BOARD OF REGENTS OF
THE UNIVERSITY SYSTEM OF GEORGIA

OFFICE OF INTERNAL AUDIT AND COMPLIANCE
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June 2, 2016

Dr. Daniel S. Papp
President
Kennesaw State University
585 Cobb Avenue NW
Kennesaw, Georgia 30144
sent via email

Dear Dr. Papp:

The enclosed draft audit report has been prepared at the conclusion of the Kennesaw State University audit engagement recently completed by members of our internal audit staff. The report addresses observations noted in the areas audited, and where warranted, the auditors have made recommendations based on the facts gathered during the audit. These recommendations should, in our opinion, improve procedures, improve internal controls, or ensure compliance with applicable policies, laws, or regulations.

Our overall opinion, key observations and ratings assigned to assurance engagement observations are included in the Executive Summary and Issues Detail sections of the report, respectively. Each observation is rated as No Issue, Comments, Significant or Material. Rating scales for assurance engagement observations are described in more detail in the Business Procedures Manual, Section 16.3.8 Exception Ratings.

You are requested to submit a formal, written and electronic response to each observation identified in the Issues-Detail section of the draft audit report to me by July 2, 2016. When reviewing the report, please consider the following: 1) implementation of the recommendations given the day-to-day operational environment of your department and 2) whether all facts stated in the report are accurate and/ or additional facts should have been presented.

Your response may or may not agree with the auditors' recommendations. If there is agreement, you should address what will be done, who is responsible, when the corrective action will be complete or the status if the observation is already remedied. If there is disagreement, you should provide a statement of facts supporting your disagreement and/or alternative resolutions for our recommendations. If there are any facts that the audit staff was not aware of at the time of the audit, please state them in your response.

Upon receipt, your response will be evaluated as to whether it adequately addresses the audit recommendations, and the final report will be issued which includes the recommendations and your response.

Sincerely,

John M. Fuchko, III
Vice Chancellor for Internal Audit & Compliance /
Chief Audit Officer

Enclosure

cc: Henry M. Huckaby, Chancellor
Dr. Steve Wrigley, Executive Vice Chancellor of Administration, BOR
Dr. Houston Davis, Executive Vice Chancellor and Chief Academic Officer, BOR
Shelley C. Nickel, Vice Chancellor Fiscal Affairs and Planning, BOR
Marion Fedrick, Vice Chancellor for Human Resources, BOR
Samuel C. Burch, Vice Chancellor for Legal Affairs, BOR
Susan H. Ridley, Associate Vice Chancellor for Fiscal Affairs & Public Private Ventures, BOR
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James F. Winters, III, Director of Public/Private Venture Audits, BOR

University System of Georgia (USG)

Audit Engagement Report: Kennesaw State University
Auxiliary Audit – Dining

Engagement 15-05 DRAFT DATE: June 2, 2016

Who we are

OIAC conducts assurance audits and consulting engagements.

Assurance audits include reviews of financial, performance, compliance, system security, and internal control processes and operations.

Consulting engagements are focused on developing joint recommendations with the client on agreed-upon issues.

Audit issues are rated using the following standards:

- Material
- Significant
- Comment
- No Issue

For Issue Rating Details, go to:

Board of Regents Business Procedures Manual, Section 16.3.3 and Section 16.3.8

EXECUTIVE SUMMARY

The purpose of this Auxiliary Services audit was to opine on the financial strength of Kennesaw State University's auxiliary services operations and the level of compliance with University System of Georgia's policies and procedures related to auxiliary services. The Food Services Auxiliary is covered in this report. To achieve this purpose, we examined the results of auxiliary operations for fiscal year 2015, year-to-date financials for fiscal year 2016 and the KSU Culinary and Hospitality Services Business Plan FY 2015-FY 2019 as submitted to the Board of Regents. We compared student fees to comparable fees at other USG institutions and compared the student services provided on the main campus to the Marietta campus. We reviewed the RFP process for the dining contract and examined the food services contract with the current outsourced dining provider.

The following is a summary of the areas reviewed. Additional details regarding issues follow this executive summary.

Issue 1: Insufficient Management of Alleged Employee Malfeasance

The institution's handling of malfeasance allegedly committed by the former director of dining services (former dining director employed through late 2015) violated USG procedures requiring the reporting of employee malfeasance and was inadequate to address the underlying issues associated with the former dining director's alleged malfeasance.

Issue 2: Dining auxiliary operating at a deficit with a negative fund balance

The dining auxiliary had a negative operating income of ($203,855) with a negative net fund balance of ($5,282,683) for the fiscal year ending June 30, 2015.

Issue 3: Dining contract includes terms in violation of USG procedures

The current outsourced dining provider's contract provides an amortized payoff of $965,898.65 of previous funded investments at the Marietta campus and a no interest $25 million extension of funds for purposes of constructing or renovating facilities.

Issue 4: Dining Contract has less than advantageous terms

The terms in the current outsourced dining provider's contract is not advantageous to students, faculty or staff. Simplification may reduce the cost of the services provided. These savings could be passed on to the students, faculty, and staff and potentially eliminate or reduce the need for mandatory commuter meal plans.

Issue 5: Bond Counsel did not review of contracts associated with PPV projects

The current outsourced dining provider contract was not reviewed by bond counsel for compliance with IRS Revenue Procedure 97-13 to protect against a loss of the tax-exempt status of the bonds as a result of satisfying the private business tests.

Issue 6: Weak expense controls for dining

The expense controls for dining need strengthening. The contract does not give adequate incentives to the current outsourced dining provider to reduce operating cost.

Issue 7: Organizational Structure not proper for oversight

The Director of Auxiliary Services and Programs, responsible for financial reporting, reports directly to Assistant Vice President for Auxiliaries Services and Programs. Although this structure allows for ease of communication within Auxiliary Division, this organizational structure lacks strong financial oversight of reported information, strong monitoring of internal controls, and allows for undue influence to alter and/or misstate financial projections and statement presentations.

