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University of South Carolina

BOARD OF TRUSTEES

Audit and Compliance Committee

March 17, 2017

The Audit and Compliance Committee of the University of South Carolina met at 11:30 a.m. on Friday, March 17, 2017, in the Alumni Center's C. Edward Floyd Boardroom.

Members present were: Dr. C. Dorn Smith III, Chairman; Mr. Chuck Allen; Mr. Thomas C. Cofield; Mr. William W. Jones Jr.; Mr. Mack I. Whittle Jr.; and Mr. John C. von Lehe Jr., Board Chairman. Mr. J. Egerton Burroughs participated by phone. Mr. Tommy Preston Jr. and Mr. Charles H. Williams were absent.

Other Board members present were: Mr. Mark W. Buyck Jr.; Mr. A. C. "Bubba" Fennell III; Mr. William C. Hubbard; Mr. Toney J. Lister; Mr. Miles Loadholt; Mr. Hubert F. Mobley; Ms. Leah B. Moody; Mr. Eugene P. Warr Jr.; and Mr. Thad H. Westbrook.

Chairman of the USC Columbia Faculty Senate August E. "Augie" Grant and USC Columbia Student Government President Ross Lordo also were present.

Others present were: President Harris Pastides; Secretary J. Cantey Heath Jr.; General Counsel Walter "Terry" H. Parham; Provost Joan T. A. Gabel; Chief Operating Officer Edward L. Walton; Chief Financial Officer Leslie Brunelli; Vice President for Information Technology and Chief Information Officer Doug Foster; Vice President for Student Affairs Dennis Pruitt; Vice President for Research Prakash Nagarkatti; Vice President for Human Resources Chris Byrd; Vice President for Facilities and Transportation Derrick Huggins; Vice President for System Planning Mary Anne Fitzpatrick; Chief Communications Officer Wes Hickman; Chief Information Security Officer James Perry; Athletics Director Ray Tanner; Chief Financial Officer, Athletics Department, Jeff Tallant; Deputy Provost Helen Doerpinghaus; Palmetto College Chancellor Susan Elkins; Executive Director of Audit & Advisory Services Pam Doran; USC Beaufort Chancellor Al Panu; USC Upstate Chancellor Brendan Kelly; USC Aiken Executive Vice Chancellor for Academic Affairs Jeff Priest; University Treasurer Pat Lardner; University Architect Derek Gruner; Associate Vice President for Business Affairs Helen Ziegler; Associate Vice President for Finance Jennifer Muir; Associate Vice President and Deputy Chief Information Officer

Jeff Farnham; Law School Dean Robert Wilcox; College of Arts and Sciences Dean Lacy Ford; Executive Director for the Office of Economic Engagement William D. “Bill” Kirkland; Executive Director of My Carolina Alumni Association Jack W. Claypoole; Director of Purchasing Venis Manigo; Director of Facilities Design and Construction Jeff Lamberson; Director of Governmental and Community Relations and Legislative Liaison Shirley D. Mills; Assistant Director of Facilities Design and Construction Thomas Opal; Assistant Director for Audit & Advisory Services Glenn Murray; Audit & Advisory Services Audit Consultants Roscoe Patterson, Richard Stingel and Mark LaBruyere; Mrs. Cynthia Lister, wife of Trustee Toney Lister; Brian D’Amico, Elliott Davis Decosimo; Benjamin Kennedy, Kennedy and Company Education Strategies; Columbia businessman Whit Suber; University Technology Services Production Manager Matt Warthen; and Board staff members Debra Allen, Terri Saxon and Ina Wilson.

I. Call to Order

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

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

Chairman Smith called for a motion to enter Executive Session for a personnel matter related to a policy violation and a proposed contractual matter related to the University’s use of external auditors. Mr. Whittle so moved and Mr. Cofield seconded the motion. The vote was taken and the motion carried.

Chairman Smith invited the following persons to remain: Dr. Pastides, Secretary Heath, Mr. Parham, Ms. Doran, Mr. Walton, Ms. Brunelli, Mr. Byrd, Mr. Tanner, Mr. Tallant, Mr. Murray, Ms. Zeigler and Ms. Manigo.

