

THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

MINUTES OF THE AUDIT COMMITTEE

May 8, 2014
Nashville, Tennessee

The Audit Committee of The University of Tennessee Board of Trustees met at 1:30 p.m. CDT on May 8, 2014, in the offices of Bradley Arant Boult Cummings in Nashville, Tennessee.

I. CALL TO ORDER

Mr. D. Crawford Gallimore, Chair, called the meeting to order.

II. ROLL CALL

Ms. Sandy S. Jansen, Executive Director, called the roll, and the following Audit Committee members were present:

Mr. D. Crawford Gallimore
Mr. Spruell Driver
Mr. Brian Ferguson (by phone)
Mr. Waymon Hickman, external member
Mr. Tommy Whittaker

Ms. Jansen announced the presence of a quorum of the committee. Trustee Brian Ferguson (ex-officio member) participated by phone. No one else was present in his location. Ms. Jansen announced those present at the meeting location. Members of the administrative staff were present, as well as State Audit staff.

III. APPROVAL OF MINUTES FROM LAST MEETING

Chair Gallimore asked for any corrections to the December 18, 2013, minutes. Hearing none, Mr. Hickman moved approval of the minutes as presented, and Trustee Driver seconded the motion. A roll call vote was taken, and the motion carried unanimously.

IV. DIVISION OF STATE AUDIT

Ms. Deborah Loveless, Director of State Audit, reminded the Audit Committee of the importance of the committee and internal audit function. She also mentioned the audit work the state auditors are conducting for the Southern Association of Colleges and Schools (SACS) accreditation process. Ms. Loveless commented on the sunset audit and noted that last year, the auditors reviewed the Board of Trustees, Board of Regents, Tennessee Higher Education Commission (THEC), and the Tennessee Student Assistance Corporation (TSAC), collectively.

Ms. Lisa Williams, In-Charge Auditor for the sunset audit, presented the results of the performance audit (Exhibit 1). After the presentation, the findings related to fingerprints and transfer pathways and the university's actions were discussed.

Mr. Ron Maples, UT Controller, presented the audit report for the University of Tennessee conducted by the Division of State Audit (Exhibit 2). The university received an unmodified opinion with two findings.

Mr. Maples presented the report of agreed-upon procedures conducted by the Division of State Audit (Exhibit 3). He commented that, in addition to the university audit, the auditors issued an independent report on applying the agreed-upon procedures. The work is referred to as the National Collegiate Athletic Association (NCAA) audit. Ms. Jansen reminded the Audit Committee that the engagement assists university management and the board and is required by the NCAA bylaws. The engagement is not an audit and no opinion is issued.

V. ATHLETICS DEPARTMENTS' FINANCIAL TRENDS

Mr. Julio Freire, Director of Intercollegiate Athletics for the University of Tennessee at Martin (UTM), presented the financial trends for UTM athletics (Exhibit 4). The financials have been stable, with little growth. Because college athletics nationwide have grown tremendously during the same period, UTM athletics depends heavily on the institution. If athletics is not growing, it is falling behind. Mr. Freire noted how intercollegiate athletics enhance the experience of everyone associated with the institution, including current and former students, and impact enrollment. Mr. Freire discussed men's basketball and program expenses in the Ohio Valley Conference. He also explained the

importance of generating private gifts for athletics so that funds could be reinvested into the student-athlete experience.

Chair Gallimore asked about the importance of guarantees. Mr. Freire responded that it is a double-edged sword and there is added expense to get those games but, from a football perspective, UT Martin has been living on guarantee money.

Mr. David Blackburn, Vice Chancellor and Director of Athletics for the University of Tennessee at Chattanooga (UTC) presented the athletics financial trends for UTC (Exhibit 5). He stated guarantee games are important for the program; however, UTC needs to grow revenues through contributions. The five-year trends show contributions are down. Growing contributions will be a focus area for athletics. He noted the \$4.5 million in grant and aid that goes to the institution. Mr. Blackburn discussed the Adidas contract and the value of buying product at discounted rates and having a national presence. This contract allows all teams to wear a great product and feel valued. He discussed the facilities needs at UTC, the only school in the Southern Conference without a stand-alone athletics facility. When the best and brightest students are brought in, Chattanooga is trying to compete with other schools with new facilities, while UTC athletics resides in a 35-year-old arena.

Mr. Brett Huebner, Senior Associate Athletics Director, presented the financial trends for the University of Tennessee, Knoxville (Exhibit 6). Mr. Huebner commented that Knoxville's athletics department is about a \$100 million enterprise, primarily funded from self-generated revenues, and has been off its peak for ticket sales and contributions. A downward trend has occurred, with a slight reversal in that trend. In fiscal year 2014, athletics is seeing excitement going into the next football season. Coach Butch Jones has done a great job promoting the program. On the expense side, athletics student aid was increased by \$2 million to support student-athletes. A one-time transfer of funds helped fund the offset expenses with a coaching transition in the football program. This transfer was based on and funded by a return of previous years' contributions from athletics to campus. When asked about severance payments, Mr. Huebner indicated the entire amount of severance payments was recognized and booked as a liability and fully expensed. There should be no expense for those in future years. Trustee Whittaker asked about the prior-year transfers to the institution and how long they had occurred. Mr. Chris Cimino, Vice Chancellor of Finance and Administration, indicated the transfers dated back 22 to 23 years. Approximately \$2 million of the transfer related to scholarships.

