

**THE UNIVERSITY OF TENNESSEE BOARD OF TRUSTEES
AUDIT COMMITTEE
APRIL 7, 2011, MEETING MINUTES**

Audit Committee members present: Chairman Mr. James Hall, Mr. Waymon Hickman, Mr. Doug Horne, Mr. D. Crawford Gallimore, Mr. Jim Murphy

UT: Ms. Judy Burns, Mr. Bill Moles, Dr. Joe DiPietro, Mr. Keith Carver, Mr. Mark Paganelli, Mr. Charles Peccolo, Mr. Ron Maples, Mr. Chris Cimino, Mr. Hank Dye, Mr. Mark Smith, Mr. Brian Gard, Mr. Tyler Johnson, Mr. Bill Myers, Dr. Ken Brown, Mr. Tony Ferrara, Mr. Phil Dane, Ms. Debbie Parker, Mr. Matt Pope, Mr. Anthony Haynes, Mr. Bob Hunter

Mr. James Hall called the meeting to order. Mr. Hall discussed the minutes from the last meeting. There were no additions or corrections. A motion was made by Mr. Waymon Hickman to accept the minutes; the motion was seconded by Mr. D. Crawford Gallimore, and the minutes were approved unanimously.

Mr. Hall thanked Dr. DiPietro for attending, noting he was continuing the tradition begun by Dr. Simek for presidents to attend audit committee meetings and observing that the president's attendance signified the importance the president's office places on the work of the committee. Mr. Hall then asked that the committee observe a moment of silence to acknowledge the passing of former Tennessee Governor Ned McWherter.

State Audit Update – Mr. Bob Hunter reported on the audit of the University of Tennessee for the last fiscal year. Mr. Hunter stated the audit was begun in May and finished in late December, noting it took longer this year because it was the first year the UT Research Foundation was included in the university's financial statements. Mr. Hunter noted the university received an unqualified opinion with no audit findings. He expressed his appreciation to the staff in the Controller's and Treasurer's offices, saying they had done an excellent job. He stated only minor problems were found related to American Recovery and Reinvestment Act (ARRA, or stimulus) funds.

Ms. Burns asked Mr. Charles Peccolo how long it had been since the university had received an audit report with no findings, and Mr. Peccolo indicated that, in his 36 years with the university, he recalled no other instance. Mr. Peccolo acknowledged that the university's business officers and staff were responsible for this achievement.

Mr. Hall asked Mr. Hunter how many more years he thought State Audit would review stimulus funds. Mr. Hunter replied there would be one more year. Mr. Ron Maples commented that the university had until September 30, 2011, to obligate stimulus funds and another three months to actually spend the money.

Mr. Hickman asked if Mr. Hunter if State Audit had found Internal Audit's work on ARRA funding valuable and whether it allowed his staff to reduce the scope of their work. Mr. Hunter replied that, although the work was very good and useful, it did not impact the scope of their work since they usually do not rely on the work of internal auditors, instead viewing them as a part of the university's system of internal controls.

Mr. Hall asked how many hours were involved in this year's audit, and Mr. Hunter replied that, although he did not know the exact number of hours, nine staff worked on the audit.

Mr. Maples noted that auditors from the U.S. Department of Energy's Investigator General's office are currently reviewing two grant programs connected to the Tennessee Solar Institute. Mr. Hall asked Mr. Maples to provide an update on this review at the next committee meeting.

Mr. Murphy thanked the university's audit staff and noted that a strong internal audit function is part of the reason there were no findings in the state's audit.

Financial Statements for the University's Athletics Departments – Representatives from the Athletics departments at UT Knoxville, UT Chattanooga, and UT Martin reviewed their departments' financial information for fiscal year 2010. The financial statements are prepared each year by the State Audit office in accordance with agreed-upon procedures prescribed by the National Collegiate Athletic Association (NCAA). Mr. Hunter explained that his staff do not audit the statements, but rather perform numerous procedures, to which university management agrees, to assist the university in determining whether the financial statements are in compliance with NCAA bylaws. They also present any findings. Ms. Burns noted only a few minor findings were identified this year and did not result in any adjustments to the statements.

