MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
AUDIT AND COMPLIANCE COMMITTEE

Wednesday, May 18, 2011 – The members of the Audit and Compliance Committee of the University of Houston System convened at 8:39 a.m. on Wednesday, May 18, 2011 at the Hilton University of Houston Hotel, Waldorf Astoria Ballroom E, Second Floor, 4800 Calhoun, Houston, Texas, with the following members participating:

ATTENDANCE –

Present	Member(s) Absent
Nandita V. Berry, Chair	Jacob M. Monty, Vice Chair
Welcome W. Wilson, Sr., Member	
Carroll Robertson Ray, Ex Officio	Non-Member(s) Present
	Jim P. Wise, Regent

In accordance with a notice being timely posted with the Secretary of State and there being a quorum present, Chair of the Committee, Nandita V. Berry, called the meeting to order. Regent Berry stated eight (8) information items would be presented to the committee and then introduced the first item, the approval of minutes.

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AGENDA ITEMS

Action Item:

1. Approval of Minutes – Item B

   On motion of Regent Wilson, seconded by Regent Ray and by a unanimous vote of the members in attendance, the following minutes from the meeting listed below were approved:

   - February 16, 2011, Audit and Compliance Committee Meeting

Regent Berry welcomed everyone to the meeting and introduced Mr. Don Guyton, Chief Audit Executive, who presented the remaining items to the committee.

Mr. Guyton, Chief Audit Executive, noted there were no open points from the February 16, 2011 Audit and Compliance Committee meeting.

2. Presentation – External Audit Process, Requirements, and Timetable - University of Houston System, Item C – AUDIT 1

   Mr. Guyton introduced this item and stated Mr. David Ellis, the Executive Director of

Financial Reporting, would give a report, followed by Mr. Matt Malinsky, KPMG Engagement Partner for the University's external audits. Once their presentations were given to the committee, both individuals were available for comments and questions.

Mr. Ellis gave a powerpoint presentation outlining the external audit process. Below is a brief summary of his remarks.

- The external audit process consists of four (4) specific projects. Financial audit and an examination of the statements required for the following:
  (a) UH Charter School;
  (b) Public Broadcasting (KUHT-TV, KUHF-FM, ACB);
  (c) UHS Endowment Fund; and
  (d) The Athletic Department is tested on specific agreed-upon procedures and a report is prepared that includes revenues and expenses.
- Each operating unit is examined as if it were a standalone business entity even though each of these is a business segment within the organizational structure of the University.
- These business operations cross several divisional lines as listed below:
  (a) Academic Affairs Division
    - Public Broadcasting
    - UH Charter School
  (b) Athletics Division
    - Intercollegiate Athletic Department
  (c) Administration and Finance Division
    - UHS Endowment Fund
- These multi-divisional/multi-departmental organizational structure and lines of responsibility does introduce some challenges for the efficient and timely performance of these projects.
- Three (3) projects are regulated by external oversight authorities and the audits are mandated by statute or regulation as noted below:
  (a) UH Charter School financial statement audit - Texas Education Agency;
  (b) Public Broadcasting financial statement audit - Corporation for Public Broadcasting; and
  (c) UH Intercollegiate Athletics agreed-upon-procedures engagement - National Collegiate Athletic Association (NCAA).
- The UHS Endowment Fund is required by one of our major endowment agreements.
- KPMG is the current external audit firm being used for these audits.
- Required submission dates for these reports were addressed which normally follows the end of our fiscal year, August 31.
  (a) The UH Charter School is the only report required by statute that requires Board of Regents approval; however, all other reports are presented to the Board for information at various meetings.
- Audit and Report Timelines were addressed.

Following a discussion of Mr. Ellis's presentation, Mr. Ellis introduced Mr. Malinksy, who gave his presentation to the committee.

Mr. Malinsky, an audit partner with KPMG, stated KPMG had been working on the University of Houston Systems' accounts since 2009. Below is a brief summary of Mr. Malinsky's remarks given to the committee.

