

Executive Summary

**Washington State Auditor’s Office
University of Washington Audit
July 1, 2004 through June 30, 2005**

The State Auditor’s Office strives to ensure the best use of state resources. To this end, we make every attempt to avoid duplication of audit efforts by considering work performed by other auditors or oversight agencies, including the University’s internal auditors, when appropriate.

In keeping with general auditing practices, we do not examine every portion of the University’s financial activities during each audit. The areas examined are those areas we have determined have the highest risk of noncompliance, misappropriation or misuse. Other areas are audited on a rotating basis over the course of several years.

Our scope of responsibility is first, financial records are audited to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation and misuse and secondly; legal compliance auditing is conducted to make sure units of state and local government adhere to required laws and regulations relating to financial matters.

ELEMENTS OF THE AUDIT

• **Compliance with laws and regulations:**

The State Constitution, Article 3, Section 20 (Audits of Public Accounts) establishes the Office as the auditor of public accounts, and to have such powers and perform such duties as may be prescribed by law. RCW 43.09 grants the auditor authority to examine the financial affairs of public agencies to ensure their integrity in the assessment, collection, and expenditure of public funds.

How? We examine compliance with selected laws, regulations, and policies of a financial. To plan the audit we applied our professional knowledge and experience with University operations and analyzed electronic University data to identify areas at the highest risk for non-compliance, misappropriation or abuse. If, during the course of the audit, we identify other areas not scheduled for review, we consider adjusting our audit scope accordingly and notify University management.

Which areas?

<ul style="list-style-type: none"> • Donations & Endowments • Open Public Meeting Act • Budgetary Compliance • Payroll • Expenditures/Purchasing/Accounts Payable • Competitive Bid Law Compliance • Conflict of Interest • General Inventory • Pharmaceutical Inventory • Bothell Campus • Tacoma Campus • Contracts & Agreements 	<ul style="list-style-type: none"> • Student Accounts • Motor Pool • Risk Management • Publishing Services • Educational Outreach • Office of Intellectual Property & Technology • Recreational Sports • University Press • Intercollegiate Athletics • Housing & Dining • Parking Services • Student Union Facilities • Out of state bank accounts
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Planned computer assisted audit tests of payroll and vendor payment transactions may lead us to additional departments.

- **Single Audit:**

The State Auditor's Office is responsible for performing a single audit of the State of Washington, as required by the revised Single Audit Act and Office of Management and Budget Circular A-133.

We have identified three major federal programs at the University that are scheduled for audit:

- National Research Resources & Research Infrastructure
- Research and Development Cluster
- Student Financial Aid

The federally funded transactions and related internal controls will be examined in the following departments:

<ul style="list-style-type: none">• Office of Sponsored Programs• Grant and Contact Accounting• Management Accounting & Analysis• Regional Primate Center• General Internal Medicine• Bioengineering• Radiology	<ul style="list-style-type: none">• AID's Center• Biochemistry• Department of Medicine• School of Social work• Psychiatry• School of Nursing• Student Financial Aid
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- **Financial Statements:**

The State Auditor's Office is responsible for performing an audit of the financial statements for the State of Washington. University of Washington financial data is included in these statements. We will attest to the fairness of presentation of certain University account balances considered significant to the state's financial statements.

REPORTING

Any conditions considered significant enough to report as a finding will be included in one or two statewide reports:

- Single audit report (for all findings involving federal funds)
- Accountability report (for all findings)

We will also provide the University with a separate accountability report to include all University findings.

Peterson Sullivan PLLC
University of Washington Metropolitan Tract Audit
For the Year Ended June 30, 2005

Peterson Sullivan PLLC has been providing audit services to the University of Washington for over fifteen years. We value our relationship with the University and welcome the opportunity to communicate with the Regents about our audit plan.

SERVICES PROVIDED

This is the second year we have conducted the financial audit of the Metropolitan Tract. Not only do we audit the Metropolitan Tract, we also provide the following other services:

- We audit the Rainier Tower sublease activity, including the results of operations and net change in cash
- We audit the Fairmont Olympic Hotel ("Fairmont") activity, including the gross rental income and percentage rent. We also test lease compliance.
- We audit the Unico Properties, Inc. ("Unico") activity, including the gross rental income and percentage rent. We also test Unico's lease compliance.

Metropolitan Tract

We focus our audit procedures in the areas deemed to be the highest risk. At the Metropolitan Tract, we have determined that cash, rent revenue and capital expenditures represent the largest dollar value and the highest volume of activity and, therefore, represent highest audit risk. We have prepared our audit programs to focus audit efforts in these areas.

