

**BOARD OF REGENTS, STATE OF IOWA
AUDIT AND COMPLIANCE COMMITTEE**

February 2, 2005 – 10:15-11:45 a.m.

University of Iowa
Iowa City, Iowa

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

Chair Regent Newlin called the meeting to order at 10:24 a.m.

AUD 1. Minutes from November 3, 2004, Committee Meeting

The minutes will not be available until the next Board meeting.

AUD 2. Revised Committee Work Plan and Committee Activities Review

The Committee reviewed its activity since inception.

Regent Newlin referred to the Sarbanes-Oxley Act and how some procedures have been implemented, such as revised audit policies. Each institution is working on implementing best practices outlined by Sarbanes-Oxley.

Regent Newlin accepted the report.

AUD 3. Semi-Annual Claims Activity Report

Regent Newlin recognized Susan Anderson, who introduced the institutional representatives.

Comments of Susan Anderson, Regent Associate Counsel

Last May, the Committee asked that institutional claims activity reports be provided on a semi-annual basis to the Audit and Compliance Committee. The first set of claims activity reports was put on the work plan to be received today. This group of activity reports covers the period of July 1 through December 31, 2004.

The Board Office received claims activity reports from each of the five Regent institutions. Each institution prepared an executive summary, which identified for that particular institution

any trends in its claims activity, any strengths observed, any areas for improvement, and initiatives to address those areas for improvement.

Representatives from each of the institutions were present who worked on the reports and could answer questions. Those individuals were:

- Paul Tanaka, Iowa State University
- William Hesson, University of Iowa Hospitals and Clinics
- Dr. Jeanne Prickett, Superintendent of the Iowa School for the Deaf
- Marc Mills, University of Iowa
- Tim McKenna, University of Northern Iowa
- Dianne Utsinger, Iowa Braille and Sight Saving School

Regent Newlin said he would like to have each institutional representative make a few comments about the report and how they prepared it.

Comments of Paul Tanaka, Iowa State University

Traditionally, bi-monthly reports have been prepared regarding claims activities at the University. This was the basis for the six-month report the Board requested. The university prepared by first looking at all the claims and then dividing them into the categories requested.

For the first report, Mr. Tanaka tried to give a background for what the university's claims experience has been in the approximately 11 years since the Office of University Counsel has existed.

Comments of Marc Mills, University of Iowa

Mr. Mills introduced William Hesson of the University of Iowa Hospitals and Clinics.

As has been mentioned, this is a new exercise for the university. Like all the institutions, being somewhat decentralized, they went around to a number of different offices to collect the information in the format requested. Information was gathered on litigation, tort claims, and administrative claims that have been made against the institution, whether in the affirmative action area or discrimination area, or other areas, as well as internal claims.

In a general sense, this first report is a benchmark, and the university doesn't have specific historical information other than some general trends. It is hoped that once the format for the reports is established, this will be easier to do.

Comments of Tim McKenna, University of Northern Iowa

Similar to the other institutions, the university has been preparing reports that were sent to the Board Office every other month. This was, in a lot of respects, a continuation of that. There were a couple of categories or parts of the report that were new, so staff had to gather additional information.

It was a very collaborative process, because staff gathered the information from a number of different sources across campus, including Human Resource Services, Compliance Equity Management, the Provost's Office, and others.

Basically, there were not a lot of trends that were seen from the university. There were not a large number of claims or lawsuits.

Comments of William Hesson, University of Iowa Hospitals and Clinics

The UIHC claims information was contained in the overall University of Iowa report. The legal office at UIHC very closely follows tort claims and litigation related to activity within the institution and has been doing so for a number of years.

The variation of data points around the Hospitals claims trend line would be extraordinary. The information is collected and becomes the data source for the various quality improvement activities at the Hospitals. They do not look at claims data as either very sensitive or specific, in terms of helping to identify areas for improvement.

Comments of Jeanne Prickett, Superintendent of the Iowa School for the Deaf

This summary was very brief, as the school has considerably fewer staff than the three Regent universities.