- KPMG's audit responsibility:
  (a) To conduct audits in accordance with the following professional auditing standards:
    - American Institute of Certified Public Accountants (AICPA).
    - Government Auditing Standards issued by the General Accounting Office.
  (b) To plan and perform the audit(s) to obtain reasonable – not absolute – assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud; and
  (c) There is no responsibility to obtain reasonable assurance that misstatements that are not material are detected.
- KPMG's independence:
  (a) An integrated and comprehensive system of quality control over independence that includes a framework of detailed policies and procedures supported by sophisticated, web-based, electronic systems and a dedicated group of experienced professionals to provide technical guidance and support has been established.
  (b) Remain compliant with all guidelines established by the AICPA Independence Standards Board and General Accounting Office.
- Audit reports and other deliverables were addressed.
- When reviewing all of the engagements performed by KPMG, the single area requiring the most critical accounting estimate relates to the valuation of non-readily marketable illiquid-type securities that are held by the endowment.
- Financial statements and operations:
  (a) The University uses accounting practices consistent with generally accepted accounting principles and those used in the industry, as appropriate; and
  (b) Financial statement disclosures are appropriate.
- Required communications were also outlined to the committee. A discussion followed.

This item was for information only and required no committee action. A complete copy of both reports have been filed in the Board office.

3. Internal Audit Report – Briefing Booklet – University of Houston System, Item D – AUDIT-2

Mr. Guyton referenced the Internal Audit Briefing Booklet which contained six (6) internal audit reports since the February 16, 2011 Audit and Compliance Committee meeting. These reports addressed areas included in the Board-approved Audit Plan for FY2011 and included a Departmental Compliance Review of the University of Houston-Clear Lake Office of Academic Affairs and Provost; a review of Executive and Foreign Travel of all components; a review of Research Administration at the University of Houston; reviews of Endowments managed by the Athletics Department and the University of Houston College of Education; and Internal Audit's quarterly follow-up activity report. These reports will be submitted to the Governor's Office of Budget and Planning, the Legislative Budget Board, the Sunset Advisory Committee, and the State Auditor, as required by the Texas Government Code.

Five (5) of these reports contain management action plans and were included in the Internal Audit Briefing Booklet. An overview of all of Internal Audit's recommendations were included in these reports.

Audit Report No. 2011-21, Internal Audit's follow-up report, addressed the status of fifty (50) action items in nineteen (19) individual audit reports. Internal Audit verified that twenty-six (26) of the action items had been implemented, twenty-three (23) were partially implemented, and one (1) not implemented. It was noted that updated management responses were obtained on the partially implemented and not implemented action items. One (1) high risk item in the report that was partially implemented related to repairs, renovation and construction. This particular item should be implemented by August 31, 2011. There were four (4) other high risk items in the report that had been completed related to facilities management and construction.

In Audit Report No. 2011-22, the report on the Departmental Compliance Review of the University of Houston-Clear Lake Office of Academic Affairs and Provost, Mr. Guyton stated Internal Audit noted no matters they considered to be significant engagement observations in this report. Management did agree to take certain actions regarding cost center management, compliance with grant terms and conditions and accounts receivable accountability.

Internal Audit's report on Executive and Foreign Travel of all components, Audit Report No. 2011-23, Internal Audit noted no matters that they considered to be significant engagement observations. Internal Audit did note several instances of non-compliance with System and campus policies related to travel which Internal Audit brought to the attention of management.

Mr. Guyton noted in Audit Report No. 2011-24, Internal Audit's report on UH Research Administration, that Internal Audit noted no matters that they considered to be significant engagement observations. Management had established policies and procedures for externally funded programs consistent with most of the guidelines listed in the Guide to Effective Management Practices published by the Council of Governmental Relations, an association of research universities. Internal Audit identified opportunities for improvement in the areas of cost center management and accounts receivable. It was noted in several departmental reviews over the past few years, deficit balances and expired grant cost centers had been a recurring item. The Division of Research, working with the colleges, have addressed the majority of the deficit balance grant cost center issues and substantial progress on addressing expired grant cost centers were being made. This progress should result in the implementation of numerous action items in Internal Audit's follow-up database.

Audit Report No. 2011-25 and No. 2011-26, were the first two (2) reports on Endowment Stewardship issued by Internal Audit. Mr. Guyton noted that the Athletics Department and the UH College of Education were managing the endowment funds effectively and efficiently and were complying with the terms of the endowments. Internal Audit noted opportunities for improvements in agreement finalization, communication of restrictions, expenditure

compliance and awarding scholarships. Management is in the process of addressing these opportunities. A discussion followed.

