

MINUTES OF THE MEETING OF THE AUDIT COMMITTEE OF THE
UNIVERSITY OF LOUISVILLE BOARD OF TRUSTEES

In Open Session

Members of the University of Louisville Audit Committee met at 11:00 a.m., on November 12, 2009, in the President's Conference Room, Grawemeyer Hall, Belknap Campus, with members present and absent as follows:

Present: Mr. Steve Poe, Chair
Mr. Brent Fryrear
Dr. Salem George
Ms. Rebecca Jackson
Ms. Brucie Moore

Absent: Mr. J. Chester Porter
Ms. Debbie Scoppechio

Other Trustees

Present:
Dr. Robert Curtis Hughes (arrived at 11:30 a.m.)
Dr. Mark Lynn
Mr. Bill Stone
Ms. Phoebe Wood

Guests: Ms. Mary McKinley, CPA, BKD, LLP
Ms. Jennifer Williams, CPA, BKD, LLP

From the
University: Dr. Larry Cook, Executive Vice President for Health Affairs
Ms. Angela D. Koshewa, University Counsel
Mr. Mike Curtin, Vice President for Finance
Mr. David Barker, Director of Audit Services
Ms. Terri Rutledge, Associate Vice President for Business Affairs
Ms. Cheri Jones, Associate Director for Audit Services
Mr. Larry Zink, Controller
Ms. Susan Magness, Assistant Controller
Ms. Anne Rademaker, Manager of Accounts
Ms. Debbie Dougherty, Board Liaison

I. Call to Order

Having determined a quorum present, Chair Poe called the meeting to order at 11:05 A.M.

Approval of Minutes, November 13, 2008

Ms. Jackson made a motion, which Mr. Fryrear seconded to approve the minutes of November 13, 2008. The motion passed.

II. Action Item: Approval of Consolidated Audited Financial for Year Ending June 30, 2009 and Independent Auditor's Report

Chair Poe directed the committee's attention to the financial statements for the period ending June 30, 2009. Vice President Curtin, and Ms. Mary McKinley, partner from BKD, explained the audit and responded to questions.

Vice President Curtin reported the external auditors have issued a clean, unqualified report. The financial condition of the University is very positive. Financial highlights included:

- The University's financial position remains strong at June 30, 2009, with assets of \$1.2 billion and liabilities of \$445.2 million. Net assets, which represent the residual interest in the University's assets after liabilities are deducted, were \$757.4 million as of June 30, 2009.
- Gross tuition and fees were \$199.0 million for the year ended June 30, 2009, an increase of \$12.4 million, or 7% compared to the \$186.6 million reported in the previous year. Approved tuition rate increases for 2008-09 generated approximately \$11.7 million in additional tuition revenues as well as increased enrollments, which contributed an additional \$.7 million.
- Total general fund appropriations from the Commonwealth were \$163.6 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 \$532.3 million and operating expenses were \$743.3 million resulting in a net operating loss of \$211.0 million. When adjusted for \$163.6 million in state appropriations and \$93.9 million in other net nonoperating revenues, net assets of the University increased by \$46.5 million for the year ended June 30, 2009.

Dr. George made a motion, which Ms. Jackson seconded, to approve the

President's recommendation that the Board of Trustees approve the attached financial statements for the period ending June 30, 2009 and Independent Auditor's Report as presented under Governmental Accounting Standards Board (GASB) 34.

The motion passed. Vice President Curtin recognized Mr. Larry Zink, Controller, and Ms. Susan Magness, Assistant Controller, and Ms. Anne Rademaker, Manger

of Accounts for their dedication and work. Chair Poe thanked Vice President Curtin and Ms. McKinley for an excellent review.

II. 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. Mr. Barker reviewed the Department of Audit Services' activities for the period of November 2008 through October 2009. He noted each recommendation was developed to improve internal controls or foster process improvements. The complete report is attached to the minutes. Chair Poe noted he and Mr. Barker talk frequently and Mr. Barker reports directly to the Audit Committee.

Mr. Barker reviewed the Audit Plan for 2009-10. Ms. Jackson made a motion, which Dr. George seconded, to approve the

President's recommendation that the Board of Trustees approve the following audit plan:

**AUDIT PLAN
2009/2010**

Nelligan Contracts - Athletics	Grants and Contracts **
Personal Services Contracts	Construction Contracts
Fleet Management**	Service Centers
Institute for Cellular Therapeutics**	Chemistry Department
Department of Anesthesiology	Bursar Office**
Internal Quality Assessment	Kidney Disease Program**
Peoplesoft Grants	Research Computing
IT Operations Center**	eSettlements
HR/SA Upgrade**	Oracle Identity Management**
Cash	Housing
Enterprise Risk Management	Request Audits/Projects**

**Denotes audits in progress

The motion passed.

IV. Review of Compliance Report 2008

Dr. Cook summarized the Health Sciences Center Compliance Report for 2008, noting the report offered an overview of compliance trends for the Health Sciences Center. Dr. Cook summarized the goals for 2009 and shared information concerning the compliance risk and investigations. The report was provided for information and no action was required.

V. Information Update: Moody's Rating Roadmap Guidance

Vice President Curtin explained Moody's Ratings, noting the twenty (20) indicators of an institution at risk and the thirteen red flag indicators. He summarized the University's standings in those ratings:

20 Indicators That Your Institution is At Risk		
Indicator	At Risk Status	UofL
Tuition discounting is more than 35%	No	24.0%
Tuition dependency is more than 85%	No	44.1%
Student default rate is more than 5%	No	2.1%
Debt service is more than 10% of annual operating budget	No	3.7%
The ratio between endowment and operating budget is less than 1-to-3	No	1-to-3.6
Average annual tuition increase has been greater than 8% for five years	Yes	9.7% average over past 5 years
Deferred maintenance is at least 40% unfinanced	Yes	91.4% average past 3 years expenditure vs. condition needs
Short-term bridge financing is regularly required in the final quarter of each fiscal year	No	
Less than 10% of operating budget is dedicated to technology	Yes	9.4% estimated for 2008-09
Average alumni gift is less than \$75, and less than 20% of alumni give annually	No	\$519 avg. alumni gift, and
Enrollment is 1000 students or fewer	Yes	14.3% of alumni gave in 2007-08
The conversion yield-the percentage of students who attend the college after applying-is 20% lower than that of primary competitors	No	21,761
Student retention is 10% behind that of primary competitors	No	5.7% higher
The institution is on probation with a regional accreditor	No	6.2% behind Benchmark average;
The majority of faculty members do not hold terminal degrees	No	9.0% ahead of State average
Average age of full-time faculty is 58 or higher	No	73% hold terminal degrees
The leadership team averages more than 12 years, or fewer than three years, of service	No	Average age is 49.5
No complete online program has been developed	No	Average 6.7 years in current positions
No new degree or certificate program has been developed for at least two years	No	Nine degree programs are online
		Eight new degree or certificate programs since 2007

