

UNIVERSITY OF MAINE SYSTEM

Board of Trustees

at the University of Maine System

October 30, 2009

Audit & Finance/Facilities Committees Joint Session

Present: **Committee Members:** James Dowe, Chair - Audit Committee; Norman Fournier, Chair - Finance/Facilities Committee; and Eleanor Baker. **Other Trustees:** Marjorie Medd. **Chancellor:** Richard Pattenau. **Faculty Representatives:** Robert Rice and Bert Jacobs (by Polycom). **Student Representatives:** Cynthia Nesbit and Dustin Ward. **Staff:** Eduard Dailide, Tracy Elliott, Darla Reynolds, Kelley Wiltbank, Miriam White, and Rebecca Wyke. **Others Attending:** John Hand and Duaine Smith from PricewaterhouseCoopers; Steven Caron, Scott Warnetski, and Renee Bourget-Place from KPMG.

Absent: Kevin McCarthy, Paul Mitchell, Barry McCrum, Victoria Murphy, and Lyndel Wishcamper.

Trustees Dowe and Fournier called the meeting to order and welcomed everyone. The attendees introduced themselves.

Ms. Rebecca Wyke, Vice Chancellor for Finance and Administration and Treasurer, commented that FY09 was a very difficult financial year for the UMS. She expressed her thanks to the staff at the System Office as well as the campuses for their hard work in recognizing the seriousness of the financial situation and working quickly.

On behalf of the Audit and Finance/Facilities Committee, Trustee Dowe expressed appreciation and thanks to the UMS staff for recognizing and responding so quickly to the difficult financial environment.

Annual Financial Report FY2009. Ms. Tracy Elliott, Director of Finance and Controller, acknowledged all of the hard work done in the financial reporting from the campuses and System staff, particularly Darla Reynolds, Director of Accounting, and her staff for their work in compiling the financial statements for FY2009. KPMG, the independent external auditors, issued an unqualified, clean opinion and the audit was conducted in accordance with the generally accepted accounting principles as established by the Government Auditing Standards Board (GASB).

Ms. Elliott gave an overview of the FY2009 financial statement results. The University of Maine System ended FY09 with Income (Loss) Before Other Changes in Net Assets of \$10.8 million and with an increase in Net Assets of \$10.2 million. As a result, Total Net Assets increased 1.6% to \$652 million as of June 30, 2009. Of the \$10.2 million increase in Net Assets, UMS experienced a positive change in Unrestricted Net Assets of \$6.4 million. This positive change was possible because of \$6.6 million in State Fiscal Stabilization Fund revenue which UMS was able to recognize in June of 2009.

Other significant financial highlights for the year ended June 30, 2009 include:

- Fall 2008 FTE student enrollment declined 1.5% to 23,688; UMS had a 10.1% weighted average increase in undergraduate in-state tuition and fees and a 6.6% weighted average increase in room and board rates in FY09.
- On a percentage basis, UMFK suffered the greatest decline in Fall 2008 enrollments at -17.3%. UM is the only campus with enrollment increases in each of the past five years and for the five year period itself.
- Reflecting a curtailment in the Fall of 2008, State appropriation revenue declined 3.5% from \$201 million in FY08 to \$194 million in FY09.
- Total cash gifts (capital, endowment and operating) were \$24 million in FY09, up from \$19 million in FY08.
- Due to the world financial crisis, the pooled investments (including endowments) experienced a -15.7% return compared to -2.6% for 2008. The UMS and affiliates' pooled endowment funds totaled \$95 million as of June 30, 2009 compared to \$115 in 2008.
- The component units (the University of Maine Foundation and the University of Maine Pulp and Paper Foundation) are presented on the Statement of Net Assets. Endowment and other investments for the University of Maine System and its component units total \$239 million as of June 30, 2009, a decline of \$63 million from 2008.
- Due to financial market conditions, the UMS experienced operating investment losses of \$2.9 million in FY09, compared to income of \$3.7 million in FY08.
- Total notes and bond payments were \$209 million as of June 30, 2009, declining \$7 million from the prior year.
- Capital asset additions, financed primarily by UMS revenue bonds, state capital bonds and gifts, totaled \$53 million in FY09 as compared to \$68 million in FY08. Major construction in progress in FY09 included the University Commons and Osher Map Library Building expansion at USM, the University of Maine Aubert Hall Laboratory updates, Collins Center for the Arts renovation, and the Hutchinson Center expansion.
- In response to GASB Statement 45, which was implemented last fiscal year, the UMS established and funded a trust in FY09 for its net other postemployment benefit (OPEB) obligation. The balance in the trust at June 30, 2009 was \$19 million with an additional \$3 million to be funded by December 31, 2009. Prior to FY08, the University's retiree medical plan benefits were recorded on a pay-as-you-go basis rather than accrual-based accounting as required by GASB 45.