Mr. Bill Myers, senior associate athletics director, and Mr. Tyler Johnson, associate athletics director, reviewed the UT Knoxville statements. Mr. Myers noted that the NCAA proscribes the 35 categories into which revenues and expenses are classified for consistency among schools, but the categories do not show details (e.g., Women's Athletics brought in \$1.4 million in private contributions, most from basketball, but these funds are classified as non-program specific). Mr. Myers stated the over \$4 million surplus was allocated two ways, the majority (\$2.4 million) for an indoor tennis facility project and the remainder (\$1.6) to the reserve account.

Mr. Myers also explained several items the NCAA requires to be included in these statements that are not in the financial statements: revenues and expenses for courtesy cars, revenue from gifts-in-kind (contributions of services or products), and revenue and expenses related to facilities and administrative (indirect) charges. These items totaled about \$15 million.

Mr. Hall noted the large number for indirect charges and asked how it is tracked. Mr. Maples explained that the Controller's Office calculated the amount, which included items such as services Athletics receives from the Treasurer's and General Counsel's offices, as well as depreciation. Mr. Myers explained that, of the \$12.5 million in indirect charges, approximately \$8.4 million was depreciation.

Mr. Hall also asked whether the numbers changed as a result of the UT Board's moving responsibility for Athletics from the president to the chancellor of the Knoxville campus. Mr. Myers and Mr. Chris Cimino, vice chancellor for finance and administration, stated they did not.

Mr. Myers stated the \$100 million in revenue represented a \$13 million increase from the previous year. The increase was due to an eighth home football game, a bowl game, and contributions. He noted the Southeastern Conference television contract brought in significant revenue. He observed that future growth would be more incremental. Expenses, he noted, have also increased. Scholarships, game guarantees, coaches' salaries, and game expenses were all up last year. He concluded by saying the positive news is that the unallocated fund balance grew to around \$4.5 million.

Mr. Horne asked whether coaches are ever offered a discounted cash settlement of their payout amounts rather than paying the entire amount over a period of time. Mr. Myers stated it had been considered and something similar was done regarding the payment to (football) Coach Derek Dooley's former school,

where a discounted amount was paid this year. Mr. Murphy noted that sufficient cash to pay a lump sum was often not available.

Mr. Horne also asked what comprised the line item "other operating expenses." Mr. Myers explained that it consists of travel for administrative staff, insurance of games, telephone charges, and other administrative expenses not tied to a specific team or game.

Mr. Horne asked who audits the numbers on these statements. Mr. Myers explained that the Athletics department conducts several audits a year on a variety of topics. Ms. Burns added that most of those audits are geared toward answering specific questions that arise, but periodically, as in this year, Internal Audit performs a general audit of the effectiveness of internal controls in the business office, which evaluate the processes that result in the amounts on the statements.

Mr. Hall asked what kind of information Mr. Myers provides to the chancellor and how often they meet to discuss financial matters. Mr. Myers explained that he works closely with Mr. Cimino and that Mr. Mike Hamilton and Ms. Joan Cronan, athletics directors for Men's and Women's Athletics, are on the chancellor's cabinet and keep the chancellor updated at all times.

Mr. Gallimore asked how the payments to former coach Bruce Pearl would be accounted for over the next year. Mr. Myers indicated they would be accounted for in fiscal year 2011, with an accrual entry for the payments outstanding as of June 30, 2011.

Mr. Horne asked what amount of debt Athletics currently holds in the form of short-term commercial paper. Mr. Myers indicated the amount had grown to almost \$40 million. This increase was due to \$32 million in short-term paper being outstanding on the Neyland Stadium project and \$8 million on the basketball practice facility (Pratt Pavilion). Mr. Peccolo explained that the Neyland and Pratt projects were no longer in commercial paper but in short-term bonds (10- and 5-year notes, respectively). Mr. Myers said the current commercial paper balance is less than \$2 million.

