote-off a grant receivable account with a credit balance, totaling $22,537, related to prior year grants within other operating revenue. This resulted in other operating revenue being overstated by $22,537.

  - For one of 40 entries tested, we noted FY 2014 actual payroll payments were $83,760 less than the accrual at September 30, 2013. Management improperly recognized $83,760 of revenue related to the difference in other operating revenue in FY 2014. This resulted in other operating revenue being overstated by $83,760.

  - For one of 40 entries tested, management incorrectly recorded payroll expenses of $4,354 and $399 in the general ledger. As all of the involved accounts are aligned to the same financial statement caption, there was no financial statement impact.

- During our testwork over the cash balances as of September 30, 2014, we noted the following:

  - Per our review of the September 30, 2014 cash reconciliation we noted that the University included two deposits in transit totaling $6,668,794 within the reconciliation to calculate the ending book balance per the system. However, we noted $2,729,389 was deposited in October 2014 and $3,939,405 was deposited in November 2014. These funds were incorrectly included in cash as a result of two erroneous entries for the recording of capital appropriation receipts from the District, which had not been received. As such, these funds should not be considered a deposit in transit and should not be reported in the cash balance

per the general ledger. This resulted in the capital appropriations revenue account and the cash account being overstated by $6,668,794.

- Per our review of the September 30, 2014 cash reconciliation, we noted that the University incorrectly recorded $631,634 within the investment account which should have been recorded as cash of $624,305 and accrued interest receivable of $7,329. This resulted in the investments being overstated by $631,634, cash being understated by $624,305 and accrued interest receivable being understated by $7,329.

Expenses Recorded in Incorrect Period

During our testwork over accounts payable, we selected 23 disbursements between October 1, 2014 and January 14, 2015 and noted the following:

- For one of the 23 samples tested, the expense was incurred during FY 2014 and paid in FY 2015. There was no accrual for the liability as of September 30, 2014. Accounts payable and operating expenses were understated by $336,132 in FY 2014.

- For one of the 23 samples tested, the expense related to equipment partially received in FY 2014 and partially received in FY 2015. Accounts payable and operating expenses were understated by $714,394 in FY 2014.

During our testwork over operating expenses, we noted the following:

- For one of the 48 samples tested, services were incurred partially in FY 2014 and partially in FY 2015. The entire amount was paid and expensed in FY 2014. Operating expenses were overstated and prepaid expenses were understated by $107,759 in FY 2014.

- For one of the 48 samples tested, services were incurred in FY 2013, but were expensed in FY 2014. There was no accrual for the liability as of September 30, 2013. Operating expenses were overstated in FY 2014 by $25,000.

Inaccurate Reporting of Cash Flows and Net Position

During our testwork over the Statement of Cash Flows, we noted approximately $5m of noncash related items requiring adjustment in order to fairly present the University's cash flows.

During our testwork over the presentation of net position within the Statement of Net Position, we noted a portion of net position, totaling $16,323,901, was incorrectly reported as restricted expendable endowments. Specifically, per inquiry of management, this amount represented earnings on the permanently restricted endowments. The amount of such earnings was unsupported as earnings on the University's investments are pooled into one account and it is not possible to discern which earnings are attributable to the permanently restricted endowments. In addition, while the University was able to provide supporting documentation that that the earnings on the University's permanent endowment of $7,568,086 are restricted for agricultural and mechanical arts programs and, therefore, should flow through restricted expendable endowments, it is the University's policy to spend restricted funds prior to spending unrestricted funds if the criterion for the restriction is met. As University operates both agricultural and mechanical arts programs throughout the year, at year-end, any earnings on the permanent endowment would have been effectively spent on these programs. Management was unable to provide sufficient evidence to support why the earnings were still restricted at year-end and an adjustment was made by the University to move the unsupported amount of $16,323,901 to unrestricted net position.

Inadequate Controls over Grant Expenses

For ten of 18 grants tested during our grant expense testwork, with total grant awards of $8,172,916, an Office of Sponsoring Programs (OSP) proposal routing form could not be provided. The routing form is required to be signed by the Director of OSP in order to signify all requirements per the grant terms have been identified and any local matching funds have been approved by the Budget Office. The approval is required prior to the submission of the grant application in order to verify the University is cognizant of all regulatory requirements.