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BACKGROUND

Kennesaw State University Culinary and Hospitality Services oversees all dining operations on both the Kennesaw and Marietta campuses (formerly Southern Polytechnic State University). The operation includes the two primary dining halls, *The Commons* (Kennesaw), and *Stingers* (Marietta), 14 quick-service retail food outlets (featuring both national and in-house concepts), campus catering services, vending, and concessions (volleyball, basketball, softball and baseball).

KSU leadership directly manages the meal plan program, catering operations, marketing and community outreach, culinary facilities maintenance, and farming operations. KSU outsources purchasing and staffing through a food service management contract with the current outsourced dining provider.

KSU's meal plan program was established in 2008, to serve the University's growing resident population. KSU was a commuter-only campus until 2002. *The Commons* dining facility was opened in fall 2009 and serves as the main dining facility for the Kennesaw campus. The facility offers a meal plan program that serves residents, commuters, faculty and staff alike. Similarly, Southern Polytechnic State University opened *Stingers* dining facility in fall 2011. This facility serves as the main dining facility for the Marietta campus. All meal plans may be used on either the Kennesaw or Marietta campuses of KSU.

Effective summer 2015, the current outsourced dining provider was awarded the food service contract with KSU following a bid process. The 15-year contract (one year with 14 renewals) became effective July 1, 2015, and is a fee-based contract rather than a traditional P & L (profit and loss) contract. Under the agreement, KSU collects and retains all revenue for food service operations and is responsible for payment of all operational expenses. Therefore, KSU receives all profit or incurs any loss from operations. Food service equipment assets and facilities are owned by, and the responsibility of, the University. Other contract terms of note include:

- KSU pays the current outsourced dining provider an annual management fee of $1.2 million in FY 2016, with an annual escalator of 3% per year, to perform all staffing, purchasing and other operating duties for both the Kennesaw and Marietta campus food service operations.
- The current outsourced dining provider pays/returns a "bonus" to KSU to be disbursed over the term of the contract with the agreement the bonus is not subject to repayment of any kind. The bonus includes payments of $1.5 million in FY 2016 and FY 2017 with the bonus decreasing to $1 million for all remaining years of the contract.
- The current outsourced dining provider provides a $25 million extension of funds (that must be repaid) for purposes of constructing or renovating facilities. Any draws on these funds by KSU is interest-free with the amount amortized on a straight-line basis over the remaining contract life (15 years maximum). Amortization payments do not commence until funds are drawn.

Through FY 2015, KSU dining has an accrued deficit of approximately $5.3 million, including accumulated depreciation of $4.3 million, within the dining auxiliary. The annual shortfall has been addressed through transfers from other more profitable auxiliary services. As part of its five-year business plan, KSU projects Culinary and Hospitality Services' financial performance to improve significantly over prior years. The business plan cites the new contract with the current outsourced dining provider. The business plan indicates Culinary Services will reduce its current reserve deficit of $4.9m to $570k by the end of FY17, with projected profit of $967k at the end of FY18, and final reserve position at the close of FY20 totaling more than $4.4m. However, financial data through for FY 2016 (through December 2015 – six months) suggests the dining program is tracking near breakeven rather than the $2.3 million profits/deficit reduction projected for FY 2016 in the business plan. Further, the FY 2016 financial data includes the current outsourced dining provider bonus payment of $1.5 million and the continuation of a mandatory commuter meal plan.[1] The financial data does not reflect any increase in expenses related to payback of funds already accessed through the line of credit offered by the current outsourced dining provider.

KSU also operates a Farm-to-Campus program launched in May 2010. KSU originally received a land gift of 55-acres in Cartersville, Georgia to begin the farming operation. Culinary Services was assigned two acres of the property for purposes of organic farming and beekeeping. In February 2013, KSU entered into a 50-year land-use agreement with the Georgia Department of Transportation for a new farm location. The former GDOT land, previously used for cement mixing and truck staging, is now the home of KSU's academic Farm-to-Campus program and has been renamed Hickory Grove Farm. The academic program associated with the culinary sustainability and hospitality academic programs also occupies the location. The property underwent extensive efforts to correct the pH of the soil, including receiving 3,000 donated dump truck loads of topsoil from a local construction company to restore essential nutrients to the soil.

Courses offered through the culinary sustainability and hospital academic programs are taught on Hickory Grove Farm. Hickory Grove Farm also serves as classroom space for students receiving instruction through the culinary sustainability and hospitality academic programs, who cultivate hyper-local produce that is grown by and for students and is served in the University's dining halls. The 25-acre property has nine field-planted acres, one greenhouse dedicated to classroom use, a hydroponic greenhouse, a seedling propagation house for use in hydroponic production, a shiitake mushroom garden, classroom pavilion, three-colony apiary for beekeeping classes, apple orchard, berry fields, asparagus fields, walking trails, and a 7,500 square foot aviary which houses 200 free-range, pasture-fed chickens that produce 1000+ organic eggs a week.

The farm is managed by two full-time KSU employees with additional support from the current outsourced dining provider's hourly employees during peak harvest season. The new dining contract provides KSU will sell produce grown on the farm to the current outsourced dining provider (value: approximately $102K per year). The current outsourced dining provider provides an annual donation

[1] KSU has been instructed to seek opportunities to limit and/or eliminate its mandatory meal plan.

of $180,250 per year (through FY 2020) to farm operations. The culinary sustainability and hospitality academic programs fund $16K annually to offset expenses associated with use of the farm for classroom instruction. Currently, the farm operation is incurring annual operating deficits with a cumulative operating deficit of just under $1 million. Therefore, student dining fees are indirectly subsidizing both farm operations and the culinary sustainability and hospitality academic programs.

