

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
UNIVERSITY OF CONNECTICUT  
SPECIAL REVIEW – UCONN 2000 EXPENDITURES*

**AUDITORS OF PUBLIC ACCOUNTS**  
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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## **Executive Summary**

We have performed a special review of operations, expenditures and other transactions related to UConn 2000 construction projects at the University of Connecticut. Our approach to this review was to examine construction project and accounting records, and to make inquiries of certain University staff and bond counsel.

Our review of records was similar in nature to audit procedures that we have performed at the University related to our routine compliance audits that are generally performed on a biennial basis. Not surprisingly, the conclusions we arrived at based on this expanded review, are similar to the issues that have been communicated in our prior audit reports, as presented on page two of this report.

As regards the inquiries we made, formal questionnaires were issued to seven current or former University employees and outside bond counsel. The five current University employees provided detailed responses, many of which indicated that the Architecture and Engineering Services unit exercised considerable control over the construction program. The two former employees, one of which directed the Architecture and Engineering Services unit, replied that they could not formally respond due to memory lapses and/or not having access to University records. University bond counsel did provide a response. Due to the organization of the University and the internal control structure that was allowed to exist at that time, it would appear that the two former employees would have had the most direct knowledge of day-to-day operations of the construction program reviewed. As a result, the lack of responses from these two key managers limited our ability to gather information to a degree.

Some of the answers we did receive were not entirely responsive to our questions and the issues at hand. In essence, some of the answers provided either lacked adequate bearing or generated other questions.

It should be pointed out that the conditions noted relate to systems at the University that are not in place at this time. Changes in the University's control structure which should assist in preventing undesirable conditions such as unsupported journal entries and revisions to supplemental indentures to reflect expenditures that have already been made, include:

- a more formalized budget process;
- a greater emphasis on tracking expenditures to amounts authorized by the indenture;
- a greater separation of duties between the Architectural & Engineering Unit and the Capital Projects and Contract Administration Unit;
- the hiring and assignment of accounting personnel to monitor expenditures to budgets;
- the assignment of accounting personnel to verify that amounts being charged to an account is consistent with the purpose of the account; and
- the establishment of a formal approval procedure for the processing of journal entries.

However, improvements made do not necessarily relieve the University from addressing the exceptions that occurred in the past. It should also be noted that while we have examined policies and procedures currently in place, we have not tested such internal controls to an extensive degree.

Based on our review we arrived at the following five conclusions that are explained in detail within our report:

- ❖ Numerous unsupported journal entries were initiated and in some fashion authorized outside the accounting department.
- ❖ Accounts established for specific construction projects were intentionally charged for expenditures of unrelated projects; such charges were initiated by the Architectural and Engineering Services unit with the assistance of the Capital Projects and Contract Administration Unit.
- ❖ University personnel, with the assistance of legal counsel, should seek assurance that certain rules and regulations concerning disclosure were adhered to.
- ❖ University personnel should research the “North Campus Renovation” project to determine if the project budget has been exceeded.
- ❖ University personnel, with the assistance of legal counsel, should seek assurance that the use of bond proceeds for the South Parking Garage was administered in an appropriate manner.

March 20, 2008

**AUDITORS' REPORT  
UNIVERSITY OF CONNECTICUT  
SPECIAL REVIEW – UCONN 2000 EXPENDITURES**

At the request of Governor M. Jodi Rell we have performed a special review of expenditures and other transactions related to UConn 2000 construction projects. In December 2007, the Governor informed us of her concern over issues that were raised during recent Construction Management Oversight Committee (for the University of Connecticut Board of Trustees) meetings. More specifically, there was concern over the appropriateness of charges to individual construction projects, and certain corrections that were subsequently made to account for certain misapplied charges. Further, there was concern over the legitimacy of adjustments to bond indentures made as a result of the corrections made and the level of management awareness and approval of the conditions noted. This report consists of the Comments, Results of Review and Recommendations, which follow.