Mr. Hall asked for confirmation of whether Stokely Athletics Center was to be demolished, and Mr. Cimino explained that the campus was under guidelines from the state fire marshal to raze the building. He explained that the site would be used in the short-term for temporary parking and in the long-term for an academic building.

Mr. Hall asked Mr. Myers whether he had concerns about finances for the current year, and Mr. Myers said he felt they had planned well for this year and would have a surplus, though it may be less than last year's. Mr. Horne asked whether the department discussed ways to become more efficient and effective, and Mr. Myers stated it was a topic almost every week. Mr. Hall concluded by encouraging Mr. Myers and Mr. Johnson to meet with the chancellor and make him aware of any potential problems well in advance.

Mr. Matt Pope, senior associate athletics director, and Ms. Debbie Parker, associate vice chancellor for business and finance, from UT Chattanooga reviewed the UTC financial statements. Mr. Pope noted that, since Mr. Rick Hart, athletics director, took over in 2006, the department had balanced its budget four of five years. For fiscal year (FY) 2009, a deficit of about \$229,000 existed, which was carried forward to FY 2010 and repaid. The department ended FY 2010 with a \$40,000 surplus. Mr. Pope stated the department had experienced about \$1 million in budget cuts during the last five years, but the reductions were not readily apparent when reviewing the financial statements since increased expenses for grants-in-aid and benefits were offset by enrollment growth and increased athletics revenue.

Mr. Pope said that direct state and institutional support represented about 49 percent of the department's budget and most, if not all, of those funds were used for salaries and grants-in-aid for student-athletes. Salaries and grants-in-aid represent 59 percent of the budget, so the department must work to generate the difference and additional revenue for travel and other activities necessary to recruit and compete. Mr. Pope noted that, to balance the budget, the department had imposed more restrictive limits on travel per diems and similar expenses.

Mr. Pope explained that the chancellor was well informed of the department's finances because he was the chairman of the athletics board, which generally meets twice a year. He receives reports such as those provided to the Board and Tennessee Higher Education Commission and annual summary reports. The athletics director meets with him once a week whenever possible. Mr. Pope noted he and Ms. Parker meet quarterly as well.

Mr. Pope noted that the department is making efforts to reduce the amount of institutional support it receives. The department expects the campus to fund only increases in tuition, salary increases, and benefits costs. He said the department is discussing a plan with the vice chancellor for finance and operations and with the Student Affairs department which would enhance the student fees allocated directly to Athletics, while the department plans to relinquish the student activities fees over the next two fiscal years. He also stated the department makes every effort to obtain guarantee money from other schools for football and men's basketball games and is enhancing its marketing and promotional efforts to increase ticket sales.

Mr. Pope stated the only debt the department incurred was for Finley Stadium. Each year, this is a budgeted expense for which the department must raise revenue. Mr. Hall asked the debt amount, and Mr. Pope replied it was about \$170,000 annually. Mr. Hall also asked how the money raised by the Friends of Finley is used, and Mr. Pope explained it goes directly to Finley Stadium operations and improvements.

Mr. Hall asked how many sports the department supports. Mr. Pope replied they were supporting 17, although 6 were indoor and outdoor track and cross county, which have only one set of coaches.

Mr. Gallimore asked whether an effort was made to schedule in-state teams, such as UT Martin, Austin Peay, or Middle Tennessee State University, to keep revenue in Tennessee. Mr. Pope replied there was. Mr. Horne noted that would increase attendance. He then asked whether UT Chattanooga had considered dropping football as East Tennessee State University had done. Mr. Pope stated he and the athletics director believed that dropping football would hurt the athletics program.

