UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Audit Committee

Wednesday, July 7, 2010

8:15 - 9:15 a.m.

600 McNamara Alumni Center, East Committee Room

Committee Members
    Steven Hunter, Chair
    Linda Cohen, Vice Chair
    Richard Beeson
    John Frobenius
    Maureen Ramirez
    Patricia Simmons

Student Representatives
    Matt McGeechy
    Matt Privratsky

A G E N D A

1. Internal Audit Plan - G. Klatt (pp. 2-16)

2. Committee 2010-11 Workplan Discussion - S. Hunter/G. Klatt (pp. 17-19)

3. Information Items - G. Klatt (p. 20)
Audit Committee  
July 7, 2010

Agenda Item:  Internal Audit Plan

☐ review  ☐ review/action  ☐ action  ☒ discussion

Presenters:  Associate Vice President Gail Klatt

Purpose:

☐ policy  ☐ background/context  ☒ oversight  ☐ strategic positioning

The Audit Committee is delegated the responsibility, via its Charter, to review the annual Internal Audit plan on behalf of the Board of Regents.

Outline of Key Points/Policy Issues:

The recommended 2010-2011 Internal Audit plan is risk-based and continues to reflect the principles of the Integrated Framework of Internal Control. The plan includes 26 audits of University units, processes, and information systems and focuses on high-risk activities and areas of strategic focus. It also includes specific audit coverage related to leadership transitions and institutional cost drivers. Audit resources have also been reserved for administrative/special requests and investigative audit need.

Background Information:

The Audit Committee charter states the Audit Committee shall review the annual internal audit plan and the extent to which it addresses high risk areas.
PURPOSE OF THE ANNUAL PLAN

The annual internal audit plan is intended to demonstrate:

- the breadth and depth of audit activities addressing financial, operational and compliance risks of the University;
- accountability for our resources; and
- the progress in our efforts to continually improve the University's Internal Audit program.

It is our intent to convey a current sense of the University's internal control environment and the extent to which controls are being assessed by regular audit activities, addressed proactively through advisory services, or investigated as a result of issues raised.

DEVELOPMENT OF THE ANNUAL PLAN

The development of the annual audit plan is based on information gathered through broad consultation across the University and a formal assessment of existing and emerging risks.

Internal Risk Assessment

As part of the planning process, discussions were held with 72 institutional officials from 43 units to solicit input on our institutional risks and any specific areas of concern. We also used these meetings as an opportunity to obtain feedback on the quality of audit services we provide. There was almost unanimity in the risks highlighted as those being of greatest concern over the next year, and they were:

- Senior leadership transitions.
- Effect of recent and anticipated future budget cuts, the hiring pause and overall staff reductions, and the current budget model on the University's strategic initiatives and its day-to-day operations and activities.

We again solicited the opinions of the committee chairs of the Board of Regents as to their views from a governance perspective of the University's institutional risks. These risks mirrored those of the institutional offices: 1) leadership transitions, especially those of the President and the Senior Vice President of the Academic Health Center, and 2) the financial future of the University, including the impact of declining state support, the need for long-range financial planning, and the downstream cost impacts of the operations and programming associated with new buildings.

External Risk Assessment

To aid in our planning efforts we surveyed other Big 10 institutions regarding the assessment of risks within their institutions. While numerous risks were identified, many of which do impact the University of Minnesota and will be considered as audit work is carried out, none of the risks were of the magnitude to influence our overall planning effort.
Operational Risk Assessment

Finally, our annual planning process includes re-examining the audit universe to identify new as well as discontinued activities and programs due to other changes in the existing organization. In addition to the changes within the operating units, we also consider changes in the overall environment within which the University exists. These environmental changes include such circumstances as new regulatory developments, new business processes, and new institutional priorities and strategic initiatives.

The Office of Internal Audit continues to utilize a formalized risk assessment methodology in selecting units/processes/activities for inclusion in the annual audit plan. Relative risk assessment is necessary to provide a basis for the rational deployment of our limited resources across the institution. The risk factors considered remain unchanged from 2010 and include:

- Known or perceived control concerns
- Impact of unit on UM mission
- Impact of information technology
- Regulatory compliance issues
- Organizational change/turnover in key personnel
- Complexity/diversity of operations
- Audit history

Based on the outcome of this assessment, the 187 individual auditable units are categorized as high, moderate, or low risk. A rating as a “high-risk unit” does not mean that the unit is perceived to have control problems, but rather reflects the criticality or centrality of the unit to the University’s mission.