**COMMENTS**

**BACKGROUND:**

Public Act 95-230 of the January 1995 Regular Session of the General Assembly, more commonly referred to as “The UCONN 2000 Act”, provided certain powers to the University to carry out an aggressive plan to enhance the infrastructure of the University. Most significantly, the legislation allowed the University to administer construction projects itself without the involvement of the Department of Public Works. The original Act, itself, authorized approximately 75 individual projects (as presented within Section 10a-109e, subsection (a), of the General Statutes) at a budgeted total cost of \$1,250,000,000. Public Act 02-3 of the May 2002 Special Session of the General Assembly, authorized approximately 50 additional projects at a budgeted total cost of \$1,348,400,000.

As part of our previous audit examinations of the University system, performed under Section 2-90 of the General Statutes, we reviewed the administration of projects and expenditures related to the Act. We have identified certain concerns related to the program within our audit reports, which are summarized and referenced as follows:

**Auditors' Report for the fiscal years ended June 30, 2000 and 2001:**

- A lack of competitive bidding related to certain UConn 2000 projects
- Payments (in excess of \$5,000,000) that were made for a project that was not specified under Section 10a-109e, subsection (a), of the General Statutes, and was not approved by the Board of Trustees, as required by subsection (d)(3) of Section 10a-109e

**Auditors' Report for the fiscal years ended June 30, 2002 and 2003:**

- Payments (in excess of \$12,000,000) that were made for a project that was not specified under Section 10a-109e, subsection (a), of the General Statutes, and was not approved by the Board of Trustees, as required by subsection (d)(3) of Section 10a-109e.
- The lack of a comprehensive Construction Policies and Procedures Manual.
- The lack of a process to publicly solicit competitive bids on projects after finalizing project design details.
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**Auditors' Report for the fiscal years ended June 30, 2004 and 2005:**

- The lack of timely notice to the Board of Trustees to approve revisions to project budgets and to revise bond indentures, when project expenditures exceed authorized amounts.
- The lack of supporting documentation and supervisory approval to justify the transferring of construction costs between individual projects.
- The lack of documentation over contractor selection related to a UConn 2000 project when a lowest cost proposal is not utilized.
- The awarding of a contract for construction management services for a UConn 2000 project that was not performed in an open and competitive manner.
- A lack of segregation of duties between requests for construction contract modifications and the pricing of such modifications.
- The failure to establish a scope and price for services prior to establishing contractual relationships with design professionals and engineers.

Specific information and report excerpts related to these recommendations and issues are presented within **Appendix A** of this report.

## **AUDIT OBJECTIVES, SCOPE AND METHODOLOGY:**

As noted above, the request for this review was precipitated by concerns raised at recent Construction Management Oversight Committee meetings. More specifically, we were requested to review certain transactions that resulted in amendments to the UConn 2000 General Obligation Bond Indentures.

The objectives of our review were as follows:

- ❖ To determine how unsupported journal entries and charges to incorrect accounts could occur.
- ❖ To determine who authorized such unsupported journal entries and charges to incorrect accounts.
- ❖ To evaluate whether possible financial exposure exists related to the unsupported journal entries and charges to incorrect accounts.
- ❖ To determine if the control structure currently in place at the University would prevent any future unsupported journal entries or charges to incorrect accounts.

In an effort to achieve the objectives described above, we distributed written questions related to four construction projects that had either had significant journal entries associated with them, involved indenture reallocations, or appeared to have expenditures charged to accounts in an inappropriate fashion. These questions were distributed to current University staff, former University staff and to the law firm currently assisting the State of Connecticut in administering the UConn 2000 bond fund program.

### **Overview:**

The University has issued in excess of one billion dollars in securities pursuant to the UConn 2000 Act (Sections 10a-109a to 10a-109y of the Connecticut General Statutes, inclusive.) Such securities are issued and secured under the provisions of a General Obligation Master Indenture Trust, dated November 1, 1995, as supplemented and amended by additional indentures. All securities issued under the Master Indenture include a supplemental indenture which contains an "Appendix A". Appendix A lists the projects for which the proceeds from the sale of securities are to be utilized. According to the supplemental indentures, no restriction on any subsequent amendments to Appendix A exists, and the University has, on occasion, revised Appendix A to change the authorized amounts contained within the original Appendix A. While some of these revisions may be described as minor and expected, others have exceeded millions of dollars, and resulted from amounts expended on specific projects that exceeded amounts authorized in the original Appendix A. Although it was a practice to eventually amend Appendix A to account for expenditure revisions (at times years after the original expenditure of the bond proceeds), Appendix A should have been revised prior to the expenditure of the bond proceeds, since the revision of Appendix A is contingent on Board of Trustees approval. Quite simply, if the Board of Trustees were to reject a proposal to amend Appendix A or fail to approve expenditures in excess of budgeted amounts, the expenditure of funds in excess of such budgeted amounts would appear to be unauthorized.