EXECUTIVE SESSION

RETURN TO OPEN SESSION

II. Elliott Davis Decosimo Agreement, Budget Comparison Project

Chairman Smith called for a motion to approve an agreement with Elliott Davis Decosimo (EDD) to continue its University Budget Comparison Project at a cost to range from \$110,000 to \$138,000. This project will update the cost allocation model summarized by EDD to present revenues and

expenses reflected in the University's 2016 Audited Financial Statements; EDD will develop a budget model for both operating and capital budgets that can be easily compared to actual results as reflected in the University's annual audited financial statements. Mr. Jones so moved. Mr. Cofield seconded the motion. The vote was taken and the motion carried.

III. External Audits

Chairman Smith called on Mr. Brian D'Amico with EDD to present the external audits.

A. USC System Single Audit, FY 2016

Mr. D'Amico said this audit is to determine if the University is materially in compliance with requirements associated with federal programs. It is used by federal granting agencies. He reported that there were no significant findings in the audit. However, EDD's "Yellow Book" opinion attributed the 2016 PeopleSoft implementation for two material weaknesses.

Trustee Fennell asked for clarification of the statement in the audit, "The above conditions present a significant risk of capital assets being materially misstated." Mr. D'Amico explained that the PeopleSoft module created a learning process for both the University's Finance Department and EDD, but he felt good about the ultimate balances.

B. USC Columbia and Regionals, FY 2016

C. USC Aiken, FY 2016

D. USC Beaufort, FY 2016

E. USC Upstate, FY 2016

Mr. D'Amico said that the Southern Association of Colleges and Schools (SACS), requires separate audits of all four-year campuses. Mr. D'Amico reported that EDD issued an unmodified opinion on those financial statements.

F. USC Columbia Department of Athletics Agreed-Upon Procedures, FY 2016

G. USC Upstate Department of Athletics Agreed-Upon Procedures, FY 2016

The NCAA Bylaws require certain financial procedures be performed related to the Athletics Department. Mr. D'Amico reported EDD took the University's financial statements as prepared according to Generally Accepted Accounting Principles, also called GAAP, and converted them into the Agreed-Upon Procedures (AUP) format, which is more specific. Mr. McNeish reported that the audits revealed no findings.

H. Horizon and Discovery Garages, FY 2015 and FY 2016

Mr. D'Amico reported although the operating income was positive for FYs 2015 and 2016, it was not enough to cover the debt service interest expense.

In response to questions, Ms. Brunelli stated the USC Development Foundation purchased the two garages from the Columbia Parking Facilities Corporation effective March 1, 2017. Ms. Brunelli said she would provide the Board more financial detail on the garages, once she received the sale documents. As requested by Chairman Smith, she will also find out if the Development Foundation will charge market-rates for parking, since the University did not.

I. Darla Moore School of Business Professional MBA Program, FY 2016

Mr. D'Amico said the State of North Carolina requires any higher education institution doing business in North Carolina to provide evidence of a guaranty tuition bond equivalent to the amount of tuition paid by the State's residents. This requirement is necessary for the Moore School Professional Master of Business Administration Program. EDD affirmed that the bond was sufficient.

Chairman Smith thanked Mr. D'Amico and stated the reports were received as information.

IV. Internal Audits/Reviews

A. Capital Maintenance and Renewal

Ms. Doran began by providing the committee an idea of the size of this activity. She said \$10.4 million was transferred to capital maintenance and renewal projects in FY 13-14; \$14.3 million in FY 14-15; \$10.6 million in FY 15-16; and \$25 million was currently committed to capital maintenance and renewal projects.

The scope of the audit addressed whether effective monitoring of buildings and equipment was performed to determine the optimal allocation of resources; the availability of sufficient staffing and funding resources to complete scheduled projects; and to determine if an appropriate process exists for transitioning new construction to operational building maintenance staff, including warranty information.

AAS determined that risks were being properly managed within the scope of the audit. However, there were two opportunities for improvement. The first opportunity involved the evaluation of the deferred maintenance backlog. Ms. Doran explained that Facilities had been working to address a deferred maintenance backlog highlighted in assessments done at the University's request in 2004, and again in 2012. Since these assessments were performed and measured differently, they were not easily comparable nor was there a monitoring or measurement process in place to determine the effectiveness of the University in addressing the backlog. Therefore, Ms. Doran said AAS recommended the development of a

plan to determine the current state of facilities; development of the University's objectives and goals for facility upkeep; and identification of the gap and development of a plan to close the gap that is measurable to track progress toward goals.