Moody's Ratings Roadmap Guidance – 13 Red Flags

Indicator	UofL
Decline in enrollment	Enrollment Steady/Quality Improving
Decline in total operating revenue	Increasing
Rising operating deficits	Offset by State Appropriation
No audit delivered 6 months after the fiscal year-end	On-time/October 1 st State Deadline
Qualified audit opinion	Non-Qualified Opinion
Technical default under bond covenants	None
Unexpected increase in debt (20% or more)	Refinancing Only
Greater national amount of swaps than debt	No swaps
More than 70% of debt is variable rate	Only ULH, Inc. Bonds

Bank bonds or auction rate debt with high rates or short payout	None
Unresponsive and stagnant management teams or boards	Not an issue
Investment allocation with more than 10% in one fund	Highly diversified portfolio
Unusually high assumed returns on long-term investments	5.5% spending policy

Chair Poe thanked Vice President Curtin for an excellent update.

VI. Other Business

There was no other business.

VI. Adjournment

Ms. Moore made a motion, which Ms. Jackson seconded, to adjourn the meeting at 12:15 p.m. The motion passed.

Board Action:

Passed: X

Did Not Pass:

Other:

Katalin M. Smith

Assistant Secretary

November 10, 2009

To: Trustees Audit Committee
Board of Trustees

Steve Poe, Chair
Brent Fryrear
Salem George
Rebecca Jackson
Brucie Moore
J. Chester Porter
Debbie Scoppechio

From: Dave Barker – Director of Audit Services

Re: Audit Services Activities

Attached is a summary report of Audit Services' activities for the period of November 2008 through October 2009. Each of our recommendations is developed to improve internal controls or foster process improvements. We have summarized key issues and recommendations from each audit. Our department has received excellent cooperation and support from all levels of management. Each recommendation has a target completion date. Audit Services performs a semi-annual (December and June) follow up on each recommendation to determine if the action plan has been implemented. The status of these recommendations is identified in this report.

cc: Mike Curtin
Jim Ramsey
Shirley Willihnganz

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AUDIT SERVICES ACTIVITIES

November 2008 – October 2009

REPORTS ISSUED

College of Education and Human Development

Executive Administration requested a financial audit of the College of Education and Human Development (CEHD) following allegations of fraud against the former dean of the college.

Based on the work performed, we conclude that:

- Financial transactions originated by the college are accurate, supported, and legitimate with few identified exceptions.
- There are **OPPORTUNITIES TO IMPROVE** the controls over financial transactions that are designed to prevent or identify questionable activity.

Significant issues were also identified relative to institutional procedures and processes. These issues indicated a need for enhanced education and training in contracts, the establishment of enhanced monitoring for compliance with sponsored project regulations, and stronger communication between senior business managers and the Vice President for Finance (VPF). These issues are being addressed in the University of Louisville's (University's) response to Cotton and Allen's report on research processes. Management has developed the following action plans:

Contracting

- Training in contract concepts and procedures will be developed on an institutional basis. Until the training is developed and delivered, CEHD will work with University Counsel to develop contract templates and decision trees to ensure contract practices are compliant. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen. **Target Implementation Date: July 30, 2009**
- Institutional Issue: Fragmented contracting processes on an institutional level will need to be addressed. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen. **Implemented**
- CEHD will comply with established contract policy regarding contract practices and will develop a centralized database to ensure college administration is aware of outstanding contracts and contract terms. **Implemented**

- Institutional Issue: Accounts payable processes will be enhanced to ensure payments are made on authorized contracts only. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen. **Implemented**

Financial Controls

- Institutional Issue: The VPF will develop stronger lines of communication with senior business managers. In addition, the VPF will provide input in the hiring, evaluating, and training of senior business managers. **Implemented**
- CEHD will review and redesign business processes to reduce the incidence of one person having complete control over transactions. A separation of duties matrix will be implemented to optimize controls where possible. **Target Implementation Date: July 30, 2009**
- CEHD will continue to use QuickBooks until an institutional solution to encumbrance accounting is developed. Staff will be trained in reconciliations and the college will use the separation of duties matrix to ensure reconciliations are performed properly. **Target Implementation Date: July 30, 2009**
- CEHD will continue to train and monitor procurement card transactions for compliance with policy. Consideration will be made to canceling cards where continued noncompliance is identified. **Implemented**
- Each business manager in CEHD will be trained in cash controls, including accountability of cash receipts, recordkeeping, separation of duties and security. The practice of borrowing from cash funds will not be tolerated. **Implemented**
- The college will implement on-going training and monitoring of employee travel and expense reimbursements for compliance with policy. **Implemented**
- CEHD will continue to monitor the Planetarium financial results. Although progress has been achieved, financial viability remains a “work in progress”. **Implemented**

Payroll Controls

- Payroll expense transfers, often necessary because of ineffective University processes, will be appropriately documented. **Implemented**
- CEHD will be compliant with the University additional pay policy. **Implemented**

Sponsored Project Compliance

- Institutional issue: Develop a central process to monitor research projects for compliance. This issue will be included in the report of the task force addressing issues raised by Cotton and Allen.
- CEHD will develop and train all faculty members on conflict of interest policies. Procedures for ensuring compliance will be developed. **Implemented**
- Instructions have been issued to prohibit business managers from signing effort reports for faculty. Controls over changes to effort reports will be implemented to ensure changes are appropriate and adjustments to salary expenses are made via expense transfers. **Implemented**
- Consistent procedures for identifying and recording contractual revenue collected by the college will be developed and implemented. Procedures will include security over funds, monitoring due dates and timing on the University's financial records. **Implemented**
- Cost share funding will be reviewed and funded. Future cost share commitments will be fully funded at the time of award. **Implemented**

Security over Sensitive Information

- Private individual information will be kept in a secured location at all times. **Implemented**

Select Agents

Select Agents are bio-toxins classified by the Center for Disease Control and the Federal Food and Drug Administration as potential weapons of terrorist activity. The USA PATRIOT Act requires researchers using these agents to comply with specific registration and security requirements. Audit Services performed a routine audit of the University's efforts to comply with regulations covering select agents.