ISSUES DETAIL

Issue 1:	**Insufficient Management of Alleged Employee Malfeasance**
Rating	Material
Observation	The institution's handling of malfeasance allegedly committed by the former director of dining services (former dining director employed through late 2015) violated USG procedures requiring the reporting of employee malfeasance and was inadequate to address the underlying issues associated with the former dining director's alleged malfeasance. Specifically, KSU employees failed to report potential employee malfeasance to the University System as required by USG Business Procedures Manual Section 16.4 or to law enforcement with respect to an internal KSU report which found "potential violations of Board of Regents' policies and State and Federal laws …" by the former dining director. KSU also did not implement sufficient corrective action with respect to the former dining director even after substantiating multiple violations of Board Policy, to include the USG Ethics Policy, while also receiving correspondence indicating "apparent deception" on the part of the former dining director with respect to a criminal investigation conducted in late 2011 and early 2012. The issues noted above pertain to three different investigations: the March 19, 2012 criminal investigation, the December 14, 2012 legal investigation, and a 2015 management investigation. A brief discussion of each investigation is noted below. A. <u>March 19, 2012 Investigation</u>: KSU properly referred an allegation to the University System Office of Internal Audit & Compliance (OIAC) pertaining to alleged misuse of KSU resources and personnel by the former dining director. OIAC referred the matter to the Georgia Department of Law and the KSU Police Department handled the criminal investigation. The Georgia Department of Law closed the matter in a March 19, 2012 memorandum to file with an indication that there "is insufficient evidence to prosecute." However, the

memorandum went on to cite "apparent deception" by KSU employees during the course of the investigation (to include the former dining director) and a "picture" of the former dining director "doing his friend a favor at State expense." The KSU Director of Legal Affairs indicated that the only personnel action taken in response to this malfeasance was a written reprimand that was delivered to the former dining director and subsequently ripped up.

B. December 14, 2012 Investigation: A second investigation was conducted by the KSU Legal Affairs department in response to additional allegations raised with respect to the former dining director. This investigation found multiple violations of Board Policies to include those governing conflicts of interests, use of state resources, ethics policies, and an alleged falsification of a W-9 form. KSU employees failed to report this alleged malfeasance to the University System OIAC as required by the USG Business Procedures Manual 16.4 and as emphasized in various correspondence from the System Office over the years. KSU's management actual response to the December 14, 2012 was to issue the former dining director a letter of reprimand.[2] KSU also failed to report the potential violations of criminal law to a law enforcement agency.

C. 2015 Management Investigation: A third investigation was initiated in 2015 by KSU. KSU also failed to report this investigation to the University System OIAC in a timely manner as required. The draft notes detailing initial investigation results outlined multiple, additional alleged

[2] The letter of reprimand to the former dining director was placed in the former dining director's personnel file. The former dining director's "complete personnel file" was the subject of a July 6, 2015 request under Georgia's Open Records Act. Internal emails among several KSU officials in response to the request indicated it was not management's intent to place the letter of reprimand in the former dining director's personnel file and, as such, would be withheld from the Open Records Act response.

The stated intent to exclude the letter of reprimand from the July 6, 2015 request stands in contrast to the actual January 16, 2013 signed letter of reprimand which states, in part: "In accordance with University policy and procedure, please sign this memorandum acknowledging you have received and read this written reprimand. The original will be placed in your personnel file. You have the right to submit written comments to be attached to this reprimand and included in your personnel file." However, it was recounted that discussion at the time the reprimand was delivered included some commitment to not include in the personnel file. Nevertheless, the record was in the personnel file at the time of the Open Records Act request. The letter of reprimand ultimately was turned over in response to the Open Records Act request after the requestor specified that his request included the "January 16, 2013 reprimand …".

policy violations issues to include misuse of state resources, conflicts of interest, nepotism, and other ethics policy violations. The former dining director was to be suspended and receive a letter of reprimand in response to the enumerated issues but later resigned.

In summary, the failure to report alleged employee malfeasance is a serious issue insofar as it is a violation of USG procedures and Board Policy. Timely reporting consistent with USG procedures ensures timely investigations and referral to law enforcement authorities insofar as potential violations of criminal law are identified. Equally important, repeated and flagrant violations of the public trust placed in and of the ethical policies governing USG employees require a level of response appropriate to the violation(s). The enumerated issues pertaining to the former director of dining services clearly warranted corrective action beyond an unofficial and/or official letter of reprimand as evidenced by, among other things, the continued apparent violations of the same policies by the former dining director.

Criteria

USG Board of Regents Policy Manual: specifically sections 8.2.20 titled "University System of Georgia Ethics Policy,"

USG Business Procedures Manual: specifically sections 16.4.4 titled "Investigation of Malfeasance,"

USG Business Procedures Manual: specifically sections 16.4.5 titled "Malfeasance Reporting,"

Official Code of Georgia - Annotated: Code of Ethics Statutes O.C.G.A. §45-10-3

Cause

It was unclear as to why KSU officials failed to report the malfeasance. One KSU official indicated they disclosed the existence of an investigation to a separate state agency but not to either law enforcement or to the University System OIAC as required.

