



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-RELATED AUDIT

*The
University of Montana
(All Campuses)*

*For the Two Fiscal Years Ended
June 30, 2009*

SEPTEMBER 2009

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DIVISION

09-12

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September 2009

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-related audit report of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2009. A financial-related audit is a component of the biennial financial-compliance audit. In these audits, the financial-related and financial audits are combined for a two-year period to constitute the financial-compliance audit. We issue a financial audit report on the university's consolidated financial statements annually. We issue a financial-related audit report every other year. The fiscal year 2007-08 financial audit of The University of Montana's consolidated financial statements was issued in January 2009. The financial audit for fiscal year 2008-09 is scheduled to be issued in December 2009.

This audit report includes two recommendations related to negative cash balances and compliance with federal regulations and a disclosure issue on endowment-related investment practices.

We thank the president and the university staff for their assistance and cooperation during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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REPORT SUMMARY

The University of Montana (All Campuses)

We performed a financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2009. The previous report for the two fiscal years ended June 30, 2007, contained five recommendations. The university implemented three, partially implemented one and did not implement one of the recommendations.

This report contains two recommendations directed to the university. The first recommendation addresses the need for monitoring and management of cash balances to ensure compliance with state law and federal regulations. The second recommendation addresses the need for periodic review of grant file documentation to ensure internal control procedures are operating as intended; this control deficiency impacts the university's ability to administer awards received through the American Recovery and Reinvestment Act in accordance with applicable federal regulations. The university's written response to the audit recommendations begins on page A-3. This report also contains a disclosure issue on endowment-related investment practices.

The listing below serves as a means of summarizing the recommendations contained in the report, the university's response thereto, and a reference to the supporting comments.

Recommendation #1.....9

We recommend The University of Montana:

- A. Manage cash balances at the subfund level to comply with state law.
- B. Ensure compliance with federal cash management requirements.

University response: Concur.....A-4

Recommendation #2..... 11

We recommend The University of Montana ensure Office of Research and Sponsored Programs internal control procedures are operating as intended through periodic review of grant file documentation.

University response: Concur.....A-4

Chapter I – Introduction

Audit and Objectives

We performed a financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2009. The objectives of the audit were to:

1. Determine the university's compliance with selected state laws and regulations.
2. Determine the university's compliance with federal regulations applicable to Student Financial Aid and Research and Development programs, including its implementation of internal control over compliance, to the extent required by OMB Circular A-133.
3. Provide recommendations for improvement in management and internal controls.
4. Determine the implementation status of prior audit recommendations.

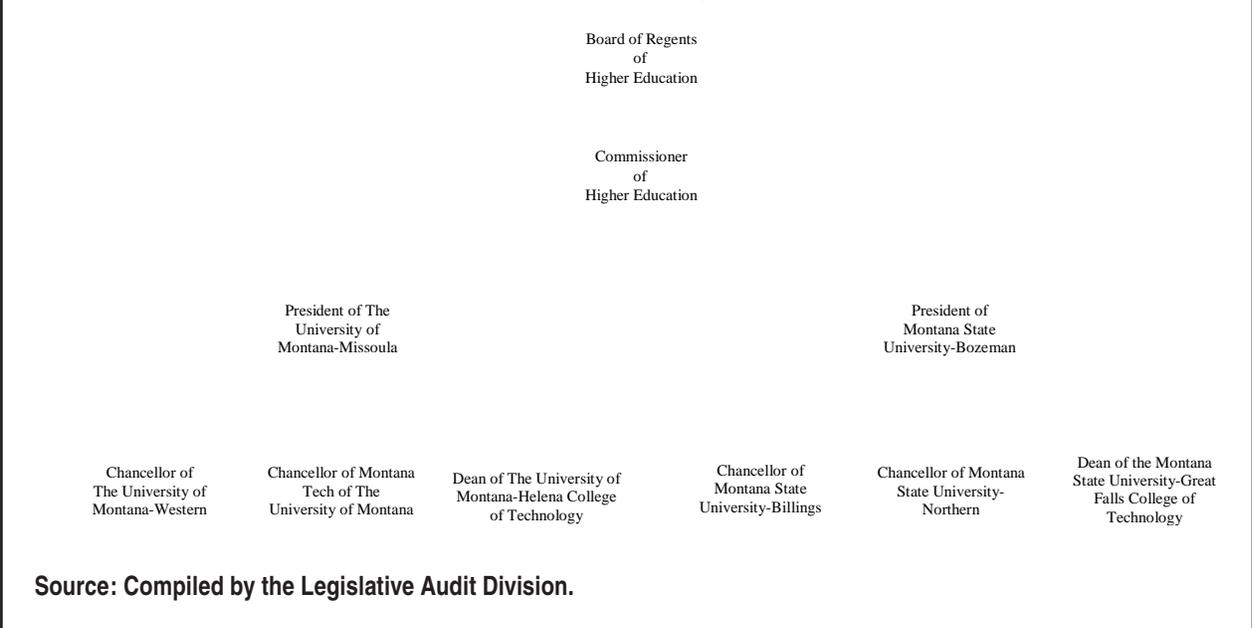
We audited the fiscal year 2007-08 consolidated financial statements of The University of Montana and issued a separate report (07-10A) in January 2009. The fiscal year 2008-09 consolidated financial statements will be audited by our office and is scheduled to be issued in a separate report (09-10A) in December 2009.