Based on the results of this audit, we conclude that:

- Compliance with the requirements of regulations related to the possession and use of biological agents and toxins is **GOOD** when researchers are known to possess select agents.
- Controls implemented to ensure Department of Environmental Health and Safety (DEHS) is informed when faculty use regulated biological agents and toxins are **INADEQUATE**. Although DEHS has taken an active role, implementing procedures that compare favorably with other institutions, procedures have not been developed to identify researchers who may be non-compliant with University policy or federal regulation.

- Procedures implemented by the biosafety program to monitor laboratories for compliance with security and inventory regulations are **GOOD**, as DEHS is properly informed that faculty are using or holding select agents.

Management has developed the following action plan:

- DEHS will continue education and awareness efforts and implement processes such as an annual survey to identify research using select agents. In addition, DEHS will work with other University departments and outside vendors to investigate if controls can be developed to identify when agents arrive on campus. **Target Implementation Date: October 31, 2009**

Payroll Application

Audit Services performed a routine audit of the PeopleSoft payroll application. Based on the work performed, we conclude that:

- The controls over payroll processing are **INADEQUATE**.
- There are **OPPORTUNITIES TO IMPROVE** compliance with University payroll policies and governmental regulations.
- There are **OPPORTUNITIES TO IMPROVE** application security to maintain adequate segregation of duties.
- Technical support of the application is **GOOD**.

Management has developed the following action plans:

Control Improvements

- Access of payroll department employees will be reviewed and modified to facilitate adequate segregation of duties for maintaining employee payroll data, processing payroll, issuing checks and transmitting electronic payment information. **Target Implementation Date: August 01, 2009**
- Human Resources will explore the possibility of implementing a position control process to manage the establishment of positions and verify that all positions are adequately funded. **Target Implementation Date: December 31, 2009**
- Deficits in employee flexible spending accounts will be resolved. Monthly reconciliation procedures will be implemented to verify account balances with records from the flexible spending plan administrator. **Implemented**
- Processes and procedures will be implemented to reduce the number of overpayments to employees and increase the efficiency and effectiveness of collecting existing overpayment amounts. **Implemented**

- Procedures will be implemented to identify and monitor employees with negative leave balances. Greater emphasis will be placed on adherence to the University's leave accrual and use policy. Payroll will include the importance of accurate and timely information in future payroll training and will address this topic in an upcoming Unit Business Administrators (UBA) meeting. System settings will be modified to allow departments to enter all leave taken during a pay period. This issue will be more effectively addressed by the implementation of an electronic time and attendance system. **Target Implementation Date: Procedures and Communications – December 31, 2009; System Implementation – December 31, 2009 (pending funding approval)**
- Procedures will be implemented to require dual authorization of all job actions that involve establishing employees in the payroll system and changing pay rates. **Implemented**
- Procedures will be implemented to more strictly control and monitor the use of check stock. (Recurring issue from 9/18/2001 audit report) **Implemented**
- Audit clauses and validation of internal control assessment will be obtained from all third party service providers. **Implemented**
- The assignment of roles and permission lists that allow broad system access capabilities will be reviewed and access restricted to only those personnel with job duties and responsibilities that require system administration capabilities. **Target Implementation Date: August 31, 2009**

Compliance

- The payroll records of employees under child support payment orders will be reviewed to verify that the appropriate state regulations are observed in calculating maximum withholding amounts. **Implemented**
- Garnishments will be monitored to verify that all requirements of court judgments are completely and accurately fulfilled. **Implemented**
- Benefit plans will be reviewed for compliance with tax regulations and all taxable income related to benefits will be reported. **Implemented**
- The calculation of local occupational taxes will be reviewed and errors corrected accordingly. **Implemented**
- Procedures for approving and classifying temporary employees will be improved to verify compliance with University policy and government regulations. This topic will also be covered in an upcoming UBA meeting. This issue will be more effectively addressed through the implementation of the electronic time and

attendance system. (Recurring issue from 9/18/2001 audit report). **Target Implementation Date: September 30, 2009**

- Procedures will be implemented to more effectively train department staff to help assure that hourly employees are paid in the period in which hours are worked. This topic will also be covered in an upcoming UBA meeting. This issue will be more effectively addressed through the implementation of the electronic time and attendance system. **Target Implementation Date: Training – Implemented; System Implementation – December 31, 2009 (pending funding approval)**
- Procedures will be implemented to more effectively train department staff so that hourly employees are properly paid for overtime hours. Payroll will notify all departments of the requirement for proper classifications of overtime hours and will coordinate with department management to resolve instances of non-compliance. This issue will be addressed in future payroll training and will be stressed at an upcoming UBA meeting. This issue will be more effectively addressed through the implementation of the electronic time and attendance system. **Target Implementation Date: Training – Implemented; System Implementation – December 31, 2009 (pending funding approval)**

Unix Operating System Environment

Audit Services performed a routine audit of the Unix operating system environment. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** the management and administration of the Unix environment.
- There are **OPPORTUNITIES TO IMPROVE** physical and logical security.
- Technical support of the operating system environment is **GOOD**.