We have a commitment to the Board of Regents Audit Committee to provide audit coverage of high-risk activities on at least a three-year cycle, and we align our audit plans with the Audit Committee’s Institutional Risk Profile. (See Appendix A). Because of the way we have structured our auditable units, several large schools within the University (Medical School, College of Science and Engineering, College of Food, Agricultural and Natural Resource Sciences, College of Liberal Arts) have been broken down into a number of smaller auditable units. These schools, if considered in their entirety, would be placed in the “high risk” category; however, the component units are now considered to be moderate or low risk. Our intent and plan is to audit units within each of these colleges each year to ensure ongoing coverage, but we will not be able to audit them in their entirety during a three year period.

OVERALL RISK ASSESSMENT

Taking into account the information we obtained in our risk assessment process, it is very clear that leadership transitions and the University’s financial future are “top of mind” across the University. We have included audits in the 2011 audit plan which specifically address both of these risk areas and will take these risk factors into consideration when completing other audit work.
ALLOCATION OF AUDIT RESOURCES

The audit plan is based on a planned staffing complement of 14.75 FTE professionals, consistent with 14.6 in FY 2010. This results in similar hours available for internal audit work.

Approximately 56% of the Office of Internal Audit’s resources are committed to the completion of planned audit projects. The annual audit plan is designed to provide coverage utilizing a variety of audit methodologies: audits of individual units, functional and process audits, University-wide reviews, and information system projects. The plan includes audit projects specifically focused on leadership transition and the overall cost structure of the University, as well as coverage of “high-risk” activities/units.

This year 13% of those resources will be needed to complete a higher than average amount of carry over work from our FY 2010 audit plan. Eleven audit projects are currently in process and need to be completed. While the amount of carry over work exceeds what we normally expect, much can be attributed to the unusually high number of special projects and investigations that Internal Audit has been asked to conduct during the past year.

The remainder of our FY 2011 audit resources are reserved as follows:

• 11% has been reserved to accommodate requests from the President, the Board, or executive committee members. This has been supported by the Audit Committee. The number of hours remains unchanged from previous years.
• 6% has been reserved for investigations. The number of hours remains unchanged from previous years.
• 6% has been reserved for follow-up procedures performed on behalf of the Audit Committee. The number of hours remains unchanged from previous years.
• 21% has been set aside for internal administrative functions, including our continuous improvement efforts.
FY 2010- 2011 AUDIT PLAN

Taking into consideration the risks identified externally as well as internally, and balancing all of the above with our available resources, the audit plan recommended for FY 2011 includes 26 audits which will provide audit coverage of:

- Two central high-risk units within the Vice President for Finance
- One high-risk technology management process
- One high-risk college-based IT unit
- Two high-risk reviews of technology changes
- One high-risk unit within the Vice President for Human Resources
- Two high-risk units/systems within the Academic Health Center
- Two high-risk units within the President's Office
- Seven moderate-risk functional units
- Four audits of UMD campus units
- Four system-wide reviews

The audits selected for inclusion in the FY 2011 audit plan also provide significant coverage of critical activities:
• 22% of the plan is devoted to information technology risks.
• Ten audits will include a technology component.
• Eleven audits will include evaluations of service quality and productivity.
• Five audits will include evaluations of central services.
• Four audits will include evaluations of research activities.
• Eight audits will include a component on gift activities in accordance with the Memorandum of Understanding between the University and the University foundations.
• Three audits will focus specifically on leadership transitions.
• Seven audits will focus on major institutional cost drivers, and cost avoidance/reduction initiatives.

By the end of FY 2011, we will have provided audit coverage of 17 of the 21 high risk units. The FY 2011 plan continues to provide well-balanced coverage across the University. The following chart shows the distribution of audit coverage by University component for FY 2011.
The allocation of audit resources among the component units of the University is fairly consistent with that of prior years, with one exception. Far more resources will be devoted to completing audits within the Executive component due to the need to complete both a financial audit and the NCAA four-year compliance audit in Intercollegiate Athletics, along with audit work planned in the President’s Office and at Eastcliff. More audit resources have been allocated in this year’s plan for coverage within the Academic Health Center. The plan does not include any coverage for Research Administration, and very limited coverage in University Services. In both cases, however, all major activities are current in their audit coverage.

