UNIVERSITY OF MINNESOTA
BOARD OF REGENTS
Audit Committee
Thursday, November 8, 2007
10:00 - 11:00 a.m.
600 McNamara Alumni Center, East Committee Room

Committee Members
Linda Cohen, Chair
Clyde Allen, Vice Chair
Dallas Bohnsack
John Frobenius
Venora Hung
Dean Johnson

Student Representatives
Meghan Keil
Nathan Swanson

A G E N D A

1. Report of the External Auditor - D. Seck/D. Loberg (p. 2)
2. Compliance Officer Report: Results of University-Wide Research Compliance Study - S. Rafferty (pp. 3-9)
3. Information Items - G. Klatt (pp. 10-16)
Audit Committee

November 8, 2007

Agenda Item: Report of the External Auditor

☐ review ☐ review/action ☐ action ☒ discussion

Presenters: Acting Controller, Denise Seck
           Don Loberg, Principal, Larson Allen
           Craig Popenhagen, Principal, Larson Allen

Purpose:

☐ policy ☐ background/context ☒ oversight ☐ strategic positioning

The purpose of this presentation is to communicate to the Audit Committee the External Auditor’s opinion on the accuracy and reliability of the University of Minnesota’s fiscal year 2007 financial statements. The presentation is intended to help inform the Committee in assuring that the University of Minnesota has the appropriate policies, procedures and systems of controls in place to produce accurate and reliable financial information.

Outline of Key Points/Policy Issues:

Discussion of the fiscal 2007 financial statements and audit results
• Required communications to the Audit Committee, including:
  o External Auditor’s responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133
  o Significant accounting policies
  o Accounting estimates
  o Audit adjustments
• Financial Statement highlights for 2007
• Emerging issues related to fiscal year 2008 financial statement audit

Background Information:

The Audit Committee is delegated the responsibility to oversee the results of the work of the external auditor on behalf of the Board of Regents. A copy of the 2007 financial statements is available in the Board Office.
Audit Committee

November 8, 2007

Agenda Item: Compliance Officer Report: Results of a University-Wide Research Compliance Study

☒ review ☐ review/action ☐ action ☒ discussion

Presenters: Susan Rafferty, Interim Director of the Office of Institutional Compliance

Purpose:

☐ policy ☐ background/context ☒ oversight ☐ strategic positioning

This purpose of this presentation is to provide the Audit Committee with information about compliance in the area of sponsored projects administration, an area identified as high risk and high impact (i.e. the “red zone” on the enterprise compliance risk assessment “heat map”).

Outline of Key Points/Policy Issues:

This report will provide compliance information to assist the Audit Committee in meeting its compliance oversight responsibilities. Specifically, this evaluation provides a favorable institutional compliance snapshot for administration of sponsored projects. High risk transactions examined in this evaluation and reflecting effective institutional oversight include: effort reporting, cost sharing, matching, subrecipient monitoring, cost transfers, and direct charging of administrative costs.

Background Information:

In September 2007, the Director of Institutional Compliance presented to the Audit Committee about a new initiative to evaluate compliance performance across the University system for higher risk compliance areas. This month the Interim Director of Institutional Compliance Susan Rafferty presents on the results of the pilot compliance evaluation which focused on the administration of sponsored projects.
Overview
The institutional snapshot provided by a pilot compliance evaluation this fall shows strong adherence to federal regulations and University policies and procedures across several key high risk activities in sponsored projects administration. The process for conducting this compliance evaluation, encompassing department-based data collection, peer review, and analysis by a central unit with oversight expertise, created a forum for members of the University’s sponsored projects administration community to discuss and increase compliance awareness and presents an opportunity for additional focused educational efforts.

Background
This pilot initiative to evaluate compliance performance across the University system is designed to provide additional institutional review and assurance over the compliance risks in the areas identified as high risk and high impact (i.e. the “red zone” on the enterprise compliance risk assessment “heat map”).