Mr. Steven Caron, KPMG, commented that the UMS financially compares very well to peer institutions. Unlike many institutions, the UMS experienced an increase in net assets for FY09.

Chancellor Pattenaude commented that there has been a great deal of hard work done and difficult decisions made by the campuses to accomplish where the UMS financial position is as of June 30, 2009. Trustee Dowe reminded the Committee that as we balance the budgets to be mindful of why the UMS is in operation and it is essential to protect the integrity of the operation.

KPMG Report Including Management Letter. Mr. Caron explained that he will be retiring in 2010 and Renee Bourget-Place will be partner on the UMS engagement. They are introducing her now so that the transition will be smooth.

Mr. Scott Warnetski, KPMG, reviewed the results of the 2009 Audit which indicates no material weaknesses involving internal control over financial reporting and its operation and no instances of non-compliance or other matters that are required to be reported under Government Auditing Standards. The areas of emphasis for the Audit include implementation of GASB 49 (*Accounting and Financial Reporting for Pollution Remediation Activities*); Education and Research; Human Resources; Facilities; Investments; and Control Environment.

Mr. Warnetski provided an overview of the Management Letter and outlined KPMG's recommendation that the UMS perform a risk assessment of the reporting operations at the campuses with significant American Recovery and Reinvestment Act (ARRA) expenditures. The risk assessment should focus on determining if the campuses are reporting information consistently, if internal controls exist to ensure accurate reporting, if a quality assurance is being performed, and if an audit readiness assessment has been performed or planned.

There is one new accounting standard that will be effective for the year ending June 30, 2010, GASB Statement No. 51 – *Accounting and Financial Reporting for Intangible Assets*. The UMS followed the AICPA State of Position (SOP) 98-1 when capitalizing costs related to the acquisition and implementation of the ERP system. However, going forward the UMS should evaluate its current process for identifying capitalization costs relating to software development and implementation to ensure it complies with GASB Statement No. 51.

Ms. Rebecca Wyke, Vice Chancellor for Finance and Administration and Treasurer, commented that the System has provided the campuses with guidance as to allowable expenditures under the ARRA criteria, has closely coordinated all data collection, and the System is responsible for the quarterly reporting of State Fiscal Stabilization Fund usage to the State.

Chancellor Pattenaude thanked Mr. Caron for the transition process that is in place and the System will look forward to working with him for another year. He welcomed Ms. Bourget-Place.

Trustee Dowe commented that he spoke with both Mr. Caron from KPMG and Mr. Smith from PWC in advance of the meeting. They both had very positive comments about the working relationship with the UMS. Trustee Dowe also discussed with Mr. Caron and Mr. Smith the topic of the Internal Audit function and approach for the UMS. There are different points of view in the industry on how this function can be accomplished and they discussed different possibilities.

Trustee Dowe and Mr. Smith also discussed the topic of Enterprise Risk Management and this is a concept that should be discussed at a future Audit Committee meeting.