The second improvement opportunity deals with the transition from construction to maintenance. The transition is increasingly more important as building systems become more complex. AAS recommended formalizing this process with specific steps, important for a successful handoff of the building and sharing important warranty information with those who need access to such information.

In response to Trustee Moody's question about prioritization of deferred maintenance, Ms. Brunelli explained the capital maintenance and renewal projects were included in the 10-Year Capital Projects Plan that Mr. Gruner annually presents to the Board.

B. Compliance with State of South Carolina's Information Security Program

At the 2016 Board Retreat, the University's Chief Information Security Officer (CISO) discussed the State of South Carolina's new IT Security Program requirements and reported that the University, as a state agency was required to comply. Ms. Doran said the CISO took several measures to assist the University in achieving compliance with the State's requirements. Those measures included: a revision to the University Policy to establish roles and responsibilities for IT security including identifying those in the units who hold the role of IT Security Liaison, responsible for carrying out the requirements of the program; the establishment of an Information Security Advisory Committee to promote visibility for security decisions and increase awareness; and a publication of minimum security standards for units based on experience with security incidents at USC and industry data. Additionally, a self-assessment survey was distributed to determine the current state of compliance. Meetings were held with each unit to discuss the results, identify gaps and develop the units' plan for closing those gaps. Next month, Ms. Doran said, a second self-assessment survey will be sent in an effort to provide a better indicator of progress and to determine what is needed to close the gaps.

Since the University already knows it is not in compliance, Ms. Doran said, the audit assessed the plan established by the Information Security Office to bring the University to compliance. The audit considered whether the self-assessment survey conforms to the State's standards and whether the units completing the survey responded accurately. It also verified that action plans were developed to close gaps within the units.

In conclusion, Ms. Doran reported that AAS determined risks were being properly managed within the audit scope and there were no reportable recommendations. She noted that the Information Security

Office put together a comprehensive program. AAS will revisit compliance again in the audit plan, and will focus efforts on reviewing individual units and their security programs for compliance.

Trustee Fennell asked about the University's IT Disaster Recovery Program and Chief Information Security Officer James Perry said that more detail would be presented at a future meeting.

C. Contract Approval Process

Ms. Doran said this was an audit of the process for establishing University contracts and obtaining appropriate approvals. The audit included those contracts that are reviewed by the Office of General Counsel (OGC), and did not include procurements made within the Purchasing department or research-related contracts. She reported that in the past fiscal year there were 2,806 new contracts executed that were valued at nearly \$94 million and there were 484 contract amendments. Also, 79% of the new contracts were processed by OGC in seven calendar days, which she noted was remarkable.

The scope of the audit included: reviewing the "Authority to Sign Contracts" policy; proper approval and a timely execution of contracts; the contract database for data accuracy and completeness; evaluation of the monitoring of contract executions, retention and storage of contracts; and determining compliance with State Procurement code, IT security standards, state required contract clauses, PCI and HIPAA compliance clauses as required.

AAS determined risks are being properly managed within the audit scope and noted several opportunities for improvement. The first area involved the Contract Policy and Procedures. The audit revealed the current policy describes the contract execution process, but does not provide guidance on establishing a contract. AAS recommended, to better communicate expectations for executing contracts, the following be included in the policy: time requirements for review and approval for timely submissions; the contract approval form to be completed; the unit responsibilities (communicated via checklist) – completeness, required general contract terms, impermissible terms, special provisions such as privacy and data security standards; and the inclusion of a financial review for contracts above a certain threshold.

The audit revealed that 41% of the 2,806 new contracts executed last year were signed after the contract start date. Many of these were due to the contract being submitted to OGC late or with insufficient time for review. AAS recommended two actions to address this issue: greater communication about what is needed for timely execution of a contract through the policy and the checklist; and the possibility of a contract database that can monitor contract expirations to assist in timely renewals.