ANALYSIS OF AUDIT COVERAGE

By the end of the four-year period through FY 2011, we will have completed audits of:

- 16 of the 21 high-risk units on a three-year cycle. Four of these high-risk units have been reviewed more than once in these four years. Two units just moved into the high-risk category this year.
- 43 of the 102 moderate-risk units, as well as 22 of the 64 low-risk units. 74 units in the moderate-risk category and 28 of the low risk units have also had some review through a University-wide audit.
- University-wide reviews of effort reporting, sub-award contracting, purchasing processes, and academic advising. University reviews of performance evaluations, President and Vice President expenditures, undergraduate classes, administration of major University contracts, and new processes for transactions less than $100 are scheduled for completion in 2011.

We will be out of cycle on three high risk auditable units:
- Accounting Services – which receives regular coverage by the external auditor in the annual financial statement audit
- Facilities Management Districts
- University Libraries

The following charts illustrate our coverage of University activities based on risk levels, as well as the coverage we have provided through University-wide reviews.
Of the 187 auditable units, 20 units have not had audit coverage since prior to FY 2000. Ten of the twenty units are in the moderate-risk category, while the ten remaining units are considered low-risk units.
Of the 20 units which have not had audit coverage since prior to FY 2000, 10 did receive some coverage as part of University-wide process reviews in the past three years.

**FY 2009-2010 RESULTS**

To date for FY 2010, we issued 15 audit reports which were the result of planned reviews and requests from management (See Appendix B).
In addition,
- Six audits are in the final stages of completion and reports will be issued in the next two months.
- Five audits are currently in the planning or fieldwork stages and will be completed in FY 2011.
- Six audits were either deferred to FY 2011 or not completed.

During the past fiscal year we completed and closed out six investigations from FY 2009, with work continuing on one other. We also conducted 16 new investigations in response to allegations of financial or operational misconduct, 10 of which have been closed out. Where appropriate, we have partnered with the University Police or the Office of the General Counsel to complete these reviews. Four of the investigations have been or will be referred to the University of Minnesota Police for possible prosecution. We have also been involved in several large special projects performed at the request of University or collegiate leadership.

### COMPARISON OF AUDIT RESOURCES FOR FY 2010 AND FY 2011

**Percent of Available Time**

<table>
<thead>
<tr>
<th>Category</th>
<th>09/10 Budget</th>
<th>09/10 Actual</th>
<th>10/11 Budget</th>
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<tbody>
<tr>
<td>Scheduled Audits</td>
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<td>48</td>
<td>56</td>
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<tr>
<td>Investigations</td>
<td>14</td>
<td>6</td>
<td>6</td>
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<tr>
<td>Special Projects</td>
<td>11</td>
<td>11</td>
<td>13</td>
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<tr>
<td>Follow Up</td>
<td>6</td>
<td>5</td>
<td>6</td>
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<tr>
<td>Administration</td>
<td>21</td>
<td>20</td>
<td>21</td>
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COORDINATION WITH EXTERNAL AUDITORS

The Office of Internal Audit continues to coordinate its audit plan with the University’s external auditors to ensure appropriate coverage is achieved through the internal and external audit plans and to leverage the collective efforts of both organizations. The Office of Internal Audit meets the professional standards required by external auditors to place reliance on internal audit work.

COORDINATION WITH OTHER INTERNAL RESOURCES

The Office of Internal Audit coordinates its work with other internal units to maximize the quality of audit coverage provided as well as to promote prompt attention when University-wide trends are identified. We have established strong working relationships with the University’s Compliance Officer, the Office of Research Integrity, the Office of Oversight, Analysis and Reporting, the Office of Regulatory Affairs, the Institutional Review Board, and the Department of Environmental Health and Safety, each of which work closely with us during audits involving complex regulatory issues.

The Office of Internal Audit interfaces regularly with the Institutional Compliance Officer and we serve on the Executive Compliance Oversight Committee and the Research Compliance Committee. Input from the Compliance Officer is solicited during our annual audit planning. In addition, throughout the year we report to and collaborate with the Compliance Officer on issues identified during our audits. We also share the results of employee surveys with the Compliance Officer. During fiscal year 2010, a total of 1,287 employee surveys were sent out as part of our audit process, with a 54% response rate. Along with the Institutional Compliance Office, we serve as a triage office for managing U Report, the University’s confidential reporting line.

