AUD 1

BOARD OF REGENTS
AUDIT AND COMPLIANCE COMMITTEE

November 3, 2004

University of Northern Iowa
Cedar Falls, Iowa

Persons in attendance (not all-inclusive):

Committee members: Owen Newlin (Chair), Mary Ellen Becker, Robert Downer, David Neil, Rose Vasquez, President John Forsyth (ex officio)

Others: David Vaudt, State Auditor; Pam Elliott, Dick See, Sheryl Rippke, Tim McKenna, Jim Davis, Doug True, Gary Shontz, President David Skorton

Regent Newlin called the meeting to order at 9:30 a.m.

Minutes from August 3, 2004 Committee Meeting

Regent Newlin asked if there were any additions or corrections to the minutes. There were none.

MOTION
Regent Neil moved to approve the minutes of the August 3, 2004, Audit and Compliance Committee meeting, as written.
Regent Becker seconded.

MOTION CARRIED UNANIMOUSLY.

Revised Committee Work Plan

Regent Newlin stated that the revisions were suggested at the last meeting and asked if there were any comments or suggestions.

MOTION
Regent Downer moved to approve the revised Committee work plan.
Regent Becker seconded.

MOTION CARRIED UNANIMOUSLY.

State of Iowa Audit Reports

Regent Newlin asked the State Auditor if he would introduce himself.
David Vaudt, the State Auditor, introduced himself and Andy Nielsen, Deputy in charge of the Financial Audit Division.

**State of Iowa Audit Reports**
The Committee received reports relating to the comprehensive annual financial report and the single audit. Those two reports represent the Iowa statewide financial statements. The financial activities of the Board of Regents and its institutions are included in these reports.

Auditor Vaudt stated he would focus his comments on the audits of the Regent institutions mentioned in Agenda Item #4.

From his perspective, he wanted the Audit and Compliance Committee to be aware of some specific items. He also stated that he had positive news on all fronts.

Separate financial statement audits were done of all three universities, which were included in the books. A full scope audit was conducted on each university. In all cases, an unqualified opinion was issued stating that based upon the audit, the financial statements fairly present the results of operations and the financial condition of each university, based upon management’s presentation.

Additionally, audit procedures were conducted at the special schools and the Board Office. Those particular entities do not have a separate financial statement, but are included in the overall state audit report. The Auditor issued several recommendations.

Auditor Vaudt commented about findings at Iowa State University regarding grant management related to some federal programs. A couple of instances were also discovered on potential conflicts of interest at the University of Iowa and Iowa State University. In light of these comments, the universities have the right policies and procedures in place. It was those policies and procedures that identified these particular issues.

Auditor Vaudt invited any questions the Committee had. He again mentioned that his comments were all positive.

Regent Downer stated that following up on the last comment, he noted in the Report of Recommendations to the University of Iowa, near the end, under Conclusions, he read “we also acknowledge the University complies with the letter of the law, but there still remains the appearance of a conflict of interest.” He understood from the comments that Auditor Vaudt made that procedures are in place to deal with that appropriately.

Auditor Vaudt agreed and stated that in this case it was more of a lack of documentation to show that a potential conflict of interest was present. He thought that the universities were going to take the extra step of making sure that in each case it would be documented, as they made those decisions.

Regent Forsyth made some comments unrelated to the audit reports. He stated as he was looking back at the expense side of the projects for the last five years, he noted that at a time where appropriations were down dramatically, the costs relative to audits from the State Auditor had gone up dramatically. He said that in 2000, about $823,000 was paid. In 2004,
$904,000 was paid. He would be interested in hearing what could be done to curb that cost increase and what the Committee might expect for the future.

Auditor Vaudt said that one of the concerns he had as he came into office was how the State Auditor’s Office makes sure that it is providing effective, efficient audits for all government bodies. One of the things that has been done internally was to take a hard look at the procedures being conducted. He said that one factor that can vary costs depends on some of the federal dollars that the universities receive each year. He also said that some accounting requirements have changed over the last few years. Some new financial reporting issues also have come into play.

Auditor Vaudt said the State Auditor’s Office is working with the universities and internal audit departments to make sure they are working together, not duplicating efforts, and sharing efforts to make sure everything is being done as effectively and efficiently as possible. One of the things that was done this year in preparing the budget for fiscal year 2006 was looking at what was being done in fiscal year 2005, and holding the State Auditor Office rates per hour to the same rate that was in effect for FY 2003-04.

Looking forward, Auditor Vaudt said that work with the Committee, universities, and Board Office will include making sure they’re doing effective, efficient audits.

Regent Forsyth said the Board has greater focus at this time and will have a better opportunity to focus on the relationship and how it can be maximized.