In accordance with §5-13-307, MCA, we analyzed the costs of implementing the recommendations made in this report. Each report section discloses the cost, if significant, of implementing the recommendation. Other areas of concern deemed not to have a significant effect on the successful operation of university programs are not specifically included in the report, but have been discussed with management.

Background

The Board of Regents of Higher Education approved the current Montana University System structure in January 1994. The following chart illustrates the organization of the Montana University System.

Figure 1
Montana University System Organizational Chart



The University of Montana consists of four campuses:

- ◆ The University of Montana–Missoula is located in Missoula. The Forestry Conservation Station is associated with this campus.
- ◆ Montana Tech of The University of Montana is located in Butte and includes the Bureau of Mines.
- ◆ The University of Montana–Western is located in Dillon.
- ◆ The University of Montana–Helena College of Technology is located in Helena.

All campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges. The four campuses of The University of Montana provide a diversity of undergraduate and graduate academic and two-year vocational/technical programs to students.

In fiscal year 2007-08, The University of Montana had approximately 2,071 full-time equivalent (FTE) employees. The following table shows fiscal year 2007-08 actual employee FTE by campus and type.

Table 1
The University of Montana Actual Full-Time Equivalent Employees
 Fiscal Year 2007-08

Agency	Contract Faculty	Contract Administrative	Contract Professional	Classified	Graduate Assistants	Part-Time & Other*	Total
The University of Montana–Missoula	642.63	50.22	82.30	599.08	91.82	81.72	1,547.77
Montana Tech of The University of Montana	126.73	8.18	33.19	68.55	7.98	9.80	254.43
The University of Montana–Western	70.00	6.96	17.06	40.34		3.23	137.59
The University of Montana–Helena College of Technology	33.50	3.00	7.83	23.62		11.36	79.31
Bureau of Mines		1.00	25.97	11.01		0.94	38.92
Forestry Conservation Station	9.04	0.36	0.80	1.90	0.14	0.32	12.56
Total	881.90	69.72	167.15	744.50	99.94	107.37	2,070.58

*This category includes permanent part-time nonfaculty, nonclassified employees, and temporary employees.

Source: Compiled by the Office of the Commissioner of Higher Education.

The table on the next page shows The University of Montana student FTE enrollments for fiscal year 2008-09. The student FTE for The University of Montana (All Campuses) was 16,930.

Table 2
The University of Montana Student FTE
 Fiscal Year 2008-09
 Summer 2008 through Spring 2009

The University of Montana–Missoula	
Undergraduate Resident	7,113
Graduate Resident	1,215
Resident-College of Technology	1,313
Total Residents	9,641
Undergraduate Nonresident	1,895
Graduate Nonresident	507
Nonresident-College of Technology	100
Western Undergraduate Exchange Program-UM Missoula	631
Western Undergraduate Exchange Program-College of Technology	10
Total Nonresidents	3,143
TOTAL THE UNIVERSITY OF MONTANA–MISSOULA	12,784
Montana Tech of The University of Montana	
Undergraduate Resident	1,434
Graduate Resident	51
Resident-College of Technology	305
Total Residents	1,790
Undergraduate Nonresident	265
Graduate Nonresident	32
Nonresident-College of Technology	20
Western Undergraduate Exchange Program-UM Tech	107
Western Undergraduate Exchange Program-College of Technology	6
Total Nonresidents	430
TOTAL MONTANA TECH OF THE UNIVERSITY OF MONTANA	2,220
The University of Montana–Western	
Undergraduate Resident	844
Undergraduate Nonresident	74
Western Undergraduate Exchange Program	202
TOTAL THE UNIVERSITY OF MONTANA–WESTERN	1,120
The University of Montana–Helena College of Technology	
Resident	791
Nonresident	12
Western Undergraduate Exchange Program	3
TOTAL THE UNIVERSITY OF MONTANA–HELENA COLLEGE OF TECHNOLOGY	806
Total UM Resident	13,066
Total UM Nonresident	2,905
Total UM Western Undergraduate Exchange Program	959
Total for The University of Montana	16,930

Source: Compiled by the Office of the Commissioner of Higher Education.