Audit results are also shared with central support units such as the Office of Information Technology, Sponsored Projects Administration, Payroll, Purchasing, Training Services, and Human Resources, when policy non-compliance or when the need for process enhancements are identified. Best practices identified in local unit audits are also shared with these central unit process owners for consideration of broader adoption.

STAFF DEVELOPMENT AND QUALIFICATIONS AND PROFESSIONAL INVOLVEMENT

The Office of Internal Audit is committed to providing educational opportunities to our staff in order to enhance our audit knowledge and abilities and to achieve our professional best. Ever-changing government regulations, new technologies, and new developments in auditing principles and methods dramatically affect not only what we audit, but also how we audit. We constantly strive to stay abreast of new developments and improve our audit proficiency in order to enhance the overall quality of our audits. To accomplish this, we pursued a variety of methods to continue our staff’s professional education.

Our departmental memberships with the Institute of Internal Auditors (IIA), the Association of College and University Auditors (ACUA), the Association of Certified Fraud Examiners (ACFE), the American Institute of Certified Public Accountants (AICPA), and the Information Systems Audit and Control Association (ISACA) provided staff members the opportunity to attend seminars and conferences that specifically address current issues and techniques in internal auditing. The interaction of our staff members with their peers through these professional organizations helps to keep us up-to-date on the latest auditing trends and issues affecting higher education.
Of the current fifteen professional staff:
- twelve have professional certifications of Certified Internal Auditors, Certified Public Accountants, Certified Information Systems Auditors, and Certified Fraud Examiners;
- five have Master of Business Administration degrees;
- one has a Master of Arts-Economics degree;
- one is pursuing a Master of Public Policy degree; and
- two are pursuing professional certifications.

In FY 2010, the Office of Internal Audit provided 833 hours of training (an average of 56 hours for each employee). These hours do not include the time associated with completing evening coursework funded by the University’s Regents Scholarship Program. For FY 2011, 840 hours have been budgeted for staff training, an average of 56 hours per employee.

We continue to hold monthly Brown Bag lunch meetings at which University leaders are invited to speak with the audit staff.

Members of the Internal Audit staff are frequent presenters at University programs and Big 10 Internal Audit meetings. Four of our staff made presentations at national internal audit and compliance conferences during the past year.

COMPACT/BUDGET PLANNING
During the compact and budget planning process, all University of Minnesota units were asked four broad questions:
- What programs or services within your unit are excellent and have a competitive advantage, and should they be strengthened and/or expanded?
- Which programs or services within your unit are less important or non-core and could potentially be reduced or eliminated?
- Which programs or services within your unit are no longer successful and should be eliminated?
- How can your activities be organized and processes reformed to improve services provided to stakeholders and increase the productivity of your unit’s resources?

The Office of Internal Audit engages in only three activities: conducting audit work, carrying out internal investigations, and providing audit advisory services to the University community. The quality and efficiency of the services we provide have been repeatedly affirmed by customer satisfaction surveys and supported by external benchmarking. We also undergo an external peer review of the quality of our audit services and practices every five years. Our last review, conducted in March 2009, affirmed that 1) the practices of the Office of Internal Audit fully comply in all respects to the *International Standards for the Professional Practice of Internal Audit*, and 2) University Management and the Board of Regents can appropriately rely on the assurance provided by the work performed by the Office of Internal Audit. We are a nationally recognized leader in internal auditing in higher education with several of our practices being recognized as “best practices” in a research monographs recently published by the Institute of Internal Auditors.

We have only one non-core activity – maintaining our Office’s website. All other work effort is directly related to the provision of audit services to the University. We have no unsuccessful programs or services.
We routinely evaluate our organization and processes to promote efficiency and/or improve the quality of the audit work we perform, and adapt our practices accordingly. We make extensive use of technology, apply a variety of audit approaches to provide the broadest audit coverage possible with the available resources, we invest in training our staff, and we are tenacious in limiting administrative activities that take time away from the conduct of audit work. We take advantage of both big and small opportunities. For example:

- Restructuring our organization to reduce our management team by 25%.
- Virtually eliminating hard-copy audit reports; reducing staff time and costs associated with printing, binding, and mailing.
- Reducing our resources on the UMD campus and utilizing residual excess staff capacity to complete audit work on the Twin Cities campus.
- Utilizing contract/temporary labor for small/discrete audit work.

