

EASTERN MICHIGAN UNIVERSITY

**Sarbanes-Oxley Act of 2002
Compliance Briefing**

March 16, 2004

Section	Sarbanes-Oxley Act of 2002	NACUBO Recommendations	EMU Policy/Practice
Title I	Public Company Accounting Oversight Board		
101 – 109	Describes public company accounting oversight board duties	<i>Not Applicable</i>	<i>Not Applicable</i>
Title II	Auditor Independence		
201	<p>Public accounting firms are prohibited from performing these non-audit services to financial statement audit clients:</p> <ol style="list-style-type: none"> 1. Bookkeeping or other services related to the accounting records or financial statements; 2. Financial system design and implementation; 3. Appraisal or valuation services, fairness opinions, or opinions contribution in kind reports; 4. Actuarial services; 5. Internal auditing outsourcing services; 6. Management or human resource functions; 7. Broker or dealer, investment adviser, or investment banking services; 8. Legal services and expert services unrelated to the audit; 9. Any other service the Accounting Oversight Board determines, by regulation, is permissible. <p>A registered public accounting firm may engage in any other service, including tax services for an audit client, but only</p>	<p>Institutions should prohibit their independent auditors from providing the non-audit services prohibited by the Act unless extenuating circumstances exist and the audit committee approves the work in advance.</p>	<p>EMU’s external auditors <u>do not</u> perform any non-audit services.</p> <p>Proposed changes to the Board’s “Selection of External Auditors” policy specifically prohibit non-audit services by external auditors without prior Board approval.</p> <p>EMU complies with Section 201.</p> <p>Approval of the amended “Selection of External Auditors” policy will mandate future compliance.</p>

	if the Audit Committee approves the activity in advance.		
202	The audit committee must pre-approve all services provided by the auditor.	Institutions should require pre-approval by the audit committee for all prohibited, nonaudit services performed by the independent auditor.	<p>Currently, non-audit services are not performed by EMU’s external auditor.</p> <p>EMU complies with Section 202.</p> <p>Approval of the amended “Selection of External Auditors” policy and “Board of Regents Finance and Audit Committee” recommendation will mandate future compliance.</p>
203	The lead (or coordinating) audit partner and the reviewing audit partner of the public accounting firm must rotate off the audit every five years.	Institutions should require a rotation of the lead partner every seven years with a timeout of two years.	<p>The recently amended “Selection of External Auditor” policy requires rotation of the audit firm every five years, as opposed to rotation of the lead audit partner, and therefore is more stringent than the Act requirement or NACUBO recommendation.</p> <p>The proposed amendment to the Board’s “Selection of External Auditors” policy adheres to NACUBO’s recommended standards for mandatory lead partner rotation every seven years with a timeout of two years.</p> <p>Upon approval of the proposed amendments to the “Selection of External Auditor” policy, EMU will comply with NACUBO’s recommendation.</p>
204	<p>The public accounting firm must report to the audit committee:</p> <ol style="list-style-type: none"> 1. All critical accounting policies and practices used by the client 	<p>Audit committee oversight is critical to ensure the independence of the audit decisions.</p> <p>The audit engagement letter should be</p>	The external auditors make these required communications on an annual basis when presenting the audited financial statements to the Board of Regents Finance Committee, as required by auditing standards.

	<p>that have been discussed with management;</p> <p>2. All alternative treatments of financial information, ramifications of such use, and the treatment preferred by the public accounting firm;</p> <p>3. Other material written communication between the public accounting firm and management, such as the management letter or schedule of unadjusted differences.</p>	<p>addressed to the audit committee rather than internal management.</p>	<p>The proposed amended “Selection of External Auditors” policy formally requires these communications to take place. In addition, the proposed amended policy requires that the engagement letters be approved by the Board, as recommended by NACUBO.</p> <p>EMU complies with section 204.</p> <p>Approval of the proposed amendments to the “Selection of External Auditor” policy will mandate future compliance.</p>
205	<p>Conforming amendments to the SEC Act of 1934</p>	<p><i>Not Applicable</i></p>	<p><i>Not Applicable</i></p>
206	<p>The public accounting firm cannot have employed the CEO, Controller, CFO, chief accounting officer, or any person in an equivalent position, during the one-year period preceding the audit.</p>	<p>Institutions should carefully consider the benefits of employing a CFO or controller who has worked for the auditing firm within the last year and consider how the position may relate to the institution’s external audit. To forego the one-year waiting period, institutions should document the benefits and risks and seek board approval.</p>	<p>No current financial leadership positions (CEO, CFO, Controller, Chief Accounting Officer) are held by former external audit firm employees.</p> <p>The proposed amended “Selection of External Auditors” policy formally restricts these types of relationships without prior Board approval.</p> <p>EMU complies with section 206.</p> <p>Upon approval of the proposed amendments to the “Selection of External Auditor” policy, compliance will be mandated.</p>
207	<p>The GAO will do a study on the potential effects of mandatory rotation of public accounting firms.</p>	<p>The current emphasis is on rotation of audit partners (section 203) rather than rotation of firms. The audit committee should annually evaluate the performance of the external auditor. In addition, the</p>	<p>See Section 203 as it relates to rotation of audit partners as opposed to audit firms.</p> <p>The proposed amended “Selection of External Auditors” policy provides for the annual</p>

