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University of South Carolina  
BOARD OF TRUSTEES

Fiscal Policy Committee

October 8, 2010

The Fiscal Policy Committee of the University of South Carolina Board of Trustees met on Friday, October 8, 2010, at 10:00 a.m. in the 1600 Hampton Street Board Room.

Members present were: Mr. J. Egerton Burroughs, Chairman; Mr. Chuck Allen; Mr. W. Lee Bussell, Sr.; Ms. Darla D. Moore; Dr. C. Dorn Smith; Mr. Thad Westbrook; Mr. Charles H. Williams; Mr. Mack I. Whittle, Jr.; Mr. Miles Loadholt, Board Chairman; and Mr. Eugene P. Warr, Jr., Board Vice Chairman.

Other Trustees present were: Mr. Herbert C. Adams; Dr. C. Edward Floyd; Mr. Greg Gregory; Mr. William W. Jones, Jr.; and Mr. Toney J. Lister.

Others present were: President Harris Pastides; Secretary Thomas L. Stepp; Vice President for Academic Affairs and Provost Michael D. Amiridis; Vice President of Finance and Planning William T. Moore; Vice President for Student Affairs and Vice Provost for Academic Support Dennis A. Pruitt; Vice President of Development and Alumni Relations Michelle D. Dodenhoff; Vice President for Communications Luanne M. Lawrence; General Counsel Walter (Terry) H. Parham; University Treasurer Susan D. Hanna; Chancellor of USC Upstate John C. Stockwell; Associate Vice President for Resource Planning, Division of Finance and Planning, Edward L. Walton; Associate Vice President for Finance and Budget Director, Division of Finance and Planning, Leslie Brunelli; Associate Vice President for Facilities Tom Quasney; Senior Vice Provost Christine W. Curtis; Vice Provost Helen I. Doerpinghaus; Dean of USC Sumter C. Leslie Carpenter; Interim Administrator for the Division of Human Resources Judith Owens; Director of Governmental and Community Relations and Legislative Liaison Shirley D. Mills; Director of the Department of Internal Audit Alton McCoy; Director of Media Relations, Division of University Advancement, Margaret Lamb; Director of Capital Budgets and Financing, Division of Finance and Planning, Charlie Fitzsimons; Director of Payroll Pamala T. Cope; Controller Patrick Lardner; Chief Financial Officer, Department of Athletics, Jeff Tallant; Special Assistant to the President and Athletics Director John D. Gregory; Special Assistant to the President J. Cantey Heath; Associate Director of Governmental Affairs and Legislative Liaison Casey Martin; Faculty Senate Chair Patrick D. Nolan; Attorney Tom McNeish, Elliott Davis, LLC; University Technology Services Production Manager, Justin Johnson; and Board staff members Terri Saxon, Vera Stone, and Karen Tweedy.

Chairman Burroughs called the meeting to order, welcomed everyone, and asked

Board members to introduce themselves. Ms. Lamb introduced members of the media who were present.

Chairman Burroughs stated that notice of the meeting had been posted and the press notified as required by the Freedom of Information Act; the agenda and supporting materials had been circulated to the Committee; and a quorum was present to conduct business.

Chairman Burroughs stated that there were legal matters which were appropriate for discussion in Executive Session. Mr. Allen made a motion to enter into Executive Session. Mr. Bussell seconded the motion. The vote was taken, and the motion carried.

Chairman Burroughs invited the following persons to remain: President Pastides, Secretary Stepp, Dr. Moore, Dr. Curtis, Dr. Hogue, Dr. Plyler, Ms. Lawrence, Ms. Dodenhoff, Mr. Parham, Mrs. Hanna, Mr. Heath, Mr. Walton, Ms. Brunelli, Mr. Tom McNeish, Mr. McCoy, Mrs. Martin, Ms. Mills and Mrs. Lamb.

Return to Open Session

I. Audit Tracking Report: Chairman Burroughs called on Mr. McCoy who stated that the following audits had been resolved since the last meeting: Gamecock Apple Hub; Russell House; Depository; College of Engineering and Computing; and USC Upstate.

Currently, there were two outstanding audits: Human Resources and the Colonial Life Arena.

