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University of South Carolina  
BOARD OF TRUSTEES

Audit and Compliance Committee

October 17, 2014

The Audit and Compliance Committee of the University of South Carolina met at 10:00 a.m. on Friday, October 17, 2014, in the 1600 Hampton Street Board Room.

Members present were: Mr. J. Egerton Burroughs, Presiding Chairman; Ms. Paula Harper Bethea; Mr. Hubert F. Mobley; Mr. Thad H. Westbrook; Mr. Mack I. Whittle, Jr.; Mr. Charles H. Williams; Mr. Eugene P. Warr, Jr., Board Chairman; and Mr. John C. von Lehe, Jr., Board Vice Chairman. Dr. C. Dorn Smith III joined the meeting by telephone.

Other Board members present were: Mr. Thomas C. Cofield; Mr. A. C. "Bubba" Fennell III; Mr. William W. Jones; Mr. Toney J. Lister; Mr. Miles Loadholt; Ms. Leah B. Moody; and Dr. Mitchell M. Zais. Also present were faculty representative Dr. James H. Knapp and student representative Lindsay Richardson.

Others present were: President Harris Pastides; Secretary Amy E. Stone; Chief Operating Officer Edward L. Walton; General Counsel Walter "Terry" H. Parham; Vice President for Student Affairs Dennis A. Pruitt; Chief Financial Officer Leslie Brunelli; Vice President for Information Technology William F. Hogue; Vice President for Human Resources Chris Byrd; Vice President for Facilities and Transportation Derrick Huggins; Athletics Director Ray Tanner; Executive Director of Audit & Advisory Services Pam Doran; Executive Director for the Office of Economic Engagement William D. "Bill" Kirkland; Chief Communications Officer Wes Hickman; Palmetto College Chancellor Susan Elkins; USC Upstate Chancellor Thomas Moore; Senior Vice Provost and Dean for Graduate Studies Lacy Ford; College of Nursing Dean Jeannette Andrews; Executive Associate Athletics Director Kevin O'Connell; Chief of Staff, President's Office, J. Cantey Heath, Jr.; University Controller Jennifer Muir; Director of Facilities Design and Construction Jeffrey D. Lamberson; Director of Capital Budgets and Financing, Division of Administration and Finance, Charlie Fitzsimons; University Budget Director, Division of Administration and Finance, Harry Bell; Audit & Advisory Services Assistant Director Glenn Murray; Managing Audit Consultant, Audit & Advisory Services, Andra Lunsford; Assistant Dean for Operations, College of Nursing, Rod West; Director of General Ledger Accounting, Controller's Office, Mary Peak; Director of A&C\_101714

Financial Reporting, Controller's Office, Sandy Smith; Executive Vice Chancellor for Academic Affairs, USC Aiken, Jeff Priest; Vice Chancellor for Finance and Administration, USC Aiken, Joe Sobieralski; Tom McNeish, Brian D'Amico and Laura Self with the audit firm of Elliott Davis, LLC; University Technology Services Production Manager Wes Reardon; Board staff members Debra Allen and Terri Saxon.

Mr. Burroughs called the meeting to order, welcomed those in attendance and asked them to introduce themselves. Mr. Hickman stated that there were no members of the media in attendance.

Mr. Burroughs stated that the agenda had been posted and the press had been notified as required by the Freedom of Information Act; the agenda and materials had been circulated to the committee members; and a quorum was present to conduct business.

Mr. Burroughs stated there was a need to receive legal advice that was appropriate for discussion in Executive Session. He called for a motion to enter Executive Session. Mr. Mobley so moved and Ms. Bethea seconded the motion. The vote was taken and the motion passed.

Mr. Burroughs invited President Pastides, Secretary Stone, Mr. Parham, Mr. Walton, Dr. Pruitt, Ms. Brunelli, Mr. Byrd, Ms. Doran, Mr. Heath, Mr. Hickman, Mr. McNeish, Mr. D'Amico, and Ms. Self to remain.

### Executive Session

#### Return to Open Session

Mr. Burroughs called on Mr. Tom McNeish to present the external audits.

