

Minutes of the Audit Committee of the
University of Louisville Board of Trustees

November 15, 2006

In Open Session

The Audit Committee of the University of Louisville Board of Trustees met on Wednesday, November 15, 2006 in the Jefferson Room of Grawemeyer Hall, Belknap Campus, with members present and absent as follows:

Present: Mr. Steve Poe, Chair
Mr. Nathaniel Green, Vice Chair
Prof. Beth Boehm
Ms. Donna Tinsley Denny
Ms. Rebecca Jackson

Absent: Mr. Grant Helman
Ms. Jessica Loving

From the
University:

Mr. Glenn Bossmeyer, Associate University Counsel
Mr. Larry Owsley, Vice President for Business Affairs
Mr. Mike Curtin, Vice President for Finance
Ms. Terri Rutledge, Associate Vice President for Business Affairs
Mr. Dave Barker, Director of Audit Services
Mr. Larry Zink, Controller
Ms. Susan Magness, Associate Controller
Ms. Susan Wilhelm, Manager of Grants, Sponsored Activities
Ms. Susan Ingram, Director of Budgets
Ms. Kathleen Smith, Assistant Secretary
Ms. Cheri Jones, Associate Director of Audit Services

Others

Present: Ms. Mary McKinley, BKD
Mr. Keith Messer, BKD

I. Call to Order

Having determined a quorum present, Chair Poe called the meeting to order at 12:00 p.m.

Approval of Minutes

Mr. Green made a motion, which Ms. Denny seconded, to approve the minutes of May 11, 2006. The motion passed unanimously.

II. Action Item: Approval of Consolidated Audited Financial for Year Ending June 30, 2006 and 2005 and Independent Auditor's Report

Chair Poe directed the committee's attention to the financial statements for the period ending June 30, 2006. Chair Poe asked representatives from BKD, the University's independent auditors to explain the audit and respond to questions. He then asked Mr. Curtin to introduce the auditors.

Vice President Curtin reported the external auditors have issued a clean, unqualified report. Mr. Curtin introduced Mary McKinley and Keith Messer from BKD. The financial condition of the University is very positive. Financial highlights included:

- The University's financial position remains strong at June 30, 2006, with assets of \$824.5 million and liabilities of \$259.8 million. Net assets, which represent the residual interest in the University's assets after liabilities are deducted, were \$564.7 million as of June 30, 2006.
- Gross tuition and fees were \$144.9 million for the year ended June 30, 2006, an increase of \$15.6 million, or 12% compared to the \$129.3 million reported in the previous year. Approved tuition rate increases for 2005-06 generated approximately \$10.5 million in additional tuition revenues as well as increased enrollments, which contributed an additional \$4.4 million.
- Total general fund appropriations from the Commonwealth were \$166.9 million for the year. Appropriations and certain other revenues and expenses are reported under Government Accounting Standards Board (GASB) Statement No. 35 as nonoperating revenues.
- Operating revenues amounted to \$464.0 million and operating expenses were \$628.6 million resulting in a net operating loss of \$164.6 million. When adjusted for \$166.9 million in state appropriations and \$30 million in other net nonoperating revenues, net assets of the University increased by \$32.3 million for the year ended June 30, 2006.

Chair Poe thanked Vice President Curtin and Ms. McKinley for an excellent and thorough report. Ms. Denny made a motion, which Mr. Green seconded, to approve the

President's recommendation to the Audit Committee of the Board of Trustees concerning the consolidated audited financial statements for the year ending June 30, 2006 and 2005 and independent Auditor's Report as presented under Governmental Accounting Standards Board (GASB) 34.

The motion passed unanimously.