## RESULTS OF REVIEW

Our examination of operations and expenditures related to the UConn 2000 construction program within the University of Connecticut, disclosed matters of concern requiring disclosure and attention.

### **Item No. 1 - General Journal Entries**

- Criteria:* General journal entries (journal vouchers) should be adequately documented and subject to supervisory review and approval before they are posted.
- Condition:* Numerous unsupported journal entries were processed by University personnel. Some of these entries amounted to millions of dollars and had characteristics which indicated that the original processing of expenditures were intentionally charged to incorrect accounts and then changed to reflect a more appropriate treatment of the expenditure.
- Effect:* Amounts were expended in a manner not consistent with the supplemental indenture as specified in the original Appendix A.
- Cause:* Journal entries were not receiving the appropriate level of scrutiny from the University's Accounting Department. Personnel within the University's Accounting Department were relying on the University's Architectural and Engineering Services unit's assessment of the propriety of transactions, rather than independently verifying the substance of the requested journal entries.
- Conclusion:* New procedures instituted by the University require greater involvement and scrutiny by the University's Accounting Department staff. These procedures include the review of the accounts charged prior to making a payment, as well as a more formal review and supervisory approval of journal entries. Further, management is to seek Board approval of budget revisions before processing journal entries, when required.

### **Item No. 2 - Charging of Expenditures to Incorrect Accounts**

- Criteria:* Governmental Generally Accepted Accounting Principles (GAAP) describe fund accounting principles and "funds" as fiscal and accounting entities with self-balancing sets of accounts "which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."



Accounts and associated budgets are established within the University accounting system to assist in assuring that amounts are expended in accordance with the desires of the University's Board of Trustees, as well as to assist in achieving compliance with contractual obligations such as those contained within the provisions of the University's General Obligation Master Indenture Trust.

*Condition:* We noted numerous instances in which accounts established for a specific construction project contained charges for expenditures for an unrelated construction project. In one instance we noted that an account established for the "New Pharmacy Building" project contained charges in excess of \$2,800,000 for payments related to the "Babbidge Library Walkway" project.

Although a general journal entry was eventually made to transfer the costs from the account established for the "New Pharmacy Building" project to an account established for the "Babbidge Library Walkway" project, and an amendment to the appropriate supplemental indenture was approved, such after-the-fact corrections would not have been effective had the Board of Trustees chosen to not approve the amendment to the supplemental indenture.

*Effect:* Charging expenditures to a project that are actually improvements to other projects violates the principal that certain capital project funds are segregated for a particular purpose.

Amounts were expended in a manner not consistent with the Supplemental indenture as specified in the original Appendix A.

*Cause:* Apparently, the University's former Executive Director of Architectural and Engineering Services, with the assistance of the University's former Director of the Capital Projects and Contract Administration Unit, chose to direct expenditures to accounts where budgeted funds existed rather than request a reallocation.

*Conclusion:* New procedures instituted by the University require greater involvement by the University's Accounting Department staff. These procedures include the review of the accounts charged prior to making a payment, as well as a more formal review and supervisory approval of journal entries.

**Item No. 3 - Assessment of Potential Exposure Related to Unsupported Journal Entries and Charges to Incorrect Accounts**

*Criteria:* Tax exempt securities, such as those issued under the Master Indenture Trust, are presumably subject to the requirements of the Internal Revenue Code as well as the U.S. Securities and Exchange Commission rules on disclosure.