President DiPietro asked what contributions had been made over the past five years. Mr. Pope explained that contributions increased greatly over that time. This year, however, although the number of donors increased, the revenue decreased. The department is trying to enhance revenue through efforts such as golf and bass fishing tournaments. President DiPietro clarified that the overall trend was growth, and the department felt it had the potential to grow even more. Mr. Pope responded yes.

Mr. Hall stated in the future it would be good to provide the committee with three to five years of data so that they could see trends.

Mr. Philip Dane, athletics director for UT Martin, reviewed the UTM financial statements. He stated that, over the past five years, expenditures increased \$3.3 million, or about 37.5 percent. This growth can be attributed primarily to a 25 percent growth in athletics aid (\$811,000), an 18 percent growth in coaching salaries and benefits (\$604,000), and a 107 percent increase in facilities and administrative (indirect)

support (\$766,000). These three areas account for 66 percent of the growth in expenditures over the last five years.

Mr. Dane noted the department has no control over the facilities and administrative support calculation, and therefore could not explain the drastic increase. However, the indirect support line item is merely an estimate and not an actual expenditure in Athletics' budget.

Regarding expenditures, Mr. Dane pointed out the athletics aid increases result from fee increases. Coaching salary and benefit increases are attributed primarily to a \$50 per semester activity fee increase that funded assistant coaching and staff positions in baseball, softball, soccer, volleyball, and sports information, and all of these positions were related to gender equity issues. The activity fee increase was implemented after a Student Government Association referendum, which was supported by 66 percent of the voting student body.

Mr. Dane stated the information from the financial statements is provided to the chancellor and Athletics Board at least annually, along with detailed reports of booster club donations and endowments. Comparative data with other Ohio Valley Conference members and with UT Chattanooga is also provided.

Regarding long-term debt, Mr. Dane noted a small amount remained on a football building, which was funded with private gifts, and the campus is taking on debt associated with a new baseball-softball field house. That debt will be serviced from revenue generated by the 2007 athletic activity fee increase. These facilities alleviated space problems in the Elam Center, which was built when the campus had only eight sports.

Mr. Dane stated the department's intention is to try to avoid any additional increases in the direct subsidies from the campus. The plan for increasing revenue is to play more and hopefully more lucrative "guarantee" games in football, increase basketball ticket sales, increase annual giving to the Skyhawk Club and for capital projects, and request additional student activity fee increases.

Mr. Dane noted UTM is operating at the most efficient level possible as an NCAA Division I member. UTM has the fewest number of sports allowed, fewest number of student-athletes, and coaches and staff paid at 20 percent below the Ohio Valley Conference (OVC) average in almost every position. In addition, he said 7 of the 14 sports have athletics aid funding far below the NCAA maximums and do not have a chance of competing for conference championships because they cannot award all scholarships due to the large amount of out-of-state tuition that must be funded.

Mr. Dane said 2010 was a good year for gifts but was the end of an era. The campus received a substantial gift from Ms. Kathleen Elam each year after her husband Tom's death, which stopped at her death. He noted not many people could give such a gift and the department had much hard work ahead to replace it.

Mr. Hall asked whether the sports camps had been discontinued since no revenue was listed for them on the statements. Mr. Dane responded that UTM sports camps were operated outside of the Athletics department by the Camps and Special Programs department. The revenue and expenditures do not come through Athletics.

Mr. Hall asked whether internal audits were planned for any of the three athletics programs, and Ms. Burns stated an audit of the UT Knoxville Athletics business office is underway and an annual audit at

UT Martin of two funds that provide emergency assistance to student-athletes, which is required by the OVC, would be performed later this year.

Financial Statements from UT Foundation, University of Tennessee Research Foundation, and University of Chattanooga Foundation – Ms. Burns discussed the financial statements from the foundations, noting that the external auditors had issued unqualified opinions on the financial statements for each foundation. She stated the UT Research Foundation (UTRF) had one internal control finding, which involved an error in the draft financial statements. The management of Genera Energy, a subsidiary of the foundation, had missed a deadline for submitting information to UTRF. This year was the first year UTRF was included in the university's consolidated financial statements as a component unit, making the deadline for submitting information earlier than usual. Ms. Burns noted she had spoken with UTRF's business manager, who has initiated monthly meetings with Genera and other entities to ensure the foundation is aware of all financial matters.

