

THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

MINUTES OF THE AUDIT COMMITTEE

May 13, 2013
Nashville, Tennessee

The Audit Committee of the Board of Trustees of The University of Tennessee met at 2:00 p.m., CDT, May 13, 2013, 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. Waymon Hickman, external member
Mr. Douglas A. Horne
Mr. Don C. Stansberry Jr., ex officio
Mr. Tommy Whittaker

Ms. Jansen announced the presence of a quorum of the committee. Other members of the administrative staff were also present.

III. APPROVAL OF MINUTES FROM LAST MEETING

Chair Gallimore asked for any corrections to the December 18, 2012, minutes. One minor change of spelling was noted. Trustee Stansberry moved approval of the minutes with the correction. Mr. Hickman seconded the motion, and it carried unanimously.

IV. STATE AUDIT UPDATE

Mr. Robert Hunter, Audit Manager for State Audit, presented the audit for The University of Tennessee (Exhibit 1). The University received an unqualified opinion and there were no findings related to accounting and reporting; however, there were two audit findings concerning compliance with federal financial aid for students. In both cases, the Knoxville and Memphis campuses were not recording enrollment changes correctly. Mr. Peccolo reported that the campuses are working on processes to eliminate these issues in the future.

V. FINANCIAL STATEMENTS FOR THE UNIVERSITY'S ATHLETICS DEPARTMENTS

The Division of State Audit's annual agreed-upon procedures were presented (Exhibit 2). Ms. Jansen reminded the Audit Committee that this engagement assists university management and the board and is required by the National Collegiate Athletic Association's (NCAA) bylaws. The engagement is not an audit and no opinion is issued.

Mr. Phil Dane, Athletics Director at The University of Tennessee at Martin, presented the financial trends (Exhibit 3). He commented on revenues and stated Athletics continues to be more dependent on guaranteed revenue. Football brings in about 50 percent of the revenue and expends about 30 percent of the expenditure budget. He indicated that student aid makes up 40 percent of the expenditures and that those expenses continue to increase.

Mr. Dane reported that the student-athlete grade-point average for the fall 2012 semester was 3.5, noting it was the second consecutive semester the average has been above 3.0.

Trustee Horne asked about the percentage of funding coming directly from the University compared to past years. Mr. Dane indicated the percentage of total revenue may have grown a percent or two in the last ten years but has stayed relatively stable.

Chair Gallimore asked about revenue games scheduled. Mr. Dane said UT Martin will play Boise State and Memphis in 2013. In 2014, football will play Mississippi State and Kentucky. Trustee Horne asked about the safety of the players in these types of games. Mr. Dane responded that they had not seen any increase in injuries during these types of games compared to conference games.

Dr. Richard Brown, Vice Chancellor at The University of Tennessee at Chattanooga, presented the financial trends (Exhibit 4). He reported that all coaching vacancies have been filled and that UT Chattanooga is pleased to have David Blackburn as the new Athletics Director. UT Chattanooga is a member of the Southern Conference, and the former Athletics Director led the program to be in a competitive position. The purpose of the program is student success, and the campus is serious about graduating student-athletes. Financial stability and championship programs continue to be goals. Financially, the program has moved forward in the last five years. The University played the Lady Vols in basketball this year and has booked the men's football team in the off year. He commented that the campus depends on the revenue from those big-game opportunities. With the preparation and training, there are not the injuries that one would have seen about ten years ago. Dr. Brown indicated that, about four years ago, UT Chattanooga moved to a student fee-supported athletics program. The philosophy is that these major programs will always require some degree of state subsidy. The programs do not generate the same level of revenue as UT Knoxville. The revenue includes about \$5 million of student activity fees and \$5 million dollars of institutional support. The other pieces of revenue are game-day guarantees and corporate sponsorships. Men's basketball is the biggest revenue generator for Athletics. The basketball program is always competitive. The football program is also headed north, so the campus believes the best days are ahead.

Trustee Horne asked about the percentage of E&G money used for Athletics. Dr. Brown indicated that it is about 48 percent of the revenue.

President DiPietro asked about the student fee base. Dr. Brown indicated the fee is about \$480 annually per student and generates about \$4.8 million for the program. President DiPietro questioned the student involvement in setting the fees. Dr. Brown responded that administration has engaged the students and there was not much resistance.

