

Sarbanes-Oxley Act of 2002

Presented to the Board of Trustees
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Outline

- What is the Sarbanes-Oxley Act (“SOX”)?
- Why discuss SOX?
- Review of SOX provisions

What is SOX?

- **Created new and amended existing provisions of federal law**
- **Enacted to enhance corporate reporting and accountability**
- **Applies to publicly traded companies**
- **Themes**
 - **Auditor Independence -- External auditors**
 - **Audit Committee Expertise/Role**
 - **Corporate Responsibility -- Senior management**
 - **Enhanced Financial Disclosures, including Audit Committees**

Why discuss SOX?

- **Very limited *direct* applicability, but it:**
 - Promotes good business practices
 - Was cited by a rating service as relevant to corporate governance, bond ratings
 - Could be used as a benchmark by courts

Review of SOX Provisions

- 1. Provisions with which UI already complies**
- 2. Areas of possible improvement:
recommended changes**
- 3. Provisions that do not apply because of
particular circumstances or exogenous
circumstances**

1. UI Already Complies

Two SOX provisions directly applicable to NFPs

- **Whistle-Blower Protection**: Institutions receiving Federal funds are subject to various anti-retaliation provisions. (Title 18, Sections 806, 1107).

UI - The University has issued a policy on Disclosure of Wrongful Conduct and Protection from Reprisal.

- *The OBFS policy defines wrongful conduct (including misuse of university resources); identifies contact persons and processes for reporting and investigating misconduct; and protects individuals who report misconduct from reprisal.*

State of Illinois - The Illinois Ethics Act similarly provides whistleblower protection and vests the Executive Inspector General with authority to receive and investigate allegations of wrongdoing. It also protects whistleblowers and provides civil remedies concerning reprisals.

- *The University is working to clarify and consolidate responsibility for handling whistleblower complaints, and to coordinate efforts to the extent practicable with the Office of the Executive Inspector General.*

1. UI Already Complies

Two SOX provisions directly applicable to NFPs (cont'd)

- Record Retention: The Act contains two penalty provisions regarding unlawful destruction of documents. (Title 18, Sections 802, 1102).

UI - The University Office of Business and Financial Services (OBFS) has a policy on its website specifying the retention period for various kinds of University records.

UI - The General Rules Concerning University Organization and Procedure require all departments to develop policies for destruction or transfer of records, based on approval of the University Archivist.

Auditor Independence

- **More than three decades ago, the State of Illinois created the position of Auditor General.**
 - OAG selects firms to audit all state activities
 - OAG manages the engagements for all audits
 - OAG staff join audit team for all financial and compliance audits
- **Audit results are presented to and must be accepted by the Illinois Legislative Audit Commission in public hearings. The LAC includes members from both the House and Senate.**
- **The LAC has issued a specific set of guidelines for a variety of financial procedures in higher education that supplement state statutes and govern public university financial operations.**

1. UI Already Complies

Auditor Independence (Title II, Sections 201, 203, 206)

- Public Accounting firms may provide only audit services.
U of I - The University is audited by a public accounting firm selected by the OAG, which prohibits non-audit services.
- Audit partner must rotate off an audit every 5 years.
The OAG requires a change in public accounting firms every six years.
- Senior management cannot have been employed by the public accounting firm during the one year period preceding the audit.
U of I - Concerns of employing one who worked for the public accounting firm would include how the position relates to the financial statement audit.

1. UI Already Complies

Corporate Responsibility (Title III, Section 301)

- The Audit Committee shall be responsible for the appointment, compensation, and oversight of the public accounting firm.

U of I - The OAG fulfills this role.

- Each member of the audit committee shall be a member of the Board.

U of I - All members of the Budget and Audit Committee are members of the Board of Trustees.

- The Audit Committee shall establish procedures for the receipt, retention, and treatment of complaints and for confidential, anonymous submission of questionable accounting or auditing matters.

U of I - The University has established the Ethics Help Line, and the University's policy Disclosure of Wrongful Conduct and Protection from Reprisal defines, in general, procedures for complaints.

- The Audit Committee shall have authority to engage independent counsel or other advisors and have appropriate funding to carry out its duties.

U of I - The Trustees have authority to engage counsel or other advisors and can appropriate funding as needed.

1. UI Already Complies

Corporate Responsibility (Title III, Section 302)

The CEO and CFO shall certify along with the annual audit report that they have:

- Reviewed the report;
- Confirmed it does not contain any untrue statement of a material fact or omission of a material fact;
- Determined that the financial statements present in all material respects the financial condition and results of operations; and
- Acknowledged responsibility for establishing and maintaining adequate internal controls, reviewed the controls, and presented their conclusions about the effectiveness of their internal controls.

1. UI Already Complies

Corporate Responsibility (Section 302)(cont'd)

The CEO and CO shall certify along with the annual audit report that they have:

- Disclosed to the auditors and the audit committee all significant deficiencies in the internal controls and any fraud, whether or not material.
- Indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls since their review and any needed corrective action.

U of I – The representation letter, signed by the President, the Comptroller and other key administrators, meet the requirements of Section 302. In addition to the representation letter, the Fiscal Control and Internal Auditing Act, FCIIA, (30 ILCS 10/1003) requires the President annually certify, to the OAG, either the systems of internal control comply with FCIIA or if they do not, to include a report describing any material weakness and the plan for correction.

