Audit Committee

February 2015

February 12, 2015

8:00 a.m. - 9:45 a.m.

East Committee Room, McNamara Alumni Center
   Docket Item Summary - Page 3
   Report - Page 4

2. OMB Uniform Guidance and Its Impact on the University
   Docket Item Summary - Page 7
   Presentation slides - Page 8

3. Internal Audit Quality Assurance Report
   Docket Item Summary - Page 18
   Report - Page 19
   Review team - Page 22

4. Perspectives on the Higher Education Landscape
   Docket Item Summary - Page 23
   Robert Kueppers Biography - Page 24
   Presentation slides - Page 25

5. Internal Audit Update
   Docket Item Summary - Page 49
   Internal Audit Update - Page 50
Audit

February 12, 2015


☐ Review  ☐ Review + Action  ☐ Action  ☒ Discussion

☒ This is a report required by Board policy.

Presenters:  Michael Volna, Associate Vice President & Controller
            Kirsten Vosen, Partner, Deloitte & Touche LLP
            Katie Knudtson, Partner, Deloitte & Touche LLP

Purpose & Key Points

This presentation will provide the Audit Committee with an update on FY 2014 audit services performed by Deloitte since their update in December. Services to be discussed will include:

- Federal A-133 compliance audit.
- MN Office of Higher Education financial aid programs examination.
- NCAA agreed-upon procedures engagement.
- Student fees agreed-upon procedures engagement.
- Weisman Art Museum audit (for MN State Arts Board grant).
- Northrop Auditorium audit (for MN State Arts Board grant).
- Management recommendations resulting from 2014 engagements.

Background Information

The external auditors present their audit results to assist the Board with its fiduciary responsibilities and to comply with professional standards for audit firms. This report is presented to the Board of Regents Audit Committee in conformance with the Board of Regents Policy: Board Operations and Agenda Guidelines.
University of Minnesota

Presentation to the Audit Committee of the Board of Regents
Summary of other 2014 audit services

A-133 Single Audit

- Audit report on the schedule of expenditures of federal awards for the year ended June 30, 2014, issued in December 2014
- Audit performed in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Circular A-133, including the OMB Compliance Supplement dated March 2014
- Audit required for federal expenditures in excess of $500,000
  - Total University of Minnesota (the "University") federal expenditures for the year ended June 30, 2014 were ~$1.067 billion
- Identified the following as major federal programs to be tested:

<table>
<thead>
<tr>
<th>Major Federal Program</th>
<th>2014 Expenditures (In thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and Development Cluster</td>
<td>$ 501,700</td>
</tr>
<tr>
<td>Student Financial Assistance Cluster</td>
<td>455,700</td>
</tr>
<tr>
<td>Cooperative Extension Service</td>
<td>12,900</td>
</tr>
<tr>
<td>Special Education Teacher Assistance</td>
<td>11,900</td>
</tr>
<tr>
<td>Supplemental Nutrition Assistance Program</td>
<td>5,900</td>
</tr>
<tr>
<td>Education and Human Resources</td>
<td>4,000</td>
</tr>
</tbody>
</table>

- The University continues to qualify as a low-risk auditee
- Decrease in major programs identified from eight in 2013 to six in 2014
- Unmodified opinions
- No significant deficiencies or material weaknesses in internal control over major programs
- No material instances of noncompliance for major programs
- No findings or questioned costs noted

Minnesota Office of Higher Education Financial Aid Programs examination

- Compliance examination for state grants performed in connection with A-133 Single Audit
- Report issued January 15, 2015
- No findings noted

NCAA agreed-upon procedures

- Procedures performed for the University of Minnesota Athletic Department's compliance with NCAA bylaws
- Report issued January 5, 2015
• No findings noted

Student fees agreed-upon procedures
• Procedures performed for 24 student organizations (11 full-scope and 13 limited-scope) with respect to the financial affairs and accounting records of the student organizations
• Findings noted and communicated to management of the student organizations and student fees committee, as applicable:
  – Lack of underlying account reconciliations
  – Lack of consistency of supporting documentation
• Reports issued January 23, 2015

Weisman Art Museum audit
• Audit of the statement of revenues, expenses, and changes in net position
• Report issued January 12, 2015
• Unmodified opinion
• Prior year errors noted related to understatement of depreciation expense and other revenue
  – Not deemed material to the statement of revenues, expenses, and changes in net position

Northrop Auditorium audit
• Audit of the statement of revenues, expenses, and changes in net position
• Report issued January 21, 2015
• Unmodified opinion
  – Single year financial statement presented for the year ended June 30, 2014 and now includes depreciation expense which previously had not been recorded in the stand-alone financial statements of Northrop Auditorium
• No misstatements noted

Management Recommendations Resulting from 2014 Other Procedures
During the course of our audits, we noted inconsistencies in the allocation of depreciation expense for departmental units for the purpose of reporting in stand-alone department financial statements for Weisman Art Museum and Northrop Auditorium. As a result of these historical and current year depreciation expense errors, we recommend that personnel from Central Accounting of the University take an oversight role in the stand-alone financial statements of these units of the University. Given the knowledge of personnel in Central Accounting, they are adequately informed of activities of the University and its departments throughout the year and have the requisite knowledge to review and appropriately challenge the stand-alone financial statements prepared and ensure the financial statements include all transactions of the department units.
Purpose & Key Points

The United States Office of Management and Budget (OMB) has combined many federal circulars related to sponsored research into a single guidance document that can be used by all federal agencies. This combined document is known as “Uniform Guidance” and went into effect on December 24, 2014. This presentation will outline how the changes brought forth by the implementation as well as the current status of the implementation at the federal level impact the University of Minnesota.
Goals of Updated Regulations

Reduce fraud, waste, and abuse

VS.