Trustee Stansberry asked about corporate sponsorship. Dr. Brown said that there are programs such as the MOCS Club, where corporations can buy certain levels of sponsorships.

Bill Myers, Senior Associate Athletics Director for The University of Tennessee, Knoxville, presented the financial trends (Exhibit 5). Athletics had a reserve starting the year of about \$5.9 million; however, there was a deficit this past year and the reserve is around \$1 million. The last couple of football seasons have had an impact on revenues. About \$90 million of \$102 million in expenditures are

fixed costs, including game guarantees, scholarships, and salaries. About \$12 million is available for recruiting, facilities improvements, and team travel to locales outside the conference. Mr. Myers explained that there is a misperception about scholarships. Athletics pays the scholarship costs for athletes. He indicated that about 80 percent of the athletes are out-of-state students and, since the scholarship cost for out-of-state is about \$37,000, Athletics pays about \$10.6 million for scholarships. He also explained that taking the team to Oregon will cost about \$300,000. The University receives \$350,000 for the game.

Trustee Horne questioned whether there was anything that could be done on the debt service, amortization, or interest rate. Mr. Myers indicated that the debt items are part of the University's debt and cannot be parsed out. He added that the rates are very favorable and the treasury group has done a good job with the rates. Mr. Peccolo said the Tennessee State School Bond Authority met the previous week and voted for a \$145 million refunding opportunity across higher education in Tennessee. He added that some of this debt will include Athletics debt.

Chair Gallimore asked about the debt amount for Athletics. Mr. Myers indicated that they were able to pay down a significant portion and that debt service is between \$200 million and \$205 million. Given the debt of other schools in the Southeastern Conference, it is not out of the norm. One of Mr. Hart's focal points is to grow the reserve and pay down debt.

Chair Gallimore asked about television revenue with the addition of Missouri and Texas A&M to the conference. Mr. Myers indicated there are still unknowns. He said he has done an analysis and felt that dividing revenues 15 ways instead of 13 creates a shortage for the University; however, the conference has guaranteed they will make up any shortage from reserves. He explained there are added expenses, almost \$1 million in travel costs for all of the teams to go to the locations now that Missouri and Texas A&M are in the conference. Those are additional costs that probably were unattended. The league announced the SEC digital network and the University believe there will be additional revenues. He estimates \$5 million to \$8 million in new money at some point, probably the 2014-2015 fiscal year.

President DiPietro asked how much revenue the Big 10 conference generated. Mr. Myers indicated roughly \$15 to \$18 million per school. Chancellor Cheek said the additional revenues are coming slower than originally anticipated. He stated negotiations with the television networks were much slower than anticipated and there was resistance for additional money for Texas A&M and

Missouri. Those two schools add about 25 percent more households to the Southeastern Conference, so they anticipate additional revenues. Chancellor Cheek said he interpreted that the conference intends to cover revenues plus any additional expense. He believes Athletics will have more revenue in the 2014-2015 fiscal year and the real concern is getting from here to there. Revenues are down somewhat and Athletics must continue to invest to be competitive. They are paying down debt and developing a reasonable reserve so that, when Athletics goes through some tough years, it can continue to operate.

Trustee Stansberry asked if there is any consideration for corporate sponsors. Chancellor Cheek responded that the University does everything possible to get all types of sponsors and donors.

VI. AUDIT REPORT ON THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.

Ms. Jansen presented the independent auditor's report for The University of Tennessee Foundation, Inc. for the year ended June 30, 2012 (Exhibit 6). The auditor issued an unqualified opinion.

VII. AUDIT REPORT ON THE UNIVERSITY OF TENNESSEE RESEARCH FOUNDATION

Ms. Jansen presented the independent auditor's report for The University of Tennessee Research Foundation for the year ended June 30, 2012 (Exhibit 7). The auditor issued an unqualified opinion.

VIII. AUDIT REPORT ON THE UNIVERSITY OF CHATTANOOGA FOUNDATION

Ms. Jansen presented the independent auditor's report on The University of Chattanooga Foundation for the year ended June 30, 2012 (Exhibit 8). The auditor issued an unqualified opinion.