III. Information Item: Presentation on SAS 112

Chair Poe asked Mr. Curtin and representatives from BKD to brief the committee on how the recent Sarbanes-Oxley legislation is having an impact on non-profits such as universities. Ms. McKinley noted the SAS No. 112 entitled "Communicating Internal Control Related Matters Identified in an Audit" was effective for periods ending on or

after December 15, 2006 and replaced SAS 60, “Communication of Internal Control Related Matters Noted in an Audit.” The new legislation defined the terms significant deficiency and material weakness, provided guidance on evaluating severity of control deficiencies; and required communication of significant deficiencies and material weaknesses in writing to management and those charged with governance. She provided a comparison of old versus new definitions, classification of control deficiencies, and examples of indicators. Ms. McKinley referenced the required communication as outlined in SAS No. 112. The document defines those charged with governance as the board of directors, committee of the board, committee of management (e.g., finance, budget or executive committee), partners, equivalent persons, and combination of these parties. Chair Poe thanked Ms. McKinley for the presentation.

IV. Report from the Director of Audit Services

Chair Poe asked Mr. Barker, Director of Audit Services to report the status of audits executed and planned for this year.

AUDIT SERVICES ACTIVITIES May 2006 – October 2006

REPORTS ISSUED

Children and Youth Project

The Children and Youth Project (C&Y) is a pediatric primary care clinic that provides primary health services to children from birth to eighteen, including Dental (unrelated to the School of Dentistry), Medical, Nutrition, Speech, and Home Health. The project also houses a licensed diagnostic laboratory. C&Y physicians are full-time employees of the University and are not members of a professional practice plan. C&Y does not receive state appropriations from the University. C&Y receives funding through the provision of patient services, with Passport the primary payer, and service grants from the Crusade for Children and the federal Women, Infants and Children program.

The objectives of the audit were to obtain reasonable assurance that:

- Patient accounts receivable are effectively controlled, managed, and collected.
- Accounting information is accurate.
- Revenue cycle activities are effective and efficient.
- Departmental processes and procedures are compliant with University policies and with applicable laws and regulations.

The scope of the audit included patient accounts receivable outstanding and financial information as of October 31, 2005. Audit procedures included:

- Interviewing select staff to identify current processes and potential improvements
- Performing analytical reviews and detail testing of patient accounts including the medical clinic, home health, dental, and laboratory activities
- Testing accounting practices and procedures

- Testing for compliance with selected university policies and procedures, such as supplemental payroll, procurement cards, purchasing, and general ledger reconciliations

As a result of the routine audit, the following action plans were developed. C&Y has implemented all action plans, unless otherwise noted.

- Management redesigned Billing Office processes to promote separation of duties and other key controls.
- All non-contractual adjustments are documented and appropriately approved.
- The Medical Front Office began a sign-in and notification process for Dental patients.
- C&Y developed procedures to require staff to post transactions to patient accounts within two business days of the date of receipt or date of service. A check log will be used to record the date all payments have been received.
- The Billing Office developed procedures to reconcile transactions posted to the patient accounting system.
- Policies and procedures for collecting delinquent accounts will be developed and implemented. Target Implementation: August 31, 2006
- Employee discounts were discontinued to be compliant with federal regulations.
- Credit balances on patient accounts are researched and refunded.
- C&Y will implement a new patient billing system that will allow electronic billing of dental claims. Target Implementation: July 1, 2007
- Deposits to the Bursar's Office are made within three business days of receipt to comply with University policy.
- C&Y staff was trained in the process of accurately accounting for patient receivables and related accounts. PeopleSoft financials are updated monthly and reconciled to the patient accounting system.
- C&Y consulted with information technology management to determine if the patient accounting system can accurately age patient accounts using the date of service rather than the claim issuance date. It was determined that this will be a function of the new patient accounting system. Target Implementation: July 1, 2007

PeopleSoft Application Security

Audit Services performed a routine audit of the security of the PeopleSoft applications maintained and processed by the University. The examination was focused on the review and assessment of the administration and design of security within the PeopleSoft financial management, student administration and human resources applications. The objectives of the audit were to:

- Evaluate the administration of security within the PeopleSoft financial management and student administration/human resources applications.
- Verify that accesses to PeopleSoft applications are appropriately authorized and controlled.