		committee should consider periodically recompeting the selection of the external audit firm.	evaluation of the auditors by the Board. In addition, competitive bids are required every five years. Upon approval of the proposed amendments to the “Selection of External Auditor” policy, EMU will comply with Section 207.
208 – 209	SEC final authority for Section 10A and considerations by appropriate State regulatory authorities.	<i>Not Applicable</i>	<i>Not Applicable</i>
Title III	Corporate Responsibility		
301	<ol style="list-style-type: none"> 1. The Commission may prohibit the listing of securities of any firm found not to be in compliance with paragraphs 2-6 of this section. 2. The audit committee shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by its company and the public accounting firm shall report directly to the audit committee. 3. Each member of the audit committee shall be a member of the Board of Directors and shall otherwise be independent. Independent is defined as not receiving, other than for service on the Board of Directors, any consulting, advisory, or other compensatory fee from the company, and not being an 	<p>Institutions that do not have an audit committee should assign the audit function to another committee of the board of trustees, for example, the finance committee, or to the board as a whole. Institutions that assign audit committee functions to another committee should add “audit” to the committee title, for example, “Finance and Audit” committee</p> <ol style="list-style-type: none"> 1. Not applicable 2. Audit committee involvement is critical in the selection of auditors and the performance of the audit. 3. Independence of audit committee members is important. Management representatives should not be voting members of the committee. 4. A good practice would be the establishment of confidential complaint mechanisms for 	<p>The Finance Committee of the Board of Regents has traditionally performed the role of an audit committee. As a formal recommendation, the Finance Committee is to be renamed the “Finance and Audit Committee” with the specific corporate responsibilities as outlined in the Act and some NACUBO best practices described in the Board recommendation.</p> <p>Upon approval of the recommendation “Board of Regents Finance and Audit Committee” EMU will comply with Section 301.</p>

	<p>affiliated person of the company.</p> <ol style="list-style-type: none"> 4. The audit committee shall establish procedures for; a. ‘The receipt, retention and treatment of complaints received by the company regarding accounting, internal controls and auditing matters. B. The confidential, anonymous submission by employees of questionable accounting or auditing matters. 5. The Audit Committee shall have the authority to engage independent counsel or other advisors, as necessary to carry out its duties. 6. Each company shall provide appropriate funding as determined by the Audit Committee for payment to the public accounting firm and any advisors employed by the Audit Committee under paragraph 5 above. 	<p>employees; for example, a hot line, anonymous e-mail/voice mail, secure complaint boxes, or extending existing employee grievance processes or communications channels to the institution’s internal auditors. The audit committee should review the nature and disposition of reported matters.</p> <ol style="list-style-type: none"> 5. The audit committee should have all necessary authority contained in its charter. 6. The charter should also specify that appropriate funding be available for the audit committee. 	
302	<p>The CEO and CFO shall certify along with the annual audit report that:</p> <ol style="list-style-type: none"> 1. They have reviewed the report; 2. Based on their knowledge, the report does not contain any untrue statement of a material fact or omission of a material fact that makes the statements misleading; 3. Based on their knowledge, the 	<p>The provisions of the Act extend the current audit representation letter responsibilities. If institutions publicly disclose financial statements, they should consider these assertions. However, be warned that assertion 4 includes new and complex affirmations on the adequacy of internal controls over both financial reporting and financial disclosures.</p> <p>The degree of decentralization of</p>	<p>The EMU President (CEO), Vice President for Business and Finance (CFO), Assistant Vice President and Controller, and General Counsel annually sign a “representation letter” affirming that the University’s administration is responsible for the fair presentation of the financial statements, all financial data has been made available to the auditors, there has been no fraud or violation of law involving management who have a significant role in internal controls or that</p>

