THE UNIVERSITY OF TENNESSEE BOARD OF TRUSTEES
AUDIT COMMITTEE
DECEMBER 16, 2011, MEETING MINUTES

Audit Committee members present: Chairman Mr. James Hall, Mr. Doug Horne, Mr. D. Crawford Gallimore, Mr. Don Stansberry.

Not present: Mr. Waymon Hickman.

UT: Ms. Judith Burns, Mr. John Fox, Mr. Bill Moles, Dr. Joe DiPietro, Mr. Charles Peccolo, Mr. Ron Maples, Ms. Catherine Mizell, Ms. Linda Hendricks, Ms. Sherry Sims, Ms. Martie Gleason.

Others present: UT Trustee Mr. James Murphy, Director of State Audit Mr. Art Hayes.

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. D. Crawford Gallimore to accept the minutes; the motion was seconded by Mr. Doug Horne, and the minutes were approved unanimously.

Comments from Mr. Arthur A. Hayes, Director of State Audit – Mr. Hall introduced Mr. Hayes, welcomed him to the meeting, and invited him to address the committee. Mr. Hayes spoke of the importance of the Audit Committee and noted that UT created an audit committee before the state law went into effect in 2005 requiring such action. He remarked that last year’s audit of UT by his office revealed no findings, which had not occurred in over 30 years. He complimented the Audit Committee, the audit staff, and the Board of Trustees. Mr. Hayes stated he knew the committee would be discussing audit staff salaries later in the meeting and noted that, although Ms. Burns had pointed out that State Audit salaries appeared higher than those of UT, his department’s salaries were discounted as they should be, given that they were in public service. He noted that his department has not had a salary increase and has had cuts in staff, with 20 of 200 positions currently being held vacant. He further noted that, when the economy recovers, his department will have problems recruiting.

Dr. DiPietro asked Mr. Hayes the typical reason staff leave State Audit, and Mr. Hayes replied “salary.” Dr. DiPietro then asked whether State Audit benchmarks salaries against other markets. Mr. Hayes indicated state audit organizations in other states are reviewed. Dr. DiPietro asked whether other markets are reviewed, and Mr. Hayes replied yes.

Mr. Hayes offered his assistance in partnering with UT in visiting university campuses, such as the University of Tennessee and University of Memphis, to discuss the advantages of a career in the public sector.

Approval of Internal Audit and Audit Committee Charters – Ms. Judy Burns presented the internal audit and the Audit Committee charters to the committee for approval. Ms. Burns noted that annually these documents are presented to the members of the committee for their review and approval in accordance with The Institute of Internal Auditors’ (IIA) professional standards and the provision of the Audit Committee’s charter. Specifically, she noted that IIA Standard 1000—Purpose, Authority, and Responsibility—requires that “the chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.” Further, she noted the “Communications and Reporting” section of the Audit Committee charter states that the committee shall “review and assess the adequacy of the committee’s charter annually, requesting Board approval for proposed changes.” Ms. Burns noted that she had no changes to recommend and asked the committee for any comments or
proposed changes. None were offered. Mr. Hall asked members of the audit staff present if any of them saw any needed changes, and none were recommended.

A motion was made by Mr. Don Stansberry to approve the charters; the motion was seconded by Mr. D. Crawford Gallimore, and the charters were approved unanimously.

Revisions to the University’s Financial Risk Assessment – Ms. Judy Burns presented revisions to the university’s financial risk assessment for the committee’s information. Mr. Burns noted that one of the committee’s responsibilities, as indicated in its charter, is to “review management’s risk assessment.” She reminded the committee that each year Internal Audit facilitates management’s review and revision to the risk assessment to reflect changes in the university’s operating environment. The original risk assessment was conducted in 2006, when the university’s central financial administrators (the chief financial officer and his staff) and the campus/institute chief business officers conducted a comprehensive risk assessment of the university’s “financial enterprise.” Risks were identified for each key business process; these were then prioritized/rated according to the seriousness of the impact on the organization if the risk occurred and the likelihood of occurrence; and existing controls to mitigate each risk were then identified.

Ms. Burns explained that the major addition this year involved adding risks and controls related to complying with the Complete College Tennessee Act. Two other minor changes were noted—the probability of “failure to incorporate succession planning” in the strategic planning process and the human resources process was reduced to “medium” in both instances. Ms. Burns noted that, although the university does not currently have a formal succession plan, developing one is in Human Resources’ strategic plan.

Ms. Linda Hendricks, UT’s chief human resources officer, explained that succession planning will be developed as part of the overhaul of the university’s performance management system, which must be in place before work on succession planning can begin. The redesign, she noted, will begin in 2013.