Management has developed the following action plans:

Control Improvements

- IT will investigate the feasibility of implementing identity access management in the operating system environment. Broad system access capabilities will be removed from individual user accounts. System related functions will be executed through system level privileges defined to individual accounts through identity management. **Target Implementation Date: December 31, 2009**
- Procedures will be improved for administering and managing user accesses in all operating system environments. Procedures will be strengthened to verify that Unix accounts and operating system accesses of transferred and terminated employees are properly disabled in a timely manner. **Implemented**

- Complex password configuration requirements will be established for all Unix accounts, with password aging and expiration in accordance with the University's information security policies. **Target Implementation Date: December 31, 2009**
- Procedures will be established for the periodic review of Unix accounts to verify the necessity and propriety of user accesses. Accounts that are no longer needed or used will be disabled and accesses removed. **Implemented**
- Procedures will be implemented for the periodic review of data center access logs. **Implemented**
- Policies and procedures for administering and managing the operating system environment will be formally documented. **Implemented**

PeopleSoft Financials 9.0 Upgrade

Audit Services conducted a review of the implementation of the PeopleSoft Financials 9.0 upgrade. The purpose of this review was to evaluate the upgrade process and obtain reasonable assurance that the system implemented to production is properly secured, processes data completely and accurately, and operates in accordance with acceptable performance standards.

Our examination was focused on the processes and procedures performed by IT Information Systems and Financial Systems Administration to implement and test system processes, verify application security and validate user functionality. We participated in weekly project status meetings, reviewed user testing documentation, and observed procedures performed by security analysts to test system security. In addition, we performed tests of certain user roles and security permissions to verify the propriety of accesses relative to job duties and responsibilities.

Based upon the review of project documentation and tests of user accesses, Audit Services proposed the following recommendations to facilitate future PeopleSoft system implementations. As this review did not encompass a formal audit examination, action plans and target implementation dates were not required.

- More comprehensive testing and validation of security scripts should be performed to verify that security is completely and accurately transferred to the upgrade system, and that user accesses are appropriate to individual job duties and responsibilities.
- A formal methodology with standards and guidelines for defining and documenting user testing, acceptance criteria and system signoff should be established. All documentation should be centrally maintained by the project manager.

- System stress testing should be performed, documented and evaluated prior to release of the production system to verify that anticipated user processing loads can be adequately met and supported.

IT Network Security

Audit Services performed a routine audit of network security. Based on the work performed, we concluded that:

- There are **OPPORTUNITIES TO IMPROVE** the management of the network environment to provide greater network redundancy and eliminate device and connectivity failure points.
- There are **OPPORTUNITIES TO IMPROVE** the physical security of the MedCenter Three data center where core network devices are housed.

Management developed the following action plans:

Management and Security of Network Devices

- Network resiliency will be improved to strengthen redundancy and reduce the risk of network unavailability from single device or link failures. **Target Implementation Date: September 30, 2009**
- Device configuration inconsistencies will be corrected to enhance the stability and performance of the network environment. **Implemented**
- Secure Shell protocol will be used for remote access to network devices. **Implemented**
- Login banner messages will be implemented on all network devices. **Implemented**
- Device configuration standards, policies and procedures will be formally documented. **Target Implementation Date: September 30, 2009**

Network Intrusion Detection

- The feasibility of implementing an intrusion detection system at the core network layer will be investigated. **Target Implementation Date: September 30, 2009**

Physical Security

- Procedures will be implemented to more effectively manage and monitor access to the MedCenter Three data center. **Target Implementation Date: September 30, 2009**

Department of Neurological Surgery

A financial audit of the Department of Neurological Surgery was conducted in response to a report of possible research irregularities received by Cotton and Allen during their review of research practices at the University. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** internal controls over financial processes.
- There are **OPPORTUNITIES TO IMPROVE** financial transaction accuracy, support, and compliance with University policies.
- There are **OPPORTUNITIES TO IMPROVE** sponsored project management and effective compliance with sponsor requirements and University research policies and procedures. Specific allegations of financial misconduct in sponsored research could not be validated during this audit.

Management has developed the following action plans:

- Administration will review staffing structure and staff responsibilities to implement separation of duties where possible. Where necessary, increased oversight and monitoring of critical or high-risk activities will be implemented where separation of duties is not possible due to staff limitations. **Target Implementation Date: September 30, 2009**
- Complete monthly general ledger reconciliations will be performed on all active programs, grants, and gift/endowments. Inactive programs and expired grants will be reviewed quarterly. Reconciliation training will be obtained as necessary. **Implemented**
- All faculty and staff will comply with procurement card policy. **Implemented**
- The business purpose for entertainment related expenses will be documented along with the individuals attending the event. Invoices will be processed for payment within 30 days. **Implemented**
- Controls over department receipts will be enhanced to increase accountability, reduce the risk of theft or lost items, and comply with University policy. **Implemented**

Research Compliance

- Payroll expense transfers will be documented with the justification for the transfer along with other necessary information as required by University policy.

Implemented

- Procedures will be implemented to ensure all research staff and faculty members comply with conflict of interest policies. All department staff and faculty will comply with nepotism policies. **Implemented**
- Committed cost share will be funded when the grant budgets are established. Deficits in cost share will be corrected. **Implemented**
- Expenditures for administrative items, such as general computer supplies or office supplies, will be charged to unrestricted programs. **Implemented**

Executive Travel and Entertainment

Audit Services performed a routine audit of executive expenditures. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** compliance with University policies, particularly with procurement cards. Reimbursements, purchases through Accounts Payable, and additional compensation are **GOOD** in regards to authorization and compliance with contractual arrangements.

Management has developed the following action plan:

- The Provost will reiterate the University procurement card policy to deans and vice presidents, particularly the requirement to maintain receipts, allowable purchases, and transaction logs. Entertainment or business receipts will be detailed enough to determine the items purchased. Transaction logs will be maintained by cardholders, signed, and dated by the reconciler and approver. **Implemented**

State Flow-Through Grants

The University is awarded grants by various state agencies that are funded with federal funds. The University is required to comply with federal regulations in the fiscal management of these grants. Audit Services performed a routine audit to obtain reasonable assurance that direct expenses on these grants comply with Office of Management and Budget (OMB) Circular A-21. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** compliance with OMB Circular A-21 for state grants with federal funding.