A. Human Resources: Mr. McCoy listed the following Human Resources audit findings on the tracking report: 1) The Prudential retired life and paid up rosters were out-of-date; 2) The division used the intra-campus mail system to distribute flyers soliciting new Travelers business as part of an agreement to provide an auto and home insurance program; and 3) Exit interviews were not being conducted in a centralized manner; 4) Prudential demutualization proceeds and stock dividends were currently held in University funds.

To resolve these findings, in July, a mailing was sent to individuals on the paid up roster. The Benefits Office continued to research addresses of individuals on both rosters for future mailings. Rosters were updated as deceased individuals were identified.

The University administration had determined that Travelers mailings were University business and that the use of campus mail was appropriate for their distribution. The division had postponed the development of an RFP for additional insurance vendors until a new Vice President of Human Resources could be hired.

Exit interview forms were now available online and an RFP for an online exit interview was being developed.

University administration was working to determine the proper disposition of the Prudential demutualization proceeds and a recommendation would be presented to the board later today.

B. Colonial Life Arena: Mr. McCoy stated that management used a co-promotion process to settle events with the promoter. This process used two settlements for events and results in a higher amount paid to the promoter in the second settlement. This co-promotion process was not supported by a contract. Also, certain documentation was missing to support the co-promoted expenses. To address this issue, management would use a co-promotion contract developed by General Counsel and request additional documentation from the promoter to show how revenues and expenses would be split if events were co-promoted and the revenue splits divided amongst the various parties.

Chairman Burroughs stated that this report was received for information.

II. Internal Audits

A. Payroll: There were four audit findings regarding Liability Accounts, Compensatory Leave Payments, Tax-Sheltered Annuities and Mandatory Direct Deposit. Several account reconciliations were not current, and contained material

account variances.

A recommendation was made that an account reconciliation policy requiring the monthly reconciliation of all asset and liability accounts be implemented. Regarding compensatory leave balances for nonexempt employees, it was recommended that the department pay employees at the time of promotion and/or pay increases so that payments would be based on the rate of pay in effect at the time the leave was earned to prevent overpayment.

For tax-sheltered annuities, the department would add internal procedures to include sending an e-mail to the employee notifying the individual that the requested deduction was lowered to comply with the IRS limit.

Relative to mandatory direct deposit, two employees had not complied. They would be notified in writing to submit electronic deposit authorization forms.

Mr. Walton stated that management and the executive leadership would work closely with Human Resources to address reconciliation issues as well as other issues and to ensure compliance in the future.

B. Student Loan Accounting: There were audit findings regarding the Perkins Loan Program (FISA), Perkins Loans Accounting, Indebtedness Statements, and policies and procedures for Student Loan Accounting were outdated. The Bursar's Office had experienced a change in management and was currently working to comply with the audit findings and to establish better controls regarding these matters.

C. Accounts Receivable: There was no Accounts Receivable Policy that addressed University Receivables. The Bursar's Office planned to work with the Administration to develop a formal University Receivables policy within the next six months. The police would address; collection of non-student receivables, the proper procedures for billing outside entities and handling invoices, approvals required for write-offs, and which debts should be placed on the Accounts Receivable System.

Chairman Burroughs stated that this report was received for information.

III. Status Report on Outstanding Audit Issues: Chairman Burroughs called on Dr. Moore who gave a status report on the following issues:

A. Prudential Demutualization: A team of experts assembled in February 2010 and had completed its recommendations to the President regarding the Prudential Demutualization matter.

There was a total of \$4.8 million for distribution. The three permissible options were: (1) retention of proceeds by the University for general purposes; (2) distribution of the proceeds to eligible plan participants (current and prior employees); and (3) application of proceeds to prospective plan premium holidays and/or enhancement of plan benefits.

Legal counsel concluded that all three options were available. The team of experts unanimously recommended distribution of the proceeds to the approximately 1,800 plan contributors which would be presented to the Board for consideration later today.

Also, proceeds net of \$200,000 applied to administrative expenses would be disbursed to the four classes of plan participants and the Educational Foundation.

B. Biomass Plant: The Biomass Energy Plant had been down since February, but was expected to be restarted in November. The University had requested payment for compensation for the delay in the plant coming on-line and that amount totaled \$5,995,344 minus \$833,730 owed by USC to the vendor. The administration would come back to the board in the future with a recommendation to accept a settlement agreement.