	<p>financial statements present in all material respects the financial condition of operations;</p> <p>4. They are responsible for establishing and maintaining internal controls, ensuring that material information relating to the company and its consolidated subsidiaries is made known to officers and others within those entities; have evaluated the effectiveness of internal controls within 90 days prior to the report; and have presented their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;</p> <p>5. They disclosed to the auditors and the audit committee all significant deficiencies and material weaknesses in the internal controls that could adversely affect the company's ability to record, process, summarize, and report financial data;</p> <p>6. They have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions.</p>	<p>financial operations is an important consideration for higher education. Business units' responsibility for financial reporting should be clearly defined, including policies for those activities. Institutions that are decentralized should consider implementing "sub-certification" requirements from financial leaders responsible for the financial results of units, departments, or schools. The sub-certification provides assurance on the underlying numbers and controls.</p> <p>Institutions should start documenting their financial reporting process; and identifying and evaluating the adequacy of controls over financial reporting and other financial disclosures.</p> <p>The audit committee should consider periodic inquiries of financial executives on the adequacy of controls.</p>	<p>would materially impact presentation of the financial statements, etc.</p> <p>In addition, the President has stated the following in his cover letter published with the annual financial statements:</p> <p>"I give my personal oath that these financial statements reflect the true and accurate picture of Eastern Michigan University."</p> <p>A certification and sub-certification process, as suggested by NACUBO, is being developed for implementation with the fiscal 2004 audited financial statements.</p> <p>Similar to the internal audit review of compliance with the conflict of interest policy, consideration should be given to having the internal auditors review the certifications and sub-certifications for compliance with the procedure under development prior to the publication of the audited financial statements.</p>
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	Reincorporating outside of the United States does not lessen the requirements of Section 302.		
303	It is unlawful for any officer or director of a company to take an action to fraudulently influence, coerce, manipulate, or mislead an auditor engaged in the performance of an audit for the purpose of rendering the financial statements materially misleading.	This should be addressed in the institutions code of conduct/code of ethics.	<p>The current code of ethics policy applies only to the Board of Regents. Currently, employees are not covered by this policy.</p> <p>In the absence of an employee code of ethics, NACUBO’s code of ethics for Business Officers is attached and has been agreed to and signed by the interim Vice President for Business and Finance and Treasurer to the Board and the Interim Assistant Vice President and Controller.</p> <p>Similar to the internal audit review of compliance with the conflict of interest policy, consideration should be given to having the internal auditors review a revised code of ethics for compliance with a revised code of ethics policy.</p>
304	If an accounting restatement is necessary due to misconduct, the CEO and CFO shall reimburse the company for any bonus or other incentive or equity-based compensation received by that person during the 12 month period following the issuance of the financial statements, as well as reimburse the company for any profits realized from the sale of securities of the company during the same 12 month period.	<i>Not applicable.</i> However, the audit committee may want to review compensation arrangements for the CEO and CFO. Incentives related to financial results should be disclosed to the audit committee.	<p>Neither the President (CEO) nor the Vice President for Business and Finance (CFO) are compensated specifically based on financial results.</p> <p>In the “Board of Regents Finance and Audit Committee” recommendation, it is noted that “the compensation arrangements for the President and Vice President for Business and Finance should be reviewed by the Audit Committee with incentives related to financial results being disclosed to the Audit</p>

			<p>Committee,” in response to NACUBO’s recommendation.</p> <p>Upon approval of the “Board of Regents Finance and Audit Committee” recommendation, EMU will comply with NACUBO’s recommendation.</p>
305	The SEC may issue an order to prohibit, conditionally or unconditionally, permanently or temporary, any person who has violated section 10(b) of the 1934 Act from acting as an officer or director of a company if the SEC has found that such person is unfit.	<i>Not applicable.</i> However, institutions should consider any SEC action in connection with hiring officers and nominating trustees; and ensure that employment contracts of senior officers allow removal for financial impropriety.	<p>Employment contracts and the University’s at-will policy provide for removal of senior administrators if financial improprieties exist.</p> <p>EMU complies with Section 305.</p>
306 – 308	Concerns sales of stock, fair funds for investors and attorneys practicing before the SEC.	<i>Not Applicable</i>	<i>Not Applicable</i>
Title IV	Enhanced Financial Disclosures		
401	SEC shall study off-balance sheet disclosures to determine their extent and whether GAAP results reflect the economics of such transactions	Higher education should follow current and appropriate accounting standard guidance (i.e. FASB, GASB).	<p>EMU operates and reports under the GASB accounting standard guide.</p> <p>EMU has several “off-balance sheet” disclosures of note:</p> <ol style="list-style-type: none"> 1. Other post employment benefits (OPEB, primarily post-retirement health care benefits and life insurance) have been actuarially determined to be approximately \$4.8 million. This liability is not yet required by GASB to be funded or included on the balance sheet, however, it is noted in the footnotes (#6) to the financial statements. 2. The University has defeased debt of

