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Office of the Auditor General
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<u>M E M O R A N D U M</u>

TO: State Universities, University Auditors, and University Audit Managers

FROM: Jane Clark, Director of Financial and Compliance Audits

DATE: September 6, 2022

SUBJECT: Matters Regarding the *University Guidelines* and Financial Audits

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Our prior memorandum dated July 25, 2000, on "Matters Regarding University Audits" is hereby rescinded. The contents of the prior memorandum have been restated or replaced by this guidance, effective immediately for periods beginning on or after July 1, 2021. The following contains:

A. policy decisions and interpretations by the Auditor General regarding the *University Guidelines* (*Guidelines*) adopted by the Legislative Audit Commission;
B. supplementary information (SI) and other information (OI) which must be disclosed in the university's financial audit report; and,
C. additional disclosures in each university's financial statements which are necessary to ensure compliance with the *Guidelines* and to support Statewide financial reporting.

A. Policy Decisions and Interpretations of the *Guidelines*

1) When computing the working capital allowance, the highest month's disbursements should not include any expenditures made directly from State appropriated funds or expenses from the university's special funding situation for pensions and other postemployment benefits and on-behalf payments, such as group insurance paid for by the State. The purpose of the *Guidelines* is to allow a certain sum within certain locally held funds to meet the entity's needs. As neither State appropriated expenditures or expenses from the university's special funding situation for pensions and other postemployment benefits or on-behalf payments draw down a fund's equity, this activity should not enter into this calculation. (from 2000 Memo Item 1)

2) When the *Engineering News Record's* replacement index is used to calculate allowable reserves, our auditors will rely upon the Building Cost Index and the City of Chicago index figures, if available. If demonstratively unavailable, the university will have the burden of

showing its selected index is substantially similar to the *Engineering News Record's* index. (from 2000 Memo Item 2)

3) If a university contracts with a University Related Organization (URO) for fundraising services and the proceeds of those fundraising services are retained by the URO, a finding should result unless the URO reimburses the university for the fundraising services using funds considered to be unrestricted for the purposes of the *Guidelines*. (from 2000 Memo Item 3)

4) A URO may be considered as compensating the university for exchange and exchange-like transactions the university provides to the URO by giving funds to the university from those assets without donor-imposed restrictions from those UROs following the financial reporting standards of the Financial Accounting Standards Board (FASB) or unrestricted assets from those UROs following the financial reporting standards of the Governmental Accounting Standards Board (GASB). (from 2000 Memo Item 4)

5) If a URO is holding donated funds "on behalf" of the university, those funds should appear as assets on the university's financial statements. (from 2000 Memo Item 5)

6) Our auditors are not responsible for "approving" calculations of excess funds under the *Guidelines* prior to an internal transfer of funds from an entity's fund to the university's Income Fund. If an internal transfer will occur for the closing fiscal year, the university should remit the cash from its entity's fund to the Income Fund no later than October 15, which is 45 days after the normal close of the State's Lapse Period. (from 2000 Memo Item 6)

7) Calculations of excess funds under the *Guidelines* prepared on forms from the *Guidelines*, along with documentation supporting any required cash transfers, must be submitted to our auditors as soon as possible after completion. These calculations, along with supporting documentation, must be retained within our auditor's public workpapers and within the university's library system with the university's financial report; however, the calculations will not be published within the University's financial audit report. Our auditors should verify, on a test basis, that these calculations and supporting documentation along with the university's financial audit report are on deposit at the university's library. (*Guidelines* Figure 2; Section IX 9B & 9D)

8) Excess funds, if any, exist as of June 30 of each year and should be appropriately reflected as liabilities in local funds and assets in the Income Fund. (See B2 below)

9) UROs may use donated funds as they see fit subject only to donor restrictions and are not subject to State procurement or travel rules. However, if the University is paying the URO to do something on its behalf, then all applicable State fiscal restrictions and compliance requirements that would apply to the university had it performed the activity itself would apply to the URO. Further, any instances of waste, abuse, or outright inefficiency should be reported as a finding. (from 2000 Memo Item 7)