The scope of the audit included an evaluation of the procedures for establishing, maintaining and modifying accesses to PeopleSoft applications. Interviews were conducted with selected personnel within financial systems administration, human resources systems administration, student records administration and information technology security and account management. In addition, certain processes were executed against the security tables of the application systems to extract information relative to user access capabilities and security design for the purposes of review and analysis.

Management agreed to implement the following action plans:

- Information Technology will modify current procedures and automate the removal of all PeopleSoft application system accesses (except employee self-service access) for transferred and terminated employees upon the effective date of transfer or termination. This effort will be coordinated with functional security administration in each PeopleSoft application area. Target Implementation: December 31, 2006
- The systems administration areas within the Office of the Vice President for Business Affairs, the Office of the Vice President for Finance, and the Registrar's Office will standardize the online request and approval process for access to the PeopleSoft application systems to facilitate more effectively the requests and approvals for academic and administrative systems access. Target Implementation: December 31, 2006
- Functional security administration for the PeopleSoft application systems will conduct a detailed review of user accounts and access capabilities in each application system to ensure that system permissions are properly defined and that user accesses are appropriate to job duties and responsibilities. Target Implementation: September 30, 2006

Departmental E-mail Systems

Audit Services performed a routine audit of e-mail systems administered and maintained by University departments. This examination was focused on the management and administration of e-mail systems within selected University departments that maintain e-mail systems separate from the University's GroupWise enterprise e-mail system. E-mail systems within the Physics department, Mathematics department, Brown Cancer Center, Kidney Disease Program and the Computer Vision and Image Processing (CVIP) Laboratory were examined.

The objectives of the audit were to:

- Assess the management and administration of departmental e-mail systems
- Evaluate the security of departmental e-mail systems relative to compliance with established University policies and procedures governing technology security.

The scope of the audit included an assessment of the operation of each department's e-mail system, and its interface with the University's enterprise e-mail system. In addition,

Audit Services reviewed the hardware and software used to process each department's e-mail and evaluated each system's physical and logical security, backup process and disaster recovery procedures. Interviews were conducted with departmental technical and management personnel and on-site observations and assessments were conducted. The GroupWise e-mail system was not included in the scope of this review.

Management agreed to implement the following action plans:

The Information Security Office will implement a formal information security and technology policy structure for the University. Among the policies and standards that have been proposed are: 1) requirements for requesting approval for the implementation of departmental technology and applications, 2) standards for securing workstations and computing devices from unauthorized access and intrusion, 3) policies for securing physical access to computing facilities and protection from environmental hazards, and 4) policies for system backup and the implementation of departmental disaster recovery/business continuity plans. Target Implementation: December 31, 2006

IT Change Control

Audit Services performed a routine audit of the change control procedures employed by Information Technology (IT) to maintain systems and applications. The objectives of the audit were to:

- Assess the policies and procedures for modifying applications maintained by IT Information Systems.
- Evaluate application changes to verify that modifications are properly requested, approved, tested and implemented according to established policies and procedures.

The scope of the audit focused on an evaluation of the completeness of the procedures and standards established for modifying applications including an assessment to verify that:

- Change requests are properly initiated, approved and prioritized.
- Change requests are appropriately documented and tracked throughout the life cycle of the modification.
- Application changes are adequately tested and approved prior to production implementation.
- A formal migration process is established to control the transfer of changes from the testing environment to the production environment.
- Procedures are established to process emergency modifications.

In addition, a sample of modifications completed during fiscal 2005-2006 was examined to verify that change control procedures were consistently observed and applied.

Management agreed to implement the following action plans:

- The IT Information Systems department will develop and establish procedures to address the execution of emergency changes to production applications and data. These procedures will be formally documented and incorporated into the existing development methodology. Target Implementation Date: December 31, 2006
- The IT Information Systems department will assess the current change request tracking system and the database system used to record information relative to the production implementation of changes to determine if the systems' reporting capabilities can be enhanced to provide more meaningful, useful statistics and metrics for managing system and application changes. Consideration will be given to implementing a new change management system should the capabilities of the current systems be deemed inadequate. Target Implementation Date: December 31, 2007

School of Music

Audit Services performed a routine audit of the School of Music. The School is organized into six academic divisions. There were 307 graduate and undergraduate students enrolled in the School in spring 2006 and 335 enrolled in fall 2005.