The audit staff has formed a process improvement group to continuously review and improve our testing procedures, audit manual, and to ensure we are compliant with all new standards and best practices. In the past two years, this group has revised all of our testing to conform with EFS terminology and processes, reviewed opportunities for additional automation, revised Internal Audit’s performance metrics and performance evaluation process, and implemented a new time tracking system, as well as facilitated the external peer review and conformance with new industry standards. Unfortunately, because of the demands placed on the staff to complete unplanned audit work, time available for these efforts has been redirected to audit work for the last several months.

**OFFICE OF INTERNAL AUDIT FY 2011 STAFFING ISSUES**

As previously noted, we have experienced a marked increase in the number of internal investigations which we must conduct; a work activity that requires the direct involvement of the responsible manager. The increase in the number of investigations, coupled with having fewer managers to handle them, has resulted in a significant capacity issue, creating a backlog in our completion of audit projects.

Because we have fewer resources to begin with, coupled with the increased time being devoted to investigative work, we have had to decline requests for 1) audit services, and 2) our participation on committees, task forces, etc.

Fortunately, we have experienced very little turnover, with one staff member moving to a position on the UMD campus. We were able to fill the position promptly. We have one position which remains unfilled due to the hiring pause put in place by the President.

**OFFICE OF INTERNAL AUDIT BUDGET STATUS**

Over 95% of the Office of Internal Audit’s expenses are devoted to salary and fringe benefit costs. Recognizing that we have very limited discretionary expenses, the administration exempted the Office of Internal Audit from additional budget cuts for FY 2011 and provided funding to cover the 2% compensation increase included in the Civil Service pay plan. We are self-funding the $72,475 cost of the 27th pay period. The expense will be partially offset by savings which accrue from the three day staff furlough and the 2.3% salary reduction for the Director. The furlough equates to a loss of 350 hours of productivity, or approximately one audit.

During these times of financial challenges throughout the University, we appreciate the continued financial and operational support we receive from the administration.
Audit Committee’s Institutional Risk Profile Heat Map

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<tr>
<th>Audit Coverage Provided</th>
<th>Impact</th>
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Academic Quality
**STATUS OF FY 2010 AUDIT PLAN**

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<th>Audits Completed</th>
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<td><strong>High Risk</strong></td>
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<td>Google Mail</td>
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<td>NCAA Sport-Football</td>
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<tr>
<td>Database Management</td>
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<td>School of Dentistry</td>
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<td>Academic Health Center IT</td>
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<td>Office of Student Finance</td>
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<td>Nonsponsored Billing and Accounts Receivable</td>
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<td><strong>Moderate Risk</strong></td>
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<td>Crookston Campus</td>
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<td>University Services Central IT</td>
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<td><strong>Low Risk</strong></td>
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<tr>
<td>UMD Business &amp; Economics</td>
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<td>UMD Theater</td>
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<td><strong>Non-scheduled</strong></td>
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<td>Job Scheduling EFS</td>
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<th>Audits in Final Stage of Completion</th>
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<td><strong>High Risk</strong></td>
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<tr>
<td>Employee Benefits &amp; Fringe Pool</td>
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<td>Administrative, Cost Pool, &amp; SLA review</td>
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<td>Code Change Management</td>
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<tr>
<td><strong>Moderate Risk</strong></td>
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<td>UMD Facilities &amp; Compass</td>
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<td><strong>Low Risk</strong></td>
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<tr>
<td>Research &amp; Outreach Centers</td>
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<td>Performance Evaluations</td>
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<th>Audits Started in FY10 but will be Completed in FY11</th>
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<tr>
<td><strong>High Risk</strong></td>
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<tr>
<td>Sponsored Financial Reporting</td>
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<td>Purchasing Card - Past/Present Review</td>
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<td><strong>Moderate Risk</strong></td>
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<tr>
<td>Boynton Health Service</td>
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<td>Vet Diagnostic Lab</td>
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<td>Real Estate Management</td>
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<th>Audits Deferred and in 2011 Audit Plan</th>
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<td><strong>High Risk</strong></td>
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<td>Investments and Banking</td>
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<td><strong>Moderate Risk</strong></td>
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<td>Family Medicine</td>
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<td>CLA East Bank-2</td>
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<td>Civil Engineering</td>
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<tr>
<td><strong>Low Risk</strong></td>
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<tr>
<td>Review of Transactions &lt; $100</td>
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<tr>
<th>Audits Not Completed</th>
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<td>UM Rochester Campus</td>
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Audit Committee