The next opportunity for improvement is contract database and storage. Ms. Doran reported that the current contract database was built to record receipt of contracts by OGC. With very limited data and

functionality, in that it does not store the contracts electronically. Original contracts are stored in paper form in the OGC and in an archive location. Some of the most current original contracts are in fireproof file cabinets; the rest are not. AAS recommended the OGC explore purchasing contract management software that would provide electronic storage and greater functionality to monitor contracts.

Ms. Doran recommended improvement of the verification of contract procurement requirements. She explained that contracts and procurement requirements are very closely related. AAS identified a contract that was not compliant with procurement requirements and recommended correction of that contract as well as including a verification of purchasing requirements on the checklist being developed and used by units and OGC when establishing a contract.

Trustee Whittle asked when the OGC would digitize contracts. Mr. Parham responded the OGC contract database was designed in the 1990s and consideration was being given to upgrading the system within budget and resource parameters. Mr. Parham said AAS's recommendations for improvement were very helpful. He also said he was proud of his staff for their hard work, noting the accomplishment of five attorneys reviewing 3,290 contracts in a year with 80% processed in seven business days.

D. University Policies

Ms. Doran said policies were the foundation of the internal control structure, being the University's primary method to communicate expectations to employees. Policies are so important that SACS accreditation requires administration of them and the University has a policy on the process for policy development. The University's website has 308 policies that are required to be reviewed at least every five years. The Provost's Office is responsible for maintaining the University Policy and Procedures Manual, with a responsible office identified for individual policies.

The audit scope included the following issues: whether policy development has sufficient input and are developed in a timely manner; mandatory versus voluntary elements in policies are clearly communicated; policies are compliant with policy template and regulations; there is communication to policy owners and liaisons; system campus policies conform with University policies; and whether policies are reviewed and updated timely as required.

AAS determined that risks are being properly managed within the audit scope with the exception of the four opportunities for improvement. The first opportunity is for policy reviews and updates to be done in a more timely manner, with 80 of 308 policies having not been reviewed within the required five years. Ms. Doran noted that a big effort to review policies seems to occur about the time the University is

readying for accreditation review; therefore the recommendation is for the Provost Office to begin sending policy review reminders to the responsible units.

Ms. Doran said a leading practice is to establish a policy review committee, with representatives from most affected constituents across campus, to assure policy requirements do not conflict with other policies and that policies are clearly written and understandable. Accordingly, the second opportunity was the establishment of Policy Review Committee.

The third opportunity for improvement dealt with policy procedures compliance. The audit revealed policies were inconsistent in providing clear guidance on whether policy provisions are mandatory or voluntary, making enforcement difficult. Therefore, AAS recommended guidance in the “Policy on Policies” on how to clearly communicate mandatory vs voluntary provisions, for consistency in the interpretation of policy provisions.

The fourth improvement area addressed system campus policies, since AAS found the websites either hyperlinked to specific policies or completely duplicated policies, causing problems with broken hyperlinks and version control issues. AAS recommended to avoid these problems, the system websites simply hyperlink to the University Policy page.

E. School of Law Capital Project Progress Report IV

Ms. Doran said the audit focused on three areas for the \$80 million School of Law construction project for the period July 1, 2016, through December 31, 2016. Those areas included: review of contractor payment applications and construction manager fees for consistency with the terms and conditions of the contracts with the architect, construction manager at risk and the construction manager agent; review of change orders for reasonableness and appropriate approvals; and validation that stipulated insurance coverage existed. Ms. Doran reported AAS found no significant reportable issues during the course of the audit process. She noted that Facilities reported the building was within budget and substantially complete with expected move-in following commencement ceremonies in May 2017.

F. Review of Fourth Quarter FY16 and First and Second Quarters FY17 President’s Office and Board Office Expenditures

Ms. Doran said AAS’s review of the April 1 – December 31, 2016, expenditure summaries found no reportable issues. The review included: reconciling each operating expense category reported in the expenditure summaries to the general ledger in the PeopleSoft Finance system; comparing each major expense account to the prior period and budget estimates; reviewing any variance over \$10,000; reviewing supporting documentation for a sample of operating expenses for compliance with

applicable policies; verifying quarterly reports sent to the Chairman of the Board detailing the President's development expenses are complete and accurate; and comparing Flight Operation Reports for the University's plane to the Passenger Approval Report, to verify business purpose for the trip.