Risks	Insufficient documentation and review of malfeasance, in particular incidents involving suspected criminal malfeasance, may result in reputational, compliance, and operational risks to both the Institution and the University System of Georgia. Compliance risks include failure to comply with the Federal and State of Georgia laws which could result in damage to the Institution. Operational risks include financial losses due to theft, fraud, waste, abuse, and other forms of wrongdoing or failure to negotiate contracts fairly and may result in legal and/or regulatory action.
Recommendation	We recommend that management ensure all future malfeasance investigations are conducted by the Department of Internal Audit and that the USG Office of Internal Audit and Compliance receive a copy of the report. At a minimum, potential employee malfeasance must be reported to the University System OIAC in a timely manner.
Management Response	

Issue 2:	**Dining auxiliary operating at a deficit with a negative fund balance**
Rating	Material
Observation	The dining auxiliary had a negative operating income of ($203,855) with a negative net fund balance of ($5,282,683) for the fiscal year ending June 30, 2015. Six of the seven dining outlets on the Main Campus operated at a loss in FY 2015. Appendix 1 shows the operating income for the Main and Marietta Campuses and a total for the dining auxiliary for the year ending June 30, 2015. This appendix also shows the operating income for each of the dining outlets on the Main Campus. Appendix 2 shows the operating income for each of the dining outlets for the 6 months ending December 31, 2015. The business plan indicates Culinary Services will reduce its current reserve deficit of $4.9m to $570k by the end of FY17, with projected

	profit of $967k at the end of FY18, and final reserve position at the close of FY20 totaling more than $4.4m. However, financial data through for FY 2016 (through December 2015 – six months) suggests the dining program is tracking near breakeven rather than the $2.3 million profits/deficit reduction projected for FY 2016 in the business plan. <u>Criteria</u> USG Board of Regents Policy Manual: specifically sections 7.2.2 titled "Auxiliary Enterprises Revenues and Expenditures," USG Business Procedures Manual: specifically sections 15.2.2 titled "Auxiliary Enterprise Activities-Food Services," <u>Cause</u> An aggressive food services business plan to provide an award winning, first in class, dining services to residential and commuter students with inadequate attention to cost efficiencies in their operations.
Risks	Inability to meet financial obligations both in the near-term and long-term.
Recommendation	OIAC recommends KSU leadership continue to implement identified practices to improve planning, budgeting, internal controls for the Dining Auxiliary Service. This includes eliminating: • The mandatory commuter meal plans; • Annual operating losses; and, • Subsidies to the culinary educations program and the farming operations. The dining auxiliary should receive an allocation from the culinary education program for the use of the kitchen facilities.
Management Response	

Issue 3:	**Dining contract includes terms in violation of USG procedures**
Rating	Material
Observation	The current outsourced dining provider's contract provides an amortized payoff of $965,898.65 of previously funded investments at the Marietta campus and a $25 million extension of funds (that must be repaid) for purposes of constructing or renovating facilities. This essentially creates what appears to be a form of debt that violates USG policy and procedures. Appendix 3 shows the reference in the current outsourced dining provider contract for each of the forbidden pledges, description of the amounts, first year's payout, subsequent years' payout, and the total 15-year contracted payout. Allowances for multi-year contracts to construct or renovate facilities are in the USG Business Procedures Manual, specifically section 3.1.1 titled "Cost Limits and Related Processing Rules," paragraph 5. "Multi-year contracts are permitted, up to a maximum of five (5) years, as long as there is no commitment of debt by the institution. An example would be a food services contract with a third party vendor where the vendor is paying the institution a commission based upon a percentage of sales. Multi-year contracts that involve an agreement by the contractor to construct or renovate facilities and amortize that cost over the life of the agreement are permitted when effectively paid by reduction of the anticipated commission payments from the contractor to the institution if: • The agreement has a clause permitting the institution to terminate prior to the contract end date; and,

	• The institution has in reserve at all times the necessary cash funds to pay the full unamortized construction costs.” <u>Criteria</u> USG Board of Regents Policy Manual: specifically sections 7.2.2 titled “Auxiliary Enterprises Revenues and Expenditures,” USG Business Procedures Manual: specifically sections 15.2.2 titled “Auxiliary Enterprise Activities-Food Services,” USG Business Procedures Manual: specifically sections 3.1.1 titled “Cost Limits and Related Processing Rules,” paragraph 5. <u>Cause</u> The KSU management did not consider the contract provision providing for the amortized payoff of $965,898.65 of previous funded investments at the Marietta campus and the contract provision for a $25 million extension of funds to be a violation of USG business procedures. As of April 30, 2016 the draw on the $25 million was $1.6 million with a target projected draw for FY 2016 of $2.0 million.
Risks	Inability to operate efficiently and effectively due to significant long-term repayment burdens.
Recommendation	OIAC recommends the KSU pay off the $965,898.65 of previous funded investments at the Marietta campus and all draws against the $25 million. As of April 30, 2016 the draws on the $25 million was $1.6 million with a target projected draw for FY 2016 of $2.0 million.
Management Response	

Issue 4:	**Dining Contract has Less Than Advantageous Terms**
Rating	Material

Observation	The terms in the current outsourced dining provider's contract is not advantageous to students, faculty or staff and is very complex. Simplification may reduce the cost of the services provided. These savings could be passed on to the students, faculty, and staff, and potentially eliminate or reduce the need for mandatory commuter meal plans. Appendix 4 is a chart showing the Additions to Basic Dinning Service, a reference to the current outsourced dining provider's contract for each of the Additions to Basic Dinning Service, description of the additional service, first year's payout, subsequent years' payout, and the total 15 year contracted payout. The following is a list of the terms in the current outsourced dining provider's contract that is less than advantageous to students, faculty or staff. These terms have the potential to increase overall contract cost which is born by the students, faculty, and staff. • Previous funded investment in the amount of $965,868.65; • Funds available for capital improvements in the amount of $25,187,000.00; • Catering services – President $750,000.00; • Catering services - Cabinet $450,000.00; • Student Scholarships, study abroad, internships. $1,042,500.00; • Chef Liaison $1,518,750.00; • Farm operations $ 2,703,750.00; • Farm operations - one time gift $100,000.00; and, • Donation to Auxiliary Services - $454,560.00. <u>Criteria</u> The current outsourced dining provider's contract <u>Cause</u> Management issued an RFP that was inclusive of provisions that exceed the needs of providing basic dining services for students, faculty and staff of KSU.
Risks	Simplification of the RFP and contract may reduce the cost of the services provided. These savings could be passed on to the students and eliminate the need for mandatory commuter meal plans.