Streamline

University of Minnesota
Driven to Discover
OmniGuidance Implementation Plan

- Understand (OMB)
  - Influence (OMB)
  - Plan (OMB)
- Understand (Agency)
  - Plan (Agency)
- Implement
- Evaluate
- Refine

2013
- 12/26/13: Release

2014
- 6/26/14: Agency plans due to OMB
- 12/26/14: Implementation (all but audit)

2015
- 7/1/15: Audit provisions go into effect for UMN
Significance of Change

- Agency prior approvals
- Policies and business processes
- University’s F&A rate
- University’s FY16 audit
Status of Federal Rollout

• Two sets of regulations
• Research Terms and Conditions
• Inconsistent agency requirements
• Inconsistent implementation for ongoing awards
• Many awards will require duplicative handling
UG Terms with Greatest Impact to the University

- Direct Charges
- Subawards
- Award Closeout
- Procurement
- Dependent Care
Campus Readiness

- Road Shows
- Symposium Presentations
- Regular visits to CRAD & SRC
- PI Quick Guides
PI Quick Guides

- Proposals (September 2014)
- Subawards (February 2015)
- Awards (Spring 2015)
- Procurement (July 2016)
Next Steps

• Continue to partner with COGR and FDP
• Continue to refine policies and business processes

• Additional information available at:
Audit Quality Assurance Report

Agenda Item: Internal Audit Quality Assurance Report

☐ Review  ☑ Review + Action  ☐ Action  ☑ X Discussion

This is a report required by Board policy.

Presenters: Gail Klatt, Associate Vice President
James Roth, President of AuditTrends and external review team leader

Purpose & Key Points

This presentation will discuss the purpose of external quality assurance reviews, the process followed, and the results of the recently completed review of the Office of Internal Audit. The requirements for external reviews of the audit function and the professional standards against which the Office of Internal Audit practices are evaluated will be explained, as will the opinions that can be rendered by the review team.

Background Information

Board of Regents Policy: Audit Committee Charter charges the committee with oversight of the internal audit function.

The Standards for the Professional Practice of Internal Auditing require that internal audit functions have a formal external quality assurance review performed every five years. The results of these reviews are required to be shared with the Audit Committee.

The results of the Office of Internal Audit’s self-assessment, conducted as part of the quality assurance review process, were communicated to the Audit Committee on December 11, 2014.
Dear Ms. Klatt:

Our team was engaged to conduct an independent validation of the University of Minnesota Office of Internal Audit (the Office) self-assessment. The primary objective was to verify the assertions made in the self-assessment report concerning adequate fulfillment of the organization’s expectations of the Office and its conformity to The Institute of Internal Auditors’ (IIA’s) International Standards for the Professional Practice of Internal Auditing (Standards).

The validation, conducted during the period February 3-5, 2015, consisted primarily of a review and test of the procedures and results of the self-assessment. In addition, we interviewed the chairman of the Board of Regents, the audit committee chair, the University president, other senior members of management, and the external auditors.

We concur with the Office’s conclusions in their November 2014 self-assessment report, with one exception. It is our judgment that Standard 1220 (Due Professional Care) should be rated as Generally Conforms because the data analytics program in place is sufficient to conform with the Standard, even though the Office has plans to upgrade its supporting technology to enhance its capabilities in this area. Generally Conforms for individual standards means that the internal audit activity complies with the requirements of the standard or elements of the Code of Ethics in all material respects.

We concur with the overall rating of Generally Conforms – the highest rating in the IIA rating system – for the Office of Internal Audit as a whole. Generally
Conforms means that University Management and the Board of Regents can appropriately rely on the assurance provided by the work performed by the Office of Internal Audit.

Our team, which collectively has extensive experience performing quality assessments, has seldom been as impressed with an internal audit activity as we were with the Office of Internal Audit. We would like to point out just a few noteworthy strengths:

- A highly qualified and experienced staff, with a positive work environment and culture of quality and professionalism
- Strong support for continuing professional education and certifications
- A well-designed audit process and work products, including an employee survey used on every audit that was featured as a best practice in an IIA research study

At the Office’s request, we tried to contribute to their continuous improvement efforts. We noted the following opportunities for improvement:

- Develop rating scales and criteria for impact and likelihood for use in the Office's risk assessments and its evaluation of the University's risk management processes. We believe this will enhance the consistency of judgments about risk and enable the Office to better allocate their resources toward higher risks as well as evaluate the cost/benefit of controls.
- Implement automated workpaper software to improve efficiency. This will have to be timed to avoid conflicting with the enterprise upgrade and data analytics implementation, as there will be a learning curve with all three.
- Consider further reducing the extensive time spent on following up on audit issues. We discussed various options for doing this without overly increasing risk to the University. The Office will further discuss and, if appropriate, bring a proposal to the audit committee for consideration.
- Continue their ongoing succession planning for internal audit management. A great deal of institutional knowledge and leadership will be lost to retirement in the coming years.

We discussed several other minor opportunities for improvement with internal audit management.
We would like to thank management and staff for exceptionally well laid out self-assessment documents that, together with the strength of the people and process, made our jobs easy.

James Roth, PhD, CIA, CCSA, CRMA on behalf of the other members of the validation team:
Patrick Copeland, CIA, CRMS, CISA, CPA
Barbara J Deily CPA, CISA
Donald Espersen, CIA, CRMA
James Roth, PhD, CIA, CCSA, CRMA, (team leader) is president of AuditTrends LLC, a training firm devoted to identifying and communicating the best of current internal audit practice. Before forming AuditTrends in 1993, he was an internal auditor in the banking industry for 12 years. He has written eight books and numerous publications for the internal audit profession, and developed eight AuditTrends seminars, which range in topic and audience from Skills for the New Internal Auditor to Best Practices in Internal Auditing for audit management. He is the 2008 winner of The IIA’s Bradford Cadmus Memorial Award for “individuals making the greatest contribution to the advancement of the internal audit profession.” This is the highest level of award and recognition for the internal audit profession.

Patrick Copeland, CIA, CRMA, CISA, CPA, created Copeland Partners LLC after completing nearly 27 years with a global pharmaceutical company where he held a variety of leadership positions within audit and finance, including chief financial officer of operations in Asia, Europe, and the Caribbean. He performs quality assessment reviews of internal audit organizations for the The Institute of Internal Auditors (IIA), conducts seminars covering a range of audit-related topics, and has written several training courses offered by The IIA. He has worked with numerous governmental agencies across the United States, Canada, and the Caribbean as well as private sector clients from various industries.