			<p>approximately \$43.5 million at June 30, 2003. Defeased debt is that which has been refinanced but held in trust by a third party until the debt is liquidated. Neither the assets nor the liabilities are the responsibility of the University, and therefore are not recorded on the balance sheet, however, the defeased debt is noted in the footnotes (#5) to the financial statements.</p> <ol style="list-style-type: none"> 3. The MPSERS assets and liabilities related to both pension and health insurance benefits for retirees are on the State of Michigan's balance sheet. A case could be made in the future that these should be recorded on the University's balance sheet. We would be strongly opposed to this. The value of these assets and liabilities related to EMU retirees is not known. 4. Effective with fiscal year 2004, GASB Statement 39 requires the University to consolidate the Foundation into the University's financial statements, both balance sheet and income statement. Currently, only the net assets of the Foundation, \$36.9 million at June 30, 2003, are noted in the footnotes (#8) to the financial statements. <p>EMU complies with GASB reporting requirements and therefore complies with the NACUBO recommendation.</p>
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402	<p>In general, it shall be unlawful for a company to extend personal loans to any director or executive officer</p>	<p>The audit committee should be aware of and review policies on personal loans and understand that housing assistance included as part of compensation is not a personal loan.</p>	<p>EMU does not make personal loans to employees.</p> <p>EMU complies with Section 402.</p>
403	<p>Directors, officers, and 10%+ owners must report designated equity security transactions by the end of the second business day following the day the transaction was executed.</p>	<p>The audit committee should be aware of and review policies on ownership interests in related ventures of start-ups. Existing conflict of interest policies can be leveraged and should be reviewed by the audit committee</p>	<p>EMU's internal auditors annually send out copies of the conflict of interest policy, along with a disclosure statement to senior administrators and Regents. The internal auditors annually report the results of their review of the disclosure statements to the Board of Regents.</p> <p>EMU complies with Section 403.</p>
404	<p>Each annual report shall contain an internal control report, which:</p> <ol style="list-style-type: none"> 1. States the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and 2. 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 <p>The public accounting firm shall attest to and report on the internal control assessment made by management.</p>	<p>Identifying, designing and maintaining controls and procedures that safeguard assets and minimize risk is sound business practice. A good business practice would be to start planning how an internal control assessment might be conducted. A few institutions have started doing risk assessments and documenting key financial processes. The audit committee should consider independence issues if contemplating using the external auditor for this review function. For reference, institutions can obtain a copy of the Committee of Sponsoring Organizations (COSO) model of an internal control framework. The COSO model is considered the most widely accepted model for controls.</p> <p>Institutions with internal audit departments should consider using them</p>	<p>Internal controls are in place at EMU. Some examples include:</p> <ol style="list-style-type: none"> 1. A comprehensive internal audit schedule reported on at each Board of Regents meeting. The schedule includes a regular rotation of audits of cash receipts, cash disbursements, investment management, various auxiliary activities, etc. 2. Positive pay (a banking control) used for disbursement accounts. 3. ICT standards, procedures and specific staffing for data security management. 4. All bank and investment accounts reconciled monthly. 5. Monthly budget report monitoring to compare budget to actual. 6. The investment committee meeting biweekly to analyze investment and banking activity. 7. Authorized signers on bank and

		<p>to periodically report on internal controls to the audit committee in addition to reporting to management. These activities should be coordinated with the risk assessment and internal control initiatives described above.</p> <p>The results of the internal control assessment should be tested to ensure compliance. A positive assertion on controls would require a large sustained effort and would require the external auditor to perform an attestation on internal controls, which would be expensive and time consuming. NACUBO does not recommend external auditor attestation or audit of internal controls. An alternative would be for management to provide the assertions and testing without the external audit attestation.</p> <p>NACUBO encourages institutions to take this topic seriously and start planning how an internal control assessment might be conducted. NACUBO will monitor the actions of institutions and communicate discoveries. At this point NACUBO and the APC are not aware of any institutions that have committed to this positive assertion on controls</p>	<p>investment accounts are limited related to transfers and redemptions.</p> <p>8. Multiple external audits (financial statement, WEMU, NCAA, A133, etc).</p> <p>Noting the value of further internal control assessment, yet the lack of movement toward positive assertion in higher education, EMU is waiting on further guidance from NACUBO, as noted.</p>
405	Sections 401, 402, and 404 do not apply to any investment company registered under section 8 of the Investment Company Act of 1940	<i>Not Applicable</i>	<i>Not Applicable</i>