Recommendation	OIAC recommends KSU leadership place the dining contract out for bid, rewrite the RFP, and ensure the results are advantageous to students, faculty and staff.
Management Response	

Issue 5:	**Bond Counsel review of contracts associated with PPV projects**
Rating	Material
Observation	The current outsourced dining provider's contract was not reviewed by bond counsel for compliance with IRS Revenue Procedure 97-13 to protect against a loss of the tax-exempt status of the bonds as a result of satisfying the private business tests. Nor has a review of the private business use of the facilities been performed to test for compliance with the applicable use restrictions imposed on tax-exempt financed facilities. <u>Criteria</u> Revenue Procedure 97-13: Management contracts between 501(c)(3) organizations and certain private parties under which private parties receive compensation for services provided with respect to a bond-financed facility may result in a loss of the tax-exempt status of the bonds as a result of satisfying the private business tests. However, the IRS has provided safe harbors regarding management service contracts between a for-profit entity and a tax-exempt organization when such service is provided in connection with a bond-financed facility. The Compliance Officer will annually review the "use" of its facilities financed with its outstanding Tax-Exempt Debt for compliance with the applicable use restrictions imposed on tax-exempt financed facilities, as set forth in the Tax Certificate. Prior to entering into certain arrangements that could give rise to an impermissible amount of private business use, the Compliance Officer will consult with its

	counsel before entering into such arrangements that include, but are not limited to, management contracts, operating agreements, licenses, leases, subleases, naming rights agreements, research agreements, cellular tower or solar panel placement agreements, clinical trial agreements, and joint venture or partnership arrangements. The Municipal Securities Rulemaking Board (MSRB), Electronic Municipal Market Access system, (EMMA) for the $21,955,000 Development Authority of Cobb County Dining Hall Lease Revenue Bonds (KSU Dining Hall Real Estate Foundation, LLC Project) Series 2008; http://emma.msrb.org/MS275944-MS273774-MD555461.pdf Dining Hall Rental Agreement between KSU Dining Hall Real Estate Foundation, LLC. And Board of Regents of the University system of Georgia, dated November 6, 2008; Section 25 (b) titled, "Landlord's Financing." "Without first notifying the Landlord, Tenant will not perform any activity on the Premises that will adversely affect the tax-exempt status of any debt instrument of Landlord relating to the Premises. In the event, the administrative office of the Board of Regents is made aware of a use that may have an adverse effect, Tenant will contact Landlord as soon as practicable after being made aware of the use or anticipated use." <u>Cause</u> Lack of awareness to have contracts reviewed by bond counsel.
Risks	Taking an action that would cause any of its outstanding Tax-Exempt Debt to become taxable "private activity bonds."
Recommendation	Appoint a Compliance Officer that will annually review the "use" of its facilities financed with its outstanding Tax-Exempt Debt for compliance with the applicable use restrictions imposed on tax-exempt financed facilities, as set forth in the Tax Certificate. Prior to entering into certain arrangements that could give rise to an impermissible amount of private business use, the Compliance Officer will consult with bond counsel before entering into such arrangements that include, but are not limited to, management contracts, operating agreements, licenses, leases, subleases, naming rights agreements, research agreements, cellular tower or solar panel placement

	agreements, clinical trial agreements, and joint venture or partnership arrangements.
Management Response	

Issue 6:	**Strengthen the expense controls for dining**
Rating	Material
Observation	The expense controls for dining need strengthening. The current outsourced dining provider's contract has four expense components: 1. Labor (35% markup over actual time expense): There are few controls on the "recorded time" shown on the monthly payroll roster; 2. Cost of goods sold (food, materials): There is a need to strengthen the controls on the receipt of goods, the use of goods to reduce waste and pilferage to reduce the cost of goods sold; 3. Draws on the current outsourced dining provider's capital reserve fund (capital expenditures): The current outsourced dining provider and its affiliate control the capital contracting. There are little controls or review of expenditures by KSU employees of the capital improvement projects that are paid by draws on the capital reserve fund. These capital expenditures are amortized over the life of the current outsourced dining provider's contract. These amortized cost are include with the monthly invoice from the current outsourced dining provider that KSU pays. 4. Annual management fee: There is a 3% annual increase to the management fee. KSU pays the current outsourced dining provider an annual management fee of $1.2 million in FY 2016, with an annual escalator of 3% per year, to perform all staffing, purchasing and other operating duties for both the Kennesaw and Marietta campus food service operations.

	The contract does not give adequate incentives to the current outsourced dining provider to reduce operating cost to cut back on food, salary and operating cost. KSU bears the risk of a loss and the benefit from gains; however, KSU management has minimal control over the dining operations and subsequent cost. <u>Criteria</u> Chancellor's Three "strategic imperatives" Accountability, Efficiency and Innovation with actions to develop and utilize measures of performance and accountability, seeking out new operational efficiencies, and a review of both existing and proposed programs to ensure relevance and encourage innovation. <u>Cause</u> An aggressive food services business plan to provide award winning, first in class, dining services to residential and commuter students.
Risks	A failure to maintain effective controls over expenditures could result in continued losses in the dining auxiliary and increased costs to students, faculty, and staff.
Recommendation	We recommend KSU strengthen the expense controls for dining, document the procedures, and document the monthly review of the current outsourced dining provider invoice. Senior management should review and act on the resulting analysis.
Management Response	

Issue 7:	**Organizational Structure**
Rating	Significant
Observation	Currently, the Director of Auxiliary Services and Programs, responsible for financial reporting, reports directly to Assistant Vice President for Auxiliaries Services and Programs. Although this

structure allows for easy communication within Auxiliary Division, this organizational structure lacks strong financial oversight of reported information, strong monitoring of internal controls, and allows for undue influence to alter and/or misstate financial projections and statement presentations.