Concerns were expressed that the increase of Board of Trustees authorizations and associated modification of supplemental indentures to reflect conditions that had already occurred, was evidence that the University was not in compliance with the supplemental indenture. This could be construed as a misuse of bond proceeds, as well as being inconsistent with amounts disclosed within the original Appendix A of the supplemental indentures.

*Condition:* In an effort to address the issues stated above, we asked five current University personnel if they were aware of any potential negative consequences for expending amounts in excess of Board of Trustees authorizations. Four of the five respondents did not indicate that they were aware of any negative consequences for expending amounts in excess of Board of Trustee authorizations.

We also asked these same employees if they were aware of any potential negative ramifications for expending amounts in a manner inconsistent with the University's bond indenture. Four of the five respondents did not indicate that they were aware of any negative ramifications for expending amounts in manner inconsistent with the University's bond indenture.

Additionally we requested that the University forward questions similar to the ones described above to the University's outside legal counsel responsible for assisting the University in representing the interests of the State of Connecticut in matters involving the sale and issuance of general obligation bonds. Although the outside legal counsel's reply did not appear to address every question posed, one substantive statement contained within the reply from outside legal counsel follows: "Since the Bonds are neither payable from Bond Proceeds nor secured by the projects financed with the proceeds it should not be surprising that the use of proceeds to finance a University project not authorized by the Indenture is not an event of default under the terms of the Indenture, and even if it was, the Indenture does not provide any meaningful relief."

It should be noted that this statement from current outside legal counsel seems inconsistent with advice received from former

outside legal counsel. On December 29, 2000, such legal counsel stated in a memo to University personnel that "... at no time may the University spend or legally encumber bond proceeds in excess of amounts authorized by its Board or for any purpose other than that authorized by statute as such spending is not legal."

*Cause:* Replies of University personnel to our questions concerning any negative ramifications of expending amounts in excess of Board of Trustees authorizations and in manners inconsistent with supplemental indentures were for the most part void of evidential matter. Further, current outside legal counsel's reply was limited.

*Recommendation:* University personnel, with the assistance of legal counsel that had been hired to represent the University on bond issues, should seek assurance that Internal Revenue Code or Securities and Exchange Commission rules and regulations concerning disclosure have not been infringed upon. (See Recommendation 1.).

**Item No. 4 - Determining if Board of Trustees Authorizations Have Been Exceeded:**

*Background:* Expenditures for the Towers Renovation Project, as recorded in the University's accounting system, total \$28,409,589. This project was among the projects subject to audit and reported on in the UHY LLP audit report entitled "Audit of Construction Expenditures of UCONN 2000 Projects Substantially Completed during the Fiscal Year ended June 30, 2004 and for Projects Substantially Completed to or during the Fiscal Year ended June 30, 2003". The UHY report found no errors in the recorded amounts for the Towers Renovation Project. Our limited analysis of the expenditures contained within the Towers Renovation Project accounts found payments made to JPI Apartment Development (JPI) in the amounts of \$978,240, \$14,854 and \$49,626. Additional analysis of the invoices and the contract related to these payments have allowed us to conclude that such payments to JPI are not related to the Towers Renovation Project, but rather should have been charged to the project known as the North Campus Renovation (Charter Oak Apartments and Suites).

*Criteria:* Rudimentary budgetary and accounting control requires University personnel be able to determine if amounts expended exceed amounts authorized to be expended.

*Condition:* We asked University personnel if the \$1,042,720 in miscoded payments made to JPI for the North Campus Renovation, when added to other amounts expended for the North Campus Renovation, results in the University having expended amounts in excess of Board of Trustees authorizations on the North Campus

Development. Four of the five employees that we asked this question responded in some fashion that they did not know.

*Effect:* University personnel are either unable or unwilling to determine what has been expended on this project or, unable or unwilling to determine what has been authorized by the Board of Trustees for this project.

*Cause:* Budgetary and accounting controls were ineffective during the period that certain expenditures were misapplied.

*Recommendation:* University personnel charged with budgeting and accounting duties should research the “Towers Renovation” and “North Campus Renovation” projects to determine if the authorized project budget for the “North Campus Renovation” project has been exceeded. (See Recommendation 2.)