Auditor Vaudt said he liked that approach. He would like to plan next year’s audits after talking with the Committee about the planned approach for the focus of the audits, and obtain the Committee’s input to make sure the Committee feels comfortable with the Auditor’s plan.

Regent Newlin followed up on Regent Forsyth’s question about state dollars going down and audit dollars going up. He asked whether the federal dollars that the University of Iowa and Iowa State University received offset those dollars and whether the complexity of the federal funds auditing is more of a challenge.

Auditor Vaudt stated that there are always more complexities with federal dollars and felt that will continue. Even though state funding has been there, total dollars that are being audited are still very similar to what they were previously; the sources are different. He said federal dollars always add complexities to programs and there is a lot the State Auditor’s Office does to comply with federal standards.

Regent Newlin asked Doug True to respond, relative to the University of Iowa.

Vice President True said you could look at federal funds that have gone up and tuition that has gone up. He said that the aggregate dollars for the institutions have certainly grown over that period of time, proportionately to the cost increases from the State Auditor. He said he felt that the best business practice was to lay out the audit function, lay out the course of the discussion with the Audit Committee, and have the Audit Committee understand the cost implications. He asked if there were ways to get as much done less expensively.
Auditor Vaudt commented there was one major financial reporting change, the Governmental Accounting Standards for GASB #34, which he felt was a dramatic change in the presentation of the financials. He felt that universities would agree that it was quite an effort to undertake the reformatting. As the process goes forward, he felt the State Auditor’s Office would have a better handle on those particular costs and bring the hours back down.

Regent Newlin asked Auditor Vaudt when he wanted to come back and visit with the Audit and Compliance Committee.

Auditor Vaudt said before June 30, 2005, would be a good time to come back and go through the planned audit approach, talk about the scope of audit procedures, and receive input from the Audit and Compliance Committee.

There was discussion about the May 4-5, 2005, next scheduled date for the Committee to meet. Auditor Vaudt said he would check with their schedules to see if that would work.

Regent Newlin asked if there were any other questions. He then asked for a motion to approve receipt of the reports.

**MOTION**

Regent Becker moved to approve to accept receipt of the reports.
Regent Downer seconded.

**MOTION CARRIED UNANIMOUSLY.**

### Sarbanes-Oxley Best Practices

Regent Newlin received a status report on the Regent universities’ activities regarding the Sarbanes-Oxley. An individual from each university came forward.

Dennis Domsic from the University of Iowa introduced himself and made the following comments: The first thing that the three universities did to adopt the Sarbanes-Oxley was to conduct a gap analysis. The gap analysis indicated that there were three areas to focus on over the next few months:

- The first area was refining and developing the business code of conduct.
- The second area was the development of a confidential reporting mechanism with anti-retaliation provisions.
- The third area was refining the financial certification practices.

The approach discussed was to select a committee or group of individuals that would pursue researching various areas. At the University of Iowa, a survey was conducted regarding the various codes of conduct, ethics policies, and policies regarding conflict of interest. There is an extensive list. The effort and focus will be to refine the staff ethics policy to focus on business practices. That will be made applicable to the senior financial officers and managers. In a document, they will also publish a summary of the other various codes throughout the University.
Gary Shontz, Controller at the University of Northern Iowa, introduced himself and made the following comments. At the University of Northern Iowa, they will develop a business code of conduct through a committee. They will develop a confidential reporting mechanism involving the reporting of the confidential matter to the Internal Audit staff. They will refine their financial certification practices. Currently, Controller Shontz and the Vice President for Administration and Finance Tom Schellhardt certified that the financial statements are accurate and certified to roughly 24 other points. The certification list is in the Board materials. It was designed to be quite extensive. For example, the Director of the Residence System would be asked to certify the data for that area, and the Director of Athletics would be asked to certify the data for that area. They would go through major areas, especially where they have audits of those areas.

Paul Tanaka, Counsel for Iowa State University, commented that they are following a similar pattern as the other two universities outlined. Iowa State University is expanding its business codes of conduct. He feels that the committees that are created will probably recommend trying to consolidate the codes. There is another entire set of codes regarding conduct and ethics. He believes that pulling some of these together would make the most sense. He feels that all of the provisions across the institution, as the other two universities outlined, need to be strengthened. As to confidential reporting mechanisms, there are some “whistle-blower” requirements that need to be in place at the institution. Finally, certification of financial practices within the organizational structure should be certified by the units that are developing that information. He feels the three institutions are following similar approaches, to get the issues implemented over the next several months.