Barbara Deily, CPA, CISA, retired in January 2015 from the University of Virginia after a 32 year internal audit career during which she served as the Chief Audit Executive since 2007. She was responsible for overseeing the University’s comprehensive audit program including financial, operational, programmatic, and compliance audits of all University and Medical Center departments, activities, and systems. She provided support for the Audit Committee of the Board of Visitors and was an advisor to the President and senior leadership team. She coordinated the University’s audit work with the Auditor of Public Accounts and the Department of the State Internal Auditor. Barbara holds degrees from both the Pennsylvania State University and the University of Virginia.

Donald Espersen, CIA, CRMA has led more than 20 external quality assessment for internal audit groups in a wide variety of industries, sectors, and international locations. He is also an independent internal audit advisor and professional trainer specializing in the design and delivery of customized training programs and internal audit quality improvement activities. He has worked with client groups in Africa, Asia, Canada, Europe, Mexico, the Middle East, South America, and the Unites States. He serves as a member of The IIA’s Committee of Research and Education Advisors.
Agenda Item: Perspectives on Governance and Trends in the Higher Education Landscape

This discussion is intended to provide Audit Committee members with the opportunity to engage with a national leader in the area of corporate governance on current higher education issues and the role of the governing board in managing the changing landscape. Topics that will be discussed include:

- Governance best practices and how Boards are changing their practices in response to increasing expectations.
- Insights on the regulatory environment of higher education, the potential for regulatory relief, and best practices for managing the cost of compliance.
- Megatrends in higher education and disruptive innovative practices, including new business models, that could change its landscape.

This is a report required by Board policy.

Presenters: Robert Kueppers, Senior Partner, Deloitte Center of Corporate Governance, Deloittee & Touche LLP
Robert J. Kueppers
Managing Partner, Center for Corporate Governance
Deloitte LLP

Robert J. Kueppers is Managing Partner for Deloitte LLP’s Center for Corporate Governance. Mr. Kueppers leads the Center’s efforts to support boards of directors and audit committees on a variety of governance and risk matters.

Since 2008, he has developed and hosted the Deloitte Directors’ Series, a live broadcast to thousands of directors across the United States discussing the latest issues and trends in corporate governance. In 2009 and 2012, Mr. Kueppers was recognized by NACD Directorship magazine as one of the top 100 influential professionals in corporate governance and in the boardroom. Mr. Kueppers is a frequent speaker and writer on issues impacting corporate governance and the audit profession.

Mr. Kueppers also serves as Senior Partner, Global Regulatory and Public Policy for Deloitte LLP. In this role, Mr. Kueppers represents the U.S. member firm of Deloitte Touche Tohmatsu Limited on global regulatory, public policy and accounting profession matters. He also serves major clients of the firm in an advisory capacity and has 36 years of professional experience. Mr. Kueppers previously served as Deputy CEO of Deloitte LLP and was responsible for regulatory and professional matters in the United States.

Mr. Kueppers is chairman of the board of directors of United Way of New York City; chair of the University of Minnesota’s Carlson School of Management Board of Overseers; a board member of American Corporate Partners, a nationwide mentoring organization for United States veterans; a founding trustee and president of the SEC Historical Society; and a trustee of the Committee for Economic Development. He also helped create the Center for Audit Quality and since its inception in 2002 has chaired many committees and task forces with his peers and professional practice leaders from other national accounting firms.
University of Minnesota

Audit committee discussion

February 12, 2015
The role of the audit committee, leading practices and trends
The role of the audit committee leading practices and trends

Staying sharp on important matters

The roles will vary from institution to institution depending on the complexity and size as well as the requirements of the governing body, but typical audit committee responsibilities include:

- Financial reporting oversight
- Working with the independent auditors
- Working with the internal auditors
- Risk oversight and role of the audit committee in the process
- Ethics and compliance: whistleblower provisions and fraud oversight
The role of the audit committee leading practices and trends

Financial reporting oversight

- The audit committee oversees the integrity of a institution's financial reporting processes and audits.

- Anticipate and understand how pending financial reporting and applicable regulatory developments may affect the institution; understand plans to address new accounting and reporting requirements – disclosures should be consistent, understandable and transparent
  - Hold training sessions
  - Meet with independent (and internal) audit teams on periodic basis.

- Understand key controls and reporting risk areas as assessed by independent auditors, internal auditors, and financial management, as well as mitigating controls and safeguards.

- Encourage coordination between audit committee and other board committees, specifically the compensation committee.
The role of the audit committee leading practices and trends

Financial reporting oversight

- Leverage the value of internal controls beyond compliance.
- Consider levels of authority and responsibility in key areas, including pricing and contracts, acceptance of risk, commitments, and expenditures.
- Understand complex accounting and reporting areas and how management addresses them.
- Understand significant judgments and estimates used by management and their impact on the financial statements, such as fair-value accounting and related assumptions.
- Partnership with the President and other management
  - Focus on the tone at the top, culture, ethics, and hotline monitoring – especially relating to financial reporting.
  - Engage in the identification of potential issues.
  - Understand plans to address new accounting and reporting requirements.
  - Provide input to management’s goal-setting process.
  - Discuss succession planning for the CFO and staff.

Do your audit committee agendas include a discussion on succession of finance talent?

- Yes: 8%
- No: 36%
- Don't know/Not applicable: 56%

The role of the audit committee leading practices and trends

Working with the independent auditors

- Exercise ownership of the relationship with the independent auditor.
- Get to know the lead partner and meet with “specialists” (tax, IT, valuation) that are used in conducting the audit.
- Set expectations and annual agenda.
- Engage in consistent dialogue outside of the regularly scheduled meetings.
- Fulfill required communications between auditor and audit committee.
- Executive sessions at every audit committee meeting.
- Complete a formal evaluation of the audit team on an annual basis; provide ongoing feedback throughout the audit cycle.

