

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

Wednesday, May 16, 2012 – The members of the Audit and Compliance Committee of the University of Houston System convened at 8:53 a.m. on Wednesday, May 16, 2012 at the Hilton University of Houston Hotel, Conrad Hilton Ballroom, Second Floor, Houston, Texas, with the following members participating:

ATTENDANCE –

Present

Nandita V. Berry, Chair

Roger F. Welder, Member

Nelda Luce Blair, Ex Officio

Tamecia Glover Harris, Student Regent

Member(s) Absent

Mica Mosbacher, Vice Chair

Non-Member(s) Present

Welcome W. Wilson, Jr., 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 that with the exception of the minutes, eight (8) items would be presented to the committee, all for information only. Regent Berry then introduced Item B, the approval of the minutes.

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AGENDA ITEMS

**Action Item:**

1. Approval of Minutes – Item B

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

- February 15, 2012, Audit and Compliance Committee Meeting

Regent Berry announced that Mr. Don Guyton, Chief Audit Executive, would be presenting the items before the committee.

**Information Items:**

1. Report on UHS Public Broadcasting Basic Financial Statements and Independent Auditor's Report for FY2011 and FY2010 – University of Houston System, AUDIT-C1-53; and

2. Report on UHS Endowment Fund, Financial Statements and Independent Auditor's Report for FY2011 and FY2010 – University of Houston System, AUDIT-D-54-88

Mr. Guyton addressed Audit C1-53 and Audit D54-88, the Financial Statements and Independent Auditor Reports for FY2011 of the UHS Public Broadcasting and the UHS Endowment Fund. The other supplemental information had been excluded from the Endowment Fund financial statements. This information included the schedule of noncurrent investments and the schedule of changes in net assets by the endowment. These schedules are on file in the Board of Regents' office with the complete set of financial statements.

Mr. Guyton then introduced Mr. Matt Malinsky, KPMG engagement partner, who presented both of these items to the committee. Below is a recap of Mr. Malinsky's comments.

- KPMG's audit responsibility was addressed:
  - KPMG has a responsibility to conduct their audits in accordance with the following professional auditing standards – AICPA;
  - In carrying out this responsibility, KPMG plans and performs the audit to obtain reasonable – not absolute – assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud; and
  - KPMG has no responsibility to obtain reasonable assurance that misstatements that are not material are detected.
- KPMG's independence:
  - KPMG has established 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.
  - KPMG is compliant with all guidelines established by the AICPA Independence Standards Board and General Accounting Office including:
    - (a) Restrictions on financial interests in the debt securities of the University of Houston;
    - (b) Restrictions on consulting and information technology services;
    - (c) Review of the impact of non-audit fees on auditor independence (at the State of Texas level); and
    - (d) Annually, report to the Board of Regents on KPMG independence. They were independent during 2011.
- Review of 2011 audit results:
  - Audit Reports – Auditors' report on the financial statements of the University of Houston Endowment – Unqualified opinion;
  - Audit Reports – Auditors' report on the financial statements of the Public Broadcasting System ("The System") – Unqualified opinion;
  - Other deliverables – Attest reports on the Corporation for Public Broadcasting Schedule of Non-Federal Financial Support – Unqualified opinion.
- Significant account estimates:
  - Valuation of non-readily marketable investments – UH Endowment Fund
    - (a) KPMG performed the following testwork in order to test the reasonableness of management's assessment of the valuation:
      - Tested controls over selection of investment valuation process;
      - Performed tests of details over all investment valuations;