I. External Audits – Elliott Davis

A. Fiscal Year 2012-2013 Upstate Athletics Agreed-Upon Procedures

The NCAA Bylaws require that certain financial procedures be performed related to the Athletics Department. In the past, the University had included this process in the full University Financial Statement, which met NCAA requirements. It had been determined that it would be more effective, and more in the spirit of the NCAA Bylaws, to use the agreed-upon procedures (AUP) format, which is more specific. Mr. McNeish reported that the audit revealed no significant findings.

Mr. Fennell asked about the deficit reported in the USC Upstate Athletics Department. Ms. Brunelli clarified that the department had made great progress to resolve the deficit.

B. Fiscal Year 2013-2014 Financial Statement Audit

Mr. McNeish presented the financial statement audit for the year ended June 30, 2014. The auditors have completed their work and based on the audit procedures performed, Elliott Davis intends to issue an unmodified opinion on the University's financial statements. An unmodified opinion indicates that the University has fairly presented its financial statements in accordance with generally accepted accounting principles (GAAP). Fair presentation in accordance with GAAP is of great importance to the primary users of the University's financial statements, such as bond underwriters and federal granting agencies. The University's financial statements are currently in draft form, have been submitted to the State Comptroller General, and will be finalized upon approval by the Board of Trustees. Following the completion of these statements, the University's financial staff will compile the Comprehensive Annual Financial Report (CAFR) and submit that document late this fall to the Government Finance Officers Association.

C. Single Audit (OMB A-133)

This audit is to determine if the University is materially in compliance with requirements of its major federal programs. It is used by federal granting agencies. No internal control weaknesses or significant deficiencies were identified and the auditor's report on compliance for the major programs is unmodified. Mr. McNeish discussed the omission of federal expenditures regarding the USC Center for Manufacturing and Technology.

D. System Audit Management Letter

Mr. McNeish presented the University's management letter, which includes items that are not audit findings, but are possible deficiencies or weaknesses. If a significant or material weakness is identified, government auditing standards require Elliott Davis to notify the University. There were no items added to the management letter following the 2014 audit. The three items that were noted date from the 2011 fiscal year audit and will be addressed with the implementation of the OneCarolina Finance System.

Mr. Burroughs asked for questions from the committee on Mr. McNeish's presentation. Mr. Fennell expressed his concern in regards to reconciliation, since the audit was conducted on an "accrual" basis while the University budget was developed on a "cash" basis. Discussion ensued. Ms. Brunelli and Mr. McNeish responded to questions.

Mr. Burroughs thanked Mr. McNeish and stated that these documents were provided as information.

## II. Audit & Advisory Services' Risk Assessment and Proposed Audit Plan

Mr. Burroughs called on Ms. Doran. She introduced Audit & Advisory Services (AAS) Assistant Director Glenn Murray and Managing Audit Consultant Andra Lunsford who were instrumental in a six-month risk assessment process to aid in the development of a multi-year audit plan. A wide range of risks were assessed including strategic, financial, operational, compliance, technological, fraud and reputational risks. As part of the risk assessment process, Ms. Doran and her team conducted 55 interviews. Among those interviewed were the Chairman and Vice Chairman of the Board of Trustees, the current and previous chairs of the Audit and Compliance Committee, key University administrators across the system, and the University's external audit firm.

In addition to conducting interviews, Ms. Doran said her team reviewed key documentation such as organizational charts, strategic plans, and relevant policies. They also compared high risk areas from peer institutions.

Ms. Doran explained that the information gathered was categorized as strengths, common themes and high priority risks.

University strengths revealed in the assessment included the University's branding; executive leadership; ability to recruit for higher quality students, faculty, and staff; and willingness to invest in new information technology solutions. These strengths can be leveraged to determine risk mitigation strategies, she said.

Common themes noted in the assessment impact the risk profile of many of the areas reviewed. Audit & Advisory Services will consider the potential impact of the identified common themes in undertaking its activities. These include:

Financial Sustainability – Declining state appropriations, coupled with rising tuition, make the cost of education more difficult to cover. The University must balance revenue sources with the cost of doing business.

Governance – In the rapidly changing higher education industry, it becomes critical for University leadership to communicate the importance of a sound governance structure..

Remaining Competitive – Recruiting and retaining faculty and staff, maintaining and continuously growing the brand, while avoiding scandals, are crucial in remaining competitive and attracting high quality students.

System Identity – How should the University System function? Who has decision-making authority? How should strategic initiatives affecting the system be considered?