1. UI Already Complies

Corporate Responsibility (Title III, Section 303)

- It is unlawful for any officer or director, or any other person acting under the direction thereof, to take an action to fraudulently influence, coerce, or mislead an external auditor engaged in the performance of an audit of the financial statements for the purpose of rendering such financial statements materially misleading.

U of I - The representation letter states there has been no false representations and the University's Code of Conduct addresses honesty and responsibility of those acting on behalf of the University.

1. UI Already Complies

Enhanced Financial Disclosures (Title IV, Sections 401-402)

- GAAP disclosures of off-balance sheet transactions should reflect the economics of such transactions.

U of I - The University follows all applicable GASB standards.

- It shall be unlawful for a company to extend personal loans to any director or executive officer.

U of I - The University does not extend personal loans to any trustee or executive officer. Moreover, any such loan would violate the UI Trustees Act. (110 ILCS 310/3). The Act permits educational loans, etc. to student Trustees. (Id.)

1. UI Already Complies

Enhanced Financial Disclosures (Title IV, Section 403)

- Directors, officers, and 10%+ owners must report designated equity security transactions to the SEC within certain timeframes.

U of I - Trustees and officers annually complete Report of Non-University Activities and Statement of Economic Interests forms.

1. UI Already Complies

Enhanced Financial Disclosures (Title IV, Section 404)

- Each annual report shall contain an internal control report which states the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting.

U of I – The representation letter acknowledges the responsibility of management for establishing and maintaining an adequate internal control structure thus meeting this subsection requirement. In addition, FCIIA (30 ILCS 10/1002) makes the President responsible for establishing and maintaining an effective system of internal control.

1. UI Already Complies

Enhanced Financial Disclosures (Title IV, Section 404)(cont'd)

- Each annual report to the SEC shall contain an internal control report which contains an assessment, as of the end of the fiscal year, of the effectiveness of the internal control structure and procedures of the company for financial reporting.

U of I – Annually, a survey is sent to key administrators requesting their input and feedback on the effectiveness of the internal control process. This year's survey had 72 questions covering all major business processes.

1. UI Already Complies

Enhanced Financial Disclosures (Title IV, Sections 406, 407)

- Each company must disclose whether it has adopted a code of ethics for its senior financial officers and the contents of the code.

U of I - The University's code of conduct

(<http://ethics.uillinois.edu/Code-of-Conduct.htm>) has been adopted for those acting on behalf of the University including executive officers.

- Each must disclose whether at least one member of the audit committee is a “financial expert.”

U of I - Board members' backgrounds and expertise are available on the University website.

2. Recommended Changes

- **Establish a charter for the Board Audit Committee with appropriate SOX-related responsibilities. The charter should provide that the Committee will:**
 - *Adopt a risk-based assessment approach with the goal of strengthening internal controls*
 - *Meet periodically with the External Auditors to approve the audit plan and to accept the audit report*
 - *Meet regularly with the University's internal auditor*
 - *Consider and approve the use of audit firms other than the State-appointed External Auditors*
 - *Receive and review "complaints" logged via the Ethics Officer's toll-free Help Line*
 - *Report periodically to the full Board*

2. Recommended Changes (cont'd)

- **Update Disclosure of Wrongful Conduct and Protection from Reprisal policy.**

Current policy needs updating to specifically include complaint procedures for accounting and auditing matters.

2. Recommended Changes (cont'd)

- **University and departmental policies on record retention should be reviewed and updated in view of the recent implementation of BANNER.**

2. Recommended Changes (cont'd)

- Consider a project to assess the effectiveness of the internal control structure and procedures of the company for financial reporting per Section 404.

Deloitte & Touche, LLP has suggested that a university can begin assessing the adequacy and documentation of its internal controls by identifying the business processes that: are the most problematic; present the most compliance risk; or, have the most significant impact within the organization.

2. Recommended Changes: Sec. 404 (cont'd)

One approach would be to:

- *Identify the business processes to be addressed*
- *Consider the control structure across the departments and functions that affect those business processes*
- *Pre-identify business tasks within the business process*
- *Map these tasks to the related financial reporting and compliance risks, the associated control objectives, and ultimately to the various control procedures being performed*

2. Recommended Changes: Sec. 404 (cont'd)

- *This approach would allow:*
 - *Tracking of control activities to the risks being mitigated*
 - *Management to gain an institution-wide view of the control design*
- *This approach would support:*
 - *Clear assessment of adequacy of controls*
 - *Identification of gaps in the control design*
 - *Identification of redundant control activities,*
 - *Identification of areas where business processes efficiencies can be obtained*

3. Inapplicable Provisions

Auditor Independence (Title II, Sections 202, 206)

- **Audit committee must pre-approve all services provided by the audit firm.**

U of I -The OAG provides requisite pre-approval; Audit Committee is not involved.

- **Public accounting firm must report to the audit committee.**

U of I - The public accounting firm reports to the OAG.

3. Inapplicable Provisions

- **Public Company Accounting Oversight Board (Title I)**
- **SEC Restrictions on who may serve as Officer/Director (Title III)**
- **Security Analyst Conflicts of Interest (Title V)**
- **SEC Resources and Authority (Title VI)**
- **Public Accounting Firm Studies and Reports (Title VII)**
- **Corporate and Criminal Fraud Accountability (Title VIII)**
- **White Collar Crime Penalty Enhancements (Title IX)**
- **Signing Requirement for Corporate Tax Returns (Title X)**
- **Corporate Fraud and Accountability (Title XI)**