PWC Internal Audit Update FY09/10. Mr. Duaine Smith, PricewaterhouseCoopers, reviewed the status of the Internal Audits for FY09 and FY10. The Internal Audits for UMS Construction Management and UMS Sponsored Programs are complete. In addition the

campus budgeting, forecasting and reporting for three campuses (UM, UMF, and UMA) are also complete.

Sponsored Programs Review

The review included a high level assessment of Sponsored Programs Business Processes at UMS, UM, USM, UMA and UMF. The objective was to review the policies and procedures to assess the effectiveness of the guidance and services provided by the System Office to the campuses and look at the effectiveness of the support that UM and USM provide to the smaller campuses in the Sponsored Programs area.

The review did not find any significant observations that require immediate action. The recommendations include reviewing the roles and responsibilities and reporting structure over Sponsored Programs Administration, improving support to smaller campuses for management of the award proposal process and post award administration formalizing with a service level agreement the advisory/consulting oversight provided by USM, improving account set-up considering the implementation of the PeopleSoft Grants Modules to provide system capabilities for performing grant accounting activities, and improving training throughout the research community.

Trustee Baker inquired if there would be any cost savings by establishing one location where Sponsored Program Administration could be controlled and is there any university system that outsources this type of function. Mr. Smith stated he is not aware of any university system that outsources this function and that some activities need to be done at the campus level but other functions could be performed at UM and USM where the majority of the sponsored programs activities occurs. There could be some reporting benefits from this model but it would require a robust information technology platform. When the UMS implements the PeopleSoft Grants module there may be opportunities for centralization.

Ms. Elliott commented that there are two separate functions for Sponsor Programs – the pre-award and the post-award. The System Office has post-award expertise but not pre-award. This expertise resides at the campuses as such USM or UM are better positioned to provide sponsored programs administrative support to the smaller campuses. In fact, with pending personnel changes, UMA and USM are currently exploring how USM might provide such assistance to UMA. Ms. Wyke stated that the PeopleSoft Grants module is an important tool and the priority for implementation is currently being reviewed. The Grants module is listed as one of four top priorities.

Trustee Dowe inquired if there were any next steps or actions that are required. Mr. Smith explained that the review outlined the commitments on the part of the System and the campuses for action and PWC would follow-up to see if those actions have taken place.

UM Sponsored Research Review

The scope and approach of the UM Sponsored Research Review include reviewing processes and controls. This review is currently in the report drafting stage. There are no findings that are significant that need to be addressed immediately. However, the key observations of the review include a recommendation that UM should enhance controls by developing more specific guidance on the business processes, to promote responsibility and accountability by principal investigators by implementing a monitoring system, implementing the PeopleSoft Grants suite of modules will enhance controls and promote efficiencies by automating

processes and eliminating shadow systems, and recommend management implement an indirect reporting line for the Post Award Office to the Vice President of Finance to provide for greater financial oversight.

UM Facilities Phase 1 Review

The scope of the UM Facilities Phase 1 Review included performing an assessment of select processes and controls within the UM Facilities Operations and Maintenance and report back to management with preliminary observations and recommendations

The key observations include the following:

- Policies and controls require strengthening to ensure that such work is appropriately recorded, classified, and charged back to departments
- Controls over gas consumption and the allocation of costs to departments require improvement
- Lack of integration between Facilities' systems lead to inefficiencies, discrepancies between systems, and a lack of insight into department activities
- Outdated applications such as MP2 (Computer Maintenance Management Software) used by Facilities personnel led to inefficient systems and processes, high support costs, and potential information loss if catastrophic failure occurs

UMS Construction Management Process Review

The scope of the review included performing a review of the construction management processes and controls at UMS, UM, USM, and UMF with a specific focus on the project development life cycle.

The key observations from the review included the following: the construction management guidance and process documentation at the System and the campuses have not kept pace with the business process changes that have occurred over the years and the policies and procedures in place on the campuses are generally not formally documented; the level of documented construction inspections varies from campus to campus and the documentation is not consistently maintained, capital project program reporting was inconsistent between campuses and the reports are difficult to use as a management tool, and a standard training program for UMS construction management policies and procedures should be developed.