School staff was surprised at the low number of workers compensation claims, given some increases in the numbers of challenging students enrolled. Usually student behaviors contribute to injuries, but staff was very pleasantly surprised with the low number. It is statistically impossible to analyze trends when you have fewer than 10 claims of any kind. One trend observed was an increase in internal grievances through AFSCME. Three have been withdrawn within the short time frame that they were active. Two are processing currently and are almost final.

Comments of Dianne Utsinger, Iowa Braille and Sight Saving School

The school is small and that allows the claims function to be centralized. Fortunately, it has had very small numbers of claims activity over the last two decades. Staff do track workers compensation very closely, because that's where they find the most activity.

They contract with Sedgwick to work with workers compensation claims, and they follow Iowa Braille and Sight Saving School people very closely. The school's number of injuries is much higher than the School for the Deaf during the last six months, which surprised her. The numbers were not unusually high for the school, in part because they teach staff to report every single incident injury. They do so for the students and for themselves. If someone falls while going upstairs and bruises a shin, the report is filed that day as a workers' compensation injury.

Regent Arbisser asked if the Committee could get a similar report from the Board of Regents Office itself. Ms. Anderson said that could be done for the next reports to be presented in August.

Regent Becker commented that she was very pleased with the report. She felt it helped her as a Regent to get an overall sense of what information is available and of the institutions' understandings of the trends.

Regent Newlin asked Regent Becker if she felt the detail of the report was adequate for the requested data, and Regent Becker said yes.

AUD 4. State Audit Reports – Report of Recommendations on the Review of Selected General and Application Controls over Accounts Receivable System (SUI)

Comments of Doug True

Doug True introduced Terry Johnson, the University of Iowa Controller who works closely with the State Auditor's Office.

Both Vice President True and Controller Johnson reviewed the audit. Vice President True felt the most important thing to note is the action on management's response on page 2 of the summary. He felt that all of the actions that were committed to have been accomplished, and that was important for the Committee to know.

Comments of Andy Nielsen, State Auditor's Office

Mr. Nielsen gave a little background on how this report came about.

Each year, at each of the three universities, the state auditors go through a risk assessment exercise to determine which information technology program they want to look at. This is done on a rotating basis. He has reported in the past where they are on some of those rotations. The state auditors pick out a program and pick out some of the general and application controls. For a very large program, three findings is a very small number of findings. The findings weren't terribly important, but he thought they were items that were able to add some value. The essence of the recommendations has been implemented, and that's what the state auditors like to see happen.

Regent Newlin said he was pleased to hear that they implemented everything.

AUD 5. Bond Audit Reports

A. University of Iowa

Comments of Doug True

Annually, audit reports on all bonded enterprises are provided to the Regents and the Committee for each of the universities. Bond covenants require that an annual financial audit be conducted and reported to the Regents.

One of the things the Committee has also asked for is for the institutions to be present, as well as the individuals who conducted the audits. For example, at the University of Iowa, Mark Berhney with Deloitte & Touche has been the auditor for the bond audits for some time. The bottom of the first page indicates there were no findings that were reported regarding financial or compliance issues with the revenue bond resolutions. Mr. Berhney can address any questions the Committee might have regarding the University of Iowa's bond audits for the last year.

Comments of Mark Berhney, Deloitte and Touche Representative

Mr. Berhney said the financial statements fairly present the financial position and result of operations of the bond funds. The significant accounting policies followed by the bond funds are disclosed in the report. It is their judgment they are on the conservative side. They had no disagreements with management regarding accounting or reporting issues, and they had the full cooperation of university management in conducting the audit.

Matters discovered in the audit were very minor. These details have been provided to the university for consideration to report in the future.

Regent Downer said that on page 2 of the report, it stated that Deloitte and Touche "noted an exception to each of their opinions, indicating that the omission of the statement of cash flow results in an incomplete presentation of the financial statements." The other auditors apparently did not note that, although it appeared that the same alleged deficiency was present in those cases. He wondered, in Deloitte's opinion, the significance of this and whether it is something the Committee should be concerned about in terms of asking the institutions to do whatever would be necessary to eliminate that exception.