IX. AUDIT REPORT ON UT MEDICAL GROUP, INC.

Ms. Jansen presented the independent auditor's report for UT Medical Group, Inc. for the year ended June 30, 2012 (Exhibit 9). The auditor issued an unqualified opinion.

Trustee Horne questioned whether UT Medical Group was paying the University as required. Chair Gallimore indicated the previous issues have been fixed and Mr. Peccolo concurred.

X. AUDIT REPORT ON UT LE BONHEUR PEDIATRIC SPECIALISTS, INC.

Ms. Jansen presented the independent auditor's report for UT Le Bonheur Pediatric Specialists, Inc. for the year ended June 30, 2012 (Exhibit 10). The auditor issued an unqualified opinion.

XI. INSTITUTIONAL COMPLIANCE UPDATE

Mr. Bill Moles, Director of Institutional Compliance, provided an update. Mr. Moles reported that UT Knoxville is making progress on the corrective action plan. There were 138 risks identified during the assessment. Those risks were consolidated to 40 action plans. Eleven action plans have been implemented and 20 are close to implementation. He reported that the UT Health Science Center risk assessment is underway, with 126 risks identified. Plans are being finalized, and about 50 plans will be reviewed and further developed prior to implementation of corrective actions. Institutional Compliance is beginning the risk assessment for the Institute of Agriculture and plans to start data collection in July. Chair Gallimore asked Mr. Moles if anything keeps him up at night. Mr. Moles replied that nothing keeps him up right now. He said that things are moving along and there is not a specific compliance issue that cannot be addressed.

XII. 2013 AUDIT PLAN UPDATE

Ms. Jansen presented the status of the audit plan (Exhibit 11). The internal audit team has made progress on engagements that were in progress from prior years. As of May 1, 2013, four audits were still in progress. Three of those engagements were in the reporting stage. Ms. Jansen commented on 2013 planned engagements and explained that additional resources have been committed for the NCAA compliance audit. When the Audit Committee approved the plan, there was a plan to outsource the engagement. After additional discussions with Athletics management, the internal audit team plans to conduct the work. In addition, based on follow-up work conducted in a previous engagement, an engagement to review controls of petty cash at the UT Health Science Center has been added.

To accommodate the hours needed for the audits added to the plan, two engagements were selected for cancellation based on changing risks: the Regional Biocontainment Laboratory Expenditure and Equipment audit and the audit of the Vice Chancellor for Research at UT Knoxville.

The team conducting the advising audit has been on each campus to better understand the academic advising processes. Now that the team understands the processes, they are planning to do an assessment based on a self-assessment tool established by the advising profession's national association. The tool will help the team focus on gaps and identify where the audit team can add value. The team will work with each of the campuses on the assessment.

Trustee Stansberry requested that the advising projects be complete in order for the work to be considered during the Trustee workshop in September. The projects will represent the quality of internal audit's work as well as the quality of the work of advising. Chair Gallimore added that the workshop will focus on retention and graduation rates, and the Trustees are all of the opinion that advising is key to both of those. He encouraged Ms. Jansen to dedicate the needed audit resources to complete the projects so that there will be good information by that meeting.

XIII. TRAVEL EXCEPTION REPORT

Ms. Jansen presented the travel exception report (Exhibit 12) and discussed the five exceptions noted.

XIV. HOUSING EXCEPTION REPORT

Ms. Jansen presented the housing exception report (Exhibit 13), noting no exceptions.

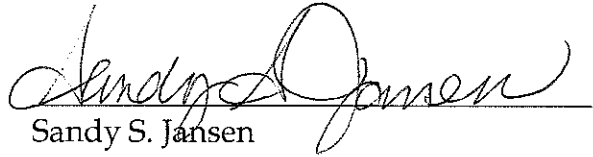
XV. OTHER BUSINESS

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 in public session, the meeting was adjourned. The remainder of the meeting concerned a matter confidential under Tenn. Code Ann. § 4-35-108(b)(1).

Respectfully Submitted,

A handwritten signature in cursive script, reading "Sandy S. Jansen", written over a horizontal line.

Sandy S. Jansen
Executive Director
Audit & Consulting Services