Criteria

In order to ensure financial information is useful in decision making and evaluating managerial and organizational performance, as well as demonstrating accountability and stewardship, controls must be properly designed, in place, and operating effectively to ensure that the University's accounting and financial information is fairly stated in accordance with GAAP.

As part of that requirement, there should be adequate controls in place over the processing of transactions recorded in the general ledger to prevent/detect a misstatement. Management is required to ensure amounts included in their general ledger represent valid and true transactions arising from the University's operations.

Cause

Adequate controls, policies and procedures are not in place to ensure amounts in the University's financial statements are complete and accurate.

Effect

Material financial statement misstatements could go undetected.

Recommendation

We recommend that management establish and implement policies and procedures to ensure that amounts reported in the University's financial statements are complete, accurate and represent actual and valid transactions arising from the University's operations.

View of Responsible Officials

Untimely Cash Reconciliation

Management concurs with this finding.

All bank accounts are now reconciled on a monthly basis. This account holds a certificate of deposit for $100,000 and the only activity during the year is the interest earned on the $100,000. The failure to reconcile this account occurred due to staff vacancies during the period of November 2013 to March 2014.

Lack of Documented Standard Operating Procedures

Management concurs with this finding.

Management agrees that there were two changes in accounting methodology. However, both changes were done to facilitate more accurate accounting and fully comply with GAAP.

Approximately one year ago, a new financial management team was assigned to UDC. During FY 2014 the management team reviewed several accounting policies with the intent to improve compliance with GAAP. The two changes in accounting methodology during FY 2014 were

related to the write-off of student receivables and accrual of contingent legal liabilities. The change in accounting methodology for the write-off of student receivables was based on an analysis of historical collection trends. This has resulted in more accurate recognition of uncollectable receivables and, fully complies with GAAP. Similarly, the change in methodology in accounting for contingent legal liabilities fully complies with GAAP.

The process of documenting policies and procedures is in progress and will be completed by the end of FY 2015.

Lack of Controls over Grants

Management concurs with this finding.

As indicated in the finding, the recording of grant expenses in excess of the award occurred in the prior year and had to be corrected in the current year. Beginning in FY 2014, drawdowns were reconciled to the approved awards to ensure that the cumulative drawdowns for each grant do not exceed the award amount.

Alternative Investment Valuation

Management does not concur with this finding.

The investments referenced are reported under the category of "equities", not "alternative investments" on Barclays' statements. Additionally, the District's Treasurer has consistently maintained that these investments are equities. Equity balances as reported on the September 30, 2014 statements accurately reflects the balances of these investments on that date.

KPMG's Response to the Views of Responsible Officials Related to Alternative Investment Valuation

We have reviewed management's response above and note that the classification of the investments was included for informational purposes and is irrelevant to the nature of our finding. The University reported the investments as of September 30, 2014 using the market value of the investments as of August 31, 2014, causing a misstatement in the investments balance.

Inadequate Preparation and Review of Manual Journal Entries

Management concurs with this finding.

Management is in the process of documenting all policies and procedures and expects to complete this process by the end of FY 2015. Accounting staff will be provided more training on the preparation and recording of journal entries. Additionally, all journal entries are now being reviewed and approved by the Accounting Officer, Special Assistant to the CFO or CFO.

Expenses Recorded in Incorrect Period

Management concurs with this finding.

Additional training will be provided to the Accounts Payable staff on the recording of accrued liabilities.

Inaccurate Reporting of Cash Flows and Net Position

Management concurs with this finding.

Management concurs with the finding for the three items related to the Statement of Cash Flows. Although this statement preparation was consistent with how it was historically prepared, we agree that the recommended changes would result in a more accurate presentation. Documentation of policies and procedures is now in progress and will be completed by the end of FY 2015.

Inadequate Controls over Grant Expenses

Management concurs with this finding.

