

## Audit and Compliance Committee Memorandum

Board of Regents, State of Iowa

**Subject:** Proposed New Audit Policies

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### **Recommended Action:**

Discuss the proposed new Regent audit policies to voluntarily adopt certain key provisions associated with the Sarbanes-Oxley Act.

### **Executive Summary:**

Federal legislation enacted in the summer of 2003 changed the landscape of corporate financial and audit governance structures. This legislation, the Sarbanes-Oxley Act, while it does not mandate similar changes for higher education, it does model some best practices. Voluntary adoption of some key provisions of the Act is advisable for the Regent enterprise.

Institutional officials and Board Office personnel have developed proposed new policies for the Committee to consider that strengthen governance and accountability, improve disclosure, increase oversight, heighten auditor independence, and clearly define an auditor's ultimate reporting responsibilities.

The proposed policies for the Regent Policy Manual, included in Attachment A, are for the Committee's discussion and consideration. Final action is expected to be in June.

### **Background**

**Federal Legislation** In July 2003, the Sarbanes-Oxley Act, commonly referred to as SOX, was signed into law. This Act represents the most sweeping reform in securities legislation since the Great Depression by dramatically altering a public company's corporate governance and reporting obligations.

**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

Applicability	While colleges and universities are not required to comply with the Act, numerous publications have been released to motivate institutions of higher education, as well as not-for-profit entities, to implement changes to address the concerns of the Act.
Regent Approach	<p>Since the fall of 2003, Regent institutional officials and Board Office personnel have had numerous interactions regarding the provisions in the Act. State Auditor Vaudt and his Office have been advisors.</p> <p>Three working groups were established to focus on difference aspects of the Act.</p> <ul style="list-style-type: none"><li>• Group 1's focus was to determine which parts of the Act would represent best practices for the Board of Regents and should therefore be incorporated into the Regent Policy Manual. The objectives of the group included:<ul style="list-style-type: none"><li>• Identifying broad issues of the Act,</li><li>• Categorizing responsibilities, and</li><li>• Drafting policies to incorporate certain aspects of the Act's provisions from the Board's perspective.</li></ul></li></ul> <p>This group held regular monthly meetings in January, February, March, and April. The resulting proposed policies, included in Attachment A, are presented for the Audit and Compliance Committee's consideration.</p> <ul style="list-style-type: none"><li>• Group 2, consisting of internal auditors and representatives from the Board Office, are expected to work on clearly defining the role of internal audit once new audit policies are adopted by the Board. Those clarifications would take the form of as proposed changes to the internal audit section of the Regent Policy Manual and would be presented to the Audit and Compliance Committee for review.</li><li>• Group 3 would consist of institutional representatives to draft procedures, consistent among the institutions, for incorporating needed changes to institutional operating procedures.</li></ul>
NACUBO Recommendations	<p>The National Association of Colleges and University Business Officers (NACUBO) issued an Advisory Report entitled "The Sarbanes-Oxley Act of 2002: Recommendations for Higher Education" in November 2003. The following is a summary of NACUBO's recommendations:</p> <p>Independent Auditors</p> <ul style="list-style-type: none"><li>• The board's audit committee should receive the audit engagement letter and take direct responsibility for appointing, compensating, and overseeing the audit.</li><li>• Institutions should prohibit their independent auditors from providing nonaudit services barred by the Act. When extenuating circumstances exist, the board's audit committee should approve such nonaudit services in advance.</li><li>• The lead audit partner should be rotated every seven years, with a timeout of two years.</li></ul>

#### Senior Management

- Senior financial managers should adopt a code of ethics and consider methods to ensure compliance.
- A confidential complaint mechanism should be made available to employees to communicate concerns about accounting, auditing, or internal control processes.
- Institutions should consider assessing the need for disclosures required by the Act, such as the chief executive officer and the chief financial officer to assert that the financial statements have no material misstatements or omissions and that they have evaluated “disclosure controls and procedures.”
- A recommended business practice is to document and evaluate internal controls over a planned time period as fundamental to sound financial reporting.

#### Audit Committees

- The board of directors should have an audit committee or its equivalent.
- The audit committee should exercise direct control over the external auditors.
- Members of the audit committee must be independent, and management should not be voting members of the audit committee.
- The audit committee should have a charter that includes role and authority language.
- At least one financial expert should be included on the audit committee.

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#### **Analysis:**

##### Rationale for Proposed Regent Policies

The Group considered several aspects of the current Regent structure before proposing the attached policies, including:

- The unique governance structure of the Board of Regents.
- The historical role of the Banking Committee in:
  - Receiving and reviewing all external and internal audit reports.
  - Reviewing and approving internal audit plans.
- Other Board's policies currently in place, such as policies for competitive selection of professional service providers.
- The statutory requirement (Iowa Code Chapter 11) that the State Auditor shall annually make a complete audit of the books and accounts of every department of the state.

Based on these factors, it was the consensus of Group 1 that not all of the NACUBO recommendation would be necessary.