Questions for audit committees to consider on oversight of independent auditors

- Did the auditor address issues of “tone at the top” and antifraud programs and controls in place in the institution?
- Did the auditors inform the audit committee of any risks of which the committee was not previously aware?
- Did the auditor communicate issues freely with the audit committee, or did he or she seem protective of management?
- Does it appear that management exercises undue influence on the external auditors?
- Is the audit committee satisfied with the planning and conduct of the audit, including the financial statements and internal control over financial reporting (as applicable)?
- Does it appear that the external auditors are reluctant or hesitant to raise issues that would reflect negatively on management?
The role of the audit committee leading practices and trends

Working with the internal auditors

A focus on the following areas:

- Reporting structure
- Internal audit risk assessment and audit plans
- Annual evaluations of department and the Chief Audit Executive (CAE)
- Succession planning
- Holistic approach to risk management
- Peer review / benchmarking
- Resources / funding

Has your company done any benchmarking on its internal audit department (e.g., budget, resources)?

- Yes: 45%
- No: 33%
- Don't know/Not applicable: 22%

The role of the audit committee leading practices and trends

Working with the internal auditors

- The internal auditor is accountable to the audit committee.
- Hold regular private sessions with the internal auditors.
- Be available when contacted by the Chief Audit Executive (CAE) and engage in discussions regularly.
- Review the CAE’s report on the status of corrective action plans in place and monitor programs.
- Actively participate in the CAE’s goal setting and performance evaluation.
- Challenge the CAE and the internal audit department.
- See that the internal auditors have appropriate stature and respect.
- Support the CAE and his/her institution.

Questions for management to consider on oversight of internal auditors

- Does internal audit have a clearly articulated strategy that is reviewed periodically and approved by the audit committee?
- Is internal audit staffed with the appropriate mix of professionals to achieve its objectives?
- Does internal audit meet regularly with the external auditors to discuss risk assessments, the scope of procedures, or opportunities to achieve greater efficiencies and effectiveness in the institution’s audit services?
- Are issues identified and reported by internal audit appropriately highlighted to the audit committee, and is the progress toward effective completed management actions tracked and reported?
The role of the audit committee leading practices and trends

Risk oversight

- The full board is ultimately accountable for risk oversight; a Risk Intelligent board is one in which all committees and the full board are discussing risks associated with each topic on their respective agendas.
- At the committee level, there is some shift from audit committees to other board committees being involved in oversight of risks identified.
  - Committee expertise drives which risks are overseen by certain committees.

The board’s role in risk oversight includes six areas:
- Define the board’s risk oversight role
- Foster a risk-intelligent culture
- Understand and set an appropriate risk appetite
- Help management incorporate Risk Intelligence into strategy development
- Assess the “maturity” of the risk governance process
- Communicate (level-set) the risk story to stakeholders

Source: Risk Intelligent governance: Lessons from state-of-the-art board practices
Overview of an audit committee's key responsibilities

Risk oversight
The role of the audit committee leading practices and trends

Risk oversight

If risk oversight is shared by multiple committees, how does the board coordinate these activities? (Select all that apply)

- Cross membership of the committees: 32%
- Joint meetings: 10%
- Risk presentations repeated at multiple committee meetings: 12%
- Detailed discussions at the full board meeting: 66%
- Sharing of minutes or other meeting materials: 40%
- Not applicable; risk oversight is not shared by multiple committees: 14%
- Don't Know/Not Applicable/Other: 14%

Examples of the "other" answer choice included:
- An annual "deep dive" updated during the year
- Annually plus discussion at other meetings
- Semi-annually and more frequently when needed

The role of the audit committee leading practices and trends
Role in ethics and compliance

- Whistleblower/ helpline program oversight
- Fraud oversight: management override of controls
- Inspection of fraud risk assessment
- Responsible for initiating internal/ independent investigations
- Code of ethics/conduct compliance oversight
- Contributes to “tone at the top”
The role of the audit committee leading practices and trends

Role in ethics and compliance

- Ensure that the institution has an effective ethics and compliance program and that it is periodically tested.
- Promote a culture of compliance and financial reporting integrity throughout the institution.
- Insist that the tone set by management is clear, unambiguous and consistent.

How often does the audit committee receive reports on internal tips from a compliance hotline?

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frequently (five or more times a year)</td>
<td>35%</td>
</tr>
<tr>
<td>Sometimes (two to four times a year)</td>
<td>36%</td>
</tr>
<tr>
<td>Rarely (once a year)</td>
<td>14%</td>
</tr>
<tr>
<td>Never</td>
<td>6%</td>
</tr>
<tr>
<td>Don't know/Not applicable</td>
<td>9%</td>
</tr>
</tbody>
</table>

In the past year, has your helpline received an increase in tips?

- Yes: 20%
- No: 17%
- Don't know/Not applicable: 63%

Audit committee effectiveness
Audit committee effectiveness
Areas of focus

- Agenda setting and prioritization
- Composition and competency
- Executive sessions
- Performance evaluations
- Meetings and information
- Coordination with other committees
## Audit committee effectiveness

### Agenda setting

<table>
<thead>
<tr>
<th>Agenda</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NACD</strong></td>
<td>The chair of the audit committee should develop, in consultation with management, the committee's agenda. This agenda should reflect, as appropriate, a periodic review of risk by each significant business unit.</td>
</tr>
<tr>
<td><strong>Business Law</strong></td>
<td>Directors should be given an opportunity to place items on the agenda. Further, the board should satisfy itself that there is an overall annual agenda of matters that require recurring and focused attention.</td>
</tr>
</tbody>
</table>
| **The Conference Board** | The audit committee chair is responsible for:  
- Finalizing the agenda in collaboration with management  
- Allocating the time to discuss each item in the agenda  
- Ensuring the agenda is fully covered and that each member is satisfied with the discussion that took place |
| **Common Practices** | A detailed calendar of activities is often helpful in guiding meetings and agenda development. |

Audit committee effectiveness
Executive Session: Questions for the audit committee to ask

President, Chief Financial Officer (CFO), Controller

- Do you believe the financial statements and applicable federal and state tax filings fairly present the institution's financial position and activities?
- Do you believe the disclosures are appropriate and complete and are understandable by the average reader?