Efficiency and Effectiveness – In the current environment, the University must strive to find new, more efficient and effective ways of doing business.

Next, Ms. Doran discussed the important points to keep in mind when considering the University's high priority risks. She said that although some risks can be resolved with structured, proactive processes,

there are ongoing risks beyond the University's control that can be managed, but not eliminated.

Therefore, the Board of Trustees, the Audit and Compliance Committee, the risk management committees, and senior leaders should monitor the University's efforts for mitigating identified high priority risks.

The risk assessment process primarily measures inherent risk before internal controls or management plans are applied. High priority risks must be considered periodically in the audit plan in order to provide assurance on the design and operating effectiveness of controls that are in place to mitigate identified risks.

Ms. Doran explained that due to the nature of the higher education industry and observations raised by interview participants, AAS did not highlight high priority risks as "problems." Rather, AAS indicated that these risk areas may warrant the University's attention and/or incorporation in the audit plan. She said that the risk assessment was not intended to test risk mitigation strategies or review the University's response to the risks identified; but to gather an understanding of risk mitigation approaches.

Ms. Doran said that AAS developed a risk framework structure in order to draft its audit plan. The high priority risk areas for the University, which were revealed in the assessment, are categorized in the following risk framework:

<u>Type of Risk</u>	<u>Risk Area</u>
Strategic	Governance; Legislative Relations
Financial	Economic Decline; Capital Debt Capacity
Hazard	Emergency Planning, Disaster Recovery, Business Continuity; Laboratory Safety; and Student Safety/Crime Prevention, including Title IX Compliance
Operational	Data Security and Privacy; Institutional Data Reporting; Capital Project Management/Deferred Maintenance; Enrollment Management; Personnel Recruiting and Retention/Succession Planning; Research Compliance; and IT Systems Implementations

Ms. Doran said the risk assessment interviews identified five areas that are not auditable by AAS, but which needed to be considered by the University. These are: Legislative/City of Columbia Relations; Student Safety and Crime Prevention; Energy Services; Reputational Risk (Scandals); and Economic Decline.

Ms. Doran explained that in development of the three-year audit plan the following points were considered:

- High priority risk areas raised during interviews were considered within the context of the risk framework and whether the risk was auditable. Other relevant information such as emerging issues, regulations, key policies and business processes, peer institution risk areas, new information system implementations and decentralized control functions were considered in determining areas to be audited.

- To determine how and when to place a topic on the audit plan, AAS scheduled reviews to over a manageable timeframe to minimize disruptions to significant strategic initiatives.
- Emerging risks, evolving processes or internal controls and management requested reviews also were considered for AAS attention in an advisory capacity.
- AAS will revisit audit plans annually to determine whether adjustments are warranted due to emerging or changing risks and/or staffing considerations.

Ms. Doran called on Mr. Murray to present the three-year audit plan, which was provided Trustees in their meeting materials. Prior to doing so, he noted that typical audit engagements consisted of evaluating internal controls of key operations and testing compliance with University policies and applicable regulations. He added that, when planning their review, the auditors would welcome management requests to include other areas.

Ms. Lunsford was asked to discuss activities conducted by AAS that are in addition to the engagements outlined in the three-year audit plan. These included:

- Determine if action plans have been effectively implemented through follow-up audits.
- Deliver training on stewardship, research audit activities, enterprise risk management concepts/processes and other areas as requested.
- Provide advisory services as requested by management, including participation on University committees.
- Oversee the University's Integrity Line and conflict of interest discussions.
- Conduct fraud investigations and related internal control reviews.
- Attend continuing education conferences and seminars to stay current and to meet professional certification requirements.

Mr. Burroughs initiated discussion on the topic of governance and the need he saw for a “governance” committee.

Following much discussion, Mr. Burroughs called for a motion to approve the Audit & Advisory Services Three-Year Audit Plan as presented by Ms. Doran and described in the materials posted on the Board Portal. Mr. Mobley so moved and Mr. Williams seconded the motion. The vote was taken and the motion carried.

Dr. Zais summarized what he thought the University leaders' guidance should be, “to report anything that would cause significant embarrassment to the institution or result in the risk or loss of significant financial resources.” He added that if a person did not “have the good judgment to figure out what that meant,” then they should not be in charge of a large organization.