Mr. Berhney said there has been some confusion as to whether a statement of cash flow is required or not. Their understanding was there was a meeting some time this past year with the GASB where it was decided that those types of special presentations still did require the statement. The statement just shows the sources and uses of funds. It would be relatively easy to prepare. Whether the Committee would want to require that, Mr. Berhney didn't think it added a lot to the financial statement disclosure, although it is a required statement in his field.

Regent Downer said he noticed in several areas, under Current Liabilities, there was an indication of checks written in excess of bank balance, which he felt is always a concern when that is seen on a financial statement. He wondered if this was something where those had just been written or whether, in Deloitte's opinion, this was a matter with which the Committee should be concerned.

Mr. Berhney said no, that basically the university pools all of its funds together in a pool cash management. From time to time, they might write checks in excess of the pooled cash on hand at the university, but they also have other investments that could be used to draw on those checks. From a financial reporting standpoint, one has to look at the checks drawn on a particular bank account. To the extent that is a negative balance, that needs to be shown as a liability. So, it's a common practice and nothing to be concerned about.

Regent Newlin asked the other institutional representatives if they had any problem with a cash flow statement being included.

Comments of Controller Margaret Pickett, Iowa State University

Controller Pickett said she would defer to Andy Nielsen, representing the state auditors who do the university's bond audits. She said that because of the fund presentation that's followed for these audit reports, which are designed to demonstrate the institutions' compliance with the bond covenants, it would be very difficult to present a cash flow statement. As accountants, they are trying to figure out technically how that could be done, because multiple funds are being reported on in this case. Whereas in the annual financial reports for the university, which does present cash flow statements, it is a single column format, and following cash in that format is a lot easier to do.

Comments of Andy Nielsen, State Auditor's Office

Mr. Nielsen thanked the Committee for the opportunity to visit about the issue. When GASB 34 and 35 came along and they looked at the format, the state auditors talked with GASB a little bit about the nature of the types of reports that they were looking at. Each of the individual bond audits is a separate fund. It has several accounts within that fund that are set up to basically determine compliance. A bond audit is probably going to be an incomplete presentation for any other purpose, other than just for the bond audit purpose.

Even the most recent audit and accounting guide talks about which financial statements are required. It is the state auditor's belief, although another firm could have a different belief, that for this type of single fund presentation, a cash flow statement is not required. That's why the state auditors did not qualify their opinion on those financial statements.

Regent Downer questioned if a cash flow statement was needed. Mr. Nielsen suggested that if you do have a cash flow statement, do so for each individual bond audit; and for however many there are for each institution, add another level of financial statement. You would want to add not only the multi-column various account presentation, but you also would want to show a single column derivation of that. In other words, you would want to collapse and make consolidations of the multi-columns into a single column. Once you came up with that single column presentation for the statement of net assets, statement of revenues, expenses and changes on net assets, at that point you would have a basis to prepare a statement of cash flows that would make some sense. The reason it would make sense at that point, where it doesn't in individual columns, is that some of the accounts that are present in the various audit reports, he defined whether to do a cash flow statement for them. It would not be possible, because there was nothing there and nothing to report, as there is no cash flow in some of the plan accounts.

Mr. Nielsen said that with the advent of GASB 34 and 35, one thought is whether the segment information that is included in each of the university's financial statement footnotes could be used to meet the requirements of the bond audits. He doesn't feel that will be done soon, as they have some multi-year bond resolutions that will need to be amended and legal interpretations will have to help pave the way with that.

This could reduce some expenses, and the format could be set up so that the segment footnote could include the footnote deemed necessary by the resolution. The other problem is that most bond audits required a short time frame. The audit work has to be done within 90 days. Obviously, for a set of university financial statements, that's a pretty aggressive time frame, so the time frame for the bond audit would have to be expanded.

Comments of Tom Schellhardt, University of Northern Iowa

Mr. Schellhardt introduced himself and two other individuals, Gary Shontz, University Controller and Treasurer, and Mike Minders, a partner with Carney, Alexander, Marold & Co. He asked Mr. Shontz to comment on Regent Downer's question about a cash flow statement, as he deals extensively with the audit.