Management has developed the following action plans:

- The Office of Grants Management and the Controller's Office Grants and Sponsored Projects unit will investigate the best practice for determining when it is allowable to direct charge a normally indirect cost when there is unrecoverable Facilities and Administrative (F&A). A policy will be developed, implemented, and communicated to ensure all awards for which the University receives less than its federally negotiated F&A rate are treating normally indirect costs in a consistent and compliant manner. Detailed project budgets and budget justifications will be required for all proposals, regardless of sponsoring agency requirements. This will help ensure only allowable direct costs are proposed to the project sponsors. **Target Implementation Date: December 31, 2009**
- A method of accounting for waived F&A committed voluntary or mandatory cost share will be developed. Developing the method within the current operating system will be investigated as the preferred solution. **Target Implementation Date: December 31, 2009**

E-Procurement Implementation

In May 2008, the University Purchasing and IT departments initiated a project to implement an electronic purchasing system using the Oracle PeopleSoft Enterprise Supplier Relationship Management application. Audit Services conducted a review of the implementation of the system, referred to as eProcurement. The purpose of this review was to evaluate the implementation process and obtain reasonable assurance that the system implemented to production is properly secured, processes data completely and accurately, and operates in accordance with acceptable performance standards.

Our examination was focused on the processes and procedures performed by IT Information Systems, Financial Systems Administration, and Purchasing to implement and test system processes, verify application security and validate user functionality. We participated in project status meetings, reviewed system documentation and attended user-training sessions. In addition, we performed tests of user roles and security permissions to verify the propriety of accesses relative to user job duties and responsibilities.

Based upon our observations, review of documentation and testing of user access, Audit Services proposed the following recommendations relative to the implementation of the eProcurement system, as well as the management of future system implementations. As this review did not encompass a formal audit examination, action plans and target implementation dates were not required.

- A thorough review of application security and user accesses should be performed to validate that user accesses are appropriate to individual job duties and responsibilities.

- Users that require system administration access should be assigned a role to provide the capabilities to maintain the application. Accesses to multiple eProcurement roles should be disabled for these individuals.
- Verification of the dual requestor/approver role should be completed by the University Controller as soon as possible.
- Pending system processes and outstanding issues should be prioritized and resolved within an agreed upon time frame.
- A schedule for the implementation of the Strategic Sourcing and Contract Management components should be developed.
- A post-implementation project management review should be performed to assess the effectiveness and success of the implementation, and to identify processes and procedures that should be improved for future projects and system implementations.
- When unforeseen circumstances result in project delays, functional and IT management should carefully assess the feasibility of achieving a specified completion date relative to the risk of implementing to production a system that is not completely tested and validated as to accuracy and functionality.

University Advancement

Audit Services completed a routine audit of University Advancement. Based on the work performed, we conclude that

- There are **OPPORTUNITIES TO IMPROVE** internal controls over processes.
- The accuracy of gift and pledge reporting is **GOOD**.
- There are **OPPORTUNITIES TO IMPROVE** the accuracy, allowability and compliance of financial transactions.

As a result of the audit, the following action plans were developed.

- Advancement will develop a timeline for re-engineering stewardship reporting. **Target Implementation Date: June 30, 2010**
- The gift-processing department will be given the authority to set up new gifts and endowment programs in PeopleSoft when academic units delay. **Target Implementation Date: November 30, 2009**

- Advancement will benchmark with peer institutions to determine whether the practice of paying bonuses to student “phonathon” employees should be discontinued. **Target Implementation Date: January 31, 2010.** Advancement bonuses are being processed through Payroll and the use of gift cards has been discontinued.
- Advancement will communicate the importance of compliance in awarding endowed scholarships and performing general ledger reconciliations on endowment accounts during their Unit Business training. **Implemented**
- Advancement will perform and document timely general ledger reconciliations with review by an administrator. **Target Implementation Date: February 28, 2010**
- Advancement will request University Hospital to encrypt their payroll donation spreadsheets. Advancement will encrypt University Hospital spreadsheets. Credit card numbers will be blacked out on documentation prior to filing. **Target Implementation Date: September 30, 2009**
- Development officers on Belknap campus will adhere to the University’s cash handling policy. **Target Implementation Date: January 31, 2010**
- Procurement cardholders will receive annual training. **Target Implementation Date: January 31, 2010**

X-pays and Supplemental Pays

Audit Services performed a routine audit of additional pay. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** accuracy and compliance with the University additional and supplemental pay policy.
- Authorization of payments was **GOOD**.

Management has developed the following action plans:

Internal Controls

- Human Resources will work with the VPF to address policy and procedure revisions for staff employees. Policy revisions will limit additional payments to 8 – 10% of an employee’s base salary, and include a prohibition on x-pays and supplemental payments to non-exempt employees due to incorrect calculations of overtime.

Human Resources will have a meeting with the Office of the President and Office of the Provost to discuss policy and procedure revisions effecting faculty members. The action plan will be revised based on the meeting. Human Resources' intentions are to revise the policy and procedures so they are clear and concise, facilitate consistent payments and require a uniform method for calculating summer salary. **Target Implementation Date: December 31, 2009**

Compliance

- Human Resources will stop processing additional pay in lieu of shift differential, on-call and stand-by pay for employees classified as professional and administrative. **Target Implementation Date: November 1, 2009**
- Human Resources will work with Business Affairs and Public Safety to ensure eligible employees are paid correctly for state training incentive. **Target Implementation Date: December 31, 2009**
- Separation of duties will be created so processors of additional payments are not verifying their own work. Human Resources will investigate automating the additional pay process through an electronic workflow process. **Target Implementation Date: November 30, 2009**

School of Interdisciplinary and Graduate Studies

Audit Services completed a request audit of the School of Interdisciplinary and Graduate Studies (SIGS). SIGS requested the audit following the Unit Business Manager's resignation without notice.

Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** internal controls over revenue and expenditure procedures and compliance with University policies.
- The support and accuracy of revenue and expenditure transactions is **GOOD**.

As a result of the audit, the following action plans were developed.