Audit Report on UTMG – Dr. Kennard Brown, executive vice chancellor and chief operations officer, and Mr. Anthony Ferrara, vice chancellor for finance and operations, both from the UT Health Science Center, discussed the audit report for the UT Medical Group (UTMG). Dr. Brown spoke of the initiatives underway to reverse the \$1.2 million operating deficit from the previous fiscal year. He noted one significant initiative was to move Pediatrics from UTMG and form a joint venture with Le Bonheur Children's Medical Center, which should improve the medical group's financial situation. The Pediatrics group was losing around \$3 million per year. He noted, for the current fiscal year, UTMG was over budget for the first two quarters and is expected to be over budget for the year. UTMG has continued to make the overhead payments due the university, which was a concern of the audit committee in previous years. Dr. Brown stated the university has not considered any waivers of the overhead payments.

Mr. Ferrara noted that, because the Pediatrics joint venture began on January 1, half of UTMG's fiscal year would include Pediatrics, producing a drain on its budget. The first-quarter financial statements for the joint venture have not been issued.

Mr. Horne stated a member of the university's financial administration should be appointed to the UTMG board, an action the audit committee had previously discussed. Dr. Brown stated that, although the board is comprised of department chairs, no one from the campus or system administration historically has been on the board. He noted, however, that the UTMG board was being restructured and ultimately either he or Mr. Ferrara would be appointed. He further stated Mr. Ferrara was secretary of the Le Bonheur Pediatrics Board and there will be UT representation on the governance structure of all the joint ventures.

Mr. Hickman asked how the ECG consulting group's recommendations were received. (ECG was engaged in 2009 to assess the organizational structure, affiliation, and performance of UTMG and the College of Medicine.) Dr. Brown noted virtually all of the recommendations were implemented and the campus continues to engage the company to help review other joint ventures and issues.

President DiPietro asked Dr. Brown to explain why Le Bonheur would be financially more profitable than the university in the Pediatrics venture. Dr. Brown stated Pediatrics practices typically lose money, but a hospital generates significant revenue from services such as X-rays and could sustain losses from a physicians' group better than a stand-alone practice. Dr. Brown stated that, although it would take a few years for the joint venture to be profitable, eventually the campus should receive \$5–6 million.

Mr. Paganelli asked about action on one of ECG's recommendations regarding use of the Germantown facility to conduct more medical procedures, such as X-rays and radiation treatments, rather than paying a third party to deliver such services. Dr. Brown stated plans had been made to build a surgical suite at the

facility and discussions were ongoing with numerous medical groups to provide oncology services there, which could generate \$5–10 million for the university.

Mr. Horne asked how the \$5 million from Le Bonheur would be used, and Dr. Brown replied that a significant percentage would be a reinvestment in Pediatrics and for research, none of it going to UTMG.

Update on the University's Emergency Management Plans – Mr. Mark Smith presented a progress report on the emergency management (preparedness) plans on each UT campus. Mr. Smith is the safety director for UT Knoxville, the university's safety officer, and the university's primary contact with the Tennessee Emergency Management Association (TEMA). Mr. Smith stated three campuses—Knoxville, Chattanooga, and Martin—now have full-time emergency managers. All campuses have updated their emergency management plans since last year and addressed concerns raised by TEMA in its review of a couple of years ago, including how to account for student and staff during a disaster and training.

Mr. Smith discussed several UT system initiatives, which include reviewing all campus plans according to new guidelines from the Federal Emergency Management Agency, developing a system-wide continuity of operations plan at the request of TEMA, delivering an annual report to the president, developing a plan to share resources in case of a disaster on one campus, reviewing a credentialing process to document skills and knowledge, and emergency management training for everyone throughout the university.

