

1. Operational/strategic risks of financial systems:

a. Electronic Discovery/Digital Records – Rulings from the federal judiciary have imposed new responsibilities on large organizations to preserve and disclose of electronic records, such as email, for use in litigation. These changes have implications for saving and producing public records, as well as defending lawsuits. Jack Johnson is part of an internal UW group working on guidelines for records preservation and discovery when there is a lawsuit -- or threat of one -- to assure the discovery process/records production meets the UW's responsibilities.

b. Inability to produce information requested by regulators creates negative impression of overall management. Triggered by a high-profile corruption scandal at New Jersey University of Medicine and Dentistry, all of NJ's public colleges were reviewed. Rutgers was singled out for censure, that its accounting system "defies and frustrates reasonable standards of public transparency and accountability." Rutgers estimates \$40 million needed to finish modernizing financial and accounting systems. Significant recommendation is to reassert greater state control over public colleges and universities, to prevent recurrence of "questionable and patently abusive operating practices."

2. Federal level risks:

a. Cell phones – IRS is reviewing personal use of employer provided cell phones as possible taxable benefit, and how that would be calculated and reported. Ann Anderson is assessing implications for UW.

b. U of California faces \$3 million fine for security breach at Los Alamos Labs. Large amounts of classified information were removed from Los Alamos and discovered in a subcontractor's trailer. US Dept of Energy rejected UC's assertion of mitigating circumstances, saying that "simple corrections could have prevented" removal of the documents. Kirk Bailey notes that Boeing has been fined hundreds of millions for security breaches in past two years, and he is working on these exposure and compliance issues with UW's Facilities Security Officer, James Poland. Primary compliance work efforts are being addressed by OSP and Office of Research.

c. US Senate reviewing tax status in several higher ed areas

i. Use of tax-free bonding debt to finance buildings and equipment while not selling off investments to use to pay those costs; problem is that typical endowment principal and earnings are restricted by intent of donor and cannot be spent on other costs.

ii. Questioning tax-exempt status of college sports and whether donors should receive tax deductions for contributing to athletics departments. Increasing commercial interests in big-time football and basketball programs may give appearance that those programs stray from educational purpose. Senate Finance committee is interested in requiring nonprofit organizations to better account for revenue and expenses.

iii. Overseas hedge-funds can be high-return, low-risk investment vehicles, and avoid federal taxes when the funds are incorporated in some countries. NACUBO estimates nearly 10 percent of total higher ed investment pools are in hedge funds. IRS says nonprofit organizations can invest in offshore hedge funds to avoid taxation. Senate Finance committee is taking broad tax review of hedge funds and private equity— universities with multi-billion dollar endowments making significant gains through offshore hedge funds avoid up to 39 percent federal taxes.

iv. Require mandatory minimum annual payouts from endowments larger than a threshold level (such as \$500 million and up), as private foundations are required to do, with goal of reducing institutional costs and therefore keeping tuition more affordable. Higher ed testimony in mid-October included American Council on Education and Association of American Universities, noting that in most endowments a majority of all assets may be spent only for specific purposes.

d. Reduced indirect cost rate for DOD sponsored research – There is proposed legislation regarding a cap on F&A (Facility and Administrative/ indirect costs) for future basic research awards from Dept of Defense. It is included in the DOD FY2008 appropriations bill. Using FY2007 funding levels, the cap of 35% on UW's DOD research awards would result in about \$15,500 annual reduction in cost recovery. Concern is that Congress or individual agencies may apply this cap to other research awards. Annual impact on the UW based on FY2007 funding levels if this cap is applied generally would be significant:

\$ 878,000 reduction in recovery for NIH awards
\$ 83,000 reduction on all other federal awards besides DOD

Of even greater concern is the precedent of Congress establishing arbitrary caps which, depending on the percentage, could seriously impact the research mission in higher education. This situation is being carefully tracked.