By nature, standard compliance monitoring, such as internal auditing of colleges and units and University operational compliance offices’ reviews and assessments, emphasizes review of issues within a unit or focuses review on units with the greatest risk activity or exposure for the institution. In contrast, this compliance evaluation initiative provides an opportunity to examine higher risk activities across many units thereby offering a snapshot institutional assessment. Although this is not a wholly forensic, exhaustive assessment, it does provide a check up on the health of risk management in certain key risk transactions. It also engages members of the University community who address these risks on a daily basis in their own units to reflect on and analyze the broader management of these risks.

Administration of Sponsored Projects
The administration of sponsored projects was selected as the pilot compliance area because of its high risk activities and high institutional impact. Traditionally this is an area of extensive federal regulation and heightened federal scrutiny. For example, for fiscal year 2008, the work plan of the Office of Inspector General for the Department of Health and Human Services again emphasizes both the review of administrative and clerical salaries colleges and universities charge to federally sponsored grants as well as the inspection of costs charged to sponsored agreements to determine if they are allowable, allocable, and reasonable.
Appropriate administration of the University’s sponsored projects is critical to the success of the institution and to the achievement of our goal to become a top three public research institution. Without rigorous controls and oversight of the administration of grants, the University is at risk of financial and other penalties, damage to reputation, and loss of project renewals and new awards.

As Vice President for Research R. Timothy Mulcahy presented to this committee in February, the University needs to close the $246 million gap with the current third ranked university in sponsored research expenditures. This goal to close the gap has several associated challenges as it occurs in a national landscape of declining proportion of federal grant funding and the likelihood of additional unfunded mandates from federal agencies. Enhancing our reputation as a reliable public steward of sponsored funds makes us more attractive to sponsors and, therefore, better positioned to close this gap.

**Process for the Review**
The Office of Oversight, Analysis and Reporting (OAR) identified a total of 69 sponsored projects having in excess of $200,000 awarded in fiscal year 2007 for this evaluation. Using this award amount resulted in capturing sponsored projects in a healthy mix of University departments. From the 69, a total of 54 departmental sponsored projects were selected resulting in an examination of $29,237,062 in sponsored funds awarded to the University.

**Results of the Review**
This snapshot institutional assessment confirmed that the monitoring systems in place for key sponsored projects administration risks are highly effective in attaining compliance with federal regulations as well as University policies and procedures. The high risk activities examined included: effort reporting; cost sharing; matching; subrecipient monitoring; cost transfers; and direct charging of administrative costs. Each of these areas is subject to close federal scrutiny and, correspondingly, appropriate University monitoring.

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th># Reviewed</th>
<th># of Issues Found</th>
<th>Compliance Rate</th>
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<tbody>
<tr>
<td>Effort Reporting</td>
<td>54 projects</td>
<td>1</td>
<td>98%</td>
</tr>
<tr>
<td>Cost Sharing</td>
<td>23 projects</td>
<td>2</td>
<td>95%</td>
</tr>
<tr>
<td>Matching</td>
<td>5 projects</td>
<td>0</td>
<td>100%</td>
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<tr>
<td>Subrecipient Monitoring</td>
<td>19 projects</td>
<td>113 subcontracts</td>
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<td></td>
<td></td>
<td>109 invoices</td>
<td>4</td>
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<tr>
<td>Cost transfers</td>
<td>32 transfers</td>
<td>256 points of risk</td>
<td>14 medium and low risks</td>
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<tr>
<td>Direct Charging of Administrative</td>
<td>41 projects</td>
<td>2</td>
<td>97%</td>
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Effort Reporting
The University administrative policy Effort Certification echoes federal standards and specifically provides: “As a condition to receive federal funding, institutions must maintain an accurate system for reporting the percentage of time (i.e., effort) that employees devote to federally sponsored projects.” Effort certification must reflect actual work performed; therefore, timely, accurate effort certification by individuals with first hand knowledge of the effort level being expended on a project is important.