Comments of Gary Shontz, University of Northern Iowa

In the general purpose financial statement, the University of Northern Iowa does show some segment information, as do Iowa State University and the University of Iowa, that recapitulates very accurately the activity in its bond issues. Technically, he felt they could do the cash flow work; however, he would personally question the value that it would add. At this time, it was not a required statement from GASB.

B. Iowa State University

Comments of Margaret Pickett, Iowa State University

Controller Pickett said it was basically the same information as given on the University of Iowa. These audits are conducted in order to demonstrate compliance with the provisions of the bond covenants. At the current time, they do separate reports for each bonded entity and their reports are all presented. The one exception that was noted in Iowa State University's case had to do with the \$10,000 insurance deductible on Hilton Coliseum on the bond covenants, which are almost 40 years and require a \$5,000 deductible. It is not possible to purchase insurance with a \$5,000 deductible. They have a very low deductible requirement in their dormitories and dining, and in that case they were able to work with bond counsel to develop an escrow procedure and agreements that if they put in enough money to make up the difference between what the bond covenants require and what the deductible and the insurance is, that that would be acceptable. The legal work and costs for doing that are pretty high for a \$5,000 difference, so they are living with that difference. She didn't think the State Auditor had any issue with that, but deferred to Andy Nielsen.

Comments of Andy Nielsen

As is seen with the individual reports, the state auditors were able to issue unqualified opinions on all of the bond audits. The only relevant issue noted regarding compliance was the insurance issue. They did accept the response of Iowa State University and felt its decision was very prudent, under the circumstances. He said their office had no problem with that decision.

C. University of Northern Iowa

Comments of Tom Schellhardt, University of Northern Iowa

The University of Northern Iowa has five bonded entities: the academic buildings, the field house enterprise, the residence system, the student union, and the student health clinic. Their external audit partner found no material findings. He asked Mike Binders from Carney Alexander for comments.

Comments of Mike Binders, Auditor, Carney Alexander

Carney Alexander have been the bond auditors for the University for a number of years, working with Gary Shontz and his staff and have found the firm to be very dedicated and very meticulous in the work they do. They issued unqualified opinions on the five bond audits and found no major findings that needed to be reported.

The university is always very responsive to anything that they do suggest and guarantee that if anything would have come up, they would have brought it to the Committee's attention. The university has been very diligent in their ability to do this.

There is a very small window to get these audits completed, and the auditors do work very well with the staff at the university. They try to complete the audits in the time frame, meet the needs of the bondholders, and get them to the Committee's attention as soon as possible.

Regent Downer asked all three of the chief financial officers how frequently they solicit bids on these audits.

Doug True said that the University of Iowa has solicited bids every five years.

Margaret Pickett said that Iowa State University ordinarily solicits bids every five years. It would have been due to solicit last year, but because of the implementation of GASB 34 and 35, the staff was overwhelmed last year. They deferred soliciting until this year and have a request for proposals ready to go out for the bond audits that will be effective for the 2005 fiscal year, with renewals for the five following years.

Tom Schellhardt of the University of Northern Iowa said they follow the same practice. They competitively bid every five years.

Regent Newlin asked the State Auditor if it would take these audits with or without a cash statement.

Comments of Andy Nielsen, State Auditor's Office

Mr. Nielsen said yes, at this time, absent something authoritative in writing, they would take the audits with or without cash flow statements. As quite frequently happens in the accounting world, things do change. If there is written guidance that is given to them that

indicates that cash flow statements are required, they certainly would be on board with that. They want to make sure they are doing the right thing, as far as the profession goes.

As has been mentioned, he was not sure that the cash flow statements add a lot to the presentation, particularly when it's an individual fund of a multiple account presentation, but said he would certainly continue to look at that.

Regent Newlin asked Mr. Berhney if he was convinced and he said that he wasn't. He said they did discuss the matter with the head of their governmental accounting practice and he was adamant that was the conclusion which was reached. Again, this is an evolving area, but the guidance isn't exactly clear on this. He could see how firms might have a different view. His firm's view is that the financial statement of cash flows is required.

Regent Newlin said he didn't know about the next meeting of this Committee, but thought they would want it one way or the other. Regent Downer said it seemed to him that having uniformity in the practice would be preferable to having opinions without any qualifications in them at all.