Controller Shontz presented additional comments regarding the financial certification. University representatives have spoken with representatives from Price Waterhouse Coopers and some of the auditing firms and taken a look at the boilerplate language they use for certification. The typical management representation letter that is produced for the State Auditor in general is more comprehensive than that boilerplate language. In many respects, they may be ahead of the curve regarding financial certification. He continued by saying there is another area in the Act, Section 404, that deals with certification from terminal controllers. He feels that is a slightly more controversial and challenging area. Full compliance with Sarbanes-Oxley from that particular aspect would be expensive and would include a more extensive review of the internal controls. They actually intend to review the goals that are currently in place, document those and then possibly develop a training program for managers and financial officers that better defines the purpose of the kinds of controls in place. It would be a more incremental approach, rather than jumping into some form of external audit of the internal controls.

President Skorton wanted to emphasize that the universities are squarely behind the effort that Dennis Domsic outlined. Two previous efforts have been mentioned that some Committee members might be familiar with. One is that federally funded institutions, like Iowa State University and the University of Iowa, for a long time have had anti-retaliation of “whistle-blower” policies related to certain research procedures. Secondly, University of Iowa Hospitals and Clinics has procedures regarding irregularities with a phone number that can be called with concerns. Some ground has been broken on both of these issues, to protect employees from retaliation.
Dennis Domsic said the UIHC program has been very helpful and has worked very well. Within the University of Iowa itself, there are multiple avenues for individuals to bring up concerns. These include the Ombudsman’s Office and the Human Resources Affirmative Action Office. The direction that the university is currently leaning is developing a hotline for reporting of financial concerns, while at the same time publicizing the other avenues for reporting concerns for staff, employees, students and public individuals.

Regent Newlin stated there was going to be another report from the same committee in May, 2005. He asked the representatives of the three universities if they could assume they will continue to work toward implementation.

Controller Shontz responded affirmatively. He added that Sarbanes-Oxley does not legally apply to non-profit and governmental entities at this point, although there are individuals who believe that’s likely to happen. The National Association of College and University Business Officers has been trying to develop some national standards in this area, built around parts of Sarbanes-Oxley that appear to make the most appropriate sense for higher education. The expectation is that once those guidelines or standards come out, they can be properly implemented within the institutions. He feels this is an evolving process as it applies to governmental and non-profit groups in terms of pieces of Sarbanes-Oxley that seem to make the most sense.

Regent Newlin asked if there was a time schedule.

Controller Shontz said they hoped to have some of it done by spring.

President Forsyth concurred with the concept of doing this in increments. He feels this is a very expensive endeavor. The basics that were discussed, such as hotlines for whistle-blowers, he feels are very appropriate. He questions whether there should be one committee for the Regent enterprise rather than three committees that are doing a lot of duplication.

President Forsyth further commented that when one thinks about compliance, there is usually some mechanism for access. It doesn’t have to be Chair Newlin. It could be somebody in the Board Office. There needs to be a way under Sarbanes-Oxley that the person who has an issue knows he or she has various ways to express it, one of which can be a vehicle to get to the auditor of the government. He asked that as the universities put this together, to think about one hotline, instead of three different ones.

Controller Shontz said that conceptually the universities would agree with President Forsyth. He felt that certainly in areas like training and developing materials, the process they have been working on is cooperative. He said that one of the challenges of the hotline, if that’s the mechanism used, is that it involves seven days a week, 24 hours-a-day coverage. The universities have been trying to work through that.

Regent Neil asked about the possibility of utilizing a recording and getting back to the caller within 72 hours, two business days, or something like that. He wasn’t aware of too many Fortune 200 companies that have a 24 hours-a-day hotline.
Regent Newlin asked for any other comments or questions. He thanked the university representatives for the work they have done to date. He said they are obviously in the preliminary stages and expects a report in May, 2005.

President Forsyth indicated there are significant advantages to having a single committee; there are also some challenges associated with it. Each of the universities has its own culture and, when they begin looking at codes of conduct, he wants the universities to work very closely together to make sure they are heading in the same direction.

President Forsyth said he had a question related to the minutes. Since the University of Iowa was present, he said that in the minutes it was discussed that it didn’t have enough resources related to the Hospitals and Clinics. He felt that the Committee should understand that there are adequate resources for audits relative to the Hospitals and Clinics.

The Committee should make sure there are adequate resources available for the Hospital and Clinics. It was in the minutes in two different places, and it was his recollection that is exactly what was said. As the audit plans are put together, he feels the Committee should understand that there are adequate resources for the UIHC audit.

Regent Newlin said the Committee would receive the status report on Sarbanes-Oxley and expect another status report in May, 2005.