10) Financial statements of each URO and the university should show the gross value of goods and services provided between each URO and the university without netting or deductions of any kind. Failure to fully reconcile activity between a URO and the university in both the URO's and university's notes to the financial statements using the format shown in Exhibit C1 should be reported as either a financial finding if the amount exceeds the passed adjustment threshold to the financial statements as a whole or as a compliance finding if the error is other than trivial. The complete and accurate presentation of inter-entity flow transactions during the fiscal year and outstanding inter-entity balances at the end of the fiscal year is critical to support the university's balances reported in the university's GAAP package, which support the State's Annual Comprehensive Financial Report. (from 2000 Memo Item 8)

11) The *Guidelines* generally prohibit creating or increasing working capital or capital reserves of auxiliary enterprises through either State appropriations or tuition from credit-bearing courses. For the sole purpose of determining compliance with this concept, the university's special funding situation for pensions and other postemployment benefits and on-behalf payments by the State for fringe benefits are not considered in these analyses. (from 2000 Memo Item 9)

12) A university does not need to distribute published financial statements for its accounting entities. However, each university must include combining schedules of its funds prepared in accordance with the current generally accepted accounting principles promulgated by the GASB, as further described in part B of this memorandum. The total columns of these two combining schedules must agree with the amounts reported for the university on the its Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Positon. As SI, these schedules will be "audited in relation to" the university's financial statements by our auditors under AU-C § 725. (from 2000 Memo Item 11)

13) The *Guidelines* state accounting entities consist of undertakings which are substantially similar and rationally related. While a given bond indenture may cover two or more entities under the *Guidelines*, such as housing and dining and parking, separate financial statements for each entity must be presented in the university's combining schedules. Each university must make fair and reasonable allocations of balances and activity split between multiple accounting entities. Our auditors should review these allocations to determine they fairly represent the economic activity of each accounting entity. (from 2000 Memo Item 12)

14) An entity with an outstanding bond indenture may have excess funds when computed under the *Guidelines*. Such excess amount shall be paid into the Income Fund only when such payment would not violate the terms of the bond indenture. (Guidelines Section V B & C1; from 2000 Memo Item 12)

15) In the case of some activities, it may not be economically feasible to determine costs paid from either appropriated funds or the Income Fund, such as personnel costs for professors' salaries or building occupancy costs. In these instances, it is acceptable for a university to prepare its entity-level financial statements excluding these costs with a footnote to explain the nature of such excluded costs. (from 2000 Memo Item 12)

16) Amounts reserved under Section IV of the *Guidelines* should be disclosed within the notes to the two combining schedules of each of its local funds and its Income Fund prepared in accordance with the current generally accepted accounting principles promulgated by the GASB, as further described in part B of this memorandum. These disclosures must describe the purposes and limitations of each reserved amount to enhance a user's understanding of the amounts reserved.

17) If the potential reserve in a local fund is more than the actual reserve amount in a local fund, this difference shall not be described as a deficit in allowable reserves or any similar phraseology. (from 2000 Memo Item 10)

18) Findings resulting from noncompliance with the *Guidelines* should be identified within the description of the finding in the report's summary. The following are examples of potential language included within the description:

> Unperformed Excess Funds Transfers (Noncompliance with the *University Guidelines*)
>
> Unallowable Subsidies Between Accounting Entities (Noncompliance with the *University Guidelines*)
>
> Diversion of Tuition Revenue from Credit-Bearing Courses to Local Funds (Noncompliance with the *University Guidelines*)

In addition, any violations of bond covenants identified by our auditors or disclosed by the university or its component units to our group auditors, in addition to any required reporting under *Government Auditing Standards*, should be identified within the description of the finding in the report's summary similar to the following: (*Guidelines* Section V A1)

> Violation of Bond Covenants (Noncompliance with the Bond Indenture Accounting Requirements of the *University Guidelines*)

19) Our auditors, as part of testing revenues and cash receipts within each university's financial audit and compliance examination, will annually test, on a sample basis and the review of entity-level reports, to ensure tuition, charges, and fees were properly deposited into the accounting entities and Income Fund in strict adherence with Section II of the *Guidelines*.