Update on Institutional Compliance – Mr. Bill Moles, director of Institutional Compliance, provided the 2012 operating plan for the Institutional Compliance division. Mr. Moles noted the first priority for the coming year is to provide direction and assistance to the UT Knoxville (UTK) Campus Compliance Committee in analyzing the results of its compliance risk assessment. Specifically, Institutional Compliance staff will facilitate the process for determining priorities, developing plans of corrective action, and following up on action plans. The next priority Mr. Moles discussed involved completing the risk assessment process at the UT Health Science Center in Memphis. He noted that 40 of the 45 compliance officers have been trained. The next steps after officers complete the risk assessment is to establish the Campus Compliance Committee to review results and facilitate its work. Mr. Moles stated the staff also planned to begin the risk assessment process at the Institute of Agriculture during 2012. Also in 2012, the staff will promote the new Code of Conduct to employees, including developing an awareness program for current employees and launching a website that directs employees to relevant policy, procedures, and training. Human Resources offices will introduce the Code to new employees in orientation. Other activities for 2012 include promoting the compliance hotline, reporting results of the UTK risk assessment to the Executive Compliance Committee, and training the new Institutional Compliance officer hired in December 2011.

Mr. Hall asked what steps the university was taking to address potential liabilities associated with third-party compliance issues. Mr. Moles replied that he had met with general counsel on the matter and conducted some research. General counsel and most resource material support having language in the third-party contract that protects the university from any third-party compliance liability. Actual monitoring of third-party compliance is apparently rare. Currently, the university verifies that certain

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licenses are obtained (e.g., food services) but normally does not monitor compliance. Mr. Hall asked that Mr. Moles review procedures at the University of Illinois and University of Florida and provide the committee with a report at its next meeting.

Approval of 2012 Audit Plan – Ms. Burns presented the proposed 2012 audit plan to the committee for approval. Before discussing the plan, Ms. Burns presented a status report on the current year’s audit plan, showing the disposition of each incomplete project—whether the project would be completed by year’s end, carried forward to the 2012 audit plan, or cancelled. The reasons for each cancellation were presented. Ms. Burns noted that this year’s projected completion rate was less than previous years’ due to staff turnover, staff absences due to medical reasons, and remaining vacancies. She noted that the office currently had seven vacancies.

Mr. Stansberry asked how the 2012 plan could be approved with such a large number of vacancies and suggested to President DiPietro that the staffing issue needed to be addressed. Mr. Hall noted that last winter he and the other Audit Committee members sent President DiPietro a letter expressing their growing concern over whether the university had adequate audit coverage and asking for his help in addressing the issues. Mr. Hall noted that one of his greatest concerns was UT Martin, which currently had no audit presence on campus.

Mr. Hall recommended deferring action on the proposed audit plan until the next meeting.

Dr. DiPietro noted that he and Ms. Burns have discussed staffing issues and asked her to clarify the number of vacancies. Ms. Burns asked the committee to turn to the next agenda item.

ACS Staffing Report – Ms. Burns presented the committee with an organization chart of Audit and Consulting Services, showing current vacancies. Ms. Burns clarified that the current vacancies consist of both existing and new positions. Existing positions vacated during 2011 include an administrative specialist who performed procurement card audits and supported the monthly analysis of procurement card use in addition to administrative duties, a senior auditor who performed internal control and compliance audits, the information technology auditor (all in Knoxville), and both staff audit positions at the Health Science Center in Memphis. In addition to those vacancies, a newly created position of performance auditor was being advertised. Ms. Burns noted that the seventh position included the executive director’s position, for which a search was underway.

Ms. Burns stated recruiting qualified applicants for the Memphis positions had been difficult. Mr. Hall asked what the issues were. Ms. Burns replied that she did not know. She noted the staff who vacated the positions both left for higher paying jobs, one within the Health Science Center and the other at a nearby hospital. President DiPietro asked how long the positions had been advertised, and Ms. Burns replied for several months. He then asked whether any offers had been made, and Ms. Burns said a candidate had been identified and an offer was likely, pending reference checks. Dr. DiPietro observed that we did not yet know if salary were an issue. Mr. Stansberry stated that, even though we did not know the problem in recruiting, we did know that the Health Science Center was one place that auditors were needed.

Mr. Hall then asked Ms. Burns to discuss compensation issues.

Internal Audit Salary Analysis – Ms. Burns explained that last year’s peer review conducted as part of Internal Audit’s quality assurance program indicated that salaries were low for certain senior-level positions and those with specialized skills, such as information technology auditors. Ms. Burns explained that, as a result, she asked Mr. John Fox, associate director of Audit and Consulting Services, to conduct a salary benchmarking review, including data from UT’s Human Resources office (salary schedules), the

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Association of College and University Auditors, the *Chronicle of Higher Education*, Robert Half (a specialized staffing firm for accounting and financial professionals), the Tennessee Board of Regents, and the Division of State Audit.