Rainier Tower Sublease

The Rainier Tower sublease financial results are included in the Metropolitan Tract financial statements. We also audit the separate schedules of results of operations and net change in cash. The risk areas where we focus our audit procedures related to these two schedules is rent revenue recognition and capital expenditures.

Fairmont Olympic Hotel

The financial results from the Fairmont Olympic Hotel schedules of gross revenue amounts and percentage rentals are included in the Metropolitan Tract financial statements. We also audit the schedules on a stand-alone basis. We focus our audit procedures on revenue recognition, completeness, and revenue/expense classification. In addition, we perform and report on specific agreed upon procedures related to lease compliance.

Unico Properties, Inc.

The financial results from the Unico Properties, Inc. schedule of gross rental income are included in the Metropolitan Tract financial statements. We also audit the schedule on a stand-alone basis. We focus our audit procedures on revenue recognition and revenue classification between commercial space and office space. In addition, we perform and report on specific agreed upon procedures related to lease compliance.

AUDIT TIMELINE AND REPORTING

Our audit procedures are expected to take place as follows:

Fairmont	May 11-13
Unico	May 16-19
Metropolitan Tract	August 1-10
Rainier Tower	August 8-10

Reports for Fairmont and Unico will be issued the end of July. These reports are prepared for the year ended December 31, 2004. Reports for the Metropolitan Tract and Rainier Tower will be issued by September 15. These reports are prepared for the year ended June 30, 2005.

In addition, we will provide the University with a management letter to address any internal control related or other findings noted during our audits.



University of Washington



2005 Audit Plan

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Contents

I.	Executive Summary	1
	Scope of Audit	1
	Coordination with Other Auditors	1
	Tentative Timetables.....	1
II.	Financial Reporting Entity.....	2
III.	Scope of Our Audits.....	4
	University Annual Report	4
	UW Medical Center	4
	Intercollegiate Athletics (ICA)	5
	Parking System	5
	All Other Audits.....	5
IV.	KPMG Team Overview	6
V.	KPMG Audit Process	7
	Overview of Audit Procedures.....	8
	Balance Sheet.....	8
	Statement Of Revenues Expense And Changes In Net Assets	10
	Coordination with Other Auditors	11
VI.	New Accounting Pronouncements.....	12
VII.	Tentative Timetable	13

I. Executive Summary

Scope of Audit

We will audit the balance sheet of the University of Washington (University) as of June 30, 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on the financial statements based on our audit, however we will not express any opinion on the effectiveness of internal controls over financial reporting.

An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we will express no such opinion.

Additionally, we will report separately on our audits for the UW Medical Center, Intercollegiate Athletics, and the Parking System.

Coordination with Other Auditors

We will coordinate and rely on audit testwork performed by the following other auditors: Peterson Sullivan, the Washington State Auditor's Office and the University's Internal Audit Department as considered necessary.

This coordinated approach allows us to reduce duplicative testwork during the audit of the University and increase overall efficiency.

Tentative Timetables

Our timetable is expected to be similar to that of the previous year. We will coordinate with the Office of Financial Management for a more detailed schedule of events and prepare an outline of specific data requirements, timelines and individuals responsible.

II. Financial Reporting Entity

The financial statements of the University of Washington consist of (a) the University of Washington, (b) organizations for which the University is financially accountable, and (c) other organizations for which the nature and significance of their relationship with the University are such that exclusion would cause the University's financial statements to be misleading or incomplete.

The definition of the reporting entity is based primarily on the notion of financial accountability. An entity is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the entity. An entity may also be financially accountable for governmental organizations that are fiscally dependent on it.

An entity has the ability to impose its will on an organization if it can significantly influence the programs, projects, or activities of, or the level of services performed or provided by, the organization. A financial benefit or burden relationship exists if the entity (a) is entitled to the organization's resources; (b) is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization; or (c) is obligated in some manner for the debt of the organization.

The following illustration depicts the entities included in the University of Washington Annual Report.