The finding is correct in that before June 2014 a former Principal Investigator and Dean at the Community College refused to submit proposals through her CEO, the Provost or the Office of Sponsored Programs (OSP), hence there are no Proposal Routing Forms for those proposals (a total of five of the ten referenced in the finding) submitted by that individual. Since her departure, the CCDC has been in compliance with the requirement that a Proposal Routing Form be submitted with the funding package; all other units at the University also comply with this requirement. The controls that are in place in the Offices of the Deans and their chair persons, the Office of the Provost, and the Office of Sponsored Programs ensure that all proposal submissions have a completed OSP Proposal Routing Form attached to the proposal submission package or the proposal is not submitted by the Office of Sponsored Programs to the Office of the Provost for approval for submission to the funding agency. Two of the five remaining files without Routing Forms were continuation grants that have been in the system for more than two years and should not have been the subject of this finding and relative to these two grants OSP nor University policy required Routing Sheets for continuation grants until the FY 2014, after these two grants were submitted and awards made. The three remaining Proposal Routing Forms were sent to the Office of the Chief Financial Officer in a timely fashion and these forms should not have been subject to an audit finding.

We would like to point out that the finding relative to the lack of Proposal Routing Forms for five proposals submitted by the UDC-CC occurred prior to FY 2014.

2014-03 Lack of Controls over Compliance with Investment Policy

Condition

The University had $45.1 million, including $3.7 million in cash, in its investment portfolio as of September 30, 2014. During our testwork over the University's compliance with the University of District of Columbia Investment and Spending Policy (Investment Policy), we noted the following instances of non-compliance as of September 30, 2014:

1. The University had $12.8 million, or 28%, of the total investment portfolio invested in Developed Market Equities. This is less than the required minimum 31% allocation amount for such investments per the Investment Policy. Additionally, the University had $14.9 million, or 33%, of the total investment portfolio invested in Alternative Trading Strategies. This exceeds the maximum allocation amount of 26% for such investments per the Investment Policy.

2. Within a separately managed account, The University had $2.8 million, or 13%, and $3.1 million, or 14%, of the total market value invested in individual securities. Each of these investments exceeds the Investment Policy's 10% threshold for investments in a single security of a separately managed account without CFO approval.

3. Within the equity portfolio of a separately managed account, the University had $778,000, or 22.5%, $762,000, or 22.5%, and $1.9 million, or 55%, of the total market value invested in individual

securities. Each of these investments exceeds the Investment Policy's 5% threshold for equity investments in a single security of a separately managed account without CFO approval.

4. Within the University's fixed income investment portfolio, the University had $3.4 million invested in corporate bonds, $377,000 invested in international bonds, and $551,000 invested in convertible bonds. Corporate, international, and convertible bonds are not authorized fixed income investments per the Investment Policy.

5. The University had $3.5 million, or 41%, of its fixed income portfolio invested in securities with a rating below 'BBB' from a nationally recognized rating agency. Of this amount, $1.8 million in investments were not rated. Investments in fixed income securities rated below 'BBB' from a nationally recognized rating agency are not authorized per the Investment Policy.

6. The University had $3.9 million, or 46%, of its fixed income portfolio invested in securities with a rating below 'A' from a nationally recognized rating agency. Of this amount, $1.8 million in investments were not rated. This exceeds the Investment Policy's 25% threshold for fixed income investments rated below 'A' from a nationally recognized rating agency.

7. The University had $14.9 million, or 33%, or its investment and total endowment funds invested in alternative trading strategies within a separately managed account. This exceeds the Investment Policy's 5% threshold for alternative trading strategies held with a single fund manager.

Criteria

1. The *University of District of Columbia Investment and Spending Policy*, Section VIII, states "Investment and invested funds, including endowment funds, must be allocated within the following parameters approved by the CFO with the advice of the Advisory Committee:"

	Allocation	
Asset Class	Minimum	Maximum
Cash and Short Bonds	0%	17%
Developed Government Bonds	0%	17%
Investment Grade Bonds	0%	15%
High Yield and Emerging Market Bonds	0%	20%
Developed Market Equities	31%	45%
Emerging Market Equities	5%	15%
Commodities	0%	11%
Real Estate	0%	12%
Alternative Trading Strategies	0%	26%

2. The *University of District of Columbia Investment and Spending Policy*, Section IX, states "No single investment may exceed 10% of the market value of an investment manager's portfolio on an ongoing basis unless written approval is obtained from the CFO or his designee. The 10% ruling for single investment only pertains to separately managed accounts."

3. The *University of District of Columbia Investment and Spending Policy*, Section IX.A, states "No more than 5% of the amount of the investment and endowment funds invested in equities (at market value) may be invested in any one company unless written approval is obtained from the CFO or his designee. The 5% ruling for a single company only pertains to all separately managed accounts as a whole."