Specifics of  
Proposed Policies

The proposed additions to Regent policies recommended for Committee consideration include the following:

Independent Auditors

- The Board's audit policies should identify general provisions that:
  - Require a competitive selection process, every five years, for those auditors that institutions are authorized to engage.
  - Mandate that all external audit firms must be currently and appropriately licensed and have a permit to practice as a CPA firm in the state of Iowa.
  - Require that audit managers be rotated at least every five years.
  - Demand compliance with all state, Regent and institutional conflict of interest policies.
  - Prohibit the provision of certain services by external auditors.
  - Require the institutions to carefully analyze the benefits and risks of employing an individual from the institution's audit firm.

Audit Committees

- The Board of Regents should establish a separate audit committee.
- The ultimate reporting responsibilities of auditors, both external and internal, should be to the audit committee.
- The audit committee should continue to:
  - Receive and review all external and internal audit reports.
  - Evaluate the annual internal audit plans proposed by internal auditors.
  - Assure continued evaluation, improvement, and adherence to all Board and institutional policies, procedures, and practices at all levels.
- The audit committee should facilitate open communications among the auditors, financial and senior management, internal auditors, Committee members, and the Board of Regents.
  - All internal and external auditors would be authorized to request time with the audit committee to discuss financial and audit related issues.
  - The Audit and Compliance Committee may also request any auditor to come before the Committee to discuss financial and audit related issues.

## 7.08 **Audit Activities**

A. For the national corporate environment, numerous actions have been taken to improve accountability through the implementation of the Sarbanes Oxley Act. The Board of Regents, through its Audit and Compliance Committee, expects to enhance accountability and fulfill its audit oversight responsibility by:

1. Reviewing all external financial, bond-specific, and other audit reports conducted on the Regents office and any part of its institutions and Regent-associated regional study centers.
2. Reviewing the annual audit plans proposed by internal auditors.
3. Reviewing all reports prepared by internal auditors of the Regent institutions.
4. Encouraging continued evaluation, improvement, and adherence to all Board and institutional policies, procedures, and practices at all levels.
5. Encouraging an open avenue of communication among the independent auditors, financial and senior management, internal auditors, Committee, and Board of Regents.
6. Reporting to the Board of Regents regularly regarding the execution of the Committee's duties and responsibilities.

B. While the Audit and Compliance Committee can delegate certain audit related responsibilities to the institutions, the ultimate reporting by all auditors for all institutional related audits is to the Audit and Compliance Committee.

C. Each institution shall develop procedures to implement the Board's audit activities policies.

### D. External Audits

#### 1. State Audits

- a. As established by law, ~~t~~The auditor of state shall annually make a complete audit of the books and accounts of every department of the state, a quarterly audit of the educational institutions, and audit testing of the Board's investments. (Iowa Code § 11.2)

Each department and institution of the state shall keep its records and accounts in such form and by such methods as to be able to exhibit in its reports the matters required by the auditor of state, unless otherwise specifically prescribed by law. Each department and institution of the state shall keep its records and accounts in a current condition. The failure of the head of any department of the state to comply with this provision shall be grounds for their suspension from office. (Iowa Code § 11.5)

- b. The institutions will send Board Office will receive from the State Auditor's Office all draft state audit comments and recommendations from the State Auditor's Office to the Board Office for review.
- c. Proposed institutional responses to state audit comments and recommendations will be developed by the institutions in consultation with the Board Office. The proposed responses must be approved by the Executive Director before they are submitted to the State Auditor's Office.
- d. A copy of all state audits related to a Regent institution shall be, upon completion, sent to the Board Office for docketing on the Banking Audit and Compliance Committee agenda.
- e. The State Auditor's Office may request to discuss financial and audit related issues with the Audit and Compliance Committee
- f. The Audit and Compliance Committee may request the State Auditor's Office to discuss financial and audit related issues with the Committee.

## 2. General Provisions

- a. For audit services other than statutorily required from the Auditor of State, the institutions are to select external auditors through a competitive Request for Proposal (RFP) process in accordance with the Board's policies on professional services contracts in the Purchasing section of this Chapter. This process shall occur no less than every five years.
- b. All external audit firms must be currently and appropriately licensed and have a current permit to practice as a Certified Public Accounting firm in the state of Iowa.
- c. Audit managers for each engagement must be rotated at least every five years.
- d. Institutions must comply with all state, Board, and institutional conflict of interest policies.
- e. External auditors for an institution are restricted from providing any of the following services for that institution:
  - 1) Bookkeeping or other services related to the accounting records or financial statements of the institution
  - 2) Financial information systems design and implementation
  - 3) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
  - 4) Actuarial services

- 5) Internal auditing outsourcing services
  - 6) Management functions or human resources
  - 7) Broker or dealer, investment advisor, or investment banking services
  - 8) Legal services and expert services unrelated to the audit
  - 9) Any other service that the Board determines is impermissible
- f. Any exceptions to the restrictions above must be approved by the Audit and Compliance Committee prior to the performance of the proposed services, unless the aggregate amount of all such non-audit services provided to the institution constitutes less than 5 percent of the total amount paid by the institution to its auditor during the fiscal year in which the non-audit services are provided. Each institution is responsible for notifying the Board Office of all such non-audit services received under this exception.
- g. Institutions should carefully consider and document the benefits and risks of employing an individual who has worked for the auditing firm within the previous year and consider how the position may relate to the institution's external audit.

