

Year 2002-03

UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Audit Committee

February 13, 2003

A meeting of the Audit Committee of the Board of Regents was held on Thursday, February 13, 2003, at 8:00 a.m. in the East Committee Room, 600 McNamara Alumni Center.

Regents present: Robert Bergland, presiding; Dallas Bohnsack, Frank Berman, Richard McNamara, and Lakeesha Ransom.

Staff present: Senior Vice President Frank Cerra; Vice President Kathleen O'Brien; Interim Vice President David Hamilton; General Counsel Mark Rotenberg; Executive Director Ann Cieslak; Associate Vice Presidents Stephen Cawley, Gail Klatt, Richard Pfitzenreuter, and Michael Volna.

Student Representatives present: Jacob Elo and Allison Rhody.

**ANNUAL COMPLIANCE AUDIT
OF FEDERAL AWARD PROGRAMS (A-133)**

Associate Vice President Pfitzenreuter introduced Clifford Hoffman, partner, Deloitte & Touche, to present the results of the Audit of Federal Programs (A-133), as found in the docket materials. Highlights from the report indicate that among the challenges facing the University is the untimely filing of financial reports on federally sponsored projects and the state budget deficit.

In response to a question from Regent Bergland, Associate Vice President Volna discussed reasons for the untimely filing of federal financial reports. He noted the problem should be alleviated by implementation of a new accounts receivable system in March 2003.

Questions were raised regarding anticipated reductions in state funding. Hoffman expressed concern about the possible response of rating agencies if the University experiences a budget deficit. He noted the University's progress on infrastructure over the last five years, cautioning against deferral of repairs and maintenance during the budget crisis. He also stressed the importance of continuing support for areas that attract research dollars.

EXTERNAL AUDITOR'S MANAGEMENT LETTER

Clifford Hoffman, partner, Deloitte & Touche, presented the External Auditor's Management Letter resulting from the fiscal year 2002 annual audit, as found in the docket materials.

Hoffman reported that the University has total net assets of \$2,171,000,000, an increase of \$2 million from FY01. Given recent difficulties in the stock market, this increase demonstrates very prudent fiscal management. Hoffman added that the University's accomplishments for the year ended June 30, 2002 include limited litigation exposure and the ability to meet audit deadlines in spite of the implementation of GASB 34/35. Challenges facing the University include collection of sponsored receivables and the impact of financial market performance on endowment funds, which decreased by \$131 million in 2002.

Hoffman reviewed Deloitte & Touche's recommendations for 2003-04, which are to continue to recruit and retain high-quality staff, enhance communication between University departments to ensure accurate accounting and reporting, complete implementation of system for management of Sponsored Receivables, and monitor alternative investments on a timely basis.

INTERNAL AUDIT UPDATE

Associate Vice President Klatt presented the Internal Audit Update, as found in the docket materials.

Klatt reported that Facilities Management has made significant improvements to processes related to competitive pricing, oversight, and control on construction projects that might use the design-build methodology.

In response to questions, Klatt and Vice President O'Brien discussed changes in the design-build delivery system. O'Brien reported that Facilities Management staff have worked rigorously to address audit issues, stating they believe it is important to have the design-build method available. She stressed that the success of a project is dependent upon having a whole team responsible for quality and accountability.

Klatt reported that 47 percent of outstanding audit recommendations rated as "essential" were implemented this quarter, with eight units completing all outstanding recommendations.

In response to questions relating to a number of audits completed in the Academic Health Center, Klatt provided additional information. Senior Vice President Cerra reported on responses to significant control issues in the Department of Pediatrics, and stated the situation is now under control.

SARBANES-OXLEY ACT OF 2002: PART II

Associate Vice President Pfitzenreuter stated the committee will hear an update on the status of the Sarbanes-Oxley Act of 2002 (the Act), related rules proposed by the Securities and Exchange Commission (SEC), and the administration's recommendations to address the provisions.

Associate General Counsel Gregory Brown reviewed eight rules, approved by the SEC as of January 27, 2003, interpreting the Act. The Office of the General Counsel has determined that those provisions of the Act do not apply to the University, the Board of Regents, or the Audit Committee. However, the administration believes the University's outside

auditors are likely to impose provisions of the Act that set auditing standards through the Public Accounting Oversight Board and that regulate the activities of independent auditors on all large clients, including the University of Minnesota.

In response to the Audit Committee's request that the administration identify best practices that are consistent with the spirit of the Act, Pfutzenreuter reviewed the administrative recommendations related to:

- independence of Audit Committee members;
- Audit Committee "Financial Expert" requirement;
- general Audit Committee recommendations;
- procurement of audit services;
- procurement of "prohibited services" from auditing firms;
- procurement of permissible services from auditing firms;
- code of conduct for financial officers;
- financial statement certification;
- internal control certification; and
- attorney reporting obligations.

With respect to attorney reporting obligations, Brown indicated that General Counsel Mark Rotenberg will update the committee on any additional reporting requirements necessary for compliance with the spirit of the Act.

Pfutzenreuter explained that the University already has addressed many provisions of the Act, but that the administration will develop any resolutions and policies required, reporting back to the committee on implementation of the recommendations.

Regent Berman, noting the overlap of responsibilities between the Audit and Finance and Operations committees, proposed combining the two. Regent Bergland explained that the Board had reviewed its management structure four years ago and decided it was important to maintain the independence of the Audit Committee.

Klatt acknowledged that issues considered by the Audit Committee often overlap issues before other committees, but she asserted that the Audit Committee charter requires its members to speak to issues that also are addressed by other committees. Berman proposed that in such instances information should be given to members of both committees. Pfutzenreuter and Klatt agreed to prepare a response for the committee's consideration at a future meeting.

The meeting adjourned at 9:10 a.m.

ANN D. CIESLAK
Executive Director and
Corporate Secretary

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