Assets (in millions)	Entities	Financial Statements
\$ 4,988	University of Washington UW Activity (teaching, research, public service)* Medical Center* Parking System* Intercollegiate Athletics* Housing and Food Services Metropolitan Tract	University of Washington Annual Report
\$ 17	Wholly Owned Insurance Company Portage Bay Insurance	
\$ 128	Affiliated Organizations - Medical Entities University of Washington Physicians* University of Washington Physicians Network*	
\$ 127	Affiliated Organizations - Real Estate Properties Commodore Duchess Student Housing Nordheim Court Student Housing Radford Court Student Housing Roosevelt I South Lake Union - Blue Flame	
\$ 30	Affiliated Organization - Alumni Entity UW Alumni Association*	

* Audited by KPMG

Organizations Not included in University of Washington Annual Report
Harborview Medical Center
University of Washington Foundation
Henry Gallery Association, Inc.
Washington Law School Foundation
Washington Pulp and Paper Foundation

III. Scope of Our Audits

University Annual Report

We will audit the balance sheet of the University as of June 30, 2005 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We will conduct our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we will express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In planning and performing our audit of the financial statements, we consider internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. Our audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. If, however, during our audit we note matters involving internal control and other operational matters, they will be presented for your consideration. These comments and recommendations, all of which will be discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies.

An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Universities internal control over financial reporting. According we express no such opinion.

This audit meets the needs of the Board of Regents and the administration to manage the University and assist in meeting the University's financial reporting requirements as a public agency and the State of Washington.

UW Medical Center

We will also audit the financial statements of the UW Medical Center as of June 30, 2005. We will conduct our audit in accordance with auditing standards generally accepted in the United States of America. We will provide an audit

report on the UW Medical Center and will use our audit as support in our overall opinion on the University.

Intercollegiate Athletics (ICA)

An audit of the ICA will also be performed for the year ended June 30, 2005. This audit is designed to meet the requirements of the outstanding debt and will be in accordance with auditing standards generally accepted in the United States of America.

We will also be performing newly required agreed upon procedures to meet the requirements of the National Collegiate Athletic Association (NCAA).

Parking System

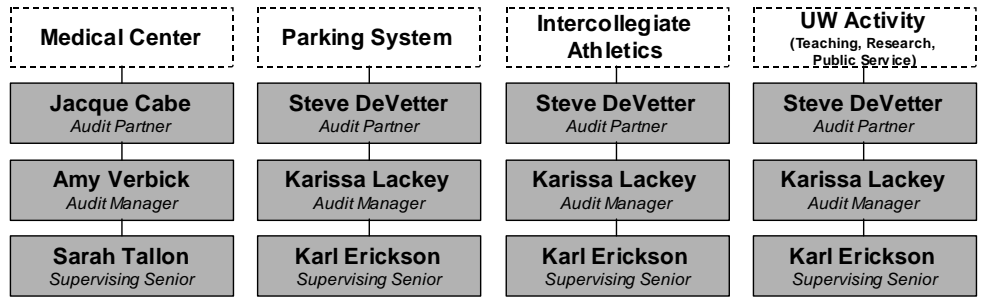
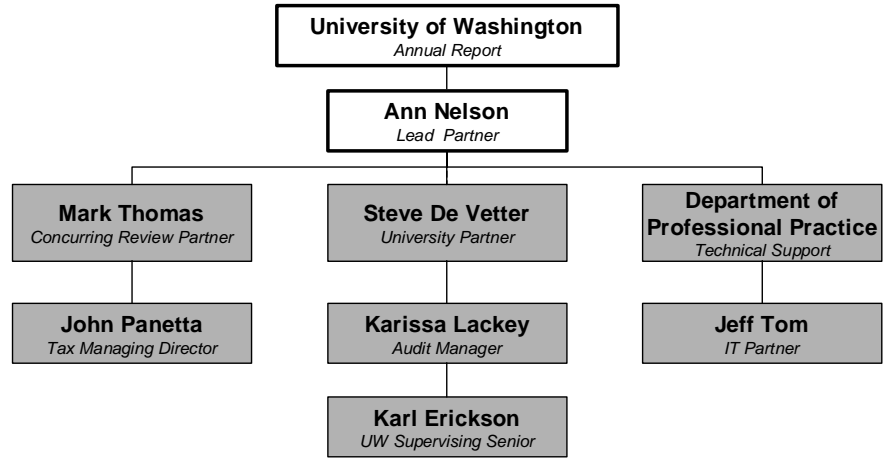
Our audit of the Parking System is designed to provide the necessary information to meet the compliance requirements of the outstanding debt associated with the parking system revenue bonds.

All Other UW Activity

All other UW activity consists of instruction, research, public service, and all other activities included in the University of Washington Annual Report, but not subject to separate reporting requirements.