### 2.3. Hospital Audits

- a. To arrive at proper basis for the payment of said bills for treatment, care, and maintenance (of indigent patients), the Board of Regents shall cause to be made annually an audit of the accounts of the University Hospital and determine the average cost per day for the care and maintenance of each patient therein, exclusive of the salaries of the members of the faculty of said university College of Medicine, and said bills shall be allowed at such average cost. All accounts shall be so adjusted and paid as to reimburse the funds of the hospital used for the purposes of this chapter. (Iowa Code § 255.25)
- b. The University of Iowa Hospitals and Clinics will arrange for an annual external audit of hospital accounts and shall submit, upon completion, a copy of the audit and management letter to be docketed on the ~~Banking~~ Audit and Compliance Committee agenda.
- c. The UIHC external auditor State Auditor's Office may request to discuss financial and audit related issues with the Audit and Compliance Committee
- d. The Audit and Compliance Committee may request the UIHC external auditor to discuss financial and audit related issues with the Committee.

#### 4. Other External Audits

Copies of all external audits conducted on any subunit of a Regent institution or regional study center shall be submitted, upon completion, to the Board Office for docketing on the Audit and Compliance Committee's agenda.

External auditors may request to discuss financial and audit related issues with the Audit and Compliance Committee.

The Audit and Compliance Committee may request the other external auditors to discuss financial and audit related issues with the Committee.

#### D. Internal Audits

1. Purpose. The Board of Regents authorizes the University presidents to hire internal audit staff to provide independent appraisal services to the Board and institutional administrators. Internal auditing is a managerial control which functions by measuring and evaluating the effectiveness of other financial and managerial controls.
2. Objective and Scope. The objective of internal auditing is to assist the Board of Regents and institutional administrators in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations and pertinent comments concerning the activities reviewed. The attainment of this objective involves such activities as:
  - a. Reviewing and appraising the soundness, adequacy and application of accounting, administrative and other operating controls, and promoting effective control at reasonable cost.
  - b. Ascertaining the extent of compliance with established policies, plans and procedures.
  - c. Ascertaining the extent to which assets are accounted for and safeguarded from losses of all kinds.
  - d. Ascertaining the reliability of management data developed within the organization.
  - e. Conducting special examinations and reviews at the request of the Banking Audit and Compliance Committee, the Board of Regents or institutional heads.
  - f. Evaluating the economy and efficiency with which resources are employed and recommending improvements in operations, including reviews of administrative and support services with the objective of reducing operating costs.

3. Authority. The internal audit staffs are authorized by the Board of Regents to conduct a comprehensive program of internal auditing. To accomplish their objectives, the internal auditors are authorized to have unrestricted access to university functions, records, properties and personnel. The three universities have internal auditors to perform these functions. The State University of Iowa internal auditor is responsible for internal audits at the Iowa School for the Deaf. The Iowa State University internal auditor is responsible for internal audits at the Iowa Braille and Sight Saving School.
4. Reporting. The internal audit staffs report to the University presidents, and where appropriate, to the Superintendents of the special schools, for all auditing activities except those related to the offices of President and Superintendent. Audit activities related to the offices of President and Superintendent are to be reported directly to the President of the Board of Regents. The ultimate reporting responsibility of internal auditors is to the Audit and Compliance Committee.
5. Annual Report Responsibility. Each year, the internal audit staffs will develop and execute a comprehensive audit plan to be conducted in accordance with applicable professional auditing standards. A comprehensive report on the internal audit function will be made to the Board through the Banking Audit and Compliance Committee ~~in July of~~ each year and will include.
  - a. ~~The report will include~~ An annual audit plan containing:
    - Methods for audit focuses, including internal control evaluation and risk assessment.
    - High-risk areas routinely included in the internal audit cycle.
    - Administrative and support services review.
    - Cooperative plans among Regent University internal audit departments.
    - Internal audits planned for the special schools
  - b. Review of all previous fiscal year audits completed and in progress, including any follow-up reviews;
  - c. Any audits which were scheduled but not completed; and
  - d. A list of all audits completed within the last three fiscal years.

6. A copy of each internal audit report and follow-up review, upon its completion, will be sent to the Board Office for docketing on the [Banking-Audit and Compliance](#) Committee agenda.
7. Any activity which is illegal or the legality of which is questioned by the audit staff (e.g. conflict of interest, embezzlement or theft) shall be reported to the appropriate institutional administrator or President of the Board (consistent with Section 4 of this [subsection of the Policy Manual](#)) immediately upon discovery by audit staff. [The Auditor of State and Other](#) ~~O~~other appropriated authorities should also be notified.
8. In the performance of their functions, internal audit staff will have no direct responsibility for, nor authority over, any of the activities and operations reviewed.
9. [Internal auditors may request to discuss financial and audit related issues with the Audit and Compliance Committee.](#)
10. [The Audit and Compliance Committee may request the internal auditors to discuss financial and audit related issues with the Committee.](#)