VI. INFORMATION TECHNOLOGY (IT) SECURITY ASSESSMENT ACTION PLANS

Dr. David Millhorn, Executive Vice President, provided an update (Exhibit 7) on the progress related to the recommendations in the BerryDunn report.

Dr. Millhorn stated BerryDunn was selected to perform a statewide security assessment. This assessment was not done in response to any security breakdown but to be proactive in identifying areas where UT is susceptible and to use the recommendations to strengthen security. A draft of the BerryDunn report was issued at the end of 2013 and distributed by Ms. Jansen to the UT System and campus officials. The final report was received on February 11, 2014. The BerryDunn report listed fourteen statewide recommendations that were communicated to the chief information officers (CIO) and chancellors. UT System leadership agrees with all fourteen recommendations. The campuses generally agree with eleven of the recommendations. System leadership is working with the campuses on the other three³. The recommendations having partial agreement are related to roles, responsibilities, and reporting relationships; data ownership; and staffing at the different entities across the system. UT believes this has been a worthwhile endeavor and feels a much more secure system exists now.

Dr. DiPietro added that information technology is important to the institutions collectively, noting that if there is a day when it is not working, people do not get work done. He commented that UT is getting closer to a consensus about the findings but would like the Audit Committee to consider one approach to oversight. The report contains a recommendation about a dual reporting structure in an effort for the UT System CIO to have oversight of security alongside the chancellor or vice chancellor, in some cases, depending on the institution. Dr. DiPietro recommended that the oversight could be provided through Ms. Jansen's team by the Audit Committee, similar to oversight of financial affairs. With the right expertise in the audit group, the auditors could perform work each year on security of the IT systems. While it is still a concept and the logistics are not in place, this structure could achieve greater influence than any dual reporting approach could achieve. The reporting approach on the various positions becomes less important if audit is performing work each year. While he believes the system CIO should work with the campus CIOs, he recommended the university structure the oversight differently than recommended in the report. Dr. DiPietro indicated the Audit Committee should review the work annually in an effort to keep the university secure. Dr. Millhorn added that the university also needs to test itself regularly. Mr. Charles Peccolo,

UT Treasurer and Chief Financial Officer, commented that the audit function could perform tests based on a risk assessment similar to what is done on the financial side. Dr. DiPietro asked for feedback from the Audit Committee on this idea.

Dr. DiPietro also noted the BerryDunn report suggests the CIO report to a high level. He thinks there is credibility in thinking about a different model. He stated it would be better to have the system CIO report to the chief financial officer, adding that he has been considering the system organization and organizing into columns of activity. Looking at operations, those fall to Mr. Peccolo and his team who handle the operational side. They do planning, construction, and financials; ensure the right enterprise systems exist; and work with the business officers around annual business processes. Dr. Millhorn's work is focused on research, outreach, the lab, and UT Research Foundation.

Chair Gallimore agreed with the governance structure proposed by Dr. DiPietro and strongly recommended that the low-hanging fruit be taken care of. All of the physical problems identified by BerryDunn need to be addressed. He added that the university needs to hire a chief information officer at the system level to drive this program.

Dr. DiPietro agreed and indicated part of the work is developing a strategy around roles, which should be done before hiring a chief information officer. He commented that it would be best to do a national search; however, a search does not preclude internal candidates. Chair Gallimore indicated that, while he did not advocate starting this work tomorrow, at some point it will make sense for it to become a priority.

Mr. Driver asked about the "heart bleed" situation, and Mr. James Perry, Interim CIO, indicated a comprehensive system-wide review was performed and UT's vulnerability was very low.

VII. INSTITUTIONAL COMPLIANCE

Mr. Maples presented information on the changes in federal regulations and OMB Uniform Guidance (Exhibit 8).

VIII. PROCEDURES FOR MINORS ON CAMPUS

Mr. Matthew Scoggins, Assistant General Counsel, made the following introductory remarks:

The national discussion on minors on campus started in November 2011. After the Sandusky issue came to light, UT sent an e-mail to all university employees and students informing them of Tennessee laws on mandatory reporting of child abuse. Audit and Consulting Services also conducted an audit on protection of minors, issued in September 2013, which indicated UT has 277 programs with minors. About 350,000 minors come to university campuses/institutes every year. All campuses have adopted the safety policy that went into effect in January 2014. It reemphasizes to employees the mandatory reporting laws. It is their responsibility, not only to follow the law, but it is a matter of university policy now. It requires criminal background checks for all employees and volunteers who work with minors. They will be trained every two years, and a person has been identified on each campus to keep track of the programs on campus and make sure those programs are complying with the UT System safety policy. Campus procedures have been established as well.