President

- Discuss your impressions of the performance of the Internal Audit Director, CFO, Controller, IT Director, Endowment, Education, Administration, and General Counsel.

Chief Financial Officer

- Are you aware of any whistleblower activity in the institution?
- Are you aware of any conflicts of interest within management?
- Now that you have the opportunity, is there anything you want to tell the Audit Committee?
- Is there anything else that we need to know?

General Counsel

- Are you aware of any issues that could cause embarrassment to the institution?
- Have you ever been told anything in confidence or otherwise that would embarrass the institution if it were known publicly?
- Are there any items that have significant financial statement impact that you have discussed with the President, CFO or other officers, or outside counsel, that the audit committee should be aware of?

Source: The AICPA Audit Committee Toolkit: Not-for-Profit Organizations, AICPA, Inc., 2010
Audit committee effectiveness
Performance evaluations

- Conduct performance evaluation on an annual basis.
- Include self and peer evaluation and an evaluation of the audit committee itself.
- Communicate with the board on resulting activities and recommendations.

<table>
<thead>
<tr>
<th>How are your directors evaluated? (Select all that apply)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Board performance evaluation led by corporate secretary or</td>
<td>34%</td>
</tr>
<tr>
<td>other in-house personnel</td>
<td></td>
</tr>
<tr>
<td>Board performance evaluation led by a 3rd party facilitator</td>
<td>11%</td>
</tr>
<tr>
<td>Board performance evaluation led by the board chair or other director</td>
<td>45%</td>
</tr>
<tr>
<td>Individual peer evaluation led by corporate secretary or other in-house</td>
<td>11%</td>
</tr>
<tr>
<td>personnel</td>
<td></td>
</tr>
<tr>
<td>Individual peer evaluation led by a 3rd party facilitator</td>
<td>6%</td>
</tr>
<tr>
<td>Directors meet one-on-one with a designated board member</td>
<td>19%</td>
</tr>
<tr>
<td>Directors evaluate board performance in group discussion</td>
<td>34%</td>
</tr>
<tr>
<td>Our organization does not have a formal board performance</td>
<td>6%</td>
</tr>
<tr>
<td>evaluation process</td>
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</tbody>
</table>

Trends in higher education
Risks and opportunities
Changing landscape for Universities
Risk factors that impact institutional strategy

A Board’s role in oversight of an institution’s strategy is one of a handful of foundational board responsibilities.

Strategy development and approval is where risks & opportunities come together: if a plan entails too much risk, it could fail in implementation; if a strategic plan fails to capitalize on prudent risks, opportunities will be lost.

One of the most elusive risks to identify and consider is DISRUPTION risk:

- What could undermine the institution’s business model?
- How could unexpected change in customer demand or competition render the strategy ineffective? Consider iTunes, Netflix, & Kindle.
- How does the Board avoid being naïve on this front?
Changing landscape for Universities
Important trends impacting higher education

- **Deloitte sees the Industry being transformed by the convergence of several Key Forces:**

- **Cost Pressures:** Institutions are responding through Smart Purchasing, Enterprise Technology solutions, Consolidation of administration, and use of Shared Service Centers

- **The New Student:** Increased expectation of a consumer type experience, significant numbers of adult learners, families looking at alternatives to the 4-year degree due to high cost (average student debt is $25k+)

- **21st Century Classroom:** Emergence of blended learning model, experience with Massive Open Online Courses, video based learning of narrow skills, game and simulation based learning techniques gaining favor

- **Rise of Digital:** Social media primacy with the millennials and younger, preference to communicate and take notes on tablets and similar devices, expectation for interdisciplinary collaboration in learning and research
Changing landscape for Universities
Important trends impacting higher education

When you examine these Key Forces in the context of the following trends, it is clear that the landscape could change in the near future:

- Entrants of new competitors into the higher education space: Udemy, College Abacus, Minerva, Kahn Academy, Coursera, DevBootcamp, etc.

- Fundamental shifts from four-year degrees and long-term employment to lifelong learning and multiple jobs over a lifetime.

- Declining enrollment due to population demographics.

- Recent announcement by the President of implementing “free” community college for all Americans.

- Declining financial support from the State with limited opportunities to cover costs with increased tuition and fees.
Changing landscape for Universities
What does this all mean?

Going forward, we expect big shifts in the model for Higher Education.

Of course, it is difficult to predict exactly how this will play out, but is it reasonable to expect the following:

• Experimenting with partnerships and other collaborations both among universities and between universities and some alternate education providers.
• More flexible programs and offerings to students of all ages
• Continued cost pressures necessitating additional IT investment and consolidation of duplicate cost structures

The key to success may be development of a long-term strategy based on multiple options.....
Audit

Agenda Item: Internal Audit Update

☐ Review ☐ Review + Action ☐ Action ☒ Discussion

☒ This is a report required by Board policy.

Presenter: Gail Klatt, Associate Vice President

Purpose & Key Points

To update the Audit Committee on Internal Audit activities, results, and observations to help the committee fulfill its fiduciary responsibilities under its reserved authority for oversight of the internal audit function, as outlined in the Audit Committee charter.

- Since the last follow-up for the September 2014 meeting, University departments implemented 36 percent of the outstanding recommendations rated as “essential.” This is slightly less than our expected implementation rate of 40 percent. Five units fully implemented all their remaining “essential” recommendations.
- An updated control evaluation chart is included for each audit to show progress made on the “essential” items.
- 11 audit reports containing 32 recommendations rated as “essential” were issued in the last five months.