#### **Item No. 5 - Delayed Use of Operating Funds for South Parking Garage**

*Background:* The Board of Trustees (BOT) authorized \$24 million of Special Obligation bonds to construct the South Parking Garage. In addition, \$2,475,430 of Debt Service Commitment bond funds, charged to an account described in the University’s general ledger as “deferred maintenance” was utilized for the same project. The parking garage was completed in late 2003. In July 2006, the University posted a general journal entry that transferred the \$2,475,430 in expenditures from the “deferred maintenance” account to an operating fund account.

*Criteria:* Tax exempt securities such as those issued under the Master Indenture Trust are subject to the requirements of the Internal Revenue Code.

*Condition:* In the case of the South Parking Garage the initial use of bond funds with a subsequent reimbursement from operating funds has characteristics which suggest that the University may have used bond proceeds for working capital purposes and, as such, could be considered “working capital replacement proceeds” as defined in Treasury Regulations 1.148-1(c)(4)(ii)(A) . We are also concerned that since the proceeds of the bonds were invested, the actions taken might be considered a violation of arbitrage provisions under Treasury Regulations 1.148-10(a)(2).

Additionally, the signed tax-exempt compliance questionnaire prepared by the University indicates that no other proceeds were utilized for the South Parking Garage other than the \$24 million of Special Obligation bonds.

*Cause:* University personnel have not addressed the issue of whether the use of bond proceeds for the South Parking was done in an appropriate manner.

*Recommendation:* University personnel, with the assistance of legal counsel that had been hired to represent the University on bond issues, should seek assurance that the use of bond proceeds for the South Parking Garage project was administered in an appropriate manner. (See Recommendation 3.)

## RECOMMENDATIONS

The following recommendations are presented as a result of our review of the operations and certain expenditures related to the UConn 2000 construction program at the University of Connecticut:

- 1. University personnel, with the assistance of legal counsel that had been hired to represent the University on bond issues, should seek assurance that Internal Revenue Code or Securities and Exchange Commission rules and regulations concerning disclosure have been adhered to.**

Comment:

Tax exempt securities, such as those issued under the Master Indenture Trust, are subject to the requirements of the Internal Revenue Code, as well as the Securities and Exchange Commission rules on disclosure.

Concerns were expressed that the increase of Board of Trustees authorizations and associated modification of supplemental indentures to reflect conditions that had already occurred, was evidence that the University was not in compliance with the supplemental indenture. This could be construed as a misuse of bond proceeds, as well as being inconsistent with amounts disclosed within Appendix A of the supplemental indentures. However, our communications with University staff indicated that bond restrictions would not be infringed on in the absence of authorizations and modifications.

- 2. University personnel charged with budgeting and accounting duties should research the “Towers Renovation” and “North Campus Renovation” projects to determine if the authorized project budget for the “North Campus Renovation” project has been exceeded.**

Comment:

We identified certain expenditures, totaling \$1,042,720, of the Towers Renovation project that should have been charged to the “North Campus Renovation” project. University personnel have not determined whether authorized project budgets have been exceeded due to the errors identified.

- 3. University personnel, with the assistance of legal counsel that had been hired to represent the University on bond issues, should seek assurance that the use of bond proceeds for the South Parking Garage project was administered in an appropriate manner.**

Comment:

Tax exempt securities such as those issued under the Master Indenture Trust are subject to the requirements of the Internal Revenue Code. We identified certain circumstances, concerning the subsequent transfer of funds (deferred maintenance and operating funds) to and from the project, which would indicate that a thorough review of such transactions should be completed to ensure that restrictions regarding the use and assignment of funding have been complied with.

**CONCLUSION**

In conclusion, we wish to express our appreciation for the courtesies and assistance extended to our representatives by the personnel of the University of Connecticut, during this review.