Agenda Item: Committee 2010-2011 Workplan Discussion

☐ review ☐ review/action ☐ action ☒ discussion

Presenters: Regent Steven Hunter
Associate Vice President Gail Klatt

Purpose:

☐ policy ☐ background/context ☒ oversight ☐ strategic positioning

The purpose of this discussion is to discuss the committee workplan for the upcoming year.

Outline of Key Points/Policy Issues:

The Audit Committee workplan is intended to focus on the oversight and monitoring of risks the Committee feels could impede the University from achieving its goal to become one of the top three research universities in the world. Topical discussion items should be selected based on their relevancy to the Audit Committee’s institutional risk assessment and their import to strategic outcomes.

The workplan is also intended to ensure the Committee receives the information necessary to carry out the governance responsibilities assigned to it in its Charter, including the supervision of the external auditor and oversight of the internal audit program. The Audit Committee also has an obligation to be informed regarding the institution’s compliance program.

In addition to identifying appropriate topics for inclusion in the workplan, the Committee members are requested to consider:

- If the time typically allocated to individual agenda items is appropriate.
- If the materials provided to the Committee are at the appropriate level of detail.

Background Information:

Each standing committee of the Board of Regents establishes an annual workplan. The workplan is a means to assist the Committee in discharging its responsibilities under its
Charter and provides a structure to ensure the topics of highest priority receive the Committee's attention.
Recommend continuing the theme:
“Calibrating the University’s risk tolerance in the “new normal” financial environment”

October: Audit Committee Workplan (S. Hunter)
External Audit Update (Deloitte)
Internal Audit Update (G. Klatt)

Even though the committee will meet in October, it will also need to review the annual financial statements prior to their finalization in mid-October. As in previous years, this will be handled by the Chair via a conference call.

November: External Auditor Report (Deloitte)
Compliance Officer Report (L. Zentner)
Information Item: Semi Annual Controller’s report

February: External Auditor’s Review of Completed Audit Work and Letters to Management (Deloitte)
Internal Audit Update (G. Klatt)

March: External Auditor Review (Fees and 2012 Engagement) (M. Volna)
Information Item: External Auditor Relationships and Services Provided

May: External Audit Plan (Deloitte)
Compliance Officer Report (L. Zentner)
Internal Audit Update (G. Klatt)
Information Item: Semi-Annual Controller’s Report

July: Internal Audit Plan (G. Klatt)

Suggested Topical Items
• Risk Tolerance discussions
• Conflict of Interest and New PHS Requirements
• Discussion of the Audit Committee landscape in higher education (Deloitte national partner)
• SOX Update: lessons learned after eight years, what has worked well, what has been abandoned
• The University’s Assurance Map, where does monitoring occur, and for what, across the University.
Audit Committee 

July 7, 2010

Agenda Item: Information Items

☐ review ☐ review/action ☐ action ☒ discussion

Presenters: Associate Vice President Gail Klatt

Purpose:

☐ policy ☐ background/context ☒ oversight ☐ strategic positioning

This item is provided to update the Audit Committee on the results of a program review conducted by the Department of Education on the University's financial aid activities.

Outline of Key Points/Policy Issues:

During the week of May 24th, the Federal Department of Education conducted a program review of the University’s management of federal financial aid and compliance with the numerous regulations associated with receiving federal money. The federal officials had no findings to report. This was the first time in the lead official’s career that he conducted a review in which no findings resulted. The federal officials indicated that they were impressed how well the University is organized in its management of financial aid, and the communication flow across all areas of Academic Support Resources, the Office of Admissions and the University. The University is not at risk of losing any financial aid from the federal government.

Background Information:

External reviews that provide assessments of the effectiveness of the internal control and compliance systems established by the administration are important sources of information for the Audit Committee in discharging its oversight responsibilities for these systems.