Various scheduled audits are in the fieldwork in progress or in the planning phase. These audits were included in the Board-approved Internal Audit Plan for FY2011. Also noted there were various special projects in progress. One (1) of these items is the State Auditor's Annual Statewide Audit for FY2011. The State Auditor's Office plans to begin its fieldwork for the UH Federal Financial Assistance Programs on July 5, 2011 for a two-week period. There will be some wrap-up work performed later after the fiscal year-end. At the present time, no other fieldwork is being scheduled by the State Auditor's Office on other UH System entities other than the required follow-up work for prior year findings.

The IRS Bond Audit was also addressed by Mr. Guyton. At the February 16, 2011 Audit and Compliance Committee meeting, Mr. Guyton gave an update on this audit for the issuance for $130 million of financed construction. The UH System has responded to the IRS's document requests and a one-day site visit is scheduled during the month of June.

There were no additional questions. This item was for information only and required no committee action.

4. Institutional Compliance Status Report for the Three Months Ended March 31, 2011 – University of Houston System, Item E – AUDIT-3

Mr. Guyton introduced this item which referred to the Institutional Compliance Status Report for the Three Months Ended March 31, 2011. Activities listed in this report included risk assessments, compliance audits, compliance committee meetings, risk mitigation, and hot-line reports. It was noted on page 7 of the report, the University of Houston-Victoria's federally mandated biennial review for the two-year period ending December 31, 2010 for UHV's drug and alcohol prevention program. Mr. Guyton stated that one question had recently been raised as to whether any of the University of Houston System entities conduct drug tests on any of its employees. Mr. Guyton asked Dona Cornell, General Counsel for the UH System, to comment on this issue. Ms. Cornell stated that the UH System typically does not conduct random drug testing on the University of Houston campus. There is drug testing in the Athletics Department, as required by the NCAA rules. We do have some authority to do a "for cause" drug test stated Mr. Cornell. This is not typically done but this is something that is currently being evaluated. The policy in the University of Houston Police Department is currently under review and changes will be made to institute random drug testing. A policy is currently being drafted and it will include both random drug and alcohol testing. A discussion followed.

This item was for information only and required no committee action.

5. External Audit Report – UHS Public Broadcasting Basic Financial Statements and Independent Auditor's Report for FY2010 and FY2009 – University of Houston System, Item F – AUDIT-4

Mr. Guyton noted that KUHT, KUHF and the Association of Community Broadcasting have been consolidated for financial reporting purposes. This audit report was a requirement of the Federal Corporation for Public Broadcasting Act. The auditor issued two (2) other related reports, the FY2010 Non-Federal Financial Support for KUHT and the FY2010 Non-Federal Financial Support for KUHF. Both of these reports may be accessed on the Internal Audit website at:
http://www.uh.edu/audit/Documents/External_Reports/UH_KUHF-FM_FY2009_Non-Federal_Financial_Support%20-%20Do%20not%20use%202010.pdf ; and

http://www.uh.edu/audit/Documents/External_Reports/UH_KUHT-TV_FY2009_Non-Federal_Financial_Support%20-%20Do%20not%20use.pdf .

Mr. Ed Hugetz, Associate Vice Chancellor for Planning and University Outreach; Mr. John Proffitt, General Manager of KUHF; Mr. John Hesse, General Manager of KUHT; and Mr. John White, President of the Association for Community Broadcasting which is the fundraising arm of the Corporation for Community Broadcasting group in Houston, were present at the meeting and were available to answer any questions.

Mr. Hugetz gave a brief report regarding the revenues, expenses and changes associated with Public Broadcasting that have occurred over the last three (3) years. Long-term, significant progress has been made on a plan that will change the basic structure of the stations as we move into the future. A plan is to merge the stations, creating an entity that would be identified as Houston Public Media, a service of the University of Houston; and that would take to the philanthropic community of Houston, a coherent common message as to why these assets are so important to the City of Houston. A lengthy discussion followed.

Mr. John Proffitt gave a brief overview of KUHF and discussed the business plan. Mr. John Hesse reported on KUHT, discussed the Berlin Wall project, and stated that the last two (2) years had been a challenge.

This item was for information only and required no committee action.

6. External Audit Report – Texas Comptroller of Public Accounts Post Payment of the University of Houston-Clear Lake, Item G – AUDIT-5

Mr. Guyton noted the scope of this audit included a sample of payroll, purchase, and travel transactions during the period from June 1, 2009 through May 31, 2010. The purpose of this audit was to determine whether the university's expenditures complied with certain state laws and rules concerning expenditures and with the processing requirements of the uniform statewide accounting system. The entire report may be viewed on the UH System Internal Auditing website at:
http://www.uh.edu/audit/Documents/External_Reports/Post%20Payment%20Audit%20UHCL.pdf.