The University of Montana Funding

The level of state support for the Montana University System is determined by the Montana legislature. The legislature appropriates state funds, comprised of general fund and six-mill levy revenues, in a lump sum for the educational units and all other higher education programs except the research and public service agencies, community colleges, and tribal college assistance programs. The Board of Regents then allocates the lump sum appropriation to the various programs and educational units. The Board of Regents' formula that allocates state funds to the educational units is based upon resident enrollment, an analysis of faculty salaries in states with similar per capita income, the academic program offerings of the university, the necessary support expenditures, regent priorities and the amount of state funds available.

The University of Montana–Missoula

The University of Montana-Missoula was established in 1893 in Missoula as a comprehensive university. The campus offers four-year undergraduate programs along with masters and doctoral graduate programs. It includes professional schools and significant research activities. The campus is the center of liberal arts education in the Montana University System and operates the only law school in the system. Other schools include Business Administration, Education and Human Science, Visual and Performing Arts, Forestry and Conservation, Health Professions and Biomedical Sciences, Continuing Education, Honors, Graduate, and Journalism. In addition, the campus includes a two-year college of technology, which provides a broad range of technical and occupational education and training courses. College of technology students receive either a certificate of completion or a two-year degree upon completion of a program.

Montana Tech of The University of Montana

Montana Tech of The University of Montana was established in 1893 in Butte as the Montana School of Mines. It provides a variety of four-year and graduate programs with a focus on mineral, geological, environmental, petroleum, mining, and other engineering and science programs. It also includes a college of technology, which provides core education courses and two-year degrees in various occupational and technical programs.

The University of Montana–Western

The University of Montana–Western was established in 1893 in Dillon as the state's Normal School for teacher education. It now provides undergraduate degrees in a number of liberal arts, professional, and pre-professional areas using a unique scheduling system in which students take one class at a time.

The University of Montana–Helena College of Technology

The University of Montana–Helena College of Technology was established in 1939 in Helena as a Vocational-Technical School. It is a two-year institution of higher education. It offers an Associate of Science or Arts Degree in general transfer for students who want to acquire a core of coursework transferable to university system baccalaureate programs throughout the state. It also offers a variety of occupational, technical, and training specialties. This includes accounting, construction, computer, electronics and welding technologies, and practical nursing. Students enrolled in these programs receive either a certificate of completion or a two-year degree.

Prior Audit Recommendations

Our office performed the prior financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2007. The university concurred with the five recommendations contained in the report. The university implemented three, partially implemented one, and did not implement one of the recommendations.

The recommendation partially implemented relates to inventory records and inspections at the Butte and Missoula campuses. In the prior audit, we recommended the university complete timely inventory counts and reconciliations required by state policy. In response, the Butte campus completed a physical inventory of its equipment. The Missoula campus completed a physical inventory of its artwork and worked with museum personnel to bring its artwork inventory and accounting records up to date. The Missoula campus also modified its procedures to ensure Business Services personnel are notified of changes in the artwork inventory. During the audit, however, we identified a piece of artwork with a historical value of \$175,000 not included in the inventory listing or recorded on the primary accounting system, as required by state law and accounting policy. In 2001, a third party donated the piece to The University of Montana Foundation, which in turn transferred ownership to the university. Business Services personnel had no record of the transfer. We believe this indicates the university's artwork inventory records may still be incomplete. The university should ensure its artwork inventory records are complete.

The recommendation not implemented addressed the need for improvements in documentation indicating established controls were followed for Research and Development grants. This issue is addressed again on page 9 of this report.

Chapter II– Findings and Recommendations

Negative Cash

All campuses experienced extended periods of negative cash in the Restricted Fund.

