

Audit and Compliance Committee Memorandum
Board of Regents, State of Iowa

Subject: Sarbanes–Oxley Best Practices
Prepared by: Jean A. Friedrich
Date Submitted: October 20, 2004

Recommended Action:

Receive the status report of the Regent universities' activities regarding the Sarbanes–Oxley Act.

Executive Summary:

At the request of the Audit and Compliance committee at its August meeting, the Regent universities outlined the status of their implementation of Sarbanes–Oxley activities.

The Regent universities jointly conducted a Gap Analysis of the Sarbanes–Oxley provisions and have adopted an action plan.

Each Regent university has appointed a committee of select staff to evaluate Best Practices consistent with Sarbanes–Oxley. Three primary focus areas have been identified.

1. Refinement/development of a business code of conduct.
2. Development of a confidential reporting mechanism with anti-retaliation provision.
3. Refinement of financial certification practices.

The Committee's Work Plan has been modified to include another status report on the universities' Sarbanes–Oxley activities in six months.

Background:

Sarbanes–Oxley Act of 2002 The Sarbanes–Oxley Act of 2002 defines “corporate responsibility” related rules for the accounting professions, auditor/client relationships, and governance of publicly traded US companies. Regent institutions as public entities, though not subject to Sarbanes–Oxley, may benefit from implementing Best Practices associated with Sarbanes–Oxley requirements.

Objectives The primary objectives of the Act seek to improve corporate management, financial reporting, internal controls, and executive conduct by:

- Enhancing the integrity and reliability of financial reporting
- Strengthening corporate governance and accountability
- Improving disclosure
- Increasing oversight and enforcement of federal securities law
- Heightening auditor independence

In May 2003, the Board adopted new policies, consistent with the Act that strengthen governance and accountability, improve disclosure, increase oversight, heighten auditor independence, and clearly define an auditor's ultimate reporting responsibilities.

With regard to the Act, the institutions have:

- Apprised administration of best practices as they relate to higher education and healthcare organizations;
 - Worked with each other and the Board Office to identify activities to determine how internal audit plays a role in the implementation of any new Board policies and what functions they would perform;
 - Participated in a web seminar and attended an extensive presentation by a non-profit legal expert on the Act;
 - Disseminated various informational materials; and
 - Researched activities of peer institutions relating to the Act.
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Action Plan

The Regent universities jointly conducted a Gap Analysis of the Sarbanes–Oxley provisions and reviewed recommendations of the national Associate of College and University Business Officers (NACUBO), published in an advisory report “The Sarbanes–Oxley Act of 2002: Recommendations for Higher Education” in November 2003. The universities:

- Identified specific provisions of the Act;
- Compared those with the NACUBO Best Practices Recommendations; and
- Determined applicability of each to the universities.

Institutional Submission

The report from the Regent universities identifies the following areas of focus consistent with the requirements of the Sarbanes-Oxley Act:

- Title III “Corporate Responsibility”
- Title IV “Enhanced Financial Disclosure”

Titles III and IV are the most relevant sections of the Sarbanes-Oxley Act for the three Regent universities and are the primary points of emphasis of this report.

Title III
Corporate
Responsibility

Title III “Corporate Responsibility” – Requires that the audit committee be independent from company management and have oversight of public accounting firms. Regent’s policy is in compliance with this provision.

It also requires the establishment of procedures for:

- a. receipt, retention and treatment of complaints received by the company regarding accounting internal controls and auditing matters; and
- b. the confidential anonymous submission by employees of questionable accounting or auditing matters.

Numerous mechanisms exist within each University for the reporting of employee, student, and public concerns such as the Ombudsperson Office, faculty disputes resolution, grievance procedures, etc. In addition, the University of Iowa Hospitals and Clinics has a "helpline" for reporting patient concerns and is part of its compliance program with federal reimbursement requirements. The existent reporting mechanisms are being expanded to specifically include complaints regarding accounting internal controls and auditing matters.

Appropriate notification of the availability of this alternative will be made throughout the three campuses to faculty, staff, and students.

Whistleblower
Protection

Closely related to the confidential reporting mechanism of Title III is the requirement noted in section 806 (Title VIII) for whistleblower protection. Anti-retaliation for reporting of wrongdoing or bringing forward complaints has been a strong tradition at the Regent universities, and all three institutions have policies in place reflecting this tradition. Those policies are in the process of being modified to provide this same protection for whistleblowers related to accounting, auditing, and financial matters.

Certification of
Annual Audit
Reports

Section 302 of Title III addresses a requirement that the principal executive officer and the principal financial officer provide certification of annual audit reports and their completeness. Currently, the Vice Presidents for Finance and the Controllers provide similar certification to the State Auditor for each institution's annual report. See Attachment A, which depicts sample language used in the management representation letter for FY 2003. Certification is also provided for the audited financial statements for the bonded enterprises. Sub-certification requirements are being evaluated for other senior managers.