- Job processes will be documented. Cross training will be implemented for all essential job duties. Workloads will be evaluated and redistributed if necessary. **Target Implementation Date: January 1, 2010**
- Cardholders will keep their own cards. Procurement cardholders will re-familiarize themselves with what is unallowable. **Target Implementation Date: September 30, 2009**

- An independent employee will review the accuracy of payroll. Time sheets will be recalculated before entry. Supervisors will submit time sheets to the payroll processor. **Target Implementation Date: January 1, 2010**

Cardiovascular Innovation Institute

Audit Services performed a request audit of the Cardiovascular Innovation Institute (CII). CII is a partnership between the University and Jewish Hospital & St. Mary's HealthCare, Inc. (JHSMH). Researchers at CII perform cardiovascular research with the mission to foster the development of commercial enterprises. CII is a 501(c)(3) entity with oversight by a Board of Directors. Based on the work performed, we conclude that:

- The infrastructure is **INADEQUATE** to support the stated mission and objectives of the CII.
- There are **OPPORTUNITIES TO IMPROVE** controls over financial transactions.
- There are **OPPORTUNITIES TO IMPROVE** compliance with government regulations and University policies. CCI's compliance with donor requirements is **GOOD**. Institute policies over regulatory compliance have not been implemented.

Management has developed the following action plans:

CII Infrastructure and Process Improvements

- The President of the University and President and CEO of JHSMH will evaluate the existing governance structure to determine the changes necessary to enhance communications and formally establish lines of authority to develop and implement policies and procedures. **Target Implementation Date: TBD**
- An equipment inventory will be maintained and evaluated to determine if fees should be assessed for use. The fees will be available to cover the cost of necessary maintenance agreements. **Target Implementation Date: January 1, 2010**

Grants Management

- Investigators will be assigned space in the CII building and their respective deans and department heads will sign a memorandum of understanding stipulating the length of the space commitment and the payment of Research Infrastructure Funds (RIF) funds. **Target Implementation Date: January 1, 2010**
- Lines of communication between CII, the Offices of Industry Contracts and Grants Management, and the Controller's Office will be strengthened. The CII Scientific Director will coordinate the establishment of grants and contracts

between the offices and will work with the Unit Business Manager to establish necessary guarantee accounts. **Implemented**

- The Scientific Director and Unit Business Manager will evaluate grants and establish the responsibility for cost share. The appropriate department head and associated Unit Business Manager will be responsible for funding the cost share. **Implemented**
- All principal investigators will receive monthly assessments of sponsored project, gift, endowment, and start-up programs. The CII Unit Business Manager will implement a contract analysis system to support timely project invoicing requests. Invoicing will be coordinated with the project principal investigator. **Target Implementation Date: November 1, 2009**

Internal Controls

- Procurement card management will comply with University policy. The services of the Office of Clinical Research Services and Support will be used to reconcile procurement card purchases. **Target Implementation Date: January 1, 2010**
- The CII Executive Director will assume responsibility for the maintenance and security of common servers and the institute's S drive Novell server. **Target Implementation Date: February 1, 2010**
- An administrative employee has been assigned to perform general ledger reconciliations. Appropriate separation of duties will be maintained. **Implemented**
- The procurement practices of CII will be aligned with the University's procurement policies. Appropriate separation of duties will be maintained. **Implemented**
- Invoices will be forwarded to the Controller's Office for payment within 30 days as required by state law. **Implemented**

Wireless Networks

Audit Services performed a routine audit of the University's wireless network environment. Based on the work performed, we conclude that:

- There are **OPPORTUNITIES TO IMPROVE** the procedures and processes for detecting and removing unauthorized wireless access points on the University's campuses.
- The security of the wireless network and the administration of account management and authentication are **GOOD**.

- The management and administration of wireless network operations and technical support are **GOOD**.

Management has developed the following action plans:

Unauthorized Wireless Access Points

- IT Communications will implement the wireless intrusion protection software (pending funding approval) and formalize procedures to detect and remove unauthorized wireless access points. Processes to validate current access points will be put in place. Departments and units will be notified of the requirement to comply with the wireless network policy. **Target Implementation Date: December 31, 2009**

REVIEWS IN PROGRESS

403(b) Plan

A routine audit of the University 403(b) Retirement Plan is in the final stages of fieldwork. The objectives of the audit are to obtain reasonable assurance that:

- Employee and University retirement contributions are accurately calculated, recorded and remitted to 403(b) providers.
- Controls over the retirement contributions are effective in detecting or preventing errors.
- Retirement contributions are compliant with the University plan document, board approved policy, and regulatory requirements.

The scope of the project included all contributions made to the plans between January 1, 2008 and May 31, 2009. This includes contributions made to accounts managed by TIAA-CREF, Fidelity Investments, and the Kentucky Deferred Compensation Plan. In addition, contracts with Fidelity Investments and TIAA-CREF were reviewed for compliance with University policy and good practices.

A draft report has been submitted to management for consideration.

Fleet Management

Audit Services performed a routine audit of the fleet management process. The objectives of the audit were to obtain reasonable assurance that:

- Controls over fleet management are adequate to safeguard University assets and ensure the accuracy of vehicle, fuel, and maintenance information.

- Fuel charges are compliant with agreed upon contract terms.

The scope of the audit included, but was not limited to, interviews with staff to identify current processes and possible improvements, and testing of selected transactions to support conclusions and recommendations. Transactions that occurred between July 1, 2006 and June 30, 2009 were used to evaluate activities.

A draft report has been submitted to management for consideration.

Clinical Research Billing

Audit Services, in conjunction with the Institutional Compliance Office and the HSC Compliance Office performed a routine audit of the process used to bill medical procedures for patients enrolled in clinical trial research projects. The objectives of the audit were to obtain reasonable assurance that:

- Controls were implemented to ensure clinical trials are appropriately monitored for compliance with Medicare and Medicaid regulations.
- Controls are effective to ensure Medicare and Medicaid is not billed for unallowable services or services that are paid by sponsors.

The scope of the audit included testing a sample of subjects enrolled in clinical trials for Medicare billing compliance, testing clinical trial agreements for covered services, and testing to ensure the sample of projects met the requirements that allow Medicare billing.

A draft report has been submitted to management for consideration.

Kidney Disease Program

Audit Services is performing a request audit of the Kidney Disease Program. The objectives of the audit are to obtain reasonable assurance that:

- Internal controls over revenues and expenditures have been implemented and are effective.
- Procedures are compliant with University policies.
- Federal grants and contracts are compliant with U.S. Government Office of management and Budget Circular A-21 and University Office of Research policies and procedures.
- Patient accounts receivable are effectively controlled, managed, and collected.