The review of these activities in this institutional evaluation focused on the adherence to the proposed effort indicated in the proposed routing form (PRF) and the awarded level of effort indicated in the Notice of Grant Award (NOGA). Of the 54 projects that were reviewed for effort, only one project showed a deviation from the proposed effort and, consequently, the grant administrator will be requesting approval from the sponsor for a reduction in effort on the project.

While the review in this area illustrated good compliance, an opportunity to improve education and promote stronger communications among administrators on a project was identified. Focused training on effort commitment to departmental effort coordinators will better inform them to alert other administrators about effort level changes in a timely fashion. The most accurate effort reporting to sponsors should result.

Cost Sharing
Cost sharing is any sponsored project cost not borne by the sponsor. At the University, cost sharing generally refers to labor items, such as faculty salary, not covered by the sponsor. The University administrative policy Handling Cost Sharing, Matching and In-Kind Contributions After Award Acceptance recognizes the inherent divergence of institutional and sponsor interests in covering costs: “The University wants to minimize cost sharing/matching on sponsored projects. It should only be offered if mandated by the sponsor or needed to accurately reflect the resources required to conduct the project.” An additional complicating factor is the pressure on the principal investigator to commit to greater cost sharing in a project proposal in order to win the award.

Of the sponsored projects reviewed, 23 projects had committed cost sharing listed on the PRF and NOGA. Two of the 23 projects were found not to have fulfilled the cost sharing commitment and, accordingly, those grants administrators will be correcting the differences with the project sponsors.

Similar to the area of effort reporting, the review of cost sharing portrayed good compliance but also presents an opportunity for offering focused training and promoting stronger communications to achieve the most accurate administration of cost sharing. The clarity of the policy and procedures guiding administrators on compliance with cost sharing principles also will be examined.

Matching
Matching also refers to project costs not borne by the project sponsor. At the University, matching generally refers to non-labor items provided by the University. Matching funds can be required by sponsors for equipment acquisition programs, specialized research centers, or other multi-disciplinary programs. As with cost sharing, the tension for committing to competitive yet accurate, reasonable institutional cost obligations exists in the area of matching.

In this review, five projects had matching requirements. All of the departments for these five projects confirmed having internal matching tracking systems that identify the amounts required and the sources of the amounts. None of these five projects has reached completion, so the matching total required is not yet due. The existence of adequate internal tracking systems, nonetheless, indicates the high likelihood of proper matching occurring at completion of these projects.

Again, no institutional compliance gaps were revealed in this area. Sharing information about departments’ effective internal tracking systems for matching obligations, however, is a follow up action that can help ensure institutional compliance in this area remains strong.

**Subrecipient monitoring**
A subrecipient is a third-party organization that conducts a portion of the programmatic aspects of a University research project. Federal regulations require the University ensure the subrecipient’s compliance with the terms of the subcontract. This chiefly involves monitoring the subrecipient’s work progress as well as monitoring financial compliance through review of invoices from subrecipients and questioning expenditures if necessary.

Nineteen of the projects reviewed here had subcontracts, and this resulted in a total of 113 subcontracts. 109 audits in compliance with OMB Circular A-133 were due for collection for these subcontracts, and 12 of these audits were still outstanding at the time of this review. Of these subcontracts, 109 invoices were selected for review to confirm signature of the principal investigator; only four of the invoices lacked this required signature. Appropriate follow up will occur in these instances.

These results demonstrate that subrecipient monitoring is another area where the University grants administration community displays good understanding and compliance with sponsor requirements.

**Cost Transfers**
Costs should be charged to the appropriate sponsored project when first incurred. If this does not happen, a cost transfer ensues where a direct charge expense is moved from one account to another after the charge has been posted in a financial system. As the University administrative policy *Adjusting or Correcting Internal Accounting Transactions for Sponsored Accounts* states: “Financial managers should initially align expenses with corresponding cash received in a fiscally responsible manner which
eliminates the need to move expenses at a later date. Frequent errors in recording expenses may indicate the need for improvements in accounting practices and/or internal controls.” Legitimate reasons can exist for a cost transfer, but the cost transfer activity itself invites closer scrutiny of the expense.