**Internal Audit Reports**

Regent Newlin moved to proceed with the Internal Audit Reports.

Director Elliott said that as the Committee may have noticed in the agenda item, it is color-coded now. The Board Office has worked with the internal auditors on getting definitions for high materiality, criticality, what’s moderate, and what’s low. She stated that each of those sections are defined at the bottom of page 3, as to what kinds of items that the internal auditors were thinking for each definition. Each of the auditors could address that, but she did want to point out that it was a coordinated effort among Board Office and internal auditors.

Director Elliott said that information on page 4 was also color-coded for the assessment of controls and efficiencies, with definitions. There had been some changes to those also. The blue is for consultation, which is not necessarily an assessment of controls and efficiencies.

She said that on page 5, the audits for all three of the university internal audits that were presented this month are, for the first time, color-coded for materiality and criticality, as well as control efficiency and assessment.

On pages 6 and 7, follow-up issues are defined. Those had changed slightly, and basically related to timing of follow-up. The red would be used if it were not completed within six months of the original schedule time.
Regent Becker said that when she looked through the material, she was a little surprised that there were so many materialities, criticalities…so many reds and yellows. Would that be because the internal auditors have already considered what might be audited and already narrowed down those that they thought would be more critical? She said one would assume there would be more of the high and moderate, because not many greens get in the mix.

Director Elliott said that was correct. When the internal auditors presented their audit plans in August to this Committee, they performed a risk assessment of the campuses and focused on those areas where there is a higher degree of risk. That is why most of those would be coded reds and yellows, with very few greens. She said the greens would not have a large audit impact. Referring to the definitions, she said if it is green in criticality and materiality, it would mean it has a very low potential of impacting the university. She said that the auditors would not devote their limited resources in those areas, but would focus on the ones that are red and yellow for criticality and materiality.

Interim Audit Director Dick See said it would not preclude Committee members from seeing green in that area. As auditors work through the schedule, they do receive requests from management for audits. He said they may have the perception that there are some weaknesses; they ask to have internal auditors come in and perhaps review those and note that they really are not weaknesses. However, to be able to record that activity, it may be shown as a green criticality.

Dick See said that the three internal audit directors worked with the Board Office last September in putting together the definitions to convey audit aspects. To be able to direct attention, that first in the high, under materiality criticality on page 3, that first bullet point, they were looking at potential harm to enrollment, teaching, research extension. Each of the definitions has an “or” so it only has to meet one of the criteria.

President Forsyth wanted to commend the auditors and the Board Office for implementing the process. He said he knew there was some reluctance at the beginning, but felt it was helpful for everyone to be able to look at it. He felt the definitions were going to evolve over time and not be locked into any set of words.

President Forsyth felt it was very helpful because it was easy to see what was being worked on and how important it was. He felt it made it easy for somebody looking at the information to really understand. It is more transparent for the members of the Audit Committee, and a lot less work to understand. He felt that over time that questions from the auditors would help the Committee better understand what the audit system is about and what the auditors are doing. Then the Committee can tie that in with the State Audit and have a better understanding of how everything links and what is being paid for from the State Audit perspective. He thinks this is a great step and everyone should be commended.

Interim Director See said that as President Forsyth mentioned, it was an evolving document in that some published reports may have many different types of comments, where one or two comments may be of a critical nature and be assigned a red code for controlling efficiency assessment, but then perhaps another set of comments may be of less critical nature and may be a green code. He said the one color assigned up front would be a weighted average based on the individual audit team and their assessment. For additional
information to the Committee, he thought it would be helpful to assign a color to each one of those comments.

Regent Newlin thought that would be good.

Internal Audit directors provided brief overviews of the original audits presented this month.

**External Audit Report – University of Northern Iowa**

**Fieldhouse Operations Concessions**

Operations Auditor McKenna said this item included two reports; one is a copy of the external report, completed by Carney Alexander for the University of Northern Iowa Fieldhouse Operations Concessions. He said concessions were started in-house by university personnel in 2001, so it was a relatively recent start-up operation. Prior to that, the University had outside vendors. He said the University started its own concession operation to increase and enhance the variety of concessions at different events.

He said there were a number of recommendations. Operations Auditor McKenna said his was follow-up work conducted. All the open recommendations that Carney Alexander noted were completed and everything appeared to be implemented with concession operations as of the time of the follow-up.

Regent Newlin asked for other comments and there were none.

Regent Newlin said the work plan indicated that the next meeting was February 2-3, 2005, in Iowa City, and he asked if anyone had any comments regarding the agenda for that meeting. He said if anyone had suggestions, Director Elliott would be happy to receive those.

The meeting adjourned at 11:20 a.m.