4. The *University of District of Columbia Investment and Spending Policy*, Section IX.B, states "Authorized fixed income investments are: U.S. government and agency bonds and notes, including convertible bonds and notes; municipal bonds and notes; and mortgage-backed securities."

5. The *University of District of Columbia Investment and Spending Policy*, Section IX.B, states "Investment managers may purchase fixed income securities rated A-, BBB+, or BBB or the equivalent."

6. The *University of District of Columbia Investment and Spending Policy*, Section IX.B, states "No more than 25% of the total amount of the investment and endowment funds invested in fixed income securities may be invested in securities rated below A. The 25% investment rating rule pertains only to all separately managed accounts as a whole."

7. The *University of District of Columbia Investment and Spending Policy*, Section IX.D, states "No more than 5% of the total market value of the endowment may be invested with any single fund manager in the alternative asset class."

Cause

The University does not have adequate controls in place to monitor compliance with its investment policy.

Effect

Non-compliance with the Investment Policy can subject the University to unplanned financial risk, and tarnished public reputation.

Recommendation

We recommend management periodically review its investment portfolio, including the fund manager's purchase decisions, to ensure compliance with all Investment Policy requirements.

Views of Responsible Officials

1. We do not concur with the finding. We have an allocation to Developed Market Equities of 42.2%. We include in this allocation investments to two mangers; Ballie Gifford and Artisan; which are Developed Market Equity managers. We do not view the limited partnership structure as the determinant of the investment style therefore we do not include these two managers as alternative investment managers. Based on this we have an allocation to alternatives of 14.3%.

2. We do not concur with the finding. We view the allocation to Ballie Gifford and Artisan as separate mandates. They are allocations to non-US Developed Market Equities. For accounting purposes Barclays places these accounts under account number 50844. The account number does not indicate that the account is a separately managed vehicle.

3. We do not concur with the finding. We view the investments in the Greenhaven Continuous Commodity Index, the Powershares DB Commodity Index and the Vanguard FTSE Emerging Markets Index as allocations to a particular strategy via a low cost option. Index's provide this low cost option by constructing index mutual funds and exchange-traded funds (ETFs) where the portfolio mirrors the components of the index thereby providing a diversified solution.

4. We do not concur with the finding. We interpret the policy to allow investments in fixed income to consist of investments in Corporate Bonds, International Bonds, and Convertible Bonds. The Fixed Income definition under Authorized Investments provides a broad context to the category of fixed income investments. The policy states convertible bonds and notes after US Government to indicate securities in addition to US government bonds and notes. Further in the definition it states "with the exception of US Government and Agency securities" which indicates there will be investments other than US Government securities. Finally under the portfolio composition and asset allocation section of the policy we have a separate allocation category for Investment grade bonds (which can be municipal government and corporate bonds), high yield and emerging market bonds (which can be emerging market corporate bonds and emerging market high yield bonds). However, we have updated the investment policy to provide greater explanatory language on what is allowable under fixed income investments.

5. We do not concur with the finding. We have a specific allocation to high yield which is acceptable according to the asset allocation section of the investment policy. Included in the high yield allocation there will be securities that are not rated by the rating agencies. This is acceptable under a high yield strategy. However, we have updated the investment policy to provide more clarity by including in the fixed income definition the use of High Yield securities.

6. We concur with the finding. We have updated the investment policy to provide the investment manager greater flexibility in allocating assets to managers while still providing the fund the appropriate level of diversification.

7. We do not concur with the finding. We do not include Ballie Gifford and Artisan in the category of alternative investments. We include Ballie Gifford and Artisan under non-US Developed Markets Equities. We do not interpret the partnership structure to indicate an asset category of alternative investments. Therefore the *5%* alternative assets test does not apply to these investments.

KPMG's Response to the Views of Responsible Officials Related to Lack of Controls over Compliance with Investment Policy

We have reviewed management's response above and we believe that the facts in our finding are accurate (see our detailed responses below). We performed our compliance testwork in accordance with the requirements set forth in the Investment Policy in affect during FY 2014.

1. The Investment Policy defines alternative investments as 'investment other than the traditional types of investments, which include: stocks, bonds, money market funds, and/or cash'. Additionally, the Investment Policy states that 'equity investments must be readily marketable and may not include illiquid securities'.