For this institutional review, OAR pulled 32 random cost transfer transactions for fiscal year 2007 from its system-wide database. Within this sample, a total of 14 issues of risk were identified. None of these risks was deemed a risk high enough to impact the University’s reputation and standing. As part of their standard transaction review process, OAR already had resolved these issues.

With these results, this review indicated that the current monitoring system for cost transfer activities is operating effectively.

**Direct Charging of Administrative Costs**

Direct charging of administrative costs to a sponsored project should occur only in special circumstances. OMB Circular A-21 mandates that administrative costs normally should be treated as Facilities and Administrative (F&A) costs and generally should not be charged directly to awards funded by the federal government. It also provides guidance as to when it may be appropriate to charge administrative costs directly to federally-sponsored agreements and dictates that special care should be exercised so that costs incurred for the same purpose in like circumstances are treated consistently as either direct costs or F&A costs. As indicated earlier in this report, the Office of Inspector General’s work plan for this fiscal year highlights review of college and universities’ operations to ensure costs charged to sponsored agreements are allowable, allocable, and reasonable.

Of the 54 sponsored projects reviewed, 41 projects were identified as having costs potentially considered to be F&A charges. Upon closer examination, two of these 41 projects demonstrated unallowable administrative charges and are being adjusted accordingly.

The compliance findings of this institutional review are in line with results from routine monitoring of project costs. While the compliance picture in this area is good, it is important to continue education and monitoring about appropriate charging of administrative costs to sponsored awards and to continue oversight promoting institutional consistency in treatment of these costs.

**Conclusion**

The institutional snapshot of compliance in administration of sponsored projects is favorable. Strong adherence to federal regulations and University policies and procedures in key high risk activities, including effort reporting, cost sharing, matching, subrecipient monitoring, cost transfers, and direct charging of administrative costs, is occurring throughout the University system. Results of this evaluation reveal an effective monitoring system for these transactions. Additional opportunities for focused educational efforts, promotion of better communications among grants administrators, and administrative policy and procedure clarification should result in even stronger compliance for this area. Through this institutional evaluation, members of the
University community who perform these transactions on a daily basis in their own units had an opportunity to increase their awareness of the associated compliance risks.
Audit Committee  
November 8, 2007

**Agenda Item:** Information Items

☐ review  ☐ review/action  ☐ action  ☒ discussion

**Presenters:** Associate Vice President Gail Klatt

**Purpose:**

☐ policy  ☐ background/context  ☐ oversight  ☐ strategic positioning

**Emergency Approvals:** To provide the Audit Committee with information regarding the emergency approval of the engagement of PriceWaterhouseCoopers, LLP.

**Semi-Annual Controller’s Report:** To inform the Audit Committee of the activities within the Controller’s Office over the last six months.

**Outline of Key Points/Policy Issues:**

**Emergency Approvals:** Following the early adjournment of the Board of Regents meeting on September 7, 2007, Regent Simmons, Allen and Cohen approved a contract to engage PriceWaterhouseCoopers, LLP by the University’s Office for Technology Commercialization to perform audit services on royalty calculations for sales occurring in calendar years 2005 and 2006. The contract is for a value not to exceed $99,000.

**Semi-Annual Controller’s Report:** This report presents a summary of activities completed by the Controller’s Office in the last six months that enhance financial accounting and reporting, strengthen internal controls, reduce financial or compliance risks to the University, and improve efficiencies and services.

**Background Information:**

**Emergency Approvals:** Board of Regents materials in support of this engagement were included in the September 2007 docket for the Audit Committee, which reviewed and recommended approval of the item on September 6, 2007.

**Semi-Annual Controller’s Report:** The Controller’s Report is prepared semi-annually and presented to the Regents Audit Committee in conformance with Board of Regents Policy: Board Operations and Agenda Guidelines.
September 10, 2007

The Honorable Patricia Simmons
The Honorable Clyde Allen
The Honorable Linda Cohen

Dear Members of the Board:

As you know, the policy on Board Operations and Agenda Guidelines stipulates that Board approval is required before all engagements of external audit firms to perform work or provide services with a value greater than $25,000.