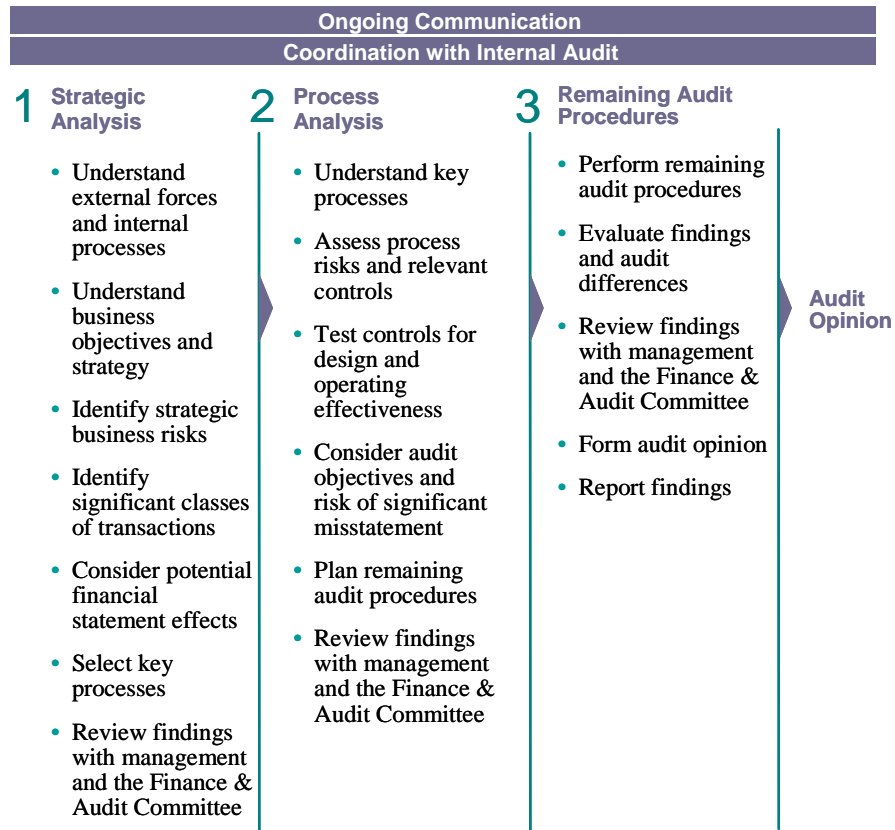
IV. KPMG Team Overview



V. KPMG Audit Process

We apply our audit process through our three-step audit approach. Each step allows us to more clearly identify the University's business risks, and hence our audit risks, and to focus our audit approach on the risks of material misstatements in the financial statements.

An overview of KPMG's standard three-step audit approach follows:



Overview of Audit Procedures

Balance Sheet

Financial Statement Caption	Audit Considerations	Key Audit Procedures
<ul style="list-style-type: none"> Cash and Investments (\$2.5 billion)	<ul style="list-style-type: none"> Accounting for and control over cash and investments focused on the completeness, existence and accuracy of the account balances 	<ul style="list-style-type: none"> Test account reconciliations Confirm key cash and investment balances
<ul style="list-style-type: none"> Accounts Receivable- Patient Services (\$190 million)	<ul style="list-style-type: none"> Existence of receivables Reasonableness of contractual and bad debt allowances Collectibility of receivables 	<ul style="list-style-type: none"> Substantive audit and controls procedures to test reasonableness of accounts receivable contractual allowance and bad debt reserves Accounts receivable testing for existence of account balances Test account reconciliation
<ul style="list-style-type: none"> Accounts Receivable- Grants and Contracts (\$118 million)	<ul style="list-style-type: none"> Existence of receivables Accuracy of receivables Collectibility of receivables 	<ul style="list-style-type: none"> Coordination, review and reliance on the State Auditor testwork over grants and contracts Evaluate internal controls Assess the validity and collectibility of billed and unbilled receivables.
<ul style="list-style-type: none"> MetroTract (\$117 million)	<ul style="list-style-type: none"> Proper recording of net assets of MetroTract 	<ul style="list-style-type: none"> Obtain and review the audit report of Peterson & Sullivan



