SPECIAL MEETING OF THE
AUDIT COMMITTEE
VIA TELECONFERENCE
Connecticut State Colleges and Universities
Board of Regents for Higher Education
61 Woodland Street
Hartford, Connecticut
Friday, December 23, 2016, at 8:30 a.m.

Minutes

REGENTS PRESENT (TELEPHONIC)
Elease Wright, Chair
JoAnn Price
William McGurk

REGENTS ABSENT
Gordon Plouffe

BOR/CONNSCU STAFF PRESENT (TELEPHONIC)
Erika Steiner, Chief Financial Officer; Karen Stone, Director of Internal Audit; Chris Forster, Controller, Erin Fitzgerald, Associate for Board Affairs.

With a quorum present, Chair Wright called the meeting to order at 8:30 a.m.

The attached document served as a discussion guide for this meeting.

Upon discussion of the changes made to the audited financial statements since the last Audit Committee meeting, the Audit Committee (on behalf of the Board of Regents) voted unanimously to accept the annual reports of Connecticut State University System, Connecticut Community Colleges, and Charter Oak State College.

Discussion ensued concerning the audit opinions on the System's Foundation audit reports, and management provided the Committee with the names of the various audit firms that audit the Foundations.

Upon follow up information provided as requested by the Audit Committee meeting at the last meeting, the Audit Committee accepted the audited reports of the System's Foundations.

With no other business to discuss, the meeting was adjourned at 9:00 AM on a motion by Regent McGurk, seconded by Regent Price.

ATTACHMENT

CSCU Financial Statement Audit Update

Follow up meeting with the Audit Committee to accept the FY2016 financial statements

12/23/16

EXCECUTIVE SUMMARY

As discussed with the Audit Committee at our December 9, 2016 meeting, there were certain adjustments still required in order to consider the audit "substantially complete" and we accordingly requested a follow up Committee meeting for purposes of accepting the audited financial statements. Also discussed at the meeting was the impact of our change of auditors in the current fiscal year, which allows for a "fresh set of eyes" on some of the judgments and decisions made during the prior year(s). Because we implemented a significant, complex new accounting pronouncement in FY2015, and recorded adjustments late into the audit period, we are now able to re-evaluate that approach, and we have accordingly made changes described below in the current (FY2016) audited financials. Some of these changes require us to restate FY2015 financial statements, also described herein.

DISCUSSION

In connection with the FY2016 audit, certain changes to the accounting and presentation of several transactions within the financial statements will be reflected. The changes relate to the following:

1) Pension accounting
2) Presentation of Pell awards within the statement of revenues, expenses and changes in net position
3) Presentation of premiums and discounts on bond issuances with the statement of net position

As it relates to #1, the beginning net position of Connecticut Community Colleges (CCC), Connecticut State Universities (CSU) and Charter Oak State College (COSC) will be restated. Items #2 and #3 represent adjustments that do not impact beginning net position, but rather a change from what was presented to the Audit Committee initially at the December 9, 2016 meeting. Refer to Attachment A, which shows a comparison of what was provided to the Audit Committee at the meeting held on December 9, 2016, and what will be submitted for acceptance as final. Details of each change are described below.

1) Pension accounting

Connecticut Community Colleges (CCC) and Connecticut State Universities (CSU) Financial Statements

As a part of our FY2016 closing procedures, we prepared entries required by GASB Statement No. 68 (GASB 68) to record each constituent unit's share of the Connecticut State Pension liability. The calculations require input from the State's actuaries in order to determine the appropriate share to be recorded and impact several different accounts.

In evaluating the entries recorded in the prior year (FY2015), which was the first year that GASB 68 went into effect, and in reviewing these entries with our current auditors, Grant Thornton, it was their belief that three FY2015 entries were incorrect. We, along with Grant Thornton (GT), spoke with our prior auditors PricewaterhouseCoopers (PwC) in order to determine their logic in recommending that accounting.

Although we believe that there was some logic to the accounting as described by PwC, and PwC believes that the accounting was correct, GT believes it was incorrect. In order to reflect correct ending balances at June 30, 2016, corrections would have to be included in the FY2016 Statement of Changes in Net Position that would cause a material misstatement of the activities related to FY2016. Because that would materially impact the current year's Statement of Changes in Net Position, GT recommends, and we agree, that the best course of action is to restate the beginning net position (ending FY2015 net position). During our phone call with PwC we advised them of the restatement and they thanked us for the information.