Due to the early adjournment of your meeting on Friday, September 7, 2007, approval of an engagement over $25,000 is possible until October under normal procedures. However, the Board Operations and Agenda Guidelines allow for an emergency procedure if an emergency situation exists as defined in the Guidelines. Specifically, in Section II, Subd. 10, the policy reads as follows:

Upon the recommendation of the president, the Board chair, vice chair, and the respective committee chair may act on behalf of the Board when delay for Board approval poses a significant health, safety, or financial risk to the University. Any such emergency approvals will be brought to the next meeting of the Board, consistent with Board policy.

Upon the request of the Director of Audits and the Vice President and Chief Financial Officer, I am recommending use of this emergency process for Board approval of the following engagement, which was reviewed and recommended for approval by the Audit Committee on Thursday, September 6, 2007:

- To approve the engagement of PriceWaterhouseCoopers, LLP, by the University’s Office for Technology Commercialization, to perform audit services on royalty calculations for sales occurring in the calendar years 2005 and 2006. The contract is for a value not to exceed $99,000.

I am recommending that this engagement be approved on an emergency basis to assure that the purchases are made as economically as possible, and to avoid interruption of the related projects.

Sincerely,

Robert H. Bruininks
President

RB:jes
September 12, 2007

FACSIMILE

To:         President Robert Bruininks
From:       Ann Cieslak, Executive Director
Re:         Emergency Approval
Pages:      2 (including cover)

Today by telephone, email, or in person, Chair Simmons, Vice Chair Allen, and Audit Committee Chair Cohen each approved the request from you for the following (as described in your attached letter):

• Engagement of PriceWaterhouseCoopers, LLP, by the University's Office for Technology Commercialization, to perform audit services on royalty calculations for sales occurring in the calendar years 2005 and 2006. The contract is for a value not to exceed $99,000.

I understand that these actions will be reported to the Board of Regents at the October 2007 meetings, as required by Board policy.

Attachment

c: Kathryn Brown, Vice President & Chief of Staff (w/o attachment)  
   Gail Klatt, Associate Vice President (w/o attachment)
This report presents a summary of activities completed by the Controller’s Office in the last six months that have improved financial reporting, enhanced internal controls, reduced financial risks, improved services to the University community, or created efficiencies in financial operations.

I. Accounting and Financial Reporting Matters

The Controller’s Office is currently planning for the adoption of four new accounting and reporting standards, and ten new proposed auditing standards that will impact the University’s external audit. The following is a brief summary of these new standards.

Accounting and Reporting Standards

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions – This Statement addresses how public entities (state and local governments, public universities, etc.) should account for and report their costs and obligations related to postemployment healthcare and other non-pension benefits. Collectively, these benefits are commonly referred to as “other postemployment benefits” or OPEB. GASB Statement No. 45 generally requires that public entity employers account for and report the annual cost of OPEB, and the outstanding obligations and commitments related to OPEB, in essentially the same manner as they currently do for pensions. The provisions of GASB Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. This statement will be effective for fiscal 2008 reporting.

GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations - The statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations. The statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset. The statement provides that, once any of the defined obligating events has occurred, the University would be required to estimate the expected pollution remediation outlays and determine whether such outlays should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. This statement will be effective for the University’s fiscal year ending June 30, 2009.

GASB Statement No. 50, Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27 – The statement aligns financial reporting requirements for pension and with those for OPEB and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information by pension plans.
and by employers that provide pension benefits. This statement is effective for the fiscal year ending June 30, 2008.

**Statement No. 51, Accounting and Financial Reporting for Intangible Assets** –
This statement addresses the recognition of intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. Additionally, it establishes a specified-conditions approach to recognizing intangible assets that are internally generated. GASB Statement No. 51 provides guidance on determining the useful life of intangible assets when contractual or legal provisions limit the length of their life. This statement is effective for the fiscal year ending June 30, 2010, and the provisions of this statement are generally required to be applied retroactively for fiscal years ending after June 30, 1980.