G. Tracking Report

Ms. Doran provided a Tracking Report indicating that at the October committee meeting there were 34 outstanding recommendations. Of the 34 recommendations, 15 had been implemented, 4 were not yet due, and 15 were extended. She said details of the deferred recommendations were provided in the report.

Chairman Smith said these reports were received as information.

V. Draft Conflicts of Interest and Commitment Policy

Ms. Doran said that at the Board's request she presented a Conflict of Interest Project Plan at the committee's October meeting. With Mr. Parham and Mr. Byrd, she developed the plan for an overall conflict of interest policy that is efficient, clear and addresses who is required to complete a disclosure, how and when it needs to be done. This policy will be an umbrella policy that will reference other already existing conflicts of interest and commitment policies and related disclosure requirements based on employees' roles with the university such as the outside professional activities for faculty, financial conflicts of interest for researchers, and outside employment for staff. The policy would also include a requirement for staff to complete an annual disclosure.

Ms. Doran reported the draft Conflicts of Interest and Commitment Policy was on the Board Portal for information only; the final version is scheduled to be presented by early Fall 2017. She reviewed highlights of the staff disclosure process and the implementation timeline.

Ms. Doran discussed the four staff disclosure requirements:

1. The employee or family member has a financial interest or are involved as an owner, operator, or as an executive officer directly involved with activities related to the employee's area of profession, expertise or institutional responsibilities (Currently a requirement for USC Faculty to disclose.)
2. The employee or family member conducts business with the University
3. The employee has a personal relationship with an individual who has a financial interest in a business entity with which the University does or proposes to do business, and the employee is in a decision-making role or otherwise is in a position of influence to the University's decisions regarding the business entity
4. The employee engages in outside employment, like the requirement for faculty to disclose outside professional activities.

Ms. Doran responded to questions about the draft policy and its compliance with State ethics laws.

The staff disclosure process will be piloted the first year, Ms. Doran said, involving supervisors and staff with purchasing approval authority. This group represents 1,600 of the 5,400 University staff.

Disclosures will be routed to an authorized reviewer, the Division of Human Resources will review conflict management plans, and AAS will have access to online disclosures and conflict management plans.

Chairman Smith said the report was received as information.

VI. Audit and Compliance Committee Reviews

A. Board of Trustees Policies Annual Review

Ms. Doran reported there were no proposed updates, other than the draft Conflicts of Interest and Commitment Policy just presented for information.

B. Committee Charter Annual Review

Based on her annual review, Ms. Doran proposed no changes to the Committee Charter.

C. Committee Matrix

Ms. Doran reported the Committee Matrix showed the committee had completed everything planned for this meeting.

Chairman Smith thanked Ms. Doran for her reports, which he said were received as information.

VII. School of Law Business Plan

Chairman Smith called on Dean Wilcox who reported President Pastides received notification on March 16, 2017, of the Law School's reaccreditation by the American Bar Association.

Dean Wilcox said Kennedy & Company was retained to develop a long-range business plan for the Law School, involving a numbers driven analysis of the school's admissions practices, national rankings, and financial picture. He discussed financial sustainability highlights; noted selected recommendations for rankings and net tuition revenue improvements; and reported on strategic steps already taken by the Law School.

Trustee Whittle recommended Kennedy & Associates meet with Elliott Davis Decosimo to ensure their study of financials was based on accurate numbers.

Dean Wilcox responded to questions from Trustee Mobley regarding current and future enrollment numbers related to faculty and facility capacity, noting national trends. He also responded to Trustee Fennell's questions regarding out-of-state enrollment and revenue.

Mr. Lordo asked about efforts being made to enhance in-state recruiting. Dean Wilcox acknowledged the Law School's tuition was high, causing in-state students to explore out-of-state schools.

Chairman Smith thanked Dean Wilcox and stated the report was received as information.

VIII. Other Matters

Chairman Smith called for any other matters to come before the committee. Secretary Heath reminded the Board that a tour of the new Law School would follow lunch.

IX. Adjournment

Since there were no other matters to come before the committee, Chairman Smith called for the meeting to adjourn at 1:35 p.m.

Respectfully submitted,

J. Cantey Heath, Jr.
Secretary