The KSU finance team is responsible strong financial internal controls and to present accurate and timely financial statements. The auxiliary accounting function should report directly to the Assistant Vice President for Financial Management and maintain an indirect reporting relationship to the Assistant Vice President for Auxiliaries Services and Programs.

Criteria

KSU Policy Manual: specifically section - Finance and Business; titled "Monitoring Internal Controls of Financial Transactions Policy," section 6.

"The purpose of this policy is to strengthen the accountability and organizational structure for monitoring internal controls of financial transactions at Kennesaw State University. The Board of Regents of the University System of Georgia delegates' primary financial and fiduciary responsibility to a university's president who is responsible for establishing a sound internal control environment." https://policy.kennesaw.edu/content/monitoring-internal-controls-financial-transactions-policy

USG Business Procedures Manual: specifically sections 15.1 titled "Managerial Responsibility,"

General Accounting Internal Controls:
The Financial Officer is committed to the highest standards of fiscal integrity and accountability. It is their responsibility to ensure that accounting policies and procedures are being adhered to, and that internal controls are in place and operating so as to safeguard the institutions assets and ensure that all financial activity is accounted for properly. Financial oversight is provided by routine audits. The integrity of the USG financial statements and the integrity of the underlying financial system are the responsibility of the president and chief business officer.

	Cause The current structure was established prior to the rapid growth of Kennesaw State University evolving from a community commuter junior college to the third largest university in the University System of Georgia.
Risks	A failure to maintain effective internal control over financial reporting could result in a material misstatement of KSU financial statements or otherwise cause failure to meet financial reporting obligations.
Recommendation	We recommend the auxiliary accounting function have a direct reporting responsibility into the Assistant Vice President for Financial Management and an indirect reporting relationship to the Assistant Vice President for Auxiliaries Services and Programs. This reporting structure can assist in preventing or minimizing wrongdoing, build fraud detection into routine management and audit practices, as well as how to respond when there is fraud.
Management Response	

APPENDIX 1: Financial Income Statement Year Ending June 30, 2015

KENNESAW STATE UNIVERSITY
Auxiliary Services
Statement of Revenues, Expenses, and Changes in Net Position
Fiscal Year Ended June 30, 2015

	Main Campus Food Services	Marietta Food Services	Total Food Services	Main Campus Food Services	Main Campus PPV Dining Hall	Culinary Ser. Administration	Farming	Sushi	Freshen's	Chick Fil A	Jazzman's	Catering, Concessions and Vending	The Hoot	Burrito Bowl	Deli
Revenues															
Operating Revenues															
Sales and Services	$ 16,172,984	$ 3,387,565	$ 19,560,549	$ 16,172,984	$ 12,190,671	$ 298,106	$ 21,757	$ 55,724	$ 425,605	$ 1,198,551	$ 340,079	$ 795,935	$ 248,502	$ 298,590	$ 299,465
Less: Cost of Goods Sold	447,730		447,730	$ 447,730	305,000		15,000	350	18,430	31,200	1,000	73,750	1,000	1,000	1,000
Gross Margin	# 15,725,254	# 3,387,565	19,112,819	15,725,254	11,885,671	298,106	6,757	55,374	407,175	1,167,351	339,079	722,185	247,502	297,590	298,465
Expenses															
Operating Expenses															
Salaries															
Staff	658,462	(426)	658,036	$ 658,462		437,702	82,779					137,981			
Employee Benefits	224,294	(85)	224,209	$ 224,294		136,756	33,364					54,173			
Other Personal Services	414,198	28,440	442,638	$ 414,198	813,957	(548,926)		935	20,146	52,571	14,550	21,915	12,533	12,587	13,930
Contractual Services	137,325	(7)	137,318	$ 137,325	69,293		621	246	2,016	35,725	196	2,490	196	21,081	5,458
Travel	28,107		28,107	$ 28,107	596	25,767						1,745			
General Material and Supplies	12,154,702	2,737,992	14,892,694	$ 12,154,701	8,876,861	(167,325)	215,135	21,606	471,379	938,584	325,481	398,204	405,735	296,338	372,703
Consulting Exp./Per Diem	139,258		139,258	$ 139,258	15,217	123,753	239					50			
Utilities	265,943	88,101	354,044	$ 265,943	243,997	16,381	4,637		110	165	143	191	99	88	132
Depreciation - (Except PPV, GHEFA)	218,321	4,618	222,939	$ 780,299		665,036	11,686	33,783	12,808	460	1,543	918	553		53,512
Depreciation - PPV, GHEFA projects	617,844		617,844	$ 55,867	55,867										
Total Operating Expenses	$ 14,858,454	$ 2,858,633	$ 17,717,087	$ 14,858,454	$ 10,075,786	$ 689,145	$ 348,461	$ 56,571	$ 506,459	$ 1,027,506	$ 341,913	$ 617,667	$ 419,117	$ 330,094	$ 445,736
Operating Income (loss)	# $ 866,800	# $ 528,932	$ 1,395,732	$ 866,800	$ 1,809,885	$ (391,039)	$ (341,704)	$ (1,197)	$ (99,284)	$ 139,845	$ (2,833)	$ 104,518	$ (171,615)	$ (32,504)	$ (147,271)
Non-Operating Revenues/(Expenses)															
Interest Expense	(1,329,010)		(1,329,010)	$ (1,329,010)	(1,329,010)										
Gifts - non-capital	7,000		7,000	$ -											
Gifts - capital	(17,973)		(17,973)	$ 7,000	7,000										
Miscellaneous Revenues (Expenses)		396	396	$ (17,973)		(1,965)			(16,007)						
Total Non-operating Revenues	$ (1,339,983)	$ 396	$ (1,339,587)	$ (1,339,983)	$ (1,322,010)	$ (1,965)	$ -	$ -	$ (16,007)	$ -	$ -	$ -	$ -	$ -	-
Income before Transfers	$ (473,183)	$ 529,328	$ 56,145	$ (473,183)	$ 487,875	$ (393,005)	$ (341,704)	$ (1,197)	$ (115,291)	$ 139,845	$ (2,833)	$ 104,518	$ (171,615)	$ (32,504)	$ (147,271)
Transfers In/(Out)															
Mandatory Transfers			-	$ -											
Non Mandatory Transfers		(260,000)	(260,000)	$ -											
Total Transfers	$ -	$ (260,000)	$ (260,000)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Change in Net Position	$ (473,183)	$ 269,328	$ (203,855)	$ (473,183)	$ 487,875	$ (393,005)	$ (341,704)	$ (1,197)	$ (115,291)	$ 139,845	$ (2,833)	$ 104,518	$ (171,615)	$ (32,504)	$ (147,271)
Net Position															
Net Position-Beg.of Year as originally reported	$ (5,254,961)	$ 176,133	(5,078,828)												
Prior Year Adjustments			-												
Net Position-beginning of year, restated	(5,254,961)	176,133	(5,078,828)												
Net Position-End of Year	$ (5,728,144)	$ 445,461	$ (5,282,683)												