Background Information

This report is prepared three times per year and is presented to the Audit Committee in conformance with Board of Regents Policy: Board Operations and Agenda Guidelines.
This report includes:
- Audit Observations/Information/Status of Critical Measures/Other Items
- Status of “Essential” Recommendations & Bar Charts Showing Progress Made
- Audit Activity Report
- Audit Reports Issued Since September 2014

Details for any of the items in this report are available on request. Individual reports were sent to the President, Provost, Vice Presidents, and Chancellors about these internal audit issues.

**Audit Observations/Information**

**Status of Critical Measures**

As part of our on-going efforts to provide the Audit Committee with critical information in as concise a format as possible, we have developed the following three charts to present a “snapshot” status report on work performed by the Office of Internal Audit.

The first chart, “Essential Recommendation Implementation”, provides our overall assessment of the success University departments had during the last quarter in implementing our essential recommendations. Readings in the yellow or red indicate implementation percentages less than, or significantly less than, our expected University-wide rate of 40%. Detailed information on this topic, both institution-wide and for each individual unit, is contained in the next section of this Update Report.

The second chart, entitled “Progress Towards Annual Audit Plan Completion”, is our assessment of how we are progressing towards completion of the FY 2015 Annual Audit Plan. Readings less than green could be influenced by a variety of factors (i.e. insufficient staff resources; increased time spent on non-scheduled audits or investigations).

The final chart, “Time Spent on Investigative Activities”, provides a status report on the amount of time consumed by investigative activities. Our annual plan provided an estimated budget for this type of work, and the chart will indicate if we expect that budget to be sufficient. Continued readings in the yellow or red may result in seeking Audit Committee approval for modifying the Annual Audit Plan.
Essential Recommendation Implementation  Progress Towards Annual Audit Plan Completion  Time Spent on Investigative Activities

Implementation rates were 36% for the period, slightly less than our expected rate of 40%.

Time spent to date on the FY 2015 audit plan is about what was expected and budgeted for the year to date.

Time spent on investigative activities and special projects is about what was expected and budgeted for the year to date.

Other Items

- Professional standards require that every five years internal audit organizations receive an independent review and assessment of their operations and practices to measure compliance with internal auditing standards. Office of Internal Audit staff completed our internal self-assessment, which was provided to the Audit Committee at their December 2014 meeting. We have been actively working to address and implement the recommendations identified during the self-assessment. A team of four external reviewers conducted their on-site formal quality assurance review during February 3-5, and their final report will be presented to the Audit Committee at the February 12th meeting.

- We recently filled a vacant IT Principal Auditor position through the hiring of an auditor from the Mayo Clinic. The IT audit group is now fully staffed. The financial audit group has recently had two auditors leave the University; one through resignation and one through retirement. Both open positions have been posted and we are actively recruiting their replacements.
### Status of "Essential" Recommendations as of January 30, 2015

<table>
<thead>
<tr>
<th>Report Date</th>
<th>Audit (P)</th>
<th>Original Report Control Rating</th>
<th># of Essential Recommendations in the Report</th>
<th># of Essential Recommendations Remaining From Prior Quarter</th>
<th>Current Quarter Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-11</td>
<td>UMD School of Fine Arts (P)</td>
<td>Adequate</td>
<td>10</td>
<td>2</td>
<td>Implemented Partially Implemented Not Past Target Date Past Target Date Not Past Target Date Past Target Date Satisfactory</td>
</tr>
<tr>
<td>Feb-12</td>
<td>Dentistry - axiUm System (P)</td>
<td>Adequate</td>
<td>14</td>
<td>1</td>
<td>Satisfactory (1)</td>
</tr>
<tr>
<td>Dec-12</td>
<td>Network Segments Not Managed By OIT (P)</td>
<td>Adequate</td>
<td>5</td>
<td>2</td>
<td>Completed</td>
</tr>
<tr>
<td>May-13</td>
<td>Travel &amp; Employee Reimbursements (P)</td>
<td>Adequate</td>
<td>6</td>
<td>2</td>
<td>Completed</td>
</tr>
<tr>
<td>Jun-13</td>
<td>Research Data Storage (P)</td>
<td>Adequate</td>
<td>5</td>
<td>2</td>
<td>Completed</td>
</tr>
<tr>
<td>Dec-13</td>
<td>UMD Information Tech, Systems &amp; Services</td>
<td>Good</td>
<td>6</td>
<td>4</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Feb-14</td>
<td>University-wide Purchasing Process (P)</td>
<td>Good</td>
<td>2</td>
<td>2</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Apr-14</td>
<td>UM - Crookston Campus</td>
<td>Good</td>
<td>8</td>
<td>2</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Apr-14</td>
<td>CLA East Bank 1 Financial Services Team</td>
<td>Good</td>
<td>1</td>
<td>1</td>
<td>Completed</td>
</tr>
<tr>
<td>May-14</td>
<td>UMD Parking Services</td>
<td>Good</td>
<td>1</td>
<td>1</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Jun-14</td>
<td>Identity Management</td>
<td>Needs Improvement</td>
<td>11</td>
<td>11</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Jun-14</td>
<td>Parking &amp; Transportation Services</td>
<td>Adequate</td>
<td>10</td>
<td>10</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Jul-14</td>
<td>UMD University Seniors</td>
<td>Good</td>
<td>2</td>
<td>2</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Aug-14</td>
<td>Minnesota Sea Grant</td>
<td>Good</td>
<td>1</td>
<td>1</td>
<td>Completed</td>
</tr>
</tbody>
</table>

**Total:** 81 44 16 13 12 2 1

- Audits > 2 years old (see the following report for details on unresolved issues)
- Audits < 2 years old, have received prior follow-up

* The following bar charts provide details on progress made towards implementation

1. Dentistry continues to make significant progress towards fully implementing this recommendation, which deals with reconciling their clinical patient accounting system to the University general ledger. Further refinement of their reconciliation, in conjunction with developing written procedures and training an individual to serve as a back-up are still needed. We have discussed this with Dentistry officials and they are in agreement.