The objectives of the audit were to:

- Review procedures over revenues and expenditures for sufficient internal control and compliance with University policies.
- Test revenue and expenditure transactions for supporting documentation and accuracy.
- Review scholarship awards for compliance with award agreements and sufficient internal controls over the award process.

The scope of the audit included testing revenues, expenditures and scholarships from fiscal year (FY) 2005 and FY 2006 through February 2006 for support, accuracy, and compliance with University and departmental policies. We interviewed selected staff to identify current processes and potential improvements.

As a result of the audit, management agreed to implement the following action plans:

- The School will comply with the existing University Payroll and Accounts Payable policies and procedures. Target Implementation: November 30, 2006
- Work performed on sponsored agreements will be compensated at the base salary rate and effort reports will be completed when required. Target Implementation: January 31, 2007
- The Dean, Music division heads, and business office staff will work together to develop procedures to improve the efficiency of purchasing and payments. Target Implementation: January 31, 2007
- The School will comply with University procurement card procedures and implement procurement card expenditure tracking. Target Implementation: January 31, 2007

- Staff and faculty will become familiar and comply with the University's Petty Cash Funds policy. Target Implementation: January 31, 2007
- The School and business office will improve the efficiency of check deposits through regular training for faculty and staff. Target Implementation: November 30, 2006
- Monthly reconciliations will be documented for Peoplesoft programs with significant activity. Target Implementation: February 28, 2007

Grants Management

Audit Services performed an operational audit of the Office of Grants Management. The Office of Grants Management reports to the Senior Vice President for Research (SVPR) and is funded with state appropriations and the SVPR's portion of indirect cost recovery. The office oversees and monitors sponsored research projects, provides federal compliance training to researchers and research administrators, and is responsible for accurate data capture. The department provides support to the overall administration of sponsored projects.

The objectives were to obtain reasonable assurance that:

- Sponsored projects are adequately managed from proposal through award and during the life cycle of the grant in accordance with sponsor guidelines, applicable laws and regulations and University policy.
- Awards are entered and maintained accurately in the PeopleSoft grants module.
- Financial processes and procedures in the department are compliant with University policies.

A sample of grants established in fiscal year 2004 through March 2006 was selected for testing. The scope of the audit included:

- Interviewing selected staff to identify current control processes and potential improvements.
- Performing analytical reviews and detailed testing of proposals and awards to verify accuracy, timeliness, and compliance with sponsor and University guidelines.
- Testing for compliance with selected University policies and procedures, including procurement cards, cash receipts, and supplemental payroll.

Management has agreed to implement the following action plans:

- Critical proposal data will be identified and only those fields will be entered at the proposal stage. Critical award data is being verified to file documentation monthly. Target Implementation: January 31, 2007
- Consistent procedures and written procedures will be developed for both campus offices of Grants Management. Target Implementation: March 31, 2007
- Information on federal debarment for suspended parties will be disseminated to researchers and a statement included on proposal clearance forms, subcontracts,

- and Letters of Intent. A process to verify no federal funds are paid to debarred parties will be developed. Target Implementation: March 31, 2007
- A system to monitor delays in proposal and award process will be developed and used to improve processing timelines. Target Implementation: January 31, 2007
 - A system will be developed to organize grant files and ensure all necessary documentation is in the file. The process for ensuring sponsor filings are completed will be documented. Target Implementation: January 31, 2007
 - The proposal clearance form was revised to require separate approvals for faculty release and salary recovery. Implemented
 - The PeopleSoft notepad function will be used consistently to document changes to grant data. Target Implementation: September 30, 2006

Foreign Visas

Audit Services performed a routine audit of foreign visas for students, faculty, and staff at the University. There are two categories of U.S. visas: immigrant and nonimmigrant. Immigrant visas are for people who intend to live permanently in the United States. Nonimmigrant visas are for people with permanent residence outside the U.S. who wish to be in the U.S. on a temporary basis for work, study or other temporary goals.