Ms. Burns said the results of this review showed that salaries were lagging behind peers. She noted that, since Mr. Fox completed the review last winter, two significant events affecting salaries occurred. One was the July and August salary increases, which included a 2 percent across-the-board increase (3 percent for Memphis-based staff) and a 3 percent discretionary pool used for merit, market, and equity adjustments. Second was the completion of a university-wide compensation study by Sibson Consulting, an external firm. Ms. Burns noted that Mr. Fox had updated the salary information and asked him to review the results for the committee.

Mr. Fox began by showing a graph comparing audit staff salaries to the “UT midpoint” as of January 2011, when the review was first completed. He explained that UT midpoint referenced on the graph was the midpoint of the UT salary ranges for each position’s pay grade classification. The salary ranges were effective July 1, 2007, and based on 2006 market data. The comparison showed that only 1 of the 11 salaries examined was above the midpoint.

Next, Mr. Fox displayed a graph showing current salaries for 12 positions compared to the UT midpoint as of December 2011, after the July and August salary increases. This comparison showed an improvement, with 5 salaries above midpoint and 1 equal to the midpoint.

The third graph showed a comparison of the 12 UT positions to the midpoint of State Audit salary ranges. Mr. Fox explained that, although we did not have actual salaries of state auditors, we were provided salary ranges for various job classifications to compare with our pay grades. In all but 1 instance, the midpoint of the state ranges exceeded the UT staff salaries.

The final graph depicted a comparison of the same UT positions compared to data from the compensation study from Sibson Consulting. The Sibson data was provided to Internal Audit by Human Resources, which determined “target salaries” for entry-, mid-, and senior-level positions. This comparison showed the target salaries exceeded all of the UT salaries, with the greatest disparity being in the senior-level positions.

Dr. DiPietro asked whether the salaries provided by Sibson were specifically for auditors, and Ms. Hendricks replied that they were. Mr. Hayes asked whether the salaries represented national averages, and Ms. Hendricks indicated the source of the Sibson data for positions in the university-wide administration (Internal Audit’s unit) was based on salary surveys specific to higher education and general industry surveys from both non- and for-profit organizations. Mr. Stansberry commented that the State Audit salaries might be the best comparison data for UT. Mr. Hall suggested that contacting faculty who teach government accounting might be helpful in trying to recruit staff. He also mentioned exploring strategies used by the California higher education system in attracting applicants.

Ms. Burns noted that, to determine whether salary was an issue in recruiting staff, the department would need to document reasons applicants withdrew from consideration (as has happened after hearing the salary range) or refused a job offer. She then asked Ms. Hendricks to present an overview of the Sibson data and discuss the university’s next steps now that the study has been completed.

**University Benefits and Salary Benchmarking Project** — Ms. Hendricks presented an overview of the benefits and salary benchmarking project conducted by Sibson Consulting and discussed how the results would be used to create comprehensive compensation plans for each campus and institute. She began by
explaining that each campus and institute determined its own peers and that position duties and responsibilities, not job titles, were benchmarked. Both higher education and general industry surveys were used. Ms. Hendricks stated median rates were measured since they are the most reliable. The median salary, plus or minus 15 percent, represents the competitive range.

Ms. Hendricks then presented tables showing aggregate benchmark results segregated by campus and institute for faculty and staff. The overall results show that faculty salaries are at 87 percent of the market median and staff salaries at 78 percent.

Ms. Hendricks discussed the results of the assessment of UT’s benefits program. Overall, the review found that faculty and staff benefits were above average when compared to general industry, but when compared to other higher education institutions, faculty benefits were only average and staff below average.

Ms. Hendricks noted it often takes multiple years to close wide gaps between current salaries and the market. She further noted that not everyone should be paid at the market median and that determining individuals’ pay levels involves a detailed analysis of such factors as knowledge, skills, experience, and performance.

She explained that the statewide compensation office was doing calculations and developing salary schedule options with the cost of implementing. These proposed schedules will be reviewed by the human resources officers and chief business officers at each campus and institute. She also stated each campus and institute has a team of staff that is analyzing information, such as acquisition (time to fill positions, number of turnovers, etc.) and retention data, and will develop recommendations to rectify any deficiencies and plans for implementation.

Dr. DiPietro noted that the Sibson study provided a large amount of data and was the first time an independent group had examined this issue.

Mr. Hall asked whether each position was benchmarked, and Ms. Hendricks explained that not every position was benchmarked. A total of 2,024 faculty and 2,624 staff positions were examined. Mr. Hall also asked when the work would be complete. Ms. Hendricks noted that a multi-year plan will be developed by June 2012 for the president and chancellors/vice presidents to present to the board. These plans will provide a framework for the university going forward.

Exceptions in Travel Expenditures – Four minor exceptions were noted. Expenses incurred by a UT Foundation administrator should have been approved in advance as required by policy. The oversight was due to the recent changes in accounting for expenses incurred by the foundation, and staff were informed of the proper procedures.

Housing Exception Report – No exceptions were noted.

Respectfully Submitted,

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

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