Mr. Smith outlined some key accomplishments for each campus. UT Martin had a SWAT team exercise and active shooter training. UT Chattanooga received a half-million dollar grant for training and upgrading campus alert and warning capabilities, conducted tabletop exercises (simulated scenarios conducted in a conference room), and held training for senior leaders. The Space Institute purchased a web-based communication system that provides voice, text, and e-mail alerts and has done planning with the local fire department, sheriff's department, and Arnold Engineering's fire and police crews. UT Knoxville conducted a tabletop exercise with 17 agencies, purchased new emergency management software to help with the planning, and completed a review of incident management team assignments. The Health Science Center has conducted evacuation drills for all buildings and training programs on emergency management.

Mr. Smith stated each of the campuses will conduct an exercise or drill this year. UT Martin will do one for each building; Chattanooga plans three exercises, including one campus-wide; the Space Institute will conduct a fire drill in the main academic building; and the Health Science Center is participating in an exercise involving an earthquake.

Mr. Smith listed challenges for 2011, including establishing a safety/emergency management culture, communicating and planning with satellite sites, defining the system's role/expectations in emergency management, and advocating for a full-time emergency manager for the Health Science Center.

Mr. Hall asked Mr. Smith what percentage of his time was devoted to each of his roles. Mr. Smith indicated he spent approximately 90 percent of his time as safety director for the Knoxville campus and the remaining 10 percent on system activities, including 1-2 percent on emergency management. Mr. Hall then asked if he felt that was adequate, and Mr. Smith said that, in the future as campus efforts became more robust, it would be preferable to spend more time overseeing their operations.

Mr. Hall also asked whether a communication center was designated at each campus, and Mr. Smith explained an emergency operation center was located on each campus. Mr. Hall asked if a spokesperson

was designated. Mr. Brian Gard, emergency manager for UT Knoxville, replied that a clear chain of command had been established at each location.

President DiPietro asked Mr. Smith about the process for ensuring all employees who need training actually complete it. Mr. Smith stated he proposes that the university build such requirements into employees' annual performance evaluations. He also said each emergency manager should track the training at each location.

Mr. Hall asked whether the Knoxville campus was integrated into the local 911 system and whether the campus trained with the local police. Mr. Gard stated the campus dispatch center is connected to the Knoxville 911 system and joint training was conducted.

Mr. Hickman asked about the university's position regarding the recently proposed guns-on-campus legislation. President DiPietro commented that the university's security employees are firmly against the legislation and felt that no one but law enforcement officials should have guns on campus. Mr. Horne asked the status of the legislation, and Mr. Anthony Haynes, director of state relations, replied that nothing had occurred.

Institutional Compliance – Mr. Bill Moles gave an update on the institutional compliance program. He first provided a progress report on the UT Knoxville risk assessment. The compliance officers from the various areas have identified the most significant risks associated with the regulations for which they are responsible and will translate those risks to appropriate corrective action plans. The Campus Compliance Committee has been established for this purpose, and the chancellor appointed Dr. Wes Hines, interim vice chancellor for research, as the chairman. Mr. Moles said he has worked closely with Dr. Hines over the past several weeks and their approach is as follows. The first risks to be evaluated will be those the compliance officers identified as being either currently in violation, having an unacceptable number of violations over the past year, or having significant control weaknesses (totaling 104 risks). Although other risks indicate potential problems, the compliance officers were most concerned with these and will evaluate them first. He stated the compliance officers have provided preliminary corrective action plans for this subset of risks. The action plans have been divided into three principal categories: plans that require additional funding; plans that do not require additional funding, but do require a significant reallocation of time and effort (e.g., changes made to UT's accounting system, mandatory training); and plans that do not require additional funding or significant reallocations of time, but do require administrative actions (e.g., improving enforcement). The next step is for the full committee (composed of senior-level administrators) to review the risks with the assistance of the associated compliance officers and establish priorities and appropriate corrective action plans.

