AUDITOR COMMUNICATIONS
TO THE AUDIT COMMITTEE

2014 AUDIT PLANNING SUMMARY

May 7, 2014
May 7, 2014

The Audit Committee of the University of Maine System:

The information included in this Audit Planning Summary has been assembled to assist you in your capacity as a member of the Audit Committee of the University of Maine System (the System).

If we can be of further assistance to you during the year concerning the audit or other related matters, please contact me by phone at (207) 942-1600 or by email at rbishop@berrydunn.com.

Sincerely,

Renee Bishop, CPA
Engagement Principal
UNIVERSITY OF MAINE SYSTEM

AUDITOR COMMUNICATIONS – 2014 AUDIT PLANNING SUMMARY

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Professional standards established by the American Institute of Certified Public Accountants (AICPA) require independent auditors to communicate certain matters directly to the members of an appropriate committee of the Board of Trustees. The standards require the auditor to ensure that the committee receives specific information regarding the scope, timing and the results of the audit to enhance the information flow and assist the committee in overseeing the financial reporting and disclosure process for which management is responsible.

I. Discussion Regarding Significant Items for the 2014 Audit

A. Risk Based Audit Approach

Our audit approach emphasizes assessing risk by financial statement assertion in order to focus the audit work towards areas that are more sensitive and/or have the greatest risk of material misstatement. We utilize investigative and analytical auditing procedures that will help gain an understanding of policies, procedures and responsibility reporting/accountability. We will gain an understanding of significant internal control systems, document the systems (from interviews and observations) and walk through certain transactions within each system to ascertain that our understanding and documentation are accurate.

After an evaluation of internal controls, we identify the major areas of strength and areas for opportunities within the internal control systems and design our audit procedures accordingly. We place heavy emphasis on analytical procedures such as the analysis of relationships between the expected and actual results, as well as industry comparisons and budget variance analysis.

B. Significant Audit Areas

We have initially assessed the following as significant areas of focus for the 2014 audit:

- Cash
- Investments, including deposits with bond trustees
- Accounts receivable and revenue (*primarily related to collectability and revenue recognition*)
- Grants receivable and related revenue
- Capital assets (*primarily related to capital projects started or finished in 2014*)
- Accounts payable and accrued expenses
- Payroll expense and related accrued liabilities, including pension and other retirement benefit obligations
- Indebtedness
- Federal financial assistance programs (OMB Circular A-133 – see Section D)

We anticipate that the time needed to complete the audit will be approximately 950 hours for the financial statement audit and 500 hours for the A-133 audit.
C. Significant Accounting Estimates and Judgments Made by Management

Accounting estimates, based upon management's judgments, are an integral part of an entity's financial statements. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments and therefore will be evaluated during the course of the audit. Based on our preliminary planning, we anticipate those estimates to be as follows:

- Liabilities for self-insured plans, pension and other retirement benefit obligations
- Allowances for uncollectible receivables
- Valuation of investments

D. Federal Compliance Audit in Accordance with OMB Circular A-133

At a minimum, we anticipate the following federal award programs will be tested for compliance under OMB Circular A-133:

- U.S. Department of Education – Student Financial Aid Cluster
- Research and Development Cluster

In addition, we are required to evaluate Type B programs (those with greater than $300,000 but less than $3,000,000 in federal expenditures) to determine whether they are high or low-risk. If it is determined there are high-risk Type B programs, we will be required to audit the program as a major program, and consequently perform additional testing. The number of high-risk Type B programs to be tested will not exceed the number of low-risk Type A programs. The additional cost for a Type B program identified as high-risk and therefore tested as major is outlined in the contract for audit services dated April 19, 2012.

E. Timing of Audit

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<tr>
<td>Planning/Interim work</td>
<td>May – June 2014</td>
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<tr>
<td>Financial statement audit fieldwork</td>
<td>September 8 – October 17, 2014</td>
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<td>On-site fieldwork – A-133 audit</td>
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<tr>
<td>USM</td>
<td>Week of July 14 and August 4 – 22, 2014</td>
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<td>UMA</td>
<td>Week of July 21, 2014</td>
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<td>UMaine</td>
<td>Week of July 28 and September 29 – October 17, 2014</td>
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<tr>
<td>Preliminary draft financial statement audit report to management</td>
<td>Week of October 13, 2014</td>
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<td>Final draft financial statement audit report for Audit Committee</td>
<td>Week of October 20, 2014</td>
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<td>Audit Committee presentation</td>
<td>Late October/Early November 2014</td>
</tr>
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<td>Final financial statement audit report delivered</td>
<td>Upon acceptance of Audit Committee and completion of any necessary updating procedures</td>
</tr>
<tr>
<td>A-133 reports finalized</td>
<td>Prior to February 15, 2015</td>
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A-133 reports finalized Prior to February 15, 2015
F. Staffing of the Audit