Following Mr. Scoggins's comments, Ray Coleman, Deputy Chief of Police, presented UT Martin's program (Exhibit 9); Tim Pridemore, Emergency Management Specialist, presented UT Chattanooga's program (Exhibit 10); Brian Browning, Director of Administrative and Support Services for Finance and Administration, presented UT Knoxville's program (Exhibit 11); and Herb Byrd, Daniel Saver, and Steve Sutton presented the program for the Institute of Agriculture (Exhibit 12).

In his presentation, Mr. Browning discussed membership in a higher education youth protection group consisting of 60 representatives from colleges and universities across the country. A conference call is made every two months or so, and a seminar or another kind of youth protection education may occur twice a year. This is an opportunity for universities to share and collaborate. Chair Gallimore asked that the other campuses look into membership in the group.

Chair Gallimore asked about the audit plan regarding this issue. Ms. Jansen explained that an audit report was issued last year and the team will follow up on the recommendations. The safety policy requires that ACS perform an audit at least every four years, so this work will be included on the annual plan as required.

IX. AUDIT STAFFING

Ms. Linda Hendricks (currently Harig), Vice President of Human Resources, and Mr. Ron Loewen, Budget Director, presented information on a market assessment of audit salaries (Exhibit 13).

Ms. Hendricks provided background on the market assessment. In 2011, UT engaged an external national compensation firm to provide market data. At that time, there was almost an \$110,000 gap to bring the audit staff to 100 percent of market. Today, with subsequent increases and changes, an \$84,000 market gap exists for the audit staff. Because all campuses and institutes have huge market gaps, the compensation advisory board recommended the first milestone be 80 percent of market. For the audit staff, in 2011 the gap to be at 80 percent was \$11,000. All audit staff are now at 80 percent or above, meeting the first milestone. The comparison markets include institutions of similar size and type for higher education and general industry. The compensation advisory board recommends another full assessment in 2016. It is important to note that not everyone should be at market. Staff who are early in their career and just learning or core performers are not usually at market. Some, however, should be beyond market, normally long-term, high-performing staff. Market is just a measuring point, but the important part is to review all individuals, their contributions, and their years of experience to determine where they should be compared to the market.

Mr. Loewen presented a graph outlining percentage of market comparing employees' current salaries with the market for that position. He commented there are reasons for employees to be paid above or below market. Dr. DiPietro questioned the trend and whether other departments would show the same kind of trend. There was discussion on perceptions of the trends.

Ms. Hendricks reminded the committee that the important thing is compensation plans are in place for each campus and institute. Department heads need to review their employees with the biggest market gaps. Sometimes there is a reason why a staff member looks out of place and the individual is exactly where he or she should be. Each person must be reviewed individually, as Ms. Jansen has done.

X. AUDIT AND CONSULTING SERVICES 2013 ANNUAL REPORT

Ms. Jansen presented the 2013 Report of Accomplishments (Exhibit 14), noting the promotion of an ethical environment being one of the most important aspects of ACS's work. This past year, the compliance team worked with other system offices to promote a revised code of conduct. Also, 58 percent of the audit effort was spent on areas of focus including fraud prevention and detection, controls, and effectiveness and efficiency. About 20 percent of audit effort was spent on fraud investigation. While ACS is trying to focus on fraud prevention and detection, much time is still dedicated to investigations. This effort will not change. With the university as large as it is, there will always be investigations. She commented on the strategic plan the office prepared this past year and was excited that the team members worked together and are building some momentum on achieving goals tied directly to the university's strategic plan.

XI. EXTERNAL AUDIT REPORTS

Ms. Jansen presented the external audit reports included in the meeting materials (Exhibit 15). All external audit reports received an unmodified opinion.

XII. 2014 AUDIT PLAN UPDATE

Ms. Sandy Jansen presented the audit plan update, and there were no questions (Exhibit 16).

XIII. TRAVEL EXCEPTION REPORT

A written report was submitted by Mr. Charles Peccolo regarding travel exceptions (Exhibit 17).

XIV. HOUSING EXCEPTION REPORT

A written report was submitted by Mr. Charles Peccolo regarding housing exceptions (Exhibit 18).

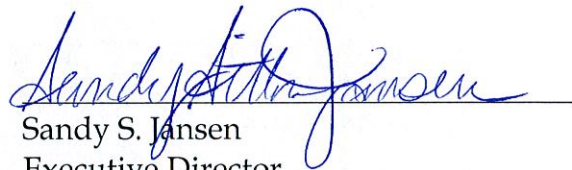
XV. OTHER BUSINESS

The Chair called for any other business to come before the Audit Committee. There was none.

XVI. ADJOURNMENT

There being no further business to come before the Audit Committee, the meeting was adjourned.

Respectfully Submitted,

A handwritten signature in blue ink, appearing to read "Sandy S. Jansen", is written over a horizontal line.

Sandy S. Jansen
Executive Director
Audit and Consulting Services