### "Essential" Recommendation Implementation Trends

<table>
<thead>
<tr>
<th>Month / Year of Follow-up Report</th>
<th># of Essential Recommendations Receiving Follow-up</th>
<th># of Recommendations Considered Fully Implemented</th>
<th>Implementation Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb. 2015</td>
<td>44</td>
<td>16</td>
<td>36%</td>
</tr>
<tr>
<td>Sept. 2014</td>
<td>53</td>
<td>12</td>
<td>23%</td>
</tr>
<tr>
<td>June 2014</td>
<td>34</td>
<td>10</td>
<td>29%</td>
</tr>
<tr>
<td>Feb. 2014</td>
<td>36</td>
<td>13</td>
<td>29%</td>
</tr>
<tr>
<td>Sept. 2013</td>
<td>64</td>
<td>30</td>
<td>47%</td>
</tr>
<tr>
<td>June 2013</td>
<td>56</td>
<td>13</td>
<td>23%</td>
</tr>
<tr>
<td>Feb. 2013</td>
<td>67</td>
<td>26</td>
<td>39%</td>
</tr>
<tr>
<td>Sept. 2012</td>
<td>72</td>
<td>16</td>
<td>22%</td>
</tr>
<tr>
<td>June 2012</td>
<td>89</td>
<td>26</td>
<td>29%</td>
</tr>
<tr>
<td>Average</td>
<td>57</td>
<td>18</td>
<td>31%</td>
</tr>
<tr>
<td>Audit/Report Date</td>
<td>Status- Partially Implemented (P) or Not Implemented (N)</td>
<td>Senior Management Contact</td>
<td>Summary of the Issue/Risk Involved</td>
</tr>
<tr>
<td>------------------</td>
<td>----------------------------------------------------------</td>
<td>---------------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td>UMD School of Fine Arts Oct-11</td>
<td>P</td>
<td>William Payne, Bilin Tsai</td>
<td>Glensheen should update and expand its inventory records with the ultimate goal of having a complete record of the entire collection. Periodically, the presence and location of inventory items should be verified on at least a sample basis.</td>
</tr>
<tr>
<td>Dentistry - axiUm System Feb-12</td>
<td>P</td>
<td>Jeff Ogden, Leon Assael</td>
<td>Dentistry should investigate the $8,642 difference between axiUm accounts receivable and the general ledger. Going forward, the reconciliation between axiUm accounts receivable to the general ledger should be completed monthly. Any errors or reconciling items should be investigated and corrected timely. Oversight to ensure completeness and timeliness of reconciliations should be established. Discrepancies between the axiUm aging report and the patient detail accounts should also be investigated. Dentistry should determine whether any processes (i.e., held payments, unapplied adjustments, etc.) need to be modified based upon their findings.</td>
</tr>
</tbody>
</table>
The bar charts shown below are presented to provide pictorial displays of the progress units are making on implementing audit recommendations rated as "essential". The bar chart included in the original report is shown in the left column, along with updated bar charts showing the previous quarter and the current status of the "essential" recommendations only (those bars that have red segments). The chart in the center column displays the status as of September 2014, while the chart on the right represents the current status. Charts are not presented for investigations. Charts for those units having implemented all "essential" recommendations during the current quarter are shown at the end of this report.

Original Report Evaluation
U of MN Duluth - School of Fine Arts (October 2011)

Previous Quarter Evaluation

Current Quarter Evaluation

Dentistry - axiUm (February 2012)

Adequate Control  Significant Control Level  Critical Control Level  Potential Over-Control
Units with Charts that Fully Implemented their "Essential" Recommendations During the Past Quarter

Original Report Evaluation

Previous Quarter Evaluation

Current Quarter Evaluation

Network Segments Not Managed By OIT (December 2012)

U of MN Duluth - College of Liberal Arts (May 2013)
Original Report Evaluation

Previous Quarter Evaluation

Current Quarter Evaluation

Minnesota Sea Grant (September 2014)

NO PREVIOUS CONTROL EVALUATION CHART
Audit Activity Report

Scheduled Audits

- Completed audits of University Recreation & Wellness, a review of top University researchers, the Carlson School of Management, Executive Officer and Regent expenses, a review of the ESUP grading process upgrade, the Athletics Aspire contract, server room security and the Hormel Institute. Details are shown on the following charts.
- Began/continued audits of: Medical School Duluth campus, new technology due diligence, the Clinical Translational Sciences Institute (CTSI), Ophthalmology and Visual Neurosciences, 21st Century Development Funds, incentive compensation, the College of Science and Engineering Dean’s Office and related centers, the College of Food, Agricultural and Natural Resource Sciences Dean’s Office and related centers, UMD Athletics, and OIT server administration.
- Continued to monitor ESUP readiness for implementation.

Non-Scheduled Audits

- Completed requested audits of the St. Anthony Falls Lab NSF Renovation Grant, the Athletics Baseline Tennis Center and Medical School department head expenses. Reports were provided to management. Details are shown on the following charts.
- Began a requested audit of SimPORTAL & CREST (a unit within the Department of Urology).

Investigations

- Performed investigative work on eight issues in accordance with the University Policy on Reporting and Addressing Concerns of Misconduct.

Special Projects

- Provided consulting services related to University payroll exception testing, performed work for the Law School related to external commitments, and began a project to review Medical School department head salary and reimbursement expenses funded by University of Minnesota Physicians.
- Participated in a search committee for an OIT Policy Analyst position, and provided technology consulting in several areas including the University’s IT security framework, HIPAA security, the University’s IT strategic plan, and external assessments of HIPAA security and the University’s IT data security program.
- Received and reviewed an external consultant’s construction audit report related to their review of the recently completed Physics Nanotechnology building.
- At the request of University Services, we are coordinating with their units to examine the potential of hiring an external consultant to assess current UM policies and procedures used for large energy-based construction projects such as the Combined Heating and Power Plant Project.