Management and staff for the audit will be:

Engagement Principal: Renee Bishop, CPA
Senior Manager: Amanda Butterfield, CPA
Manager: Emily Parker, CPA
Senior: Benjamin Benwell, CPA
Staff: Melissa Gouin
Erin Doucette
Chris Mouradian
Rachael Siegfriedt
Other staff as necessary
II. New Accounting or Auditing Standards and Other Professional Guidance

**GASB Statement No. 65 (GASB 65) – Items Previously Reported as Assets and Liabilities**

GASB 65 is effective for the System’s 2014 fiscal year and will be applied on a retroactive basis. It provides guidance on determining which balances currently reported as assets and liabilities should instead be reported as deferred outflows of resources or deferred inflows of resources. Based on those definitions, GASB 65 reclassifies certain items currently being reported as assets and liabilities (such as assets and liabilities from refunding of debt) as deferred outflows of resources and deferred inflows of resources.

In addition, GASB 65 will require that certain items currently being reported as assets and liabilities (such as debt issuance costs) be instead expensed in the period incurred. This will result in a restatement to opening net position in the June 30, 2014 financial statements primarily as a result of expensing prior debt issuance costs that prior to GASB 65 were capitalized and amortized.

**GASB Statement No. 68 (GASB 68) – Accounting and Financial Reporting for Pensions**

GASB 68 mandates new measurement and reporting requirements for governmental employers that provide defined benefit pension plans to their employees.

Calculation of the total pension obligations involves three essential steps:

1. projecting future benefit payments for current and former employees or their beneficiaries,
2. discounting the projected future benefit payments to their present value, and
3. allocating the present value to past and future years during which the employees have worked or are expected to work.

GASB 68 is designed to recognize pension liabilities that reflect the entire unfunded portion of pension obligations regardless of when the government intends to fund the obligations. In addition, GASB 68 requires future pension obligations to be discounted to present value using a single discount rate that reflects both of the following:

- The long-term expected rate of return on pension plan investments that are expected to be used to finance the payment of benefits, to the extent the pension plan’s fiduciary net position is projected to be sufficient to make projected benefit payments and pension plan assets are expected to be invested using a strategy to achieve that return.
- A yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher (or equivalent quality on another rating scale), to the extent that those conditions are not met.

Current standards require the discount rate to only reflect the long-term investment expected rate of return. Because pension investments generally yield greater returns than long-term borrowing rates, the discounted net present value of pension obligations will be larger under GASB 68 to the extent the projected fiduciary net position will not be sufficient to cover all the projected benefit payments.
The effects of changes to an employer’s expected proportion of total employer-related contributions, as well as the effects of differences between the expected and actual proportionate share of total employer-related contributions each period, will be reported as a deferred outflow or inflow of resources and recognized in the employer’s pension expense in a systematic and rational manner over a closed period representative of the average expected remaining service lives of employees, beginning with the period of adoption.

In January 2014, GASB issued the Guide to Implementation of GASB Statement 68 on Accounting and Financial Reporting for Pensions to provide further guidance to governments on how to implement the new standard.

GASB 68 is effective for periods beginning after June 15, 2014 (the System’s 2015 year-end). To the extent practical, accounting changes made to comply with this statement should be reported as adjustments of prior periods and financial statements presented for the affected periods should be restated.

**GASB Statement No. 71 (GASB 71) – Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68**

GASB 71 amends paragraph 137 of GASB 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability.

GASB 71 is effective for periods beginning after June 15, 2014 (the System’s 2015 year-end – in conjunction with the implementation of GASB 68).

**GASB Concepts Statement No. 6 (Statement 6) - Measurement of Elements of Financial Statements**

Statement 6 was issued in April 2014. Concepts statements provide a conceptual framework of interrelated objectives and fundamental principles that are used as a basis for establishing consistent accounting and financial reporting standards. These statements are foundational but do not prescribe standards that might apply to a particular transaction or situation.

Statement 6 establishes two new approaches to measuring assets and liabilities in financial statements:

1) Initial transaction date measurement, which represents the transaction price or amount assigned when an asset is acquired or a liability is incurred.
2) Measurement as of the financial statement date, which represents the amount assigned to an asset or liability when the elements(s) are re-measured for reporting in the financial statements.