For the purposes of this audit, we focused on the following types of visas:

1. F-visa holders: For people accepted into a program to study or conduct research at an accredited U.S. college or university.
2. J-visa holders: For people accepted to a program through a designated sponsoring organization to participate in an exchange visitor program in the U.S. The "J" visa is for educational and cultural exchange programs.
3. H-visa holders: For temporary workers.

The objectives of the audit were to:

- Evaluate the controls over processes and transactions related to international visas of students, employees, and scholars at the University.
- Determine compliance with applicable laws, regulations, rules, and University policies related to international students, employees, and scholars.
- Evaluate SEVIS (Student and Exchange Visitor Information System) data for accuracy.

The scope of the audit included the review of student and employee documentation, interviewing University staff, and testing enrollment and employment transactions for accuracy.

Management has agreed to implement the following action plans:

- Eliminate excessive number of outstanding PeopleSoft alerts. Target Implementation: June 1, 2007
- Work with PeopleSoft support in an effort to develop a working batch process for J visa holders. Target Implementation: October 31, 2006

- Develop written policies and procedures for entry of F and J visa holders into SEVIS and PeopleSoft. Target Implementation: December 31, 2007
- Enter accurate visa expiration dates in PeopleSoft. Target Implementation: November 1, 2006

REVIEWS IN PROGRESS

Industry Contracts

A routine audit of the Office of Industry Contracts has begun and is in the fieldwork phase. The objectives of the audit are to obtain reasonable assurance that:

- The contracting process for sponsored research agreements is adequately managed from inception through closeout in accordance with sponsor guidelines, applicable laws and regulations, and University policy.
- Contracts comply with policy and applicable regulations.
- Project information is accurately entered and maintained in the PeopleSoft grants module.

James Graham Brown Cancer Center

Audit Services is in the process of performing a routine audit of the James Graham Brown Cancer Center activities that occurred between July 1, 2004 and June 30, 2006 (fiscal years 2005 and 2006). The objectives of the audit are to obtain reasonable assurance that:

- Financial transactions, including expense transfers, procurement activities, and payroll are recorded accurately and in compliance with University policies.
- Philanthropy records are accurate and gifts are used in a manner consistent with gift agreements.
- Sponsored agreements are managed in a manner that is compliant with contract and/or federal law and regulations.
- Patient accounts receivable in the Flow Cytometry Laboratory and Dental Oncology Clinic are accurate, collected, and recorded on the records of the University.
- Service Center cost calculations and charges are supported and compliant with federal regulations and University policy.

Psychology Department

Audit Services is performing a routine audit of the Department of Psychological and Brain Sciences. The objectives of the audit are to:

- Review procedures over revenues and expenditures for sufficient internal control and compliance with University policies.
- Test revenue and expenditure transactions for supporting documentation and accuracy.

- Evaluate a sample of federal grants and contracts for compliance with U.S. Government Office of Management and Budget regulations and University of Louisville Office of Research policies and procedures.
- Review procedures for sufficient internal control and compliance with University policies and test client transactions for supporting documentation and accuracy in the Noble H. Kelley Psychological Services Center.

Firewalls

A routine audit of the University firewall system has begun and is in the fieldwork phase. The objectives of the audit are to:

- Evaluate the management, administration and security of the University's firewall system.
- Assess the adequacy of the firewall configuration to verify that the University's networks are properly protected from external threats and unauthorized access.

Scholarships

A routine audit of University funded scholarships, including Trustee and Porter scholarships, has been completed, and is in draft report status. The objectives of the audit were to obtain reasonable assurance that:

- Available scholarships are awarded.
- Scholarship awards are compliant with program criteria.
- Awards are entered and maintained accurately on Peoplesoft.

OTHER ACTIVITIES

Institutional Compliance Risk Assessment

The Compliance Oversight Committee earlier this year requested Audit Services to perform a compliance risk assessment for the University. The purpose of this assessment was to identify:

- A universe of key regulatory requirements for the University of Louisville.
- If the University has adequate resources to comply with the growing volume of federal and state regulations.
- Any gaps that need remediation to ensure that the University has an effective compliance program.