20) Interfund loans should be recorded when either a cash advance between accounting entities occurs or when an accounting entity lacks sufficient cash to meet its current obligations. As such, no accounting entity should ever show a negative cash balance. Our auditors will test to ensure no such interfund loans are outstanding for more than one year. Our auditors will consider any "stringing" of loans to avoid having a loan outstanding for more than one year as a circumvention of the *Guidelines*. (*Guidelines* Section III D1, E, & F)

21) Transfers of real property and capital asset items from accounting entities with a revenue bond indenture will be considered allowable by our auditors when either fair value has been exchanged between the involved accounting entities and/or other funds (such as the university's Income Fund) to protect the interests of the bondholders or when the university has received prior written approval of the transfer from bond counsel.

22) The *Guidelines* require certain information to be prepared and disclosed annually within each "university's financial report or supporting schedules document." Based on discussions with Mike Glenn (Senior Manager of Audit and Attest Standards) and Mary Foster (Senior Director of Governmental Auditing and Accounting) at the American Institute of Certified Public Accountants, the Illinois Office of the Auditor General is no longer including any report components or summary schedules in State compliance examination reports. As a result, we have concluded this requirement will need to be met through annual reporting as either SI and/or OI in the university's financial report.

B. SI and OI within Financial Reports Necessary to Comply with the *Guidelines*

It is important for all universities to review this document in its entirety and prepare, at a minimum, the SI and OI described herein. A university may, with the concurrence of both the university's assigned Auditor General's Audit Manager and our Special Assistant Auditors, add other SI and OI which does not create a conflict with the SI and OI described herein. Failure to prepare any of the SI and OI in accordance with this guidance within the university's financial audit report during any fiscal year will result in a finding in the university's corresponding compliance examination.

For all SI, all universities must adopt and report using current standards promulgated by the GASB, with appropriate modifications if necessary to address situations within the entity not addressed by GASB's entity-level guidance (such as inter-entity transfers between accounting entities, which must be eliminated from the university's financial statement presented as a whole).

For this SI and OI, each university must ensure the SI and OI fit on standard letter paper (8.5" by 11"). When practicable, we prefer one-inch margins. Regardless of margin size, the margin must always provide sufficient space on the edge of the sheet of paper to allow for report binding during the printing process. Each university is also responsible for using a font size and type that is easily read and reproduced.

1) **Table of Operating Expenses** (necessary to show expenses split between the State and the university)
   Each university must prepare and present as SI within its financial audit report the Table of Operating Expenses in the prescribed format (Exhibit B1) for the current fiscal year.

2) **Combining Schedules and Related Notes** (*Guidelines* Section I A & B; Section II E; Section III C, D2, & D3; Section IV; Section V A2; Section IX B)
   Each university must prepare and present as SI within its financial audit report combining schedules along with footnote disclosures for the University's various accounting entities. The combining schedules build up from the accounting entities into the University-wide financial statements based on the following combining schedules by campus:

1) Combining Schedule of Auxiliary Enterprises – Revenue Bonds
2) Combining Schedule of Auxiliary Enterprises – No Revenue Bonds
3) Combining Schedule of Activities – Revenue Bonds
4) Combining Schedule of Activities – No Revenue Bonds
5) Combining Schedule of the Income Fund and State Treasury Funds

Each of these combining schedules will add together, after accounting for adjustments and eliminations displayed in a separate column, into a total column for each category. If the university only has one campus, the total column from each of the five combining schedules would be displayed together along with the indirect cost entity on an additional combining schedule that, after accounting for adjustments and eliminations in a separate column, would sum together to equal the amounts reported in the University's Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position. If the university has multiple campuses, the total column from each of the five combining schedules would be displayed together along with the indirect cost entity on an additional combining schedule that, after accounting for adjustments and eliminations in a separate column, would sum together to equal the amounts for that campus. Then, the total column from each of the campuses would be displayed together onto another additional combining schedule that, after accounting for adjustments and eliminations in a separate column, would sum together to equal the amounts reported in the University's Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position.