Gregory J. Slupecki  
Principal Auditor

Approved:

Kevin P. Johnston  
Auditor of Public Accounts

Robert G. Jaekle  
Auditor of Public Accounts



## **Appendix A-1**

### **Excerpts of Auditors' Report for the fiscal years ended June 30, 2000 and 2001**

Audit issues referred to on Page 2 of this special report are presented as they appear in our Auditors' Report for the fiscal years ended June 30, 2000 and 2001, as follows:

- **The University should request a formal opinion from the Attorney General to determine if the methods used by the University to obtain certain construction services are in compliance with bidding requirements of Section 10a-109n of the General Statutes.**

Comment:

The lack of bidding and public opening of bids on certain construction projects are violations of the General Statutes.

#### **Other Matter presented:**

On February 7, 2001, we reported that during an analysis of University expenditures, we noted payments in excess of \$5,000,000 made by the University for the construction of the new central warehouse. The source of the funds for these payments was UCONN 2000 bond funds. The central warehouse is not specified as a project under Connecticut General Statutes Sec. 10a-109e, subsection (a). According to Connecticut General Statutes Sec. 10a-109e, subsection (d)(3), a material addition of a project requires formal approval of the Board of Trustees, as well as a public or special act approving such addition. We were unaware of any such formal approval of the Board of Trustees or any public or special act approving such addition. Accordingly, at that time we believed this condition to be an unauthorized use of funds.

## **Appendix A-2**

### **Excerpts of Auditors' Report for the fiscal years ended June 30, 2002 and 2003**

Audit issues referred to on Page 2 of this special report are presented as they appear in our Auditors' Report for the fiscal years ended June 30, 2002 and 2003, as follows:

- **The University should use UCONN 2000 bond funds in the manner specified in Section 10a-109e, subsection (a), of the General Statutes.**

Comment:

We found that the University used UCONN 2000 bond funds for a project not specified within Connecticut General Statutes Section 10a-109e, subsection (a), without obtaining the required public or special act.

- **The University should develop a comprehensive Construction Policies and Procedures Manual.**

Comment:

The existence of a well constructed Construction Policies and Procedures Manual and adherence to such policies and procedures assists in providing reasonable assurance that objectives will be obtained.

- **The University should enhance competition by publicly soliciting open competitive bids on construction projects after finalizing project design details.**

Comment:

The University's use of the "Construction Manager at Risk with a Guaranteed Maximum Price" delivery method/procurement technique may have caused the State to incur higher than necessary costs.

## Appendix A-3

### Excerpts of Auditors' Report for the fiscal years ended June 30, 2004 and 2005

Audit issues referred to on Page 2 of this special report are presented as they appear in our Auditors' Report for the fiscal years ended June 30, 2004 and 2005, as follows:

- **For those UCONN 2000 projects for which it is anticipated that expenditures will exceed authorized amounts, the University should seek the approval of the Board of Trustees to revise the General Obligation indenture and increase authorized amounts, prior to actually incurring the expenditures.**

Comment:

In several instances UCONN 2000 construction expenditures exceeded existing Board of Trustees authorizations.

- **All non-routine journal entries should be subject to supervisory review to insure that adequate backup exists to support the entry.**

Comment:

We noted instances in which the reason for making journal entries was not adequately documented.

- **In those instances in which the lowest cost proposal is not selected the University should prepare documentation that provides evidence of the rational for their decision.**

Comment:

We noted that the University did not select the lowest cost proposal for the new cogeneration facility. Our analysis of available information left us concerned as to why the lowest proposal was not selected.

- **In those instances in which fundamental terms upon which a contract was awarded have changed, the University should take steps to ensure that the new contract is awarded in an open and competitive process.**

Comment:

The University incurred a contractual obligation in which a major party was selected in a less than transparent fashion.

## **Appendix A-3**

### **Excerpts of Auditors' Report for the fiscal years ended June 30, 2004 and 2005**

- **The University should publicly advertise to solicit competition for projects that have not previously been publicly advertised and for which less than three bids have been received.**

Comment:

We found the instances in which competition for certain construction contracts had been restricted to less than the traditional three bid minimum.

- **The University should establish the scope and price of services prior to establishing contractual relationships with design professionals and engineers. In those instances in which the scope of a project significantly changes due to unforeseen circumstances consideration should be given to soliciting new proposals in an open and competitive process.**

Comment:

We noted several instances in which the final contract amount for design and engineering services was significantly higher than the original contract amount.