The external auditor, Elliott Davis, had reviewed this matter to determine if the book value of the plant should be revised in previous financial statements. It was management's understanding, supported by Elliott Davis, that it was not necessary to restate the plant's value in the financial statements.

All capital investments that require Board approval (\$250,000 or more under current policy) were now reviewed by the reinstated University Capital Planning Committee before recommendation to the president, and ultimately the Board.

C. Parking Garages: There were two issues regarding the Innovista Parking Garage, one of which involved an accounting issue and the other a technical default issue.

Accounting: In 2008, the University and the Columbia Parking Facilities Corporation entered into an agreement for the Corporation to provide the University approximately \$30 million for the construction of the Horizon and Discovery Garages which were built on land owned by the University.

The Corporation had ownership of all improvements through the year 2058, after which ownership of all land and improvements would revert to the University.

The Corporation raised approximately \$18 million of the construction funds by issuing debt. The remaining \$12 million was contributed by the City of Columbia and Richland County.

The external auditors had advised how to correct the accounting issue that arose as a result of the agreement. USC would restate financial statements for 2009.

Dr. Moore acknowledged the help and support provided by Barclays Capital, as well as advice and guidance from Trustee Mack Whittle.

Technical default: Dr. Moore stated that if parking receipts were less than monthly debt service requirements, the University was required by the terms of the agreements to use its "best efforts" to locate sources to provide the additional funds required to satisfy obligations.

Parking revenues had not adequately covered the debt service requirements. To date, the University had funded all monthly shortfalls with institutional funds. As of June 30, 2010 this amounted to \$496,000 in operating expenses and \$2.275 million in debt service. These transactions were processed as advances from the University with the expectation that future revenue would repay the advances.

The covenant calls for garage revenues to be sufficient to cover at least 110 percent of the related debt service. Currently, parking revenues were not sufficient to meet this requirement. The University was covering the requirements by advancing institutional funds.

At this time, the University was in negotiations with the debt holder (BB&T) to obtain a waiver of the default. Dr. Moore expected the plan to be acceptable to the debt holder, resulting in waiver.

The administration had instructed the Associate Vice President for Transportation and the Director of Capital Finance, to devise a parking and financing plan that would generate the revenue required for debt service and repay the advances. A report on that plan would be presented at the next Fiscal Policy Committee meeting.

The University now monitored restrictive covenants in all debt issued by the University, its auxiliaries, and its affiliates including Foundations. This was part of debt management process and policy. A Comprehensive Debt Report including covenant status would be reported in the Executive Committee.

D. Medical School Trust Debt: The School of Medicine Educational Trust had a technical default on its revenue bond and the University was close to resolving this issue today if the Board approved the proposed new debt agreement. The bonds were issued in 2000 to acquire Medical Park 2 and Medical Park 4.

Dr. Moore stated that later in the day, the administration would request Board approval for a proposed First Amended and Restated Reimbursement and Security Agreement dated October 4, 2010 between University of South Carolina School of Medicine Educational Trust and Wachovia Bank, N.A.

The updated Agreement was the basis for obtaining waivers of certain covenants for the periods ended December 31, 2009 and June 30, 2010, and it would provide for more favorable terms related to specific debt-ratio covenants. The restated and updated Agreement did not alter the indebtedness of the Trust under the bonds, the determination of interest paid to bondholders, the principal on the bonds, or the maturity date of the bonds.

E. Annual Financial Statements: Dr. Moore stated that our financial statement auditors had completed their fieldwork and were in the reporting phase of their audit. The statements were complete, and he expected a final report on October 15<sup>th</sup>.

This was consistent with how the University had performed in the past, but it was not how the University wanted to perform in the future. The administration was rescheduling future timelines for our financial statement compilations and audit tests so that the Administration could be better prepared to deliver a complete set of financial statements in time for Board review and release to the public.

Going forward, he said the administration would like to schedule auditors and board meetings in a manner that allowed the auditors to present their report to the full board at its October meeting.

This year, for the first time, the senior and regional campuses were audited separately in an expanded scope and with a lower threshold of materiality. The University implemented this new effort to comply with SACS requirements and to better prepare for planned improvements to financial reporting in the future.