This audit will include the fiscal years between July 1, 2007 and June 30, 2009. The scope of the audit will include:

- Interviewing selected staff to identify current processes and potential improvements.
- Performing analytical reviews and review of the collection process.
- Testing transactions, including payroll, procurement cards, revenues, and grants and contracts, for accuracy, support, and compliance with selected Circular A-21 and University policies and procedures.

IT Operations Center

Audit Services is performing a routine audit of IT operations center. The objectives of the audit are to:

- Evaluate the management and administration of IT operations including preventative maintenance, capacity planning and help desk procedures.
- Assess the management of data center facilities, physical security, and environmental controls.
- Evaluate storage management, backup and recovery procedures, and disaster recovery operations.

The scope of the audit will include interviews with staff, review of policies and procedures, review of documentation, as well as other items identified during the course of the audit. This audit is currently in the fieldwork phase.

Institute for Cellular Therapeutics

Audit Services is performing a routine audit of the Institute for Cellular Therapeutics. The objectives of the audit are to obtain reasonable assurance that:

- Internal controls over business activities have been implemented and are effective in preventing or detecting errors.
- Operational processes are efficient and effectively assist the Institute meet its goals and objectives.
- Financial activities and sponsored project management are compliant with applicable laws, regulations, and University policy.

The scope of the audit includes interviews with staff to identify current processes and possible improvements and tests of selected transactions to support conclusions and recommendations. The financial period that will be included is from July 1, 2008 through August 31, 2009.

Grants and Contracts

Audit Services is performing a compliance audit of the Arts and Sciences Psychology Department's Genotype/Phenotype Correlations in Williams Syndrome grant. The objectives of the audit are to obtain reasonable assurance that:

- Financial transactions are accurate, properly supported, and compliant with University policy and federal regulations.
- Management of the grant is efficient and effective for compliance with sponsor requirements and University research policies and procedures.

The scope of the audit will include, but not be limited to interviews with staff to identify current processes and possible improvements and test of selected transactions to support the conclusions and recommendations. Transactions that occurred between April 1, 2008 and October 6, 2009 will be used to evaluate the activities.

Oracle Identity Management Implementation

Audit Services is performing a review of the implementation of the Oracle Identity Management system. The purpose of this review is to evaluate the implementation process and obtain reasonable assurance that the production system achieves expected standards for creating, securing, and provisioning user accounts across the University's various system platforms. The scope of our work includes an examination and assessment of system set-up, testing, and production roll-out.

This review is being coordinated with members of the implementation team, comprised of database administration, secure access management and technical support personnel. We are participating in implementation meetings and are acting in an advisory capacity for issues related to internal control. Upon completion of our review, we will summarize our findings in a memorandum to IT management.

PeopleSoft Human Resources and Student Administration System Upgrade

Audit Services is performing a review of the implementation of the PeopleSoft Human Resources and Student Administration system upgrade. The purpose of this review is to evaluate the upgrade process and obtain reasonable assurance that the system implemented to production is properly secured, processes data completely and accurately, and operates in accordance with acceptable performance standards. The scope of our work will include an examination and assessment of security set-up and testing, system testing, user training, and system rollout.

We will coordinate this review with members of the implementation team, including systems administration functional analysts, database administration, development and upgrade personnel and secure access management personnel. We will participate in implementation meetings as well as system and security testing. Upon completion of our

review, we will summarize our findings in a memorandum to Information Technology, Human Resources, and Student Administration management.

Bursar's Office

Audit Services is performing a routine audit of the Bursar's Office. The objectives of the audit are to obtain reasonable assurance that internal controls and procedures are being adhered to for the following:

- Billing
- Processing, application, and reconciliation of payments
- Higher One
- Collections and reserve for doubtful accounts

The scope of the audit includes interviews with staff to identify current processes and possible improvements and tests of selected transactions to support conclusions and recommendations. The financial period that will be included is from July 1, 2008 through September 30, 2009.

OTHER ACTIVITIES

Institutional Compliance

Compliance Helpline:

The Institutional Compliance Office (ICO) maintains the University-wide "Compliance Helpline." The scope of the Helpline system includes but is not limited to Research, Medical, Privacy, Information Security, Environmental Health and Safety, Financial Transactions, Human Resources, and Athletics compliance issues. The Helpline's toll free number provides a confidential, anonymous (if desired), mechanism for University faculty and staff to report compliance concerns to the ICO for follow-up and resolution with University compliance officials. University employees may also access the vendor's web-based system to report a compliance concern to the ICO. The ICO is responsible to ensure that all issues reported are followed-up on by University compliance officials and that appropriate resolutions are provided to complainants in a timely manner. The following statistics identify the number of reports by concern category to the Helpline for the three month period ended September 30, 2009 and the prior fiscal year ended June 30, 2009:

	<u>Three Months Ended 9/30/09</u>	<u>Twelve Months Ended 6/30/09</u>
Conflict of Interest	0	2
Discrimination/Equal Opportunity	1	0
Financial Matters	0	2
Human Resources	3	9
Other	2	5
Patient Care/Abuse - Health Sciences Center	0	1
Research - Human Subjects	0	1
Time Abuse	0	1
Total	6	21

One of the six, or 17%, of the reports closed for the three months ended September 30, 2009 required institutional corrective action. Four of the twenty-one or 19%, of the reports for the twelve months ended June 30, 2009 required institutional corrective action.

The University Compliance Officer provides a report of Helpline activity at each Compliance Oversight Council (COC) meeting.

Mr. Barker described the process for handling anonymous compliance concerns expressed through the University Helpline. Compliance concerns are passed to the responsible university compliance official for review, investigation and resolution if necessary. The results of the investigation are returned to Institutional Compliance and posted to the Helpline. This provides a mechanism for the anonymous individual to review the status/resolution of the investigation. As noted in the Helpline statistics; Human Resources represent the plurality of compliance inquiries and these are all investigation by Human Resources staff.

Compliance Risk Assessment:

Over 340 federal, state, local and other regulations for which the University must comply were identified as part of the University-wide compliance risk assessment completed by the ICO for Fiscal Year 2009. A final report noting the risk exposure and likelihood of non-compliance by compliance area/issue was provided to the COC in May 2009.