406	Requires each company to disclose whether it has adopted a code of ethics for its senior financial officers and the contents of the code of ethics.	A best practice is the adoption of a code of ethics for senior financial officers. Subsequently, the audit committee should review the adequacy of the code and periodically review how compliance is assured.	See Section 303.
407	<p>Companies are required to disclose whether at least one member of the audit committee is a “financial expert”.</p> <p>The final rule also provides a definition of a financial expert. In the final rule, recognition was given that an audit committee financial expert can acquire the requisite attributes of an expert in many different ways and that experience, in addition to education, is an important consideration.</p>	<p>A best practice would be the inclusion of at least one financial expert on the audit committee. Institutions should consider the following in defining financial expertise:</p> <ol style="list-style-type: none"> 1. familiarity with estimates, accruals, and reserves relevant to higher education 2. longevity and experience with a given institution can be considered “other relevant experience” <p>Colleges and universities should also consider rotating the financial expert and begin planning for the process and cost of recruiting, training and retaining financial expertise.</p> <p>The recruitment and retention of a financial expert by public institutions might be limited when alumni or elected officials appoint the board.</p>	The Board of Regents should determine who its designated financial experts are based on NACUBO’s recommended qualifications and ensure at least one is a member of the Finance and Audit Committee.
408 – 409	Addresses enhanced and real time disclosure by issuers of securities	<i>Not Applicable</i>	<i>Not Applicable</i>
Title V	Analyst Conflict of Interest		
501	Treatment of security analysts by registered securities associations and national security exchanges	<i>Not Applicable</i>	<i>Not Applicable</i>

Title VI	Commission Resources and Authority		
601 – 604	Appearance and practice before the SEC, funding, federal court authority and qualifications of brokers and dealers.	<i>Not Applicable</i>	<i>Not Applicable</i>
Title VII	Studies and Reports		
701 – 705	Concerns studies regarding accounting firms, credit rating agencies, violators, violations, investment banks, financial advisors, and enforcement of securities laws	<i>Not Applicable</i>	<i>Not Applicable</i>
Title VIII	Corporate and Criminal Fraud Accountability		
801 – 807	Discusses securities fraud, penalties, statute of limitations, sentencing, and employee protection.	<i>Not applicable</i> , however regarding section 802, a good practice would be to ensure that documents and records sent or received in connection with the audit are retained for seven years.	EMU has a practice of storing records related to audits for a minimum of seven years. EMU complies with NACUBO’s recommendation. Approval of the amended “Selection of External Auditors” policy will mandate future compliance.
Title IX	White Collar Crime Penalty Enhancements		
901 – 906	This section advances criminal penalties for fraudulent acts and the US Department of Justice jurisdiction of financial statement certification. The certification requirement under section 906 is separate from the requirement under sections 302.	<i>Not Applicable</i>	<i>Not Applicable</i>
Title X	Corporate Tax Returns		
1001	The chief executive officer, per the “sense of the senate” should sign the federal income tax return of a corporation.	Institutions should review the level of authority of signers on the various tax returns; a senior financial manager with financial accountability for the	There are two tax returns prepared and submitted by EMU: 1. The Employer’s Quarterly Federal

		information presented on the tax return should sign the return.	<p>Tax Return, form 941, is prepared in the Payroll Office and signed by the Assistant Vice President and Controller.</p> <p>2. The Exempt Organization Business Income Tax Return, form 990T, is prepared in the Accounting Department, reviewed and compiled by the external auditor and signed by the Vice President for Business and Finance.</p> <p>EMU complies with the NACUBO recommendation.</p>
Title XI	Corporate Fraud Accountability		
1001 – 1004	Discusses fines, consequences, and sentencing for individuals and issuers.	<i>Not Applicable</i>	<i>Not Applicable</i>
1005	Gives the SEC the authority to prohibit anyone convicted of securities fraud from being an officer or director of any publicly traded company.	Institutions should consider securities fraud convictions relevant in background checks for new employees.	<p>Background checks for State criminal convictions are done on all regular and temporary staff positions upon hire through the Michigan State Police website.</p> <p>If requested by a departmental hiring authority, a more indepth background check is available (e.g. senior financial positions).</p> <p>More research into background check standards and best practices is under way.</p>
1006 - 1007	Addresses criminal penalties under the SEC Act of 1934 and penalties for retaliation against informants	<i>Not Applicable</i>	<i>Not Applicable</i>