Mr. Moles stated the Institute of Agriculture is determining its compliance officers and should have a list in a couple of weeks. He will then train the officers on general compliance topics and performing the risk assessment. Once these compliance officers are trained, Mr. Moles said he will begin the risk assessment process with the UT Health Science Center.

Finally, Mr. Moles discussed the status of the revised UT Code of Conduct. The Code was recently approved by the president's staff (the final necessary approval), but General Counsel requested a small change. Once this change is made and approved, Mr. Moles said he will work on launching an awareness campaign for current employees. In addition, new employees will be directed to a website to read the Code and to acknowledge online that they have read and agree to abide by the Code. The electronic acknowledgement will be permanently recorded in their personnel record. The online program has already been developed and tested.

Mr. Hall asked what types of risks existed at the Institute of Agriculture, and Mr. Moles responded that the risk assessment had not been completed. President DiPietro stated there would be biomedical issues, exposure to fire, radiation safety, and animal care, among others.

2010 Annual Report from Internal Audit – Ms. Burns presented a summary of the accomplishments by the internal audit function for 2010, as required by the UT bylaws. She noted the audit staff completed 32 internal audits last year; 4 management reviews (studies that focus on efficiency and effectiveness); 23 investigations of fraud, waste, and abuse; 117 procurement card audits; and 25 equipment audits. The number of audits was down slightly from 39 completed last year, primarily due to staff turnover in positions dedicated to internal audits. The number of investigations increased by only one, but the number of procurement card audits increased dramatically from 66 the previous year, due to the office's hiring two student workers to assist. Ms. Burns noted the staff deserved much credit for the good results this year considering the challenges presented by the former director's resignation, vacant positions, staff illnesses, and some relatively inexperienced staff.

Ms. Burns also presented the number of audits done at each campus and institute in 2010, emphasizing that, although the Space Institute and the Institute for Public Service were not covered last year (due to the change in state law eliminating the requirement to have annual audits of their chief executive officers), both institutes were included in the 2011 audit plan and would be audited periodically in future years.

Ms. Burns highlighted 3 significant audits for 2010. These included an audit of the university's biofuels initiative, involving \$40.7 million in capital construction and \$29.75 million in operating funds; a review of the Treasurer's Office's processing of travel reimbursements, totaling almost \$16 million; and an examination of the university's controls over the acquisition, accounting, and disposition of \$256 million in equipment. All of these projects resulted in recommendations for improving internal controls. Likewise, Ms. Burns noted that, although only 3 instances of fraud were confirmed (and for relatively low dollar amounts), each of the 23 investigations resulted in improved processes and internal controls, such as strengthened cash-handling processes and reconciliations, improved leave reporting and timekeeping practices, and improved hiring practices. Significant management reviews included a review of the capital projects process, which was discussed at previous committee meetings; annual coordination of a self-assessment of internal controls by the 500 university departments; and a self-study to prepare for the peer review that examined our conformance to professional standards and code of conduct. The procurement card audits revealed increased control weaknesses as follows: lack of separation of duties between the cardholder and the verifier, who compares receipts to monthly statements for accuracy, compliance with policy, and legitimacy of purchases.

Ms. Burns described initiatives for 2011, including assessing the sufficiency of audit coverage across the university, instituting a performance auditing program, enhancing the institutional compliance efforts, implementing operational improvements within the department, and initiating a new type of invoice audit and monthly invoice fraud review.

Mr. Gallimore asked, given that frauds continue to occur, whether Ms. Burns had met with Human Resources (HR) to ensure that employees were made aware of the university's expectations regarding their conduct. Ms. Burns stated that Mr. Moles had been working with Human Resources to implement a new Code of Conduct that would be presented to current employees and each new employee during orientation. She also mentioned that as of January 1, 2011, the campus HR departments had begun conducting background checks on all new employees. Ms. Burns stated that Internal Audit had also considered conducting training on internal controls and how to recognize and prevent fraud.