Other Audit Activities

- Participated in the following:
  - Senior Leadership Group
  - Operational Excellence Leadership Team
  - President’s Policy Committee
  - Board of Regents Policy Committee
  - Executive Compliance Oversight Committee
  - Institutional Conflict of Interest Committee
  - University of Minnesota Foundation Audit Committee
  - Fairview Health Systems Audit Committee
  - Enterprise System Upgrade - Human Resource Functional Steering Committee
  - Uniform Guidance Steering Committee
  - IT Leadership Community of Practice & Advance Leadership Program
Audit Reports Issued Since September 2014

University Recreation and Wellness

The Baseline Tennis Center (BTC) is the home of the University of Minnesota tennis teams in addition to serving the Twin Cities public. Results of the audit work performed show the BTC has developed a control environment and system of internal control that addresses most of its major business and compliance risks. The audit resulted in two issues considered “essential” involving conflicting employment roles for the Head Tennis Professional and not assigning accurate payroll earnings codes for bonus/commission payments.

Baseline Tennis Center

The Baseline Tennis Center (BTC) is the home of the University of Minnesota tennis teams in addition to serving the Twin Cities public. Results of the audit work performed show the BTC has developed a control environment and system of internal control that addresses most of its major business and compliance risks. The audit resulted in two issues considered “essential” involving conflicting employment roles for the Head Tennis Professional and not assigning accurate payroll earnings codes for bonus/commission payments.
In September 2010 SAFL received a National Science Foundation (NSF) Academic Research Infrastructure - Recovery and Reinvestment (ARI-R2) Grant totaling $7,104,536. That award, funded by the American Recovery and Reinvestment Act (ARRA), plus Higher Education Asset Preservation and Renewal (HEAPR) funds totaling approximately $8.7 million, were used to renovate laboratory infrastructure and facilities. From the results of our review and testing of the NSF-SAFL renovation grant expenditures, we believe there were several factors which led to several non-compliance issues, duplication of efforts and unnecessary delays that impacted this NSF sponsored award. These included inadequate communication, a lack of understanding of NSF/ARI/ARRA guidelines, and a lack of providing guidance and direction for the project team in a proactive manner by the NSF Program Officer.

This audit included a review and assessment of current operating controls and procedures used by twelve of the University’s top researchers. Collectively, these researchers were managing 107 sponsored awards with expenditures totaling $83.4 million during the audit period. From the results of the audit work performed, we believe the twelve researchers tested are managing their sponsored projects in general compliance with both University and sponsoring agency policies and regulations. Any exceptions noted were for items we also typically identify during our ongoing audits of sponsored projects at the University. An “essential” recommendation was developed concerning the need for improved systems to better manage and monitor subcontracts.
Executive Officer and Regent Expenses

Due to the limited scope of this audit
a control evaluation chart was not developed for this report.

This audit included a review and assessment of executive officer and regent expenses processed during fiscal years 2013 and 2014. The audit resulted in no issues considered "essential" to minimizing existing operational and compliance risks; however, for the criteria used to evaluate compliance with University policies, we noted one area of concern involving reimbursement for non-conference lodging expenses exceeding the 150% limit. Our review noted that 13% of all the lodging expenses reviewed exceeded the 150% limit, and prior approval had not been obtained to exceed the limits. We have worked with the respective University official(s) or business process owner(s) to ensure any expenses charged to an unallowable funding source are moved an appropriate fund code, any over/underpayments $25 or greater are corrected, and controls are improved and processes are revised as necessary.
A Review of the ESUP Grading Process Upgrade

This audit included a review of the process used to manage the development and implementation of the new Grading Process, part of the Enterprise System Upgrade Program. From the results of the audit work performed, we believe Academic Support Resources has adequately addressed the major risks and concerns related to the Grading portion of the Upgrade. Grading is a piece of the Student Records module, which is undergoing significant redesign and improvements in the upgrade. Even though ASR was unable to provide a formal analysis of project risk, no major gaps were noted. Stakeholders, instructors and other staff were consulted on significant changes, and communication to future users has been frequent.

Athletics Aspire Contract

Athletics entered into a contract with The Aspire Sport Marketing Group LLC (Aspire) in April 2012. The goal of the contract is to maximize sales revenue, increase attendance, and build life-long relationships with fans. Aspire currently serves as the main sales personnel for new season ticket sales (not season ticket renewals), individual game sales, and group sales. We believe the controls and processes related to the Aspire Athletic ticketing contract are generally effective. Contract management controls relating to ticketing and commissions for the Aspire contract are stronger than those observed during our previous audits of Athletic contracts. The one item rated as "essential" is due to the miscalculation of management fees since the inception of the contract, resulting in Athletics overpaying Aspire.
Server Room Security

Server rooms are facilities housing one or more servers and associated components. These rooms’ physical security, access, and environmental controls are foundational requirements for data security. This audit found that the University has 24 critical server rooms managed by 18 different units. Several of these server rooms, including the University’s primary server room, are well managed and have strong controls. However, we identified vulnerabilities in many non-centrally managed server rooms that could compromise critical systems’ data confidentiality, integrity and availability. In addition, there is insufficient overall oversight of server rooms across the University, and problems exist with some central control systems and processes.

Medical School Department Head Expenses

Due to the limited scope of this audit a control evaluation chart was not developed for this report.

This audit included a review of Medical School department head and select Dean’s Office executive expenses incurred by the University during fiscal years 2013 and 2014. We believe the expenses of these individuals, while generally in compliance with University policies and procedures, would benefit from improved review and oversight. The majority of department heads are not obtaining the required “one-up approval” when submitting their expense reimbursements and procurement card transactions for approval.
The Hormel Institute was established in 1942 by an agreement between the Regents of the University of Minnesota and the Hormel Foundation as a research unit of the University's Graduate School. Oversight for the Hormel Institute has since moved to the Office of the Vice President for Research. The mission of the Hormel Institute is to conduct research and provide education in the biological sciences with applications in medicine and agriculture. We believe the Hormel Institute has developed a control environment and a system of internal control that addresses most major business, compliance and information technology risks. The audit resulted in one recommendation considered "essential", and it relates to a lack of adequate monitoring of the Animal Care Facility (ISO) operational and financial activity as well as poor maintenance of supporting records for ISO charges.