The audit reports were accepted by general consent.

AUD 6. University of Iowa Hospitals and Clinics Audit Report

Comments of Anthony DeFurio, University of Iowa Hospitals and Clinics

Mr. DeFurio, UIHC CFO Director, introduced himself and Dan Koraleski, audit partner from KPMG.

Mr. DeFurio thanked the entire hospital staff. He said that normally a financial audit is a very intensive process. They instituted a number of procedures this year specifically related to inventory control that requires the participation of the entire UIHC staff and that received tremendous support. He also thanked his finance and accounting staff, Michael Murphy, Mark McDermott and Tom Nedeliki, in bringing the financial statements to a new level of quality. He also recognized Dick See and Deb Johnston, who were present and also extremely supportive this past year.

The most notable piece in the audit is related to the changes related to the patient billing operation, which they previously discussed with the Regents. He believes the receivables position is much more accurately and completely accounted for, as well as the very dramatic increase in cash in the past year. This again required an immense amount of work on the part of the staff. He asked Dan Koraleski for his comments.

Comments of Dan Koraleski, KPMG

Mr. Koraleski wanted to talk about the results of the audit. They were engaged in conducting an audit of the University of Iowa Hospitals and Clinics, which has been done and completed. They have issued an unqualified opinion and finished that work in October.

The audit process begins with understanding the internal control environment of the hospitals and clinics. To understand that, they determine what the risks are of the organization, thus helping test for those risks. They spent a lot of time looking at internal controls surrounding processes, such as revenue. They looked at the processes of admissions, discharge, and documentation of medical records. They also looked at collection and at the expenditure, whether it would be capital or not capital, salaries and benefits and so on. In the report this morning, they look at risk management also. They look at incident reporting to make sure that claims are being filed and being reported in a reasonable period of time. They also look at financial reporting to try for accuracy.

They do not issue an opinion on internal controls, which is now required for companies subject to Sarbanes-Oxley, but they did issue a letter to the Board of Regents that indicates as part of the control work, they did not find any significant insufficiencies in internal control. That is very important as part of the audit.

As the audit was being conducted, they looked at accounting policies and changes in policies, which there weren't any during the year. Again, if there is an accounting policy change, they would want to make sure the control environment supports that change. Then they will look at judgments and estimates. Mr. DeFurio described accounts receivable. There are millions of dollars of estimates that are calculated in connection with receivables, to determine the net value of receivables. They look at management's process, evaluate that process, test it and have concluded that the process is conservative and very reasonable in relationship to the areas that were tested.

There were no significant audit adjustments and no disagreements with management. He reiterated what Mr. DeFurio had said, his team pulled together and helped KPMG get through the audit.

Chair Newlin asked whether the auditor's management letter was available.

CFO Director DeFurio said he had some medical problems and said that's the reason it's not yet complete. He believes they are within days of finalizing that. He would like a chance to review it and also have Donna Katen-Bahensky review it.

Regent Newlin asked when they finished their audit. CFO Director DeFurio said the last day of field work was October 13, and they issued financial statements in the first few weeks of December.

Regent Newlin asked for any questions. Regent Downer said as the most vocal critic on the accounts receivable issue over the last year or so, he commended Mr. DeFurio and his staff for everything that was done. Seeing an increase in approximately \$140 million in cash collections is truly outstanding. He feels that validates what Mr. DeFurio was saying all along, when some of the Committee were having a hard time buying into it.

Mr. DeFurio added that the quality of the receivable base is much better going forward, so the university should see improved collections over the previous year, although it won't obviously be \$140 million. He said that cash flow operations last year were \$117 million versus the year before, which was \$4 million. He felt it was a tremendous improvement in cash flow.

Regent Newlin referred to pages 22-23, note (8) of the Notes to Financial Statements. He asked for a discussion about the relationships between UIHC and College of Medicine and the \$75 million.