   The Ballie Gifford and Artisan investments referred to in management's response are limited liability companies incorporated under the laws of the Cayman Islands. These funds seek to achieve their investment objective by investing all of their investable assets in master funds, which are limited partnerships also formed under the laws of the Cayman Islands having the same investment objective of the fund. We obtained the audited financial statements of the funds, which state that the funds determine the fair market value of the investments using only level two inputs. By definition, level two inputs are inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active. Accordingly, we conclude that the Ballie Gifford and Artisan investments meet the definition of an alternative investment per the University's Investment Policy.

2. For purposes of testing compliance, we considered a 'separately management account' to be the individual accounts set up by the investment manager. Barclays has nine individual investment

accounts for, and provides nine individual investment statements on a monthly basis to, the University. We note that the Investment Policy does not provide a definition for 'separately managed account', and does not mention separate mandates.

3. Although the investments identified were strategy based index funds, they exceeded the approved individual investment criteria in the Investment Policy.
4. The Investment Policy states that 'authorized fixed income investments are: US government and agency bonds and notes, including convertible bonds and notes; municipal bonds and notes; and mortgage-backed securities'. We interpret the policy to dictate that convertible bonds and notes must be for US government or agency bonds and notes. Additionally, we note that the policy does not include corporate or international bonds as authorized fixed income investments.
5. The fixed income investments with a rating below 'BBB' and investments which were not rated were those investments that we concluded were not authorized fixed income investments per the Investment Policy, We believe investment in securities with this level of credit risk should be explicitly provided for in the policy.
6. Not applicable – Management concurs with the finding.
7. See KPMG's response at number one and two above.

Based on management's responses, we understand the University revised their Investment Policy during FY 2015 to include more detailed explanations of allowable investments, and to update compliance requirements to address the observations in this letter.

2014-04 Lack of Controls over Capital Procurement

Condition

During our audit over the University's capital addition activity for FY 2014, we noted that the capital additions detail submitted for audit included certain pools of aggregated capitalized costs amounting to $3,098,382. Upon our request to allocate these costs to specific projects, the University was only able to provide detail for $1,159,605. As such, there is no support for capital additions of $1,938,777 as of September 30, 2014.

In addition, during our review of internal audit reports, we noted that the University was aware of various questionable transactions. Based on review of supporting documentation for the issues noted in the reports, we noted that controls were not in place to prevent or detect:

- Questionable transactions related to the security deposit for two motor coach buses, which resulted in an overstatement of expenses and revenue of $300,000 during FY 2014.

- Various costs which were incorrectly capitalized instead of expensed, resulting in an understatement of operating expenses and an overstatement of capital additions of $485,928.

Criteria

In order to ensure financial information is useful in decision making and evaluating managerial and organizational performance, as well as demonstrating accountability and stewardship, controls must be properly designed, in place, and operating effectively to ensure that the University's accounting and financial information is fairly stated in accordance with GAAP. As part of that requirement, there should be adequate controls in place over the processing of transactions recorded in the general ledger to prevent/detect a misstatement. Management is required to ensure amounts included in their general ledger represent valid and true transactions arising from the University's operations. Governmental Accounting Standards Board (GASB) Concepts Statement No.3 states, "Items recognized in a financial statement are intended to provide reliability representations of the effects of transactions and other events."

Specifically GASB 34, paragraph 18 states the following:

"Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees."

Cause

The University does not have procedures in place to ensure capital asset activity is allocated to specific projects.

The University does not have proper segregation of duties within the Capital Procurement Division to prevent or detect inappropriate transactions.

Effect

Capital additions were overstated and operating expenses were understated by $1,938,777 and $1,638,777, respectively in FY 2014. Additionally, revenue was overstated by $300,000 in FY 2014.

Recommendation

We recommend that management ensure the established controls, policies, and procedures related to capital asset additions are operating effectively, and verify there is proper segregation of functions within the Procurement Division.

View of Responsible Officials

Management concurs with this finding.

The University's administration and the University's CFO worked together in 2010 to develop policies and procedures for allocating all capitalized costs. These agreed upon procedures allowed for categorizing costs across multiple projects. As is the case with FY 2014 costs for both Capital Management Support and Mechanical and Electrical Systems costs totaling $1,938,777. The University's administration understands the current audit findings identify this practice to be inadequate. To address the FY 2014 findings the University's administration will work with the University's CFO to develop expanded control measures for allocating all capitalized costs to specific projects. The University considers this action sufficient to address the current finding.