This item was for information only and required no committee action.

7. External Audit Report - State Auditors Reports – University of Houston System, Item H – AUDIT-6
   - SAO Report 11-318, Federal Portion of the Statewide Single Audit Report for Fiscal Year Ended August 31, 2010; and
   - SAO Report 11-555, Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2010

   Mr. Guyton stated this item referred to the University of Houston System excerpts of the State Auditor's recently issued reports on the Federal and Financial Portions of the Statewide Single Audit Report for FY2010. The key points as they relate to the University of Houston System entities were outlined in the reports. Mr. Guyton stated that management action plans were prepared to address each of the recommendations in the State Auditor's report as these items related to the University of Houston, University of Houston-Downtown and the University of Houston-Victoria. These action plans will be tracked in Internal Audit's follow-up database.

   This item was for information only and required no committee action.

8. UH System Support Organizations – University of Houston System, Item I – AUDIT-7
   - Compliance Report of UH System Support Organizations
   - UH System Support Organizations Report

   Mr. Guyton introduced this item which referred to the Compliance Review of the UH System Support Organizations and the UH System Support Organizations Report. The Compliance Review of the UH System Support Organizations indicates the status of the receipt of this information. The UH System Support Organizations Report is a compilation of information from audited financial statements, IRS Forms 990, investment reports, and other information furnished to the UH System by the Support Organizations. The purpose of this report was to provide information on Support Organizations' activities and the Board of Regents and UH System's responsibilities with respect to the Foundations. This was the second time such a compilation had been attempted; the last attempt occurred on August 11, 2009. The regents' fiduciary responsibilities to the UH System related to these organizations was addressed in agreements between the UH System and the organizations. In meeting the requirements of the Board of Regents' policy on Support Organizations, Section 32.06, the UH System implemented a policy on Support Organizations which requires them to furnish certain information to the UH System. This requirement was outlined in our agreements with the Support Organizations. The last time this report was presented, there were two (2) organizations with different year-ends from the University's year-end, but they are now the same. Having the same year-end facilitates management's review of annual information furnished by the Support Organizations to the UH System including the review and comparison of financial statements and tax returns to the corresponding information on the University's books and records. A discussion followed.

   It should be noted in the minutes that in the Summary of Support Organizations Activity Report, a percent change was noted in the Investments Section under the University of Houston Law Foundation – Return (1-year) percent changed from 5.82% to 9.1%.

This item was for information only and required no committee action.

9. Update on Internal Audit Follow-up Database – University of Houston, Item J – AUDIT-8

Mr. Guyton gave an update on the Internal Audit Follow-up Database. This report had been requested at the previous Audit and Compliance Committee meeting held on February 16, 2011. A column has been added to the database to identify the issue type, e.g., compliance, cost center management, or internal control. The first page of the report is an analysis of the issues with a detailed breakdown of compliance issues and the risk levels. Many of the items in the cost center management area should be resolved by the University of Houston, Division of Research working with the colleges to clear expired grant cost centers. Two (2) high risk areas related to compliance with the Texas Higher Education Coordinating Board (THECB) rules and establishing a monitoring mechanism in one of the University of Houston divisions. Progress has been noted on both of these areas.

This report was for information only and required no committee action.

There being no further business to come before the committee the meeting adjourned at 10:13 a.m.

All documentation submitted to the Committee in support of the foregoing action items, including but not limited to "Passed" agenda items and supporting documentation presented to the Committee, is incorporated herein and made a part of these minutes for all purposes; however, this does not constitute a waiver of any privileges contained herein.

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Others Present:

Renu Khator
Carl Carlucci
John Antel
Dona Cornell
William Flores
Dan Wells
Lauren Francis
John Hesse
Fred McGhee
Marquette Hobbs
Don Guyton
David Ellis
Judy Young
Jon Aldrich
Eli Cipriano
Barbara Stanley
Ed Hugetz
Georgeann Smith
Lisa Holdeman
Gerry Mathisen
Raymond Bartlett
Liz Fletcher
Ed Jones
Russ Hoskins
Craig Ness
Monica McHenry
John Proffitt
Malcolm Davis
Matt Malinsky (*KPMG*)
John White (*Assn.of Community Broadcasting)*