Mr. Burroughs commended Ms. Doran and her staff for their work on the AAS Risk Assessment and Audit Plan.

### **III. Internal Audits/Reviews**

#### **A. College of Nursing – Business Operations Audit Report**

Ms. Doran said that the audit focused on three major areas: financial, human resources, and information technology (IT). Revenue reconciliations, processing of non-payroll expenditures, capital equipment, stewardship, and educational foundational account management were included in review of the financial area.

The completion of performance appraisals and time/leave reporting were reviewed for the human resources portion of the audit. The IT review focused on data access and privacy.

In addition, the University's Office of Risk Management conducted a review of insurance, contracts, and student welfare issues. Ms. Doran stated that there were no reportable issues revealed in the course of the audit.

#### **B. Darla Moore School of Business Construction Progress Report V**

The audit focused on whether payment applications and management fees were consistent with terms and conditions of the construction contract; whether the appropriate insurance coverage existed; and whether change orders were reasonable and properly approved. In addition, auditors traced payment applications to the general ledger and verified the completeness of the reporting of expenses.

Ms. Doran reported that the audit staff found no significant reportable issues during the course of the audit process.

Mr. Burroughs asked Mr. Walton to report on the Darla Moore School of Business (DMSB) project change orders. Following his brief report, Mr. Burroughs said that the DMSB construction progress reports were a great exercise in which the Audit and Compliance Committee, the Buildings and Grounds Committee, and Audit & Advisory Services worked together on a large capital project.

Mr. Williams asked Mr. Walton to discuss the lessons he learned on the DMSB project that he thought could help with the new Law School project. Mr. Walton responded that the most important lesson learned was the decision to hire a project manager to oversee the complex project. He also said that scheduling of the project was tight and the construction audit was invaluable.

#### **C. Review of Third-Quarter Fiscal Year 2013-2014 President's Office and Board Office Expenditures**

Ms. Doran said that she reconciled the expenditure report prepared by the University Treasurer and noted that were no reportable issues and that expenses were being properly managed within the scope of the review.

D. Tracking Report

Ms. Doran noted that the outstanding reconciliations noted in the Payroll Audit had been resolved and that internal audit staff would conduct a limited testing of the processes in December to assure the reconciliations remained current. She reported that issues found during the Study Abroad and the Lancaster Special Collections audits were being resolved.

Mr. Burroughs stated that the tracking report was provided in the meeting materials and was received as information.

IV. Fiscal Year 2014-2015 Committee Matrix Review

Ms. Doran explained that the matrix outlined the areas AAS needed to address within the fiscal year. All October listings were accomplished. The matrix was received as information.

Mr. Whittle asked Ms. Doran to explain how the “whistleblower” process worked, specifically the reporting chain. Ms. Doran did so by explaining the process outlined in the University’s Board of Trustees Policy BTRU 1.22 Reporting Violations of State and Federal Laws or Regulations, commonly referred to as the “whistleblower” policy. She noted that she would provide an annual summary of reports made to the University’s “integrity line.” However, if there was an occasion where a report was significant enough to warrant immediate notification to the Board, she will do so through the committee’s chairman.

Discussion ensued. Mr. Burroughs said that as an Audit and Compliance Committee member, he wanted to see all integrity line reports on a regular basis.

Mr. Fennell asked Ms. Doran if she had adequate staffing and resources to conduct AAS business. She responded that she currently was advertising for two audit positions, which would bring AAS to full staff.

IV. Other Matters

Mr. Burroughs noted that he did not see an Audit and Compliance Committee retreat listed on the Board’s 2015 meeting scheduled. He said that he hoped one would be scheduled and noted that past retreats had provided a time for self-evaluation and review of the committee’s charter.

Mr. Whittle said that a committee retreat would be a great time to look at the University’s “enterprise wide risk management” and “whistleblower” reporting and policy.

Mr. Burroughs encouraged members of the committee to communicate their thoughts regarding a retreat to Dr. Smith, the committee’s chairman. Mr. Burroughs thanked all involved in the presentations and commended them for a great job.

V. Adjournment

Since there were no other matters to come before the committee, Mr. Burroughs called for the meeting to adjourn at 11:10 a.m.

Respectfully submitted,

Amy E. Stone  
Secretary