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- For funds that were not readily marketable, tested critical information pertaining to the valuation and classification of the investments through confirmations with external fund managers or alternative procedures; and
- Utilized a KPMG investment valuation specialist to assist in their procedures.
- Significant Accounting policies used by the Stations were described in Note 2 of the financial statements – Public Broadcasting System
  - (a) KPMG performed testwork over all significant estimates to ensure reasonableness of management’s assessment of significant estimates.
- Matters of Interest
  - Financial Statements and Operations
    - (a) The University uses accounting practices consistent with generally accepted accounting principles and those used in the industry, as appropriate.
    - (b) Financial statement disclosures were appropriate.
- Required Communications
  - KPMG’s responsibility under generally accepted auditing standards:
    - (a) Expressed their opinion on the financial statements based on their audits;
    - (b) Assessed risk that financial statements may contain a material misstatement;
    - (c) Considered internal control structure/secure understanding of accounting systems.
  - Accounting Policies
    - (a) There were no significant changes in the accounting policies that were made during fiscal year 2011
  - Consideration of Internal Control Structure
    - (a) No material weaknesses in internal controls were noted during the 2011 audit;
    - (b) Scope of work performed on internal controls not sufficient to render an opinion on effectiveness of internal controls.
  - Disagreements with Management
    - (a) There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our report on the University’s/System’s financial statements.
  - Consultation with Other Accountants
    - (a) To the best of their knowledge, management has not consulted with or obtained opinions, written or oral, from other independent accountants during the year ended August 31, 2011.
  - Major Issues Discussed with Management Prior to Retention
    - (a) KPMG generally discusses a variety of matters, including the application of accounting principles and auditing standards, with the University and System throughout the year. However, these discussions occurred in the normal course of their professional relationship and their responses were not a condition to their retention.
  - Management Judgments and Accounting Estimates
    - (a) Certain estimates are particularly sensitive because of their significance. Future events may change such assessments.
    - (b) Pertaining to the UHS Endowment Fund – Management estimates which require more extensive audit procedures:
      - Valuation of private equity investments, non-marketable investments
  - Difficulties Encountered in Performing the Audits:

- (a) KPMG encountered no difficulties in dealing with management and appreciated their cooperation while performing their audits.
- Significant Written Communications Between KPMG and Management:
  - (a) In accordance with the auditing standards communications requirements, copies of the following material written communications between management and KPMG,
    - Independent Contractor Agreement
    - Management Representation Letter
- Review of other Information:
  - (a) KPMG's responsibility for other information in documents containing the University's financial statements and their report thereon did not extend beyond the financial information identified in their report, and they had no obligation to perform and procedures to corroborate other information contained in these documents.
  - (b) KPMG has read the other information included in the aforementioned financial statement report.
  - (c) No matters came to their attention that caused them to believe that such information, or its manner of presentation, was materially inconsistent with the information, or manner of its presentation, appearing in the consolidated financial statements.

Mr. Malinsky stated KPMG has an ethics and compliance hotline available to all firm partners and employees, as well as clients, contractors, vendors, and others in a business relationship with KPMG, including other KPMG member firms whose partners and employees may be working with the U.S. firm on engagements with U.S. clients. The KPMG hotline provides a confidential, non-retaliatory, and anonymous hotline for the good faith reporting of concerns about possible violations of law, professional and ethical standards, and KPMG policy.

Regent Berry thanked Mr. Malinsky for his presentations and attending the meeting.

A committee discussion followed. These items were presented for information only and required no committee action.

3. Report on External Audit Report, State Auditor Reports – University of Houston System, AUDIT-E89-148
  - SAO Report 12-328 – Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2011
  - SAO Report 12-555 – Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2011

Mr. Guyton presented this item which referred to the UHS excerpts of the State Auditor's recently issued reports on the Federal and Financial Portions of the State-wide Single Audit Report for FY2011. On the first two pages of this item, a listing of key points in the reports as they relate to UHS entities can be found. Internal Audit (IA) had prepared management action plans to address each of the recommendations in the State Auditor's report. These action plans have all been implemented, as noted in the follow-up status report which was included in the IA Briefing Booklet. These action plans primarily addressed the awarding of Federal financial aid.

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Regent Berry pointed out that most of the audits from the state level dealt with the financial aid area and stated she was pleased with the results of the audit but reiterated for moving forward, especially with our drive to Tier One, how important compliance with our policies and procedures for financial aid and research was going to be in the future.

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

4. Report on Statement of Net Assets of the University of Houston-Clear Lake as of August 31, 2011, and the related Statement of Revenues, Expenses and Charges in Net Assets and Statement of Cash Flows for the year then ended and Independent Auditor's Review Report issued by the State Auditor – University of Houston System, Item F – AUDIT-F149-178.

Mr. Guyton presented this item which referred to the Report on Statement of Net Assets of the University of Houston-Clear Lake (UHCL) as of August 31, 2011, and the related Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows for the year then ended and Independent Auditor's Review Report issued by the State Auditor. This report had been prepared for the use of the Southern Association of Colleges and Schools (SACS) in connection with the review of UHCL for accreditation purposes. The State Auditor's Office (SAO) requested Internal Audit Departments to perform fieldwork on these types of engagements using the work program provided by the SAO and using the common audit software for working papers that IA obtained through a contract with SAO. The IA department performed the majority of the fieldwork for this engagement during December. The SAO issued a clean opinion on this report. The SACS site visit occurred during April 2012.

Mr. Guyton introduced Dr. William Staples, President of the University of Houston-Clear Lake (UHCL), who gave a brief update on the status of the accreditation recently completed. Below is a summary of President Staples' remarks.