APPENDIX 2: Financial Income Statement 6 Months Ending December 31, 2015

Kennesaw State University
Food Services
Statement of Revenue, Expenses, and Changes in Net Position
For the Quarter Ended: December 31, 2015

	PPV4308000	PPV5003000					
	PPV - Dining Hall	**Marietta Dining Hall**	**Administration**	**Farming**	**Catering**	**Retail-Other**	**Total**
Department Numbers							
					1239100-700, 1250000, 1250100 1266769, 1270000		
REVENUES							
Operating Revenues							
Sales and services							-
Commissions	141,599.61	40,449.29	628.49	28,738.65	33,555.20	2,107,470.75	2,352,441.99
Catering	152,614.69				528,178.32	(17,287.79)	663,505.22
Other Misc	31,461.25		1,494,805.54				1,526,266.79
Meal Plans	8,099,333.80	2,123,454.32					10,222,788.12
Mandatory Meal Plans							
Access 220 Res Freshman	4,911,785.00						
Access 40 First Year Com	1,714,400.00						
Access 14 Resident	101,262.46						
Access 14 Commuter	985,277.54						
Access 7 Resident	13,970.98						
Access 7 Commuter	249,405.02						
Non-Mandatory Meal Plans							
Access 115	427,108.00						
Access 75	471,062.00						
Access 30	244,545.00						
Access 25	5,400.00						
3Square	494,073.00						
Gold	445,536.00						
Facullty/Staff Meal Plans	14,344.00						
Additional Plans/Upgrades Purchases	144,619.12						
Less: Cost of Goods Sold	1,638,341.14	471,118.52		9,097.87	111,534.42	522,780.40	2,752,872.35
Gross Margin	6,786,668.21	1,692,785.09	1,495,434.03	19,640.78	450,199.10	1,567,402.56	12,012,129.77
Expenses							
Operating expenses							
Salaries							
Faculty		-	-	-			-
Staff			298,745.98	43,768.14	52,750.02	7,053.04	402,317.18
Employee benefits			98,453.29	18,195.15	23,277.67	1,144.20	141,070.31
Other Personal Services			56.00				56.00
Personal Services Allocations							-
YTD Culinary O/H	208,510.31	107,445.64	(397,199.27)	8,480.64	13,539.63	59,223.04	(0.01)
ASaP Labor Alloc YTD	91,977.33	30,659.11		141.31	5,410.43	50,217.36	178,405.54

Plant Allocations			28,087.67			1,404.39	29,492.06
Contractual services	4,225,368.77	1,179,928.07		13,675.87	249,786.35	1,267,580.22	6,936,339.28
Travel	656.63		689.37				1,346.00
Travel Allocations							-
Scholarships and Fellowships							-
General material and supplies	820,918.00	218,177.55	284,843.46	35,102.08	15,870.85	411,856.26	1,786,768.20
General Operations Allocations							-
YTD Culinary O/H	176,459.93	64,931.15	(305,558.34)	6,875.06	11,458.43	45,833.76	(0.01)
ASaP Labor Alloc YTD	(17,399.99)	(5,800.00)		18.35	(1,023.53)	(11,232.51)	(35,437.68)
ASaP O/H Alloc YTD	30,351.40	10,117.13			1,785.38	17,432.41	59,686.32
Plant Allocations			45,227.02			2,261.41	47,488.43
Consulting expenses/per diem		155,443.28	236,602.23				392,045.51
Utilities							-
Electricity	26,951.40					6,514.86	33,466.26
Gas	30,581.11						30,581.11
Water	21,252.15			2,388.00		1,564.06	25,204.21
Telecom	4,268.45	635.94	5,387.59		308.69	27.45	10,628.12
Garbage Pickup	18,948.60					8,443.07	27,391.67
Depreciation	33,762.54	108.33	330,282.16	5,843.04	459.00	50,208.81	420,663.88
Total operating expenses	5,672,606.63	1,761,646.20	625,617.16	134,487.64	373,622.92	1,919,531.83	10,487,512.38
Operating income (loss)	1,114,061.58	(68,861.11)	869,816.87	(114,846.86)	76,576.18	(352,129.27)	1,524,617.39
NONOPERATING REVENUES(EXPENSES)							
State appropriations	-	-	-	-	-	-	-
Grants and Contracts	-	-	-	-	-	-	-
Interest income							-
Interest expense	(505,068.57)						(505,068.57)
Gifts, non-capital							-
Gifts, capital							-
Miscellaneous revenues			9,527.51				9,527.51
Total nonoperating revenues	(505,068.57)	-	9,527.51	-	-	-	(495,541.06)
Income before transfers	608,993.01	(68,861.11)	879,344.38	(114,846.86)	76,576.18	(352,129.27)	1,029,076.33
Transfers							
Mandatory Transfers	-	-	-	-	-	-	-
Non Mandatory Transfers	-	(260,000.00)	-	-	-	-	(260,000.00)
Total Transfers	-	(260,000.00)	-	-	-	-	(260,000.00)
Change in Net Position	608,993.01	(328,861.11)	879,344.38	(114,846.86)	76,576.18	(352,129.27)	769,076.33
Net Position							
Net position-beginning of year							
Net position-end of year	608,993.01	(328,861.11)	879,344.38	(114,846.86)	76,576.18	(352,129.27)	769,076.33
(equal to 3xxxxx period 0 next year)							
						less 1/2 of the $1,500,000	(750,000.00)
						adjusted Change in Net Position	19,076.33