We have completed this risk assessment and have shared the preliminary results with the Compliance Oversight Council. The Council will be developing plans to address Institutional Compliance at the University.

Unit Business Administrator Training Task Force

The University is in process of developing a new Unit Business Administrator certification program. The purpose of the program is to give staff members responsible for unit business functions the tools and training necessary to perform highly complex and critical activities. Audit Services is serving on the committee that is designing the format and curriculum of the new program. After implementation, Audit Services will continue to be involved in the design and delivery of internal control related modules.

Procurement Card Request for Proposal

Audit Services served on the committee that was impaneled to select a vendor to administer the University’s procurement card program. The contract with Fifth Third Bank, the current procurement card vendor, will expire in December 2006.

Among the criteria evaluated in selecting the vendor were the following:

- Completeness and adequacy of procedures for securing and transmitting procurement card transaction data to the University on a daily basis.
- Ability to provide transaction data in a format compatible with the requirements of the PeopleSoft financial management system.
- Demonstrated capability to prevent and detect fraudulent card activity.
- Proposal for rebate to the University based upon a specified dollar amount of transactions to be realized annually.
- Proposal for ongoing customer service and support.

Thirteen regional and national financial institutions submitted proposals, of which, five were invited to the University to make formal presentations. PNC Bank was chosen as the new procurement card vendor. The implementation of the PNC Bank card program will commence in October 2006 and is expected to begin operations in January 2007. Fifth Third bank will continue to provide procurement card services to the University until the PNC Bank program becomes operational.

AUDIT PLAN - 2006/2007

| AUDIT | STATUS |
|---|------------------|
| Brown Cancer Center | Fieldwork |
| Ophthalmology | |
| Family/Community Medicine Clinics | |
| Equine Industry Program | |
| Psychology Department | Fieldwork |
| Construction Contracts | |
| Athletics Capital Construction Funding | |
| External Quality Assessment | |
| University Reports | |
| Expense Transfers | |
| CAMS/LDAP Computer Accounts | |
| Procurement Card Application | |
| IT Department Administration | |

| | |
|--------------------------------------|------------------|
| IT Consulting Projects | Ongoing |
| Peoplesoft Application | |
| Institutional Compliance | Ongoing |
| Sponsored Programs Accounting | |
| Firewalls | Fieldwork |
| Request Audits | Ongoing |

**Audit Services
Professional Staff Qualifications and Experience**

| Staff | Position | Certification | A | B | Industry Experience |
|----------------|------------------------------------|----------------------|----------|----------|------------------------------------|
| Dave Barker | Director | CIA, CISA, CFE | 25 | 6 | Utility, Retail |
| Cheri Jones | Associate Director | CIA, CPA, CFSA | 22 | 5 | Financial Services, Healthcare |
| Will Metcalf | Auditor | * | 1 | 1 | |
| Jeanne Kennedy | Senior Auditor | CIA | 6 | 4 | Manufacturing, State Audit |
| Barry Scott | Senior Information Systems Auditor | CISA | 9 | 2 | Public Accounting, Consulting |
| Patty Durbin | Healthcare and Research Auditor | CPA | 20 | 2 | State Government, Higher Education |

Certifications:

CIA – Certified Internal Auditor

CPA – Certified Public Accountant

CISA – Certified Information Systems Auditor

CFSA – Certified Financial Services Auditor

CFE – Certified Fraud Examiner

* - Preparing for the November 2006 CIA Exam

A – Years of Audit Experience

B – Years at University of Louisville

Chair Poe thanked Mr. Barker for his report and noted no action was required.

V. Adjournment

Ms. Jackson made a motion, which Prof. Boehm seconded, to adjourn the meeting at 1:10 p.m. The motion passed unanimously.

Committee Action:

Passed: _____x_____

Did Not Pass: _____

Other: _____

Date: _____

Katalin M. Smith

Assistant Secretary