Based on guidance from PwC, the FY2015 entries recorded, which we are now deem to be incorrect, were as follows:

a) Rather than reducing deferred outflows by the 2014 contributions, 2014 contributions were recorded as State Appropriations revenue. This is not contemplated in GASB 68.

b) Post measurement date contributions were not recorded correctly. GASB 68 indicates that post-measurement date contributions should be recorded as deferred outflows.

c) The accrued payroll/fringe was reduced to remove the accrual associated with the fringe specific to pension to avoid "double counting" the pension liability. This does not seem to be necessary in connection with the adoption of GASB 68.

Upon review in the current year, GT believes, and CSCU management concurs, that the FY2015 Balance Sheets are incorrect and should be adjusted. Refer to attachment A for the comparison of draft financial statements for the identification of changes. We note that the reporting provided to the Office of the State Comptroller is pre-GASB 68 and therefore these changes do not impact our reporting to the State.

Charter Oak State College (COSC) Financial Statements

The prior year financial statements of Charter Oak State College (COSC) were audited by O'Connor and Drew. In their review of the entries to reflect GASB 68, there were two errors noted by GT, as follows:

a) Post-measurement date contributions were recorded at an incorrect amount.

b) A portion of the entry to record initial net pension liability was recorded to deferred outflows rather than entirely to beginning net position.

Upon review in the current year, GT believes, and CSCU management concurs, the FY2015 balance sheets are incorrect and should be adjusted. Refer to attachment A for the comparison of draft financial statements for the identification of changes.

Comments

a) In our recent discussion with PwC, they provided some background on the basis for the three entries of focus by GT. No new information came to light from that discussion which would lead GT to agree with PwC.
b) Because this is a restatement of a prior year it will be reported as a material weakness in internal control. This will be included in GT's Internal Control Letter to the Audit Committee.
    a. In determining this, it is not relevant to the auditing firm that the guidance to make such entries was provided by the prior auditors. In the auditing literature, a restatement is a strong indicator of a material weakness, with little judgment allowing for a different conclusion.
    b. We note that the weakness is already remediated, and requires no additional action by management.
c) Our current year opinion from GT will include language to describe the restatement. It is not considered to be an adverse opinion, but rather an emphasis of a matter in an unmodified opinion (similar to the prior year emphasis of a matter related to the initial adoption of GASB 68).
d) Although we have not yet spoken to O'Connor & Drew, we expect the outcome for COSC to be similar (restatement of beginning net assets and material weakness).

2) Presentation of Pell awards within the statement of revenues, expenses and changes in net position

In 2008, GASB issued a clarification regarding the appropriate presentation of Pell awards within the Statement of Revenues, Expenses and Changes in Net Position to require that Pell awards be presented as non-operating revenue rather than operating revenue or an agency obligation. Prior to FY2016, the System presented Pell awards as operating revenue. This change from presenting Pell awards as operating revenue to non-operating revenue has no impact on change in net position or beginning net position. It only changes the operating loss and non-operating revenue amounts for FY16. The amount of the reclassification from operating revenue to non-operating revenue for CSU is $41 million and for CCC is $74.3 million. Because it is not a restatement, there is no need to discuss this change with predecessor auditors.

3) Presentation of premiums and discounts on bond issuances with the statement of net position

GASB requires any premium or discount on bonds to be presented net of the related liability rather than deferred inflows/outflows of resources. CSU previously reported unamortized bond discounts as deferred outflows and unamortized bond premiums as deferred inflows. The reclassification removes the amounts reported as inflows and outflows and includes them as a net increase to bonds payable, which increases liabilities. This change has no impact on change in net position or beginning net position. It only changes deferred outflows, deferred inflows and liabilities for FY16. The net amount of the reclassification is $12 million. Because it is not a restatement, there is no need to discuss this change with predecessor auditors.

CONCLUSIONS/RECOMMENDATION

With the changes described herein, management believes, and GT agrees, that we are substantially complete with our year-end procedures. We expect that the reports will be signed in early January, subsequent to the Office Attorney General providing a second legal letter closing out the audit period.

We request that the Audit Committee on behalf of the Board of Regents, accept the audited financial statements presented at the December 9, 2016 meeting, but subject to the changes described herein.