APPENDIX 3: Current outsourced dining provider Contract Review

Board of Regents of the University System of Georgia
Office of Internal Audit and Compliance
Kennesaw State University
Chartwells Contract Review

This analysis is based on the auditor's interpretation of the Chartwell's contract and may not be the legal interpretation of this contract.

Additional payments to Kennesaw State University or its affiliated foundation.

reference	Additions to Basic Dinning Service	First Year's payout	Subsequent Years' Payout	Total 15 Year Contract Payout
L.41. page 21	Previous funded investment	$64,391.24	$64,391.24 for 14 years	$965,868.65
			$901,477.41	
L.41. page 21	"new" funds for investment	depends on draw	depends on draw	$25,187,000.00
	Required draw to meet contractor's "implement improvements" (note the paragraph after the schedule)			
	2015-16	$ 6,025,000.00		
	2016-17		$ 2,550,000.00	
	2019-20		$ 1,225,000.00	
	2021-22		$ 550,000.00	
	2023-24		$ 550,000.00	
	2025-26		$ 550,000.00	
	2027-28		$ 550,000.00	
	Additional $'s Available		$ 13,187,000.00	

APPENDIX 4: Current outsourced dining provider Contract Review

Board of Regents of the University System of Georgia
Office of Internal Audit and Compliance
Kennesaw State University
Chartwells Contract Review

This analysis is based on the auditor's interpretation of the Chartwell's contract and may not be the legal interpretation of this contract.

Additional payments to Kennesaw State University or its affiliated foundation.

reference	Additions to Basic Dinning Service	First Year's payout	Subsequent Years' Payout	Total 15 Year Contract Payout
L.38. page 21	Discounts for items purchased	Cannot calcul+C10:C31ate	Cannot calculate	Cannot calculate
L.39. page 21	35% gross payroll mark up	Cannot calculate	Cannot calculate	Cannot calculate
L.40. page 21	Signing Bonus	$1,500,000.00	$1,500,000 for first 2 years	$14,000,000.00
			$1,000,000 for 11 years	
			$12,500,000.00	
L.41. page 21	Previous funded investment	$64,391.24	$64,391.24 for 14 years	$965,868.65
			$901,477.41	
L.41. page 21	"new" funds for investment	depends on draw	depends on draw	$25,187,000.00
	Required draw to meet contractor's "implement improvements" (note the paragraph after the schedule)			
	2015-16	$ 6,025,000.00		
	2016-17		$ 2,550,000.00	
	2019-20		$ 1,225,000.00	
	2021-22		$ 550,000.00	
	2023-24		$ 550,000.00	
	2025-26		$ 550,000.00	
	2027-28		$ 550,000.00	
	Additional $'s Available		$ 13,187,000.00	
L.42. page 23	a. Catering services - President	$ 50,000.00	$ 700,000.00	$ 750,000.00
	b. Catering services - Cabinet	$ 30,000.00	$ 420,000.00	$ 450,000.00
	c. Student Scholarships, study abroad, internships.	$ 69,500.00	$ 973,000.00	$ 1,042,500.00
	d. Chef Liaison	$ 101,250.00	$ 1,417,500.00	$ 1,518,750.00
	e. farm operations	$ 180,250.00	$ 2,523,500.00	$ 2,703,750.00
	f. farm operations - one time gift	$ 100,000.00		$ 100,000.00
	f. donation to Auxiliary Services -	$ 30,304.00	$ 424,256.00	$ 454,560.00
	Totals	$8,150,695.24	$39,021,733.41	$47,172,428.65
		Subsequent year average	**$ 2,787,266.67**	

APPENDIX 5: Exception Ratings

Individual ratings are assigned to each assurance engagement observation contained in reports issued by the OIAC. ICAs may choose not to publish observation ratings but shall assign ratings to observations in the USG Internal Audit function enterprise system. ICAs shall use the USG Internal Audit rating system insofar as ICAs elect to publish observation ratings. All issues would be included in the audit report but "Comments" would not be presented in a full audit finding format. The scales for the USG Internal Audit rating systems are listed below.

Report Item Rating Scale

- Advisory
  - Categorized by area reviewed
  - Used to identify recommendations contained in a consulting engagement report
- No Issue
  - Engagement Team did not identify any reportable issue
  - Included in report and tracked in USG Internal Audit function enterprise system.
- Comments
  - Nominal or minor violations of procedures, rules, or regulations.
  - Minor opportunities for improvement.
  - Not included in report but are tracked in USG Internal Audit function enterprise system.
  - Corrective action suggested verbally, but not required.
- Significant
  - Significant violation of policies and procedures, and/or weak internal controls.
  - Significant opportunity to improve effectiveness and efficiency.
  - Significant risk identified.
  - Corrective action required.
- Material
  - Material violation of policies/procedures/laws, and/or unacceptable internal controls, and/or high risk for fraud/waste/abuse, and/or major opportunity to improve effectiveness and efficiency.
  - Material risk identified.
  - Immediate corrective action required.

Source: USG *Business Procedures Manual* § 16.3.8 – "Audits: Engagement Process: Exception Ratings"