Section 17-2-107(7), MCA, requires each unit of the university system to maintain a positive cash balance in its higher education funds. A fund or subfund may carry a negative cash balance for no more than seven working days. If the negative cash balance exists for more than seven working days, transactions may not be processed in the fund. Section 20-25-201, MCA, defines The University of Montana, all campuses combined, as a unit of the university system. Section 17-2-107(7), MCA, specifically requires positive cash balances be maintained at the subfund level. Cash balances in the university's subfunds, all campuses combined, should not be negative for more than seven working days.

Restricted Fund

During the audit, we analyzed the university's Restricted Fund cash balances, all campuses combined, for the months of July 2007 through June 2009. The Restricted Fund is a subfund of the university's Current Operating Fund and is used to account for financial resources that can be expended for general operations, but only for purposes imposed by external sources. The university accounts for grants and contracts administered by its Offices of Research and Sponsored Programs and its Student Financial Aid programs in the Restricted Fund. Most of the restricted funds operate on a cost-

reimbursement basis. Table 3 summarizes several instances where cash balances were negative for periods exceeding seven days for all campuses combined. The university

Table 3
Restricted Fund Negative Cash Balances
All Campuses Combined
July 2007 through June 2009

Number of Working Days Negative	Start Date	Average Negative Cash Balances
10	July 25, 2007	\$1,257,251
39	August 15, 2007	4,762,419
9	November 1, 2007	599,614
57	November 30, 2007	3,007,975
14	March 1, 2008	1,274,958
8	April 3, 2008	1,491,968
46	April 23, 2008	1,185,001
10	July 26, 2008	1,053,924
50	August 20, 2008	5,377,732
37	November 3, 2008	1,769,825
26	January 6, 2009	7,379,032
306		\$3,254,436

Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting and Human Resources System.

continued to process transactions in the Restricted Fund during these times, even though such activity is specifically prohibited by §17-2-107, MCA. The negative cash balances shown in Table 3 primarily result from negative balances at the Missoula campus, although we identified negative cash balances in excess of seven working days at each campus.

Student Financial Aid Cash Management

In conjunction with our analysis of cash balances, we reviewed the university's procedures for complying with Student Financial Aid program federal cash management requirements at the Missoula campus. Office of Management and Budget Circular A-133 requires the university to maintain internal control over federal programs that provides reasonable assurance the programs are managed in compliance with federal regulations. Federal regulations require the university to minimize the time elapsing between receipt and expenditure of Student Financial Aid funds. The university draws cash for its Student Financial Aid programs on a reimbursement basis. The university's procedures involve drawing cash for the amount by which its Student Financial Aid funds are negative.

We determined the university's cash management procedures did not comply with either federal cash management requirements or §17-2-107(7), MCA. At the time of our audit, one employee was assigned responsibility for Student Financial Aid cash draws. The employee's cash draws were not reviewed by others for compliance with federal regulation or state law. During the audit, we noted one instance where \$127,898 was drawn in advance of university needs. In this instance, a positive cash balance existed and no draw was needed. A review of the draw could have prevented this noncompliance with federal regulation.

Grants and Contracts Billing

The billing process for grants and contracts administered by the Offices of Research and Sponsored Programs is labor intensive, due to the volume of grants and contracts administered. Personnel at the Missoula campus estimate the monthly collection process averages 45 days. Personnel at the Butte campus indicated the billing process is often a month behind, making it difficult to maintain positive cash balances. University personnel are implementing an automated billing system on the Missoula campus; they anticipate the conversion will be complete by March 2010 and will allow for more timely billing and receipt of funds.

Summary

All of the university's Restricted Funds have loans from the Designated Funds to maintain positive cash balances. At June 30, 2008, the loan balances were \$4.85 million,

\$1 million, and \$30,000 for the Missoula, Butte, and Dillon campuses, respectively. The Missoula campus increased its loan balance in December 2008 and February 2009; the balance was \$7.85 million at June 30, 2009. University personnel indicated the loan balances were not always large enough to cover expenses incurred in advance of reimbursement.

As implemented, the university's cash draw procedures were inadequate to ensure compliance with state and federal cash management requirements. Beginning in February 2009, university personnel began managing cash balances by subfund. We observed significant improvement in the university's compliance with §17-2-107(7), MCA, beginning at that time. To comply with state law, we believe the university should continue to manage cash balances at the subfund level. Each campus is responsible for its own cash billing and receipting. Unless cash is monitored and managed appropriately at its four campuses, we believe the university as a whole will be unable to consistently comply with the requirements of §17-2-107(7), MCA.