This year, the auditors would report two weaknesses that were the result of the way the administration previously accounted for the Horizon and Discovery parking garages and the Prudential demutualization. In cooperation with the auditors, the University made adjustments to account for these items in accordance with Generally Accepted Accounting Principles. These adjustments (though minor) caused the Administration to restate prior years account balances which lead to required reports of control weakness. These weaknesses would be reported to the Board by the auditors as a matter of their compliance with audit standards.

Chairman Burroughs thanked Dr. Moore and Internal Auditor Alton McCoy, External Auditor Tom McNeish for their hard work and their efforts to make the system better in getting reports to the committee. He said their spirit of cooperation was excellent.

F. IRS Examination: Dr. Moore reported that the IRS Tax Exempt and Government Entities Division were reviewing USC, following a compliance check questionnaire requesting information for the tax year ending in 2006. Focus of the examination was on unrelated business income and executive compensation. USC was one of at least 30 institutions currently under review. The examination began formally in late fall 2009. On-site review began when IRS staff visited the campus January 19-21; and would continue to do so for several days each month through September 2011.

At this time it appeared that the IRS was reviewing the University only and not including other affiliated entities. Also, it did not appear that the IRS was spending time on executive compensation, but rather focusing on the unrelated business income tax returns.

There were a total of 43 Information Document Requests; and there were no findings thus far.

IV. Fiscal Policy Retreat Report: Chairman Burroughs called on Secretary Stepp and Dr. Moore to give a brief report on the Fiscal Policy Retreat.

Secretary Stepp stated that the Retreat would be held on October 18<sup>th</sup>, at Capstone in the Carolina Room, 17<sup>th</sup> floor; and there would be a working lunch on the 18<sup>th</sup> floor of Capstone. He called on Dr. Moore to give details of the agenda.

Dr. Moore said that persons attending the meeting would be this committee, Chair and Vice Chair of the Board of Trustees, and any other member of the Board who would be interested in participating. He stated that the Retreat was supported by a consultant from the Association of Governing Boards, Mr. Richard "Rick" Staisloff. Also attending would be the External Auditor Tom McNeish, Internal Auditor Alton McCoy, Ed Walton, Associate Vice President of Operations, and Mr. Bratton Fennell, CFA, Burroughs & Chapin Company, Inc. to give different perspectives on auditing processes.

Finally, he stated that the purpose of the Retreat was to give this committee the opportunity to review its role and responsibilities and to examine the relationship between the committee and the administration, as well as to discuss and re-evaluate the roles of internal and external auditors and their relationship to the committee. The administration would report to the committee on a draft internal control policy that was being developed and a proposed Comprehensive Annual Financial Report.

Chairman Burroughs commended everyone on their hard work in preparation of the Retreat. He stated that they would go over the Charter of the committee and would bring something back to the full board updating the Charter. He stated that if there was anyone on the committee who would like to talk to the moderator prior to the meeting, he would be available.

V. Department of Internal Audit Search Committee Report: Chairman Burroughs called on Mrs. Hanna who reported that the Internal Audit Director Search Committee had its first organizational meeting on Friday, June 25, 2010. The Committee received information from Terry Parham, Bobby Gist and Judy Owens regarding legal parameters, the Freedom of Information Act, Equal Opportunity and South Carolina Human Resource Policies and Procedures.

The position was posted in the following print publications: *The State*, *Greenville News*, *Post & Courier* (Charleston), and *Sun News* (Myrtle Beach). In addition, it was also posted on-line with the *Association of College and University Auditors and Diverse Magazine* (minority publication).

A second meeting was held on Friday, September 17, 2010. As a result of the advertisements, 30 applications had been received and each Committee member had prepared a list of top candidates. Telephone and on-site interviews would follow and the committee would identify the three strongest candidates for consideration by the Board. The committee hoped to have the position filled by December 1, 2010.

Secretary Stepp said that he anticipated a telephone committee meeting being held the next week, and a face-to-face meeting the following week in hopes of having someone hired by December 1<sup>st</sup>.

Chairman Burroughs stated that this report was received as information.

Since there were no other matters to come before the Fiscal Policy Committee, Chairman Burroughs declared the meeting adjourned at 12:00 p.m.

Respectfully submitted,

Thomas L. Stepp  
Secretary