**Auditing Standards**

**Statement on Auditing Standards No. 103, Audit Documentation** – This standard expands the amount and level of detailed documentation that the auditors must retain in order to support their opinion. It also requires that auditors be able to support their opinion with audit evidence before they issue their opinion. This standard is effective for the University’s fiscal year ending June 30, 2007.

**Statement on Auditing Standards No. 112, Communicating Internal Control Related Matters Identified in an Audit** – This standard requires the auditor to communicate significant deficiencies in internal control to the audit committee. For purposes of SAS No. 112, the following definitions apply:

**Deficiency** The design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Deficiencies, as defined, are the least severe in nature, and may therefore be communicated verbally to management.

**Significant Deficiency** A single control deficiency, or a combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principals such that there is more than a remote likelihood that a misstatement of an entity’s financial statements that is more than inconsequential will not be prevented and detected. Significant deficiencies are required to be communicated in writing to management and to the Board of Regents.

**Material Weakness** A significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Material weaknesses, as defined, are the most severe in nature and, like significant deficiencies, must be communicated in writing to management and to the Board of Regents.
SAS No. 112 and *Government Auditing Standards* (the Yellow Book) requires the auditor to separately identify and communicate in writing any significant deficiencies and material weaknesses. This standard is effective for the University’s fiscal year ending June 30, 2007.

**Risk Assessment Standards: SAS No. 104—SAS No. 111**

In March 2006, the AICPA ASB issued eight Statements on Auditing Standards (SASs) that provide extensive guidance concerning the auditor’s assessment of the risks of material misstatement in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the SASs establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit. These statements in general apply to the external auditors and will impact the University most heavily in the documentation of internal controls. SAS No. 104—SAS No. 111 are effective for the University’s financial statement audit for fiscal year ending June 30, 2008.

**II. Internal Control, Compliance, and Service and Efficiency Improvements**

Since the last report to the Audit Committee, the Enterprise Financial System project and the year-end audit have been the primary focus of the Controller’s Office. Nevertheless, the following improvements have been recently implemented.

The Board of Regents approved management’s recommendation to increase the competitive bid threshold for purchases at the December 2006 Board of Regents meeting. These changes were rolled-out and made effective on March 1, 2007. The changes increased the bid threshold for purchases from $10,000 to $50,000; increased the bid threshold for construction purchases (excluding architects and engineers) from $10,000 to $250,000; and increased the bid threshold for construction purchases for architects and engineers from $50,000 to $100,000.

This change simplified the purchasing process, dramatically reducing processing time for thousands of purchases, with minimal additional financial or compliance risk.

The bid threshold is the dollar level at which Purchasing Services is required by policy to publicly solicit competitive bids/proposals or approve an exception, and issue the Purchase Order.

**III. Enterprise Financial System Replacement Project**

**Background**

The University purchased the PeopleSoft Enterprise Financial System software in September 2003, pursuant to Board approval. The University has pursued a two-phase approach to implementation. Phase 1, a preparatory and exploratory phase, ran from January 2004 through July 2005. Phase 2, the implementation phase, began August 2005 and runs up to the go-live date of July 2008.
The project continues to be on track to meet the go-live date of July 2008. The project successfully completed the Technical Design phase in July 2007 and is scheduled to complete the Build phase of the project in November. Testing will begin in mid-November, with a full 7 months of testing planned prior to go-live. There is also significant ongoing technical work to integrate existing enterprise systems, such as the student and human resource systems.

Key to the long-term success of the new system are the training, competencies, and change management components of the project. Approximately 4,000 users must be trained in the three months prior to go-live. There will be approximately 40 training courses designed project continues to prepare the financial user community for the rollout of the new system through organizational design and change management activities, the development of training plans, and financial competencies assessments.

The Controller’s Office is integrally involved in all project phases. We are currently in the midst of restructuring our units to effectively support the new system in July 2008. We are also working on revising all financial policies and procedures, so they conform to the new system. Finally, work is underway for the conversion of financial data from the existing systems into the new system.