RECOMMENDATION #1

We recommend The University of Montana:

- A. *Manage cash balances at the subfund level to comply with state law.*
 - B. *Ensure compliance with federal cash management requirements.*
-

Research and Development Internal Control

University personnel did not consistently follow internal control procedures designed to ensure compliance with federal regulations for its Research and Development grants.

The Office of Research and Sponsored Programs is responsible for administering the university's Research and Development federal awards. A research and development award focuses on a specific research or development activity. Each award has its own specialized goals and requirements. The university expended approximately \$36 million in fiscal year 2007-08 and \$46 million in fiscal year 2008-09 under these awards. The Office of Research and Sponsored Programs administers approximately 1,100 awards each year.

The Office of Management and Budget (OMB) Circular A-133 requires the university to maintain internal control to provide reasonable assurance its programs

are managed in compliance with laws, regulations and provisions of the contracts or grant agreements. The Office of Research and Sponsored Programs has developed two checklists designed to ensure its grant accountants and principal investigators comply with applicable federal regulations, the account summary sheet and the ending grant checklist. During our audit, we identified instances where these checklists were not used as intended.

The account summary sheet summarizes key requirements for each grant. The grant accountants use it as a resource for verifying grant requirements are met. We tested a sample of 20 grants with expenditure activity during our audit period. Three of the grant files tested did not contain the required account summary sheet.

The ending grant checklist outlines each procedure the grant accountant must complete at or before the end of the grant period. This checklist directs the accountants to notify principal investigators that the grant is ending, document compliance with cost match requirements, and complete final financial reports. The principal investigators are responsible for completing the technical and performance requirements of the grants. The grant accountants are expected to initial and date each procedure as it is completed. We tested a sample of 22 grants that were closed during the audit period. We noted the procedures are not always completed or documented as required. Of the 22 ending grant checklists reviewed:

- ◆ Two did not indicate final reports were completed, even though the reports were submitted as required.
- ◆ One did not contain documentation that match requirements were met, even though the match requirements were met.
- ◆ One did not indicate the principal investigator was notified of the grant end date, even though the notification occurred.
- ◆ Four indicated the principal investigators were not notified of the grant end date as early as required. In two of these cases, the notification was made after the close of the grant period. We identified no questioned costs associated with these late notifications.

We addressed similar issues in the past two audits of the university. Not using the checklists as intended limits the university's ability to prevent, or detect and correct, material noncompliance with federal regulations in a timely manner. Starting in fiscal year 2008-09, the university received additional federal awards through the American Recovery and Reinvestment Act. Unless corrected, this issue could also affect the university's ability to comply with the unique requirements applicable to these awards.

University personnel are in the process of automating their billing processes; they believe automation will help achieve efficiencies in the future. Based on the work performed, we believe the University needs to ensure its designed internal control procedures are operating as intended. Periodic review of grant file documentation should allow the university to ensure controls are operating as intended.

RECOMMENDATION #2

We recommend The University of Montana ensure Office of Research and Sponsored Programs internal control procedures are operating as intended through periodic review of grant file documentation.

Chapter III– Disclosure Issue

Investment of Public Funds

The university administers endowments gifted from third parties. The principal portion of an endowment is nonexpendable, but is available for investment. Earnings must be used as specified by the donor. The university's endowment-related investments totaled \$18,989,965 at June 30, 2008, and \$15,186,264 at June 30, 2009. The University of Montana contracted with The University of Montana Foundation to manage most of the university's endowment-related investments; \$16,244,246 at June 30, 2008, and \$12,715,692 at June 30, 2009. These funds are held in an investment pool that owns corporate stocks and bonds, treasury bonds, money market funds and other types of securities. The Board of Investments manages the remainder; \$2,745,719 at June 30, 2008, and \$2,470,572 at June 30, 2009. These funds are invested in the Montana Domestic Equity Pool, which owns domestic stock, and the Trust Fund Bond Pool, which owns corporate bonds and U.S. government bonds.

Article VIII, Section 13, of the Montana Constitution provides for the investment of public funds and directs the legislature to provide for a unified investment program. Codified in §17-6-201, MCA, the law requires public funds be invested through the Board of Investments unless otherwise provided by law. Article X, Section 10 of the Montana Constitution requires state university funds to be invested under such regulations as may be provided by law.

