A REPORT
TO THE
**ARIZONA LEGISLATURE**

Financial Audit Division

Report on Internal Control and Compliance

# University of Arizona

Year Ended June 30, 2009


**Debra K. Davenport**
Auditor General

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# University of Arizona
# Report on Internal Control and Compliance
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## Report Issued Separately

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

# Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Arizona Board of Regents

We have audited the financial statements of the business-type activities and aggregate discretely presented component units of the University of Arizona as of and for the year ended June 30, 2009, which collectively comprise the University's financial statements, and have issued our report thereon dated October 28, 2009. Our report was modified to include a reference to our reliance on other auditors. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the aggregate discretely presented component units, the University of Arizona Foundation, Inc., the University of Arizona Alumni Association, the Law College Association of the University of Arizona, and the Campus Research Corporation, as described in our report on the University's financial statements. The financial statements of the aggregate discretely presented component units were not audited by the other auditors in accordance with *Government Auditing Standards*. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

## Internal Control over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control. We consider items 09-01 through 09-03 described in the accompanying Schedule of Findings and Recommendations to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Managements' responses to the findings identified in our audit have been included herein. We did not audit managements' responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Arizona Board of Regents, the University, and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Debbie Davenport
Auditor General

October 28, 2009

## Component Unit Findings

The other auditors who audited the Law College Association of the University of Arizona, the Campus Research Corporation, and the University of Arizona Alumni Association reported the following significant deficiencies for those component units.

### 09-01
### Law College Association
### Audit Adjustments

For the year audited, audit adjustments were required for the financial statements to be materially correct at year-end. Although auditors are permitted to draft an organization's financial statements, the preparation of the underlying general ledger, which is used to prepare the financial statements, including the footnotes, is the responsibility of management. The unadjusted general ledger was not materially correct under generally accepted accounting principles. We recommend that the Association have appropriate processes in place to properly reconcile the general ledger throughout the year and especially at year-end, prior to audit fieldwork, as part of the year-end closing process. This is a repeat comment.

*Management response*: There were six adjusting journal entries made during the audit. Following is a brief description of the adjustments:

- Two of these adjustments were given to the auditors prior to the start of field work but after the trial balance was provided to the auditors. The Association asked the auditors if they wanted the adjustments posted and the trial balance resubmitted. They declined because they had already entered the trial balance into their system. One of the adjustments was a reclassification between realized and unrealized gains and losses on investments. The total loss recorded was correct. The other was to record $4,047 of depreciation expense.
- Of the remaining four adjustments, three were prior period adjustments. Two of those were valuation adjustments, one for land ($600 reduction in value) and the other for an interest in a partnership ($39,525 reduction in value). The land and the interest in the partnership have been carried on the books for approximately the same value for a number of years. This year it was determined that they should be revalued because of changes in accounting pronouncements. Even though the valuation of the partnership was reduced to zero, the Association will continue to receive its share 0.347261% profit from a $5,415,715 note receivable ($3,867,064 deferred gain) plus interest on the note. The remaining prior period adjustment was to record a $35,000 balance from a pledge made in 2004. The Association discovered the discrepancy during the 2008/2009 fiscal year and recorded the pledge balance. The auditor requested that the Association record it in a prior year.
- The final adjustment was reclassification of net assets between unrestricted, temporarily restricted and permanently restricted that we do as part of the year-end audit. The result of this adjustment was to move $19,928 out of permanently restricted net assets, $9,428 and $10,500 to unrestricted net assets and temporarily restricted net assets respectively.

The net result of all adjustments was to reduce total net assets by $39,047 in fiscal year 2008/2009 or 0.10% of the $37,882,027 total net assets, reduce total net assets by $5,125 in prior years, reduce revenue in the 2008/2009 fiscal year by $35,000 (increased in a prior year) and increase expenses by $4,047.

09-02
Campus Research Corporation
Financial Statement Preparation

Campus Research Corporation, like many nonprofit organizations, has historically relied upon its auditors to draft its annual financial statements and required disclosures as part of the year-end audit process. Upon completion of audit fieldwork management has reviewed and approved any adjustments made to the general ledger, and then the audited financial statements have been subjected to review and approval by management and the organization's Audit Committee prior to issuance.

U.S. generally accepted auditing standards require management be responsible for the preparation of an organization's financial statements and all required disclosures in accordance with U.S. generally accepted accounting principles (GAAP). Accordingly, to comply with these standards an organization must not only have accounting personnel that have expertise in the area of financial reporting standards, but a system in place that ensures on-going training for its personnel in the area of financial reporting and the necessary reference materials or other resources to ensure compliance with financial reporting standards.

While the Organization's accounting personnel possess the level of skill necessary to produce the basic financial statements, they lack the technical expertise needed to ensure compliance with the current reporting standards promulgated in GAAP. Further, the organization does not have the necessary technical reference materials and resources needed to ensure the propriety and completeness of all of the required financial disclosures applicable to its financial statements. We believe these resource limitations would limit the organization's ability to comply with the requirements as outlined and as such would be deemed an internal control deficiency with respect to the financial reporting control.

We acknowledge that this is an element of internal control embodied in the new standards that may be difficult for some organizations to overcome. For many organizations like Campus Research Corporation, financial constraints make it more cost effective to rely on its auditors for this technical expertise. This item was communicated in the 2008 audit.

*Management response*: We have an extremely small and limited staff at Campus Research Corporation, but we do provide Management monthly and year-end financial reports. Our annual audited financial statements and footnotes are outsourced to our auditors because of the cost/benefit standpoint and our auditors have direct knowledge that aids in preparing the annual audited financial statement package. Our trial balance and financial package is used for basis in the preparation of annual audited financial statement package.

09-03
Alumni Association
Review Procedures

During the year ended June 30, 2009, we noted that bank reconciliations, investment activity, and non-standard journal entries were not being reviewed by the Chief Financial Officer. In order to enhance segregation of duties controls and to ensure accuracy of non-standard journal entries, we recommend that bank reconciliations, investment activity and non-standard journal entries posted be reviewed and approved by the Chief Financial Officer.

*Management response*: Effective immediately, procedures will be implemented in which the Chief Financial Officer's approval of non-standard journal entries are required prior to such entries being posted. In addition, monthly review of the bank and investment account reconciliations will be made part of the month-end closing procedures to be performed by the Chief Financial Officer.