Internal Audits for FY10

The Internal Audits for FY10 include campus budgeting, forecasting and reporting for Presque Isle, Fort Kent, and Machias; and the System compensation and benefits follow-up.

Mr. Smith commented about issues for future. One issue is the stress at the individual processing level because everyone is being asked to do more with less. The concern from an internal control prospective is ultimately if those people are overwhelmed then they are not able to do more with less; they will do less with less which will affect their fiduciary responsibilities. There is likelihood for exploring opportunities for shared services, particularly at the smaller campuses with back office operations.

The Chancellor commented that currently UMFK and UMPI share a Director of Human Resources and other shared services are being pursued.

Ms. Wyke commented that the smaller campuses cannot continue to endure additional budget cuts and UMS will have to figure out how to continue to provide those regional services. As outlined in the Arena 1 report, the Chief Financial Officers stated that UMS has truly neglected the facilities management area and this area needs focus. For many years dedicated staff have worked to get the right things done without the proper tools. The UMS can no longer continue to operate without the proper tools in place. This is essential in order to reduce risk and ensure the future of the System.

Internal Audit Function

Trustee Dowe asked for the Committee's thoughts on the UMS Internal Audit Function. He explained that currently the UMS has outsourced its internal audit function because of difficulties in hiring Internal Audit positions. It is an appropriate time to review the System's internal audit needs and look at different models. For the purposes of discussion, Ms. Elliott explained the various possible internal audit models, presented a survey of audit services costs including CUPA-HR Salary information for Internal Audit positions, and job descriptions. Ms. Wyke commented that the work PWC has performed has been reviews and not audits and in order to get the real value of an internal audit function the System should reconsider its internal audit model. If the UMS moves to an in-house internal audit function, the amount of funding dedicated to this function could remain the same, however, the difference would be an increase in the number of hours spent on audit services.

Ms. Wyke explained there are three possibilities for the internal audit function. First, the UMS could go out to bid externally for internal audit services. It has been three years since the last bid process. The second model is to develop a list of qualified vendors from in-state and out-of-state and as the UMS has particular audit needs the expertise of the vendors could be matched with the UMS needs. The final model is an in-house option. Ms. Elliott explained the internal audit analysis, a survey of audit services costs, and the various possible internal audit models: a UMS Internal Audit Department, a co-sourced audit relationship, and an outsourced audit relationship.

Chancellor Pattenauade asked about the risk factor if the UMS is not attentive to the audit function. Mr. Caron commented that one of the functions that has been missing for the UMS is the level of detail that is reviewed in a true internal audit and KPMG would be in favor of UMS going back to some form of in-house audit function. Ms. Baker commented that it is a different market today than a few years ago and the UMS may have more success in hiring internal audit positions. She also commented that she would prefer to spend money on Maine people and Maine jobs on this function versus out-of-state.

Ms. Wyke commented that she feels there would be a benefit to going out to bid to develop a list of qualified vendors and look at a hybrid model of internal audit and outsourcing. She commented that Internal Audit is a huge cost but it is an investment that the System cannot afford not to make. Professor Robert Rice, faculty representative from UM, cautioned the Committee about adding staff to the System Office. Trustee Dowe recommended exploring the three models over the next few months.

Year-End Financial Reporting FY09. Ms. Wyke reviewed the Year-End Financial Reporting for FY09. For FY09, UMS experienced a positive net increase from unrestricted operations of \$8.3 million. It should be noted, however, that this includes the receipt of \$6.6 million in State Fiscal Stabilization Funds from the American Recovery and Reinvestment

Act (ARRA). If these funds had not been available, the net increase from unrestricted operations would have totaled only \$1.7 million. Although the overall operating results were positive, one campus incurred an operating loss and the System experienced a significant loss in Temporary Investment Income.