Governance and control of the Montana University System is given to the Board of Regents in Article X, Section 9 of the Montana Constitution. The Board of Regents was granted the full power, responsibility and authority to supervise, coordinate, manage and control the university system. A 1975 Attorney General's opinion provides guidance on the application of certain legislative enactments, including investment statutes, to the university. The opinion indicates the requirements of the unified investment program apply to the investment of university funds. However, the opinion does not specifically address endowment funds. It is unclear whether endowments from third parties are public funds for the purposes of Article VIII, Section 13 of the Montana Constitution. Because of this lack of clarity, we requested an Attorney General's opinion on the matter. We make no recommendation regarding the university's endowment-related investment practices at this time.

THE UNIVERSITY OF
MONTANA
(ALL CAMPUSES)
AND
COMMISSIONER OF
HIGHER EDUCATION

UNIVERSITY RESPONSE



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11 September 2009

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AUDIT DIV.**

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Legislative Audit Division
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Helena, MT 59620-1705

Dear Ms. Hunthausen:

We thank the Legislative Audit staff for the professional work on the Financial-Related Audit. As usual, the audit staff worked thoroughly through this important process. The University of Montana has a commitment to provide transparency and accountability in all activities. Two essential aspects in providing this accountability include a strong system of internal controls and compliance.

We concur with the two recommendations contained in this report and have already taken appropriate measure to insure compliance in the future. We appreciate the cooperative efforts made by the Audit team and thank those involved for their assistance.

Sincerely,

George M. Dennison,
President

GMD/kc
Denlet4023

c: S. Stearns, Commissioner of Higher Education

The University of Montana

Response to Legislative Audit Division Financial Related Audit

For the Two Fiscal Years Ended 30 June 2009
September 2009

RECOMMENDATION #1

WE RECOMMEND THE UNIVERSITY OF MONTANA:

- A. MANAGE CASH BALANCES AT THE SUBFUND LEVEL TO COMPLY WITH STATE LAW.**
- B. ENSURE COMPLIANCE WITH FEDERAL CASH MANAGEMENT REQUIREMENTS.**

The University concurs with the recommendation. The University identified this weakness through an internal control review prior to the Legislative Auditors arrival. University personnel were in the process of revising the cash management review procedures. Since the audit, University personnel have refined the cash balance monitoring procedures and implemented a daily review of cash balance by sub-fund for all The University of Montana campuses. The new process has allowed the University to be compliant since February 2009. The cash balance review process continues to be refined to ensure compliance with state and federal cash management requirements.

RECOMMENDATION #2

WE RECOMMEND THE UNIVERSITY OF MONTANA ENSURE OFFICE OF RESEARCH AND SPONSORED PROGRAMS INTERNAL CONTROL PROCEDURES ARE OPERATING AS INTENDED THROUGH PERIODIC REVIEW OF GRANT FILE DOCUMENTATION.

The University concurs with the recommendation. The University will ensure compliance with appropriate internal control processes and procedures by Office of Research and Sponsored Program employees. A file documentation review process will be refined in fall 2009. Review results will be used for staff training and development, and, if necessary, personnel action will be taken as appropriate.



September 9, 2009

Tori Hunthausen
Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena MT 59620-1705

Dear Ms. Hunthausen:

Please see the response below from the Office of the Commissioner of Higher Education to the The University of Montana financial-related audit for the two fiscal years ended June 30, 2009. We appreciate the opportunity to respond to the disclosure issue.

Response to Chapter III: Disclosure Issues

The Montana Supreme Court, in *Board of Regents v. Judge*, 1975, issued in the same year but after the 1975 AG opinion cited in the LAD Report, ruled that donated funds are private funds beyond the authority of the legislature to appropriate. The Court further held that the regents' constitutional authority is subject only to the power of legislative appropriation and the public policy of the state. Given the regents' "full control" over university system funds and the court's limitations on legislative control of these funds, only an express provision of the Montana Constitution can supersede regents' authority over private funds donated to the university.

The campus practice of contracting with campus-affiliated foundations, for investment of university donations, is a long-standing practice which pre-dates the 1975 AG opinion. Board of Regents' policy specifically authorizes the campuses to contract with the foundations for investment of donated funds, and The University of Montana is in compliance with policies relating to accounting and investment of such funds. These policies are based on the regents' firm belief that this practice is permissible under the Montana Constitution.

Sincerely,

A handwritten signature in cursive script that reads "Sheila M. Stearns".

Sheila M. Stearns
Commissioner of Higher Education

C: President George Dennison

Sheila M. Stearns
Commissioner of Higher Education

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