- SACS was the entity responsible for performing the accreditation.
- This is the regional accreditor for universities and community colleges from a multi-state area.
- Regional accreditation is different from other forms of accreditation; and occurs every ten (10) years. Each of the UH System institutions must go through this process.
- These site visits are staggered. The UH-Clear Lake visit was recently completed in April 2012; the UH-Victoria visit will occur in 2014; UH-Downtown's visit occurring in 2016; and the University of Houston's visit will be held in 2018.
- The site team consisted of ten (10) individuals for three (3) days and was a very comprehensive review.
- The decision for reaffirmation of accreditation will be made in December 2012 in Dallas, Texas at their annual meeting.
- There were two minor recommendations made by SACS:
  - Adding a few sentences to the catalogue; and
  - Adding a SACS requirement to the Board of Regents By-laws that states the governing board has a policy whereby members can be dismissed only for appropriate reasons and a fair process. This applies to all institutions under SACS review and will be addressed at the Board of Regents meeting later today.
- These recommendations will be implemented shortly.

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

5. Presentation on Association of College and University Auditors (ACUA) – University of Houston System, Item G – AUDIT-G179.

Mr. Guyton introduced this item and a brief video was presented which gave an overview of the Association of College and University Auditors or ACUA. This association is a valuable resource for internal auditors in higher education stated Mr. Guyton. ACUA maintains a website which contains a repository of work programs, a risk dictionary, and many other useful tools for auditors. The members of ACUA volunteer their time to assist the organization and other member institutions. Mr. Guyton introduced the three (3) volunteers who were from ACUA member institutions, including the president of ACUA, Toni Messer from UT Dallas, Sabrina Hearn from the University of Alabama System and Brian Mikell from the University of Florida, who had graciously volunteered their time to perform a peer review of the Internal Auditing Department.

Regent Berry thanked the members of ACUA for volunteering their time and taking part in the review process.

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

6. Report on Internal Audit Report – Briefing Booklet – University of Houston System, Item H – AUDIT-H180.

Mr. Guyton presented this item which referred to the Internal Audit Briefing Booklet. Internal Audit (IA) had prepared 15 Internal Audit Reports since the February Audit and Compliance Committee meeting. The executive summaries and individual reports in the Briefing Booklet addressed areas included in the Board-approved Audit Plans for FY2011 and FY2012 and included Departmental Compliance Reviews of the University of Houston-Victoria's President's Office and Schools of Arts & Sciences, Education and Human Development and Business Administration, a review of endowments managed by the UH System Administration and various departments throughout the System, a review of Information Security Standards at the University of Houston-Clear Lake and University of Houston-Victoria, a review of the University of Houston Athletics Rules – Compliance Program, an Operational Review of the University of Houston Texas Learning & Computation Center, a review of University of Houston's eligibility in the National Research University Fund (NRUF), an Internal Quality Assurance Review of the Internal Auditing Department, and Internal Audit's Quarterly Reports on construction award and follow-up activity. These reports will be submitted to the Governor's Office of Budget and Planning, the Legislative Budget Board, the Sunset Advisory Commission, and the State Auditor, as required by the Texas Government Code. Ten (10) of these reports contained management action plans and an overview of all of Internal Audit's recommendations were all included in the Briefing Booklet.

Audit Report No. 2012-15, Internal Audit's follow-up report, addressed the status of twenty (20) action items in seven (7) individual audit reports. Internal Audit verified that fifteen (15) of

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these action items had been implemented and five (5) partially implemented action items. There were no high risk items in this report.

Audit Report No. 2012-16 was the construction award status report. This is a standing report in the Internal Audit Briefing Booklet, similar to their follow-up status report. The objective of the construction award review was to determine whether the major construction contract awards complied with institutional policies and state statutes, particularly the Texas Education Code. This report covered the activities from January 1, 2012 through March 31, 2012. Internal Audit reviewed the RFP on the multi-modal parking garage and the two (2) RFQ's on the football stadium.

Audit Report Nos. 2012-18, 2012-22, 2012-23, 2012-26, 2012-27, and 2012-28 addressed the Departmental Compliance and Endowment Management Reviews at the University of Houston and University of Houston-Victoria. There were no major areas of concern in these engagements.