The campus breakdown is as follows:

University of Maine

UM had a net increase of \$5.4 million and a net student charges revenue of 5.7% above budget which reflects a 4.2% increase in tuition and fee revenue and a 7.3% increase in budgeted dining and residence revenue. The total operating expenses were \$2.1 million or .9% below budget as departments curtailed expenditures in anticipation of FY10 base reductions. Due to the receipt of ARRA funds, UM was able to redirect E&G funds to pay more internal debt than originally budgeted.

University of Maine at Augusta

UMA had a \$496 thousand net increase and the net student charges revenue was 5.9% above budget resulting from increased enrollments due, in part, to extensive intervention efforts to retain students and the start-up of the Bachelor of Science in Nursing program.

University of Maine at Farmington

UMF had a \$803 thousand net increase and the total operating revenue was \$719 thousand or 1.9% above budget due, in part, to strong summer enrollments, and increases in Educational Outreach programs, and conservative budgeting. UMF total operating expenses were slightly below budget at .8% due to savings in benefits costs resulting from the utilization of part-time personnel and campus-wide efforts to spend minimally.

University of Maine at Fort Kent

UMFK had a \$602 thousand net loss and the net student charges revenue was \$1.3 million or 15.9% below budget due to an enrollment decline, primarily the Canadian Certification Students. UMFK did not have adequate reserves to cover the loss.

University of Maine at Machias

UMM had a net increase of \$15 thousand. UMM originally had budgeted an overall loss of \$123 thousand; therefore, year-end results reflects a favorable variance of \$138 thousand. The total net operating revenue was \$118 thousand or 1.1% below budget. The net student charges revenue was \$177 thousand or 3% below budget but the dining and residence component was \$125 thousand or 7.4% above budget due to growth in new residents and improved retention.

University of Maine at Presque Isle

UMPI had a \$173 thousand net increase and total operating revenue was \$414 thousand or 2.6% above budget due to increased other revenue sources such as conferences and Gentile Complex memberships. The total operating expenses were \$338 thousand or 2% above budget due in part to increased utility costs.

University of Southern Maine

USM had a \$1.5 million net increase and the net student charges revenue was \$2.8 million or 3.7% above budget due to an increased number of non-resident students, standardization of

fee assessment, and residential hall occupancy exceeding budget. The total operating expenses were \$848 thousand or .6% below budget. Due to the receipt of ARRA funds, USM was able to redirect E&G funds to pay more internal debt than originally budgeted.

System-Wide Services

System-wide Services (SWS) had a net increase of \$1.7 million. SWS made mid-year budgetary cuts and continued to reduced spending through the remainder of the year. SWS realized \$1.1 million of operational cost savings that are being utilized to offset the loss of temporary investment income. The System also experienced \$275 thousand cost savings from business insurance which will be used to build the Risk Management Reserves to mitigate future insurance claims and reduce premium costs.

System Temporary Investment Loss

The Temporary Investment Income FY09 budget was \$4.5 million. In FY09, the System experienced a loss of \$3.2 for a total budget-to-actual negative variance of \$7.7 million. Approximately \$1.9 million of this \$7.7 million loss was allocated to the campuses resulting in the current System loss of \$5.8 million. System-wide Services operational savings and amortized interest rate swap gain of \$1.4 million were applied against this loss. Prior year temporary investment income reserves of \$3.8 million and \$.6 million in unrestricted System reserves will offset the remaining loss.

System-wide Employee Benefits

Conservative budgeting for healthcare resulted in a \$4.6 million over-recovery in the allocation of departmental benefit costs during FY09. This over-recovery will be utilized in FY10 to offset the significant increase in post-employment healthcare costs.

UMS “Flash” Reports – Pension, Endowment and Operating Fund

For the fiscal year to date as of September 30, 2009, the Pension fund increased by 10.4% with a total market value of \$45.2 million. The Managed Investment Pool, including Endowments, increase by 11.3% with a ending market value of \$140.4 million and the operating fund realized a 3.3% return for a gain in excess of budget of \$5.5 million as of September 30, 2009.

Adjournment.

Ellen Doughty
for J. Kelley Wiltbank, Clerk