Title IV
Enhanced
Financial
Disclosures

Title IV "Enhanced Financial Disclosures". Although the Regent universities follow current and appropriate accounting standard guidelines, NACUBO recommends planning the assessment of internal controls and the development of appropriate code of conduct language related to ethics for senior financial officers. The latter would also be consistent with Title III which prohibits actions to fraudulently influence, manipulate or mislead the independent public certified accountant engaged in the performance of an audit of the financial statements for the purpose of rendering such financial statements materially misleading.

Ethics Policies The Regent universities currently have a number of financial/business ethics policies in place, including policies on conflicts of commitment; conflicts of interest (both in purchasing decisions and in conducting sponsored research, as well as nepotism); use of university resources (equipment, facilities, university name, IT resources, etc.); restrictions on lobbying; and prohibitions on giving and receiving gifts. The Regent universities are currently formulating code of conduct language that would explicitly acknowledge the principles underlying these existing policies as they relate to ethics for senior financial officers and administrative staff.

Internal Control Assessment Section 404 of Title IV “Management Assessment of Internal Controls” has proven to be a controversial and challenging provision for both corporate and higher education institutions. NACUBO has officially reported that no higher education institution has committed to this provision and recommends that institutions start planning how an internal control assessment might be conducted. Currently, multiple audit entities including the State Auditor, the external auditors for the universities’ bonded enterprises and the universities’ internal auditors examine the Regent universities internal controls. Although this does not involve a formal certification of the internal controls, it does provide another form of monitoring. Each Regent university has a group reviewing its current internal control policies and making recommendations to improve clarity and training regarding such controls.

The joint Gap Analysis indicated that the remaining Titles of the Sarbanes–Oxley Act were of little or no relevance to the Regent universities and as such have not been addressed in a detailed manner in this report:

Title	Requirement	Comments
I	Establishes public company accounting oversight board	Not applicable
II	Auditor independence	Regent’s policy has been modified to be consistent with this section as noted above.
V	Securities Research Analyst Conflicts of Interest	Not applicable
VI	Securities Exchange Commission Resources and Authority	Not applicable
VII	Studies and Reports (General Accounting Office)	Not applicable
VIII	Corporate and Criminal Fraud Accountability (Audit Record Retention & Whistleblower protection)	As noted above whistleblower protection will be built into the confidential reporting mechanism
IX	White Collar Crime Penalty Enhancements	Not applicable
X	Corporate Tax Returns	Not applicable
XI	Corporate Fraud Accountability (SEC powers)	Not applicable

**Auditor of State, Typical Language of Management Representation Letter
For Annual Financial Statements**

Your audit of the financial statements of the _____ as of and for the year ended June 30, 2003, has been conducted for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair representation of the _____'s financial statements in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

In connection with your audit, we confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

- 1) The financial statements, which are included in the State of Iowa's financial statements, are presented fairly in conformity with U.S. generally accepted accounting principles.
- 2) We have made available to you all:
 - a. Financial records and related data.
 - b. Minutes of meetings or summaries of actions of recent meetings for which minutes have not yet been prepared.
- 3) There have been no communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices.
- 4) There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
- 5) We believe that the effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
- 6) There has been no:
 - a. Fraud involving management or employees who have significant roles in internal control.
 - b. Fraud involving others that could have a material effect on the financial statements.
- 7) We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
- 8) The following have been properly recorded or disclosed in the financial statements:

- a. Related party transactions and related amounts receivable or payable.
 - b. Guarantees, whether written or oral, under which we are contingently liable.
 - c. Significant estimates known to management that are required to be disclosed. Significant estimates are estimates at the balance sheet date that could change materially within the next year.
- 9) There are no:
- a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
 - b. Unasserted claims or assessments that we have been advised are probable of assertion and must be disclosed.
 - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed.
 - d. Events that have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustments to or disclosure in the financial statements.
- 10) We have satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.
- 11) We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of non-compliance.
- 12) We are responsible for the _____'s compliance with applicable laws and regulations.
- 13) We have identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.
- 14) The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations.
- 15) Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance reserves and designations are properly classified and if applicable, approved.
- 16) Provisions for uncollectible receivables have been properly identified and recorded.
- 17) Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
- 18) Deposits and investment securities are properly classified in category of custodial credit risk.
- 19) Capital assets, including infrastructure assets, are properly capitalized, reported, and if applicable, depreciated.
- 20) Required supplementary information is measured and presented within prescribed guidelines.