A display of how these combining schedules relate to each other is available (Exhibit B2).

In addition, each University must prepare a single set of notes to the combining schedules (presented after all of the combining schedules) with sufficient details to ensure a user can understand the information presented within the combining schedules. At a minimum, the notes must include:

1) a description of each accounting entity with its purpose, sources of revenues, and uses of resources;
2) the purposes and limitations of each established reserve, along with any changes to the reserve which occurred during the fiscal year and the ending balance of the reserve;
3) a disclosure the university's income from deposits and investments have either been allocated to the entity or source of funds generating the investible cash with any remaining balances allocated to the university's Income Fund or pooled deposits and investments have been allocated and credited to the original source of funds to the extent practicable with any unallocated investment income deposited into the university's Income Fund; and,
4) the amount of allocated and unallocated indirect cost reimbursements not reported as liabilities as of the end of the fiscal year (this amount should sum to the total net position equity balance in the indirect costs accounting entity).

3) **Cost Statistics** (from 2000 Memo Item 13s)

Each university must prepare and present as OI within its financial audit report two cost statistics calculations in the prescribed format (Exhibit B3) for the current fiscal year. Both of these methods have been vetted with officials at the State of Illinois, Board of Higher Education.

4) **Summary of Transactions with the UROs** (*Guidelines* Section VI)
Each university must prepare and present as OI within its financial audit report a summary of its fund raising transactions with each URO in the prescribed format (Exhibit B4) which occurred during the current fiscal year. This disclosure must include any unreimbursed subsidies by the University to the URO as of the end of the fiscal year.

5) **Tuition Waivers** (*Guidelines* Section II D)
Each university must prepare and present as OI within its financial audit the value of tuition waivers granted to both undergraduate and graduate students by campus in the prescribed format (Exhibit B5) during the current fiscal year.

C. Additional Footnote Disclosure within Financial Reports

1) **URO Disclosures** (*Guidelines* Section VI A-F)
The university and each of its UROs must prepare an independent footnote disclosure in both the URO's and university's notes to the financial statements showing inter-entity flow transactions during the fiscal year and outstanding inter-entity balances at the end of the fiscal year by specific account using the prescribed format (Exhibit C1). This presentation should be made by account (receivables, payables, etc.) and not at some higher level (such as current assets, current liabilities, etc.).

2) **Summary of Significant Accounting Policies** (*Guidelines* Section VI A-F)
Each university must disclose each of its UROs recognized under the *Guidelines* and any independent organizations. In the event a university does not have either any UROs or any independent organizations, the university must disclose they do not have any UROs or any independent organizations.

3) **Certificates of Participation** (*Guidelines* Section IX C)
Each university, if it has issued new certificates of participation or participated in lease or purchase arrangements involving certificates of participation during the fiscal year under audit, must describe the transaction or arrangement entered into within the appropriate footnote disclosure within the financial statements.

4) **Real Estate Acquisitions** (*Guidelines* Section VI I2; Section IX A)
Each university must disclose its acquisition of any real estate in excess of $250,000 which was not funded by a separate appropriation from the State specifically for the real estate so acquired, if any such events occurred during the fiscal year. In addition, each university must disclose either the acquisition or acceptance by its UROs of any real estate with an acquisition cost or fair value in excess of $250,000, if any such events occurred during the fiscal year. The university must include these disclosures as part of an appropriate footnote disclosure within its financial statements, such as within the university's or its component

unit's/units' capital assets, pledged receivables, or investments note. The acquired real estate should be described in sufficient detail for a user to easily identify the property and understand the essential terms of the agreement.

5) **<u>Debt Financing by UROs</u>** (from 2000 Memo Item 13p)
For each URO, the component unit's/units' debt footnote within the university's financial statements must include a disclosure of and description of debt issued by each URO which conforms with the current formatting of debt disclosures required by the GASB.