PROPOSED NEW BOND AUDIT FORMAT

**Action Requested:** The Regent universities seek approval to use segment footnotes in each university’s audited financial report to serve as the required annual financial report for each bonded enterprise and for Academic Building Revenue Bonds, with one exception - the University of Iowa Hospitals & Clinics would continue to prepare an audited financial report each year.

**Executive Summary:** Beginning in FY 2009, the three public universities propose using the segment footnote shown in each university’s audited annual financial report to satisfy the audit requirement found in every bond resolution. The State Auditor’s Office will conduct bond audits and the segment footnotes.

If approved, each University’s audit bill will be significantly reduced since most of the work currently performed by each bond audit firm is replicated when the State Auditor’s Office reviews the segment footnote. In addition, staff time associated with preparing the bond audits will be reduced.

FY 2008 will be a transition year in which a stand-alone bond audit will be produced and the segment footnote will be expanded to provide all the necessary information required by the bondholders, bond rating agencies and the Auditor of State.

**Background:** In accordance with the Code of Iowa, Chapter 262, the Regent universities created a number of bonded enterprises to provide important services to University departments, faculty, staff and students or the general public. Some examples include: athletics and recreational facilities, dormitories, parking facilities, student unions, student health centers, utility systems and telecommunications systems. Bonds are issued by the Board to finance new construction or major renovation of buildings and facilities operated by the enterprise anticipating future revenue of the enterprise. As required by Iowa law, each bonded enterprise pledges certain streams of revenues generated by the enterprise to fund debt service payments. The covenants associated with each bond issue are described in the Bond Resolution prepared by the Regents bond counsel, Ahlers & Cooney, P.C. One covenant found in every bond resolution requires that an annual financial audit be prepared by an independent audit firm. Even though Academic Building Revenue Bonds (ABRBs) are not establish as bonded enterprises, each Regents institution employs a bond audit for their respective ABRBs, which will also become subject to this new bond audit format.

Segment footnotes found in each University’s audited financial report are required under governmental accounting standards and provide segmented information for each bonded enterprise and each University’s ABRBs. The segment footnotes represent identifiable activities for which one or more revenue bonds or other revenue-backed debt is outstanding. Beginning in FY 2008, the segment footnote is being enhanced to include all financial information required by Moody’s or Standard & Poor’s to provide a debt rating on each bonded enterprise.
Currently the following firms conduct bond audits:
  o McGladrey & Pullen audits the University of Iowa except for the University of Iowa Hospitals & Clinics audit, which is prepared by KPMG Peat Marwick.
  o The State Auditor's Office audits Iowa State University
  o Carney, Alexander, Marold audits at the University of Northern Iowa.

It is important to note that these bond auditors already rely heavily on the work performed by the State Auditors Office in auditing the annual financial report (e.g.: cash and investment workpapers, IT system audits, etc.). The bond audit fees for fiscal year 2009 are estimated to be:

<table>
<thead>
<tr>
<th>University</th>
<th>FY2009</th>
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<tbody>
<tr>
<td>University of Iowa</td>
<td>$ 67,500 (excludes UIHC)</td>
</tr>
<tr>
<td>Iowa State University</td>
<td>$ 62,800</td>
</tr>
<tr>
<td>University of Northern Iowa</td>
<td>$ 23,650</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$153,950</strong></td>
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</tbody>
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The State Auditors Office currently expends significant billable hours each year reviewing bonded enterprises in performing the annual financial audit. To complete work related to the enhanced bond segment footnotes, the State Auditors Office projects it will bill the universities approximately $51,000 in additional fees. Therefore, it is expected that by using the State Auditors Office for these segment footnotes and not hiring external audit firms, audit fees will decrease by approximately $100,000 per year. Since audit costs are charged directly to each bonded enterprise, savings will be realized by the enterprises.

In November 2007, representatives from each university, the Board Office, Springsted, Ahlers & Cooney P.C., and the State Auditors Office met to review the enhanced segment footnote prepared by the University of Iowa in consultation with the State Auditors Office. Following that discussion, and several subsequent conversations and meetings, Springsted Incorporated reviewed this proposal with the bond rating agencies, Moody’s and Standard & Poor’s, and received approval from the rating agencies that the segment footnote developed would satisfy the bond audit requirement. The rating agencies stated this would simplify their review because the financial information needed to provide a bond rating would be contained in a single university report.

Upon Board approval of this request, each university will contact the current bond audit firm to terminate the professional services arrangement.