Statement 6 also establishes four measurement attributes:

- Historical cost—the price paid to acquire an asset or the amount received pursuant to the incurrence of a liability in an exchange transaction.
- Fair value—the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Replacement cost—the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.
- Settlement amount—the amount at which an asset could be realized or a liability could be liquidated with a counterparty other than in an active market.
Other GASB Projects

Fair Value Measurement and Application

The objective of this project is to review and consider alternatives for the further development of the definition of fair value, the methods used to measure fair value, and potential disclosures about fair value measurements. Within this review, issues including fair value measurement of alternative investments are to be addressed. It is expected an exposure draft will be issued in 2014.

Other Postemployment Benefit Accounting and Financial Reporting

The GASB Board will consider the possibility of improvements to the existing standards of accounting and financial reporting for postemployment benefits—including other postemployment benefits (OPEB)—by state and local governmental employers and by the trustees, administrators, or sponsors of OPEB plans. One objective of this project is to improve the accountability and transparency of financial reporting in regard to the financial effects of employers’ commitments and actions related to OPEB. This objective would include improving the information provided to help financial report users assess the degree to which interperiod equity has been achieved. When this is achieved, the burden of the cost of current period services is borne by present-year taxpayers and revenue providers rather than shifted to future-year taxpayers or revenue providers.

The other objective of this project is to improve the usefulness of information for decisions or judgments of relevance to the various users of the general purpose external financial reports of governmental employers and OPEB plans. It is expected an exposure draft will be issued in 2014.

Fiduciary Responsibilities

The objective of this project is to assess whether additional guidance should be developed regarding the application of the fiduciary responsibility criteria in deciding whether and how governments should report fiduciary fund activities in their financial reports. There has been diversity in practice regarding the interpretation of governments’ fiduciary responsibilities. The Board has also been discussing clarifying what types of fiduciary funds would be included and excluded from presentation in the financial statements. It is expected an exposure draft will be issued in 2014.

Leases

The objective of this project is to reexamine issues associated with lease accounting, consider improvements to existing guidance, and provide a basis for the GASB Board to consider whether the current guidance is appropriate based on the definitions of assets and liabilities. It is expected an exposure draft will be issued in 2014.
OMB “Super Circular” Released in Federal Register

To strengthen oversight of federal awards and increase the efficiency and effectiveness of Office of Management and Budget (OMB) audits, the OMB recently issued final guidance of the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards in the Federal Register.

These changes have reformed administrative requirements (Circulars A-102, A-110 and A-89), streamlined the cost principles (Circulars A-21, A-87 and A-122), and reformed audit requirements (Circulars A-133 and A-50). The final guidance, known as the Super Circular, supersedes the eight circulars noted above.

Below are key changes included in the final guidance:

- Administrative requirements
  - Greater focus on responsibilities of sub-recipient monitoring pre- and post-award
  - Expansion of conflict-of-interest guidance
  - Greater focus on internal controls

- Cost principles
  - Changes to the guidelines regarding indirect costs to promote consistency and transparency in applying indirect cost rates: Indirect cost rates must be provided to pass-through entities.
  - Alternatives to the current reporting requirements for salaries and wages to prevent duplicating efforts when organizations have good internal controls.

- Audit requirements
  - Increased threshold of federal expenditures (from $500,000 to $750,000) that triggers an A-133 audit.
  - Increased Type A threshold (from $300,000 to $750,000) for those with expenditures below $25 million.
  - Reduced the overall percentage of expenditures required to be tested:
    - For low-risk auditees, adequate testing coverage is achieved by testing at least 20% of the federal expenditures as major (down from 25%).
    - For other than low-risk auditees, adequate testing coverage is achieved by testing at least 40% of the federal expenditures as major (down from 50%).
  - Increased threshold for reporting known or likely questioned costs (from $10,000 to $25,000).

There was much discussion in favor of reducing the number of compliance requirements to be tested in order to focus the auditor’s attention on compliance requirements with the greatest risk. The final guidance specifically declined to address this issue because there was concern that any removed compliance requirements would be added back as special tests and provisions, increasing the overall administrative burden.

Any future reductions to the current 14 types of compliance requirements would need to take place when the compliance supplement is changed, which would occur under a separate process. Initial drafts of the 2014 A-133 Compliance Supplement do not indicate any reductions in the types of compliance requirements.

The reforms were published in the Federal Register on December 26, 2013, and are effective for years beginning on or after December 26, 2014.