Compliance Reviews:

The ICO has completed, or is in the process of completing, three compliance reviews as of October 2009. The objective of each of these reviews is to determine the level of compliance with the applicable law, regulation, or standard.

Payment Card Industry Data Security Standard

The ICO completed a review of the University's compliance with the Payment Card Industry Data Security Standard (PCI DSS) on June 15, 2009. The PCI DSS was established by a group of card brands, including MasterCard and Visa, with the mission of enhancing payment card data security. The PCI DSS requires the University to perform five key tasks to achieve compliance with the standard. One of the key tasks required is to implement technical security procedures, such as building and maintaining a secure network. Expenses related to non-compliance include the cost of the investigation, remediation, card re-issuance, and severe fines. Additionally, the University could lose the ability to process card payments.

We found that the University is not effectively managing the five key tasks that are applicable to its operations. As a result, the University has a high risk of non-compliance with the PCI DSS. The ICO made six recommendations to bring the University into compliance with the standard. Management has responded to the recommendations and has developed a plan to bring the University into compliance.

Bloodborne Pathogens and Immunizations for Healthcare Workers

The ICO completed a review of the University's compliance with the Occupational Safety & Health Administration's (OSHA) bloodborne pathogens standard on July 8, 2009. Within the review, the ICO also addressed immunizations for healthcare workers. OSHA's bloodborne pathogens standard is found in the Code of Federal Regulations. It was designed to protect employees who work in occupations where they are at risk of exposure to blood or other potentially infectious materials. In addition to the OSHA standard, the Center for Disease Control (CDC) has issued recommendations for immunization of healthcare workers. Both the OSHA standard and CDC recommendations include procedures for hepatitis B immunization. Non-compliance with the OSHA standard can result in regulatory fines, negative publicity, civil lawsuits, and/or shutdown of operations.

The ICO made two recommendations to bring the University into compliance with the OSHA standard and CDC immunization practices. These recommendations are currently under review by management and are pending management response.

Export Control Regulations

The ICO completed a review of the University's compliance with export control regulations on October 2, 2009. Researchers may be subject to export control regulations that impose access, dissemination, or other restrictions on the transfer of certain items and information. Federal export control regulations exist for many reasons including national security, foreign policy, anti-terrorism or non-proliferation. The regulations are implemented by the Department of State,

Department of Commerce, and the U.S. Department of Treasury. Violations of these regulations may result in the loss of research contracts, monetary fines, and/or imprisonment. Both the University and the individuals involved may be subject to the penalties.

The ICO made seven recommendations to bring the University into compliance with export control regulations. These recommendations are currently under review by management and are pending management response.

AUDIT PLAN 2009/2010

Nelligan Contract – Athletics	Grants and Contracts
Personal Service Contracts	Construction Contracts
Fleet Management	Service Centers
Institute for Cellular Therapeutics	Chemistry Department
Department of Anesthesiology	Bursar Office
Internal Quality Assessment	Kidney Disease Program
PeopleSoft Grants	Research Computing
IT Operations Center	eSettlements
HR/SA Upgrade	Oracle Identity Management

Cash	Housing
Enterprise Risk Management	Request Audits/Projects

Green – In Progress

Audit Services Professional Staff Qualifications and Experience

Staff	Position	Certification	A	B	Industry Experience
Dave Barker	Director	CIA, CISA	29	9	Utility, Retail
Cheri Jones	Associate Director	CIA, CPA, CFSA	24	8	Financial Services, Healthcare
Jeanne Kennedy	Senior Auditor	CIA	10	8	Manufacturing, State Audit
Barry Scott	Senior Information Systems Auditor	CIA, CISA	12	5	Public Accounting, Consulting
Scott Miller	Auditor II	CIA	5	1	Metro Government
Gretchen Hyde	Senior Auditor	CPA	10	0	Banking, Public Accounting, Utility
Robin Wilcox	Associate Compliance Officer	CPA, CHC, CCEP	22	3	Public Accounting, Healthcare Compliance
Will Metcalf	Senior Compliance Analyst	CIA, CCEP	4	4	Higher Education

Certifications:

CIA – Certified Internal Auditor

CPA – Certified Public Accountant
CISA – Certified Information Systems Auditor
CFSA – Certified Financial Services Auditor
CHC- Certified in Healthcare Compliance
CCEP- Certified Compliance Ethics Professional

A – Years of Audit Experience
B – Years at University of Louisville

AUDIT PLAN STATUS REPORT

2008/2009

Clinical Research Billing	Retirement Plan – 403b
State Flow-Through Grants	X-Pays and Supplemental Pays
Construction Contracts	College of Education and Human Development
Executive Travel and Entertainment	Advancement Operations
Department of Neurology	E-Procurement Implementation
Cardiovascular Innovation Institute	Financials Upgrade
Wireless Networks	Payroll Application
Data Archiving	Select Agents
IT Network Security	Unix Operating System Environment
Request Audits	

Black – Deferred

Red – Complete

Green – In Progress (Report Drafted)

**RECOMMENDATION TO THE BOARD OF TRUSTEES
CONCERNING THE AUDIT PLAN**

Audit Committee: November 12, 2009

Board of Trustees: November 12, 2009

The President recommends the Board of Trustees approve the following Audit Plan:

**AUDIT PLAN
2009/2010**

Nelligan Contracts - Athletics	Grants and Contracts
Personal Services Contracts	Construction Contracts
Fleet Management	Service Centers
Institute for Cellular Therapeutics	Chemistry Department
Department of Anesthesiology	Bursar Office
Internal Quality Assessment	Kidney Disease Program
Peoplesoft Grants	Research Computing
IT Operations Center	eSettlements
HR/SA Upgrade	Oracle Identity Management
Cash	Housing
Enterprise Risk Management	Request Audits/Projects

Green in progress

Committee Action

Passed: X
 Did Not Pass: _____
 Other: _____

 Katalin M. Smith
 Assistant Secretary

Board Action:

Passed: X
 Did Not Pass: _____
 Other: _____

 Katalin M. Smith
 Assistant Secretary