Resources Devoted to Audit Coverage – Ms. Burns and President DiPietro led a discussion of the university’s examination of whether sufficient resources are devoted to audit coverage. In a letter dated February 10, 2011, Mr. Hall (committee chair) expressed concern to President DiPietro about a decline in resources for the audit function over the past decade. Ms. Burns stated that, in response to the letter, she spoke with each campus and institute chief business officer to determine whether they felt the audit coverage was sufficient at their location. She said three of the officers, from UT Chattanooga, UT Martin, and the Institute of Agriculture, stated a desire for additional resources to enhance coverage. Ms. Burns noted that, due to budget cuts, the audit office at UT Martin was closed almost ten years ago and at the end of this fiscal year, the audit staff at UT Chattanooga would be reduced by one-half of a position. President DiPietro stated that, after hearing the chief business officers’ concerns, he asked Ms. Burns to discuss these issues with the chancellors and other president’s staff members, focusing on the risks faced by the university. He said the business officers’ concerns should be evaluated and the chancellors are sympathetic to the issues. He indicated the issues would be weighed during the budget process and he and his staff would continue to work on this issue and update the committee.

Ms. Burns noted she had provided the committee with a report she prepared for President DiPietro and the chancellors, showing where she sees risks to the university, gaps in audit coverage, and the amount of staff time devoted to each campus and institute over the past three years.

Mr. Gallimore stated he expected that at the department would examine benchmarks on staffing levels at other universities, and Dr. DiPietro suggested examining other university systems, such as the University of Connecticut.

Mr. Hickman asked what the current staffing level was for the internal audit function. Ms. Burns responded that currently the department had 14.3 full-time equivalent staff auditors and, as of July 1, the number would be reduced to 13.2. In addition to the staff audit positions, the department has three management positions and a performance audit/management consulting position.

Mr. Hall expressed his appreciation to President DiPietro for his responsiveness to this issue and reiterated his concern that the university needed to ensure more resources for the audit function.

Update on Capital Projects Committees – Mr. Charles Peccolo, UT treasurer and acting chief financial officer, presented an overview of the activities of two ad-hoc committees he created to address recommendations made in two reports on the capital project process. One report was issued by Internal Audit (Audit and Consulting Services), the other by the UT Knoxville College of Business Administration. Both committees had representation from across the university system. One was charged with reviewing financial reporting/management information and the other with the administration/organizational structure.

Mr. Peccolo stated the committee on financial reporting determined the most significant problem to address was lack of timely, up-to-date information in the university’s accounting system. He said the committee recommended using a function in the system called “funds reservation,” where funds can be reserved on a particular project so that campus staff can view a particular project account at any point and see both the expenditures and future commitments. The one remaining issue to address is how to record timely information on change orders, which often are not formalized until three or four changes are grouped together.

Mr. Peccolo explained that the committee on administration and organizational structure collected information from staff at each campus and compiled a 20-page report describing their concerns. He said the committee's recommendations fall into four areas. The first area involves the development of consistent and timely facility program statements, coordinated by the system and developed by the campuses. Also of concern is the Facilities Planning department's organizational structure and staffing levels. The recommendation is to add staff by converting two half-time positions to one full-time and adding another position. The third area of project administration addresses communication, responsiveness, and customer service. Most of the issues and recommendations are being addressed by the financial reporting committee. Lastly, Mr. Peccolo outlined other issues that should be addressed, some of which are beyond the university's control, including the design selection process, the dollar threshold for State Building Commission approval, and the state fire marshal's plan review process.

Mr. Horne asked if Mr. Peccolo could provide the members with the ad-hoc committees' detailed and summary reports, and Mr. Peccolo agreed to provide them when complete.

President's and Chancellors' Discretionary Expenditures – One minor exception was noted.

Exceptions in Travel Expenditures – Two minor exceptions were noted.

Housing Exception Report – No exceptions were noted.

Respectfully Submitted,



Judith A. Burns
Interim Executive Director, Internal Audit
The University of Tennessee