CFO Director DeFurio said every year, part of the audit procedures that KPMG tests on the hospitals' behalf are the related party transactions, which actually occur with many of the organizational units within the university. Primarily, the largest volume and dollar magnitude of those transactions occur within what is generally called central administration of the university and with the College of Medicine. They do have interaction and purchase service transactions with the College of Nursing, the College of Pharmacy, the College of Dentistry, the graduate school of public health. As part of the Hospitals Executive Board Committee report this afternoon will be further details of those dollar amounts. Important for this Committee is that KPMG does test and thoroughly review those transactions. They consistently report from year to year as part of the audit.

Regent Downer asked Mr. DeFurio if they followed the same schedule as was reported by the CFOs for the universities as a whole, with respect to bidding the hospital audit. Mr. DeFurio answered yes. The audit just completed was year five of the RFP process for the hospital audit specifically. They will be issuing in the next couple of weeks a Request for Proposal to KPMG and other qualified firms. UIHC is also on a five-year cycle, and just happen to be at the point to go through the bid process again for the coming year.

AUD 7. Internal Audit Reports (SUI/UIHC)

Comments by Director Elliott

Director Elliott pointed out that each of the comments has been individually color-coded by the auditors. The overall evaluation of those comments is done by the internal auditors. For example, there might be two red, two green and two yellow comments for one audit, but the overall judgment of the internal auditors for the control/efficiency assessment is yellow.

Iowa State University's one audit, the National Automated Clearing House Association, that the University's Treasurer has asked be done every year. There were no reportable findings. This is to be expected with a repeat audit.

Tim McKenna reported that the University of Northern Iowa had no internal audits for this Committee session. There was one report sent in approximately two weeks ago, but did not make it in time to make the docket for this meeting. The matrix is still due to be submitted for that one. They have two more that should be completed within the next couple of weeks.

Regent Downer asked if one of those would be the Conference and Event Services.

Mr. McKenna said he was just talking about original reports. He said he would be happy to talk about the Conference and Event Services and what has transpired. This is a follow-up report that is due. The original report on that had five audit recommendations. Internal Audit did a follow-up on the Conference and Event Services and four of those five

recommendations were taken care of and closed, which left one audit recommendation open. The internal auditor visited Conference and Event Services half a year after that to check on that final audit recommendations. The Conference and Event Services had done some work in that area. The audit recommendation was a cost recovery study. They wanted to make sure the office was looking at its costs and how it was trying to recover that, in the scope of its day-to-day activities and the different events and services it was providing.

Internal Audit was not 100 percent satisfied with part of the work that was done or that the Conference and Event Services had a good history at that point of the second informal follow-up. At this point, the internal auditor actually met with the director of Conference and Event Services last Thursday and had already scheduled a meeting for tomorrow. They expect to have this resolved by talking with the program director or individuals above that person, if needed, within the next month or two.

Mr. McKenna said it was not a major issue. It was partially tied with the original report. They had a deficit with their accounts. That was taken care of and there has been no problem with the deficits. It's just been the one issue of trying to make sure they have a good business practice in place so they know what they're doing with their various programs and events.

Regent Downer thanked Mr. McKenna for the explanation. He felt it creates a cause of concern for the Committee when this has been open for that long. Mr. McKenna agreed and said they have the same concern.

Regent Becker said it would have been her preference to move to the department head of that program a little sooner than was done. Mr. McKenna said that was a true statement and agreed that it should have been done.

Regent Newlin accepted the audit reports by general consent.

Dick See had one request for the Committee, to revisit some wording. These are documents that we become accustomed to working with on a day-to-day basis. On page 6, the dashboard color code for follow-up issues, the issue being brought to the Committee is a request to change the definition for the color green. That request is that in working with trying to put the follow-up audits assigned the correct color, an issue was encountered where there was a three-month gap in the definition, where the green should be assigned to when a follow-up is completed to the time we base it as reported to the Committee in the matrix.

The yellow color is then to be assigned to the follow-up reports that are greater than three months beyond that date of expected completion, which leaves the gap of three months between the date of completion and three months beyond.

They request a re-wording of the definition of the green to say that the following report is completed by or within three months of the original scheduled date and all issues are resolved. On occasion, they do run into situations that their clients have encountered, timing that is outside of their control or developments that come up when they are making their best effort to complete their corrective action, where they need a little extra time.