Financial Statement Caption	Audit Considerations	Key Audit Procedures
<ul style="list-style-type: none"> • Capital Assets (\$2.2 billion) 	<ul style="list-style-type: none"> • Proper capitalization and classification of assets • Appropriate depreciation/ amortization • Safeguarding assets 	<ul style="list-style-type: none"> • Review a reconciliation of capital asset activity • Test and evaluate internal controls over capital asset additions • Test a sample of significant additions and retirements by examining supporting documentation.
<ul style="list-style-type: none"> • Accounts Payable and Accrued Liabilities (\$277 million) 	<ul style="list-style-type: none"> • Recognition of transaction in proper accounting period • Accuracy of amounts recorded and assessment of management's estimates 	<ul style="list-style-type: none"> • Perform review of subsequent disbursements • Review reasonableness of balances compared to expectations
<ul style="list-style-type: none"> • Self Insurance Reserve (\$31 million) 	<ul style="list-style-type: none"> • Valuation of management's estimates for legal liabilities 	<ul style="list-style-type: none"> • Test the internal control system for monitoring litigation, claims, and assessments • Obtain and review audit report of the captive insurance company.
<ul style="list-style-type: none"> • Debt (\$668 million) 	<ul style="list-style-type: none"> • Proper classification • Compliance with financial covenants 	<ul style="list-style-type: none"> • Confirm balances • Test disclosure and classification • Test financial covenants
<ul style="list-style-type: none"> • Net Assets (\$3.7 billion) 	<ul style="list-style-type: none"> • Proper classification of restrictions 	<ul style="list-style-type: none"> • Review reasonableness of balances compared to expectations

Statement Of Revenues Expense And Changes In Net Assets

Financial Statement Caption	Audit Considerations	Key Audit Procedures
<ul style="list-style-type: none"> • Student tuition and fees (\$304 million) 	<ul style="list-style-type: none"> • Accounting for and control over the tuition cycle • Proper accounting for scholarship allowances 	<ul style="list-style-type: none"> • Review reasonableness of balances compared to expectation • Test and evaluate internal controls
<ul style="list-style-type: none"> • Patient services (\$689 million) 	<ul style="list-style-type: none"> • Proper recording of revenues • Proper cut-off of revenue between periods • Accuracy of recording of contractual deductions from revenue • Proper recording of charity care amounts in accordance with charity care policy 	<ul style="list-style-type: none"> • Charge capture testing for appropriate capture of revenues at set charge master rates • Revenue cut-off testing for appropriate revenue recognition • Test and evaluate internal controls
<ul style="list-style-type: none"> • Grants and Contracts revenue (\$758 million) 	<ul style="list-style-type: none"> • Proper recording of revenues and collections • Accuracy of account balances 	<ul style="list-style-type: none"> • Coordination, review and reliance on the State Auditor testwork over compliance • Test and evaluate internal controls
<ul style="list-style-type: none"> • Auxiliary Enterprise revenue (\$126 million) 	<ul style="list-style-type: none"> • Proper consolidation of entities 	<ul style="list-style-type: none"> • Obtain and review departmental and component unit statements for proper inclusion in the financial statements



Financial Statement Caption	Audit Considerations	Key Audit Procedures
<ul style="list-style-type: none"> Salaries and Benefits (\$1.6 billion) 	<ul style="list-style-type: none"> Recognized in proper accounting period Accuracy of amounts recorded 	<ul style="list-style-type: none"> Test and evaluate the internal controls Coordinate departmental reviews through work performed by the State Auditor Review reasonableness of balances compared to expectation
<ul style="list-style-type: none"> State Appropriations (\$343 million) 	<ul style="list-style-type: none"> Accuracy of amounts recorded 	<ul style="list-style-type: none"> Confirm balances with information provided from the state accounting system
<ul style="list-style-type: none"> Investment Income (\$220 million) 	<ul style="list-style-type: none"> Accuracy of amounts recorded 	<ul style="list-style-type: none"> Confirmation of amounts with the custodian Obtain and review the SAS 70 internal control report provided by the service organization.

Coordination with Other Auditors

When necessary we will coordinate and rely on audit testwork performed by the following other auditors.

Auditor

Peterson Sullivan

Washington State Auditor’s Office

University of Washington Internal Audit

University Component

Metro Tract, Housing & Food Services

Research – Compliance with Laws and Regulations

Statewide Debt

Various

This coordinated approach allows us to reduce duplicative testwork during the audit of the University and increase overall efficiency.

VI. New Accounting Pronouncements

Statement No. 42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

GASB No. 42 was issued in November 2003 and is effective for the University's fiscal year ended June 30, 2006, although early implementation is encouraged.

This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries.

Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost.

VII. Tentative Timetable

	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Initial Planning Meetings	•									
Present Audit Plan to Board of Regents' Finance & Audit Committee		•								
Planning Meetings with University of Washington Finance Department			•							
Interim Fieldwork		•	•	•						
Final Fieldwork					•	•	•			
Financial Statements Preparation and Reporting							•	•	•	
Presentation of Financial Statement and Management Letter to Board of Regents' Finance & Audit Committee										•

We will coordinate with the controller's office a more detailed schedule of events which outlines specific data requirements, timelines and individuals responsible for each will be prepared.