Audit Report No. 2012-17, Internal Audit's review of the UH Texas Learning & Computation Center (TLC2) addressed both compliance and operations. It was determined that there were numerous areas of non-compliance, some problems with the overall governance of centers and institutes and that effort reporting was not always in compliance with OMB Circular A-21. Internal Audit viewed these issues to be significant and high risk. This center reports to the Division of Research and steps have been taken to address these issues. Mr. Guyton requested Dr. Rathindra Bose, Vice Chancellor for Research and Technology Transfer, to give remarks concerning this issue. Dr. Bose had no complaints on the audit findings and what had happened at that part of the center but he did want to share with the committee what he was doing management-wise to address the issues. Below is a brief summary of Dr. Bose's remarks.

- Since Dr. Bose arrived at the University of Houston on August 1, 2011, monthly meetings have been held with all of the directors of the center including TLC2.
- Executive Director of Fiscal Management has been directed to meet with the financial managers of all of the centers on a weekly basis to monitor their activities.
- Every center has been instructed to give an annual progress report and these reports have been received.
- There were twelve (12) active centers but one (1) of those centers has been closed.
- There are currently 425 employees in the eleven (11) active centers reporting to Dr. Bose but only forty-three (43) are staff members.
- Total funding was \$5.0 million with an annual return of over \$20.0 million.
- For the past five years, these eleven (11) centers have generated \$138.0 million but only \$32-\$33.0 million was spent supporting these centers.
- These centers generate many grant revenues and most of the centers work on multi-disciplinary research.
- Most Federal agencies fund projects that are highly complex and research teams are needed to address these complex issues.
- In order to be a functioning and maintaining and sustaining a Tier One status, processes must be reviewed.

Regent Berry thanked Dr. Bose for his comprehensive explanation.

Mr. Guyton continued with his report and it was noted that there were no major concerns with the UH Hilton operations in Audit Report No. 2012-19.

In Internal Audit's Information Security Reviews at the University of Houston-Clear Lake and University of Houston-Victoria in Audit Reports No. 2012-20 and No. 2012-21, it was found that the institutions had fully complied with most of the State's standards. These reviews are required every two (2) years by statute.

During Internal Audit's review of the University of Houston eligibility for the National Research University Fund (NRUF) in Audit Report No. 2012-23, it was found that most of the information submitted to the Texas Higher Educational Coordinating Board (CB) was accurate. Although there were no major areas of concern, Internal Audit noted opportunities for improvement related to the effort reporting process. Management is implementing Internal Audit's recommendations. The State Auditor's Office is also in the process of completing its state-mandated review of the University of Houston's and Texas Tech University's eligibility to receive these funds.

Audit Report No. 2012-25 was Internal Audit's review of University of Houston Athletics Rules – Compliance. Internal Audit noted two (2) areas that needed improvement: playing and practice sessions and departmental compliance procedures. Every three out of four years, one (1) major area is reviewed for compliance and a handful of others using the ACUA NCAA Audit Guides. ACUA worked with the NCAA to complete these audit guides which is basically a work program tailored for the various rules and bylaws of the NCAA. This is another good tool to use in order to make certain that the Athletics program has a process in place to adhere to the rules of the NCAA. Mr. Guyton introduced Mr. Kevin Klotz, Compliance Officer in Athletics, to give his comments regarding this audit. Below is a brief summary of his remarks.

- Specifically related to the playing and practice session area of the audit, a software program had been purchased in the last year that would require all coaches and all athletic programs to designate those calendars. The NCAA rules have very specific definitions of: What is a playing season? When can student athletes engage in competition and practice? What is outside of the playing season?
- The issues noted were predominately documentation issues.
- Steps have been taken to make certain that Athletics has the documentation and that it is centrally stored and available for any type of audit.

Mr. Guyton noted that in the review of the Internal Auditing Quality Assurance Program, Internal Audit's senior auditor, Bobby Kegrresse made recommendations related to upgrading Internal Audit's software, improving their administrative procedures to help ensure compliance with the IIA Standards and evaluating the use of computer assisted auditing techniques. Internal Audit intends to implement these recommendations and the ones that were offered by the External Peer Review Team.

Referring back to the activity outline in the Briefing Booklet, Mr. Guyton stated there were various scheduled audits in the reporting, fieldwork in progress or in the planning phase. These audits were included in the Board-approved Internal Audit Plan for FY2011 and FY2012.

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Internal Audit also has various special projects in progress. One of these items was the State Auditor's Annual Statewide Audit. The State Auditor's Office is planning its FY2012 fieldwork for the UH Federal Financial Assistance Programs and R&D programs. The preliminary fieldwork is scheduled to commence on June 18, 2012 for a two-week period when they do their Financial Aid audit. The R&D audit has not been scheduled but it should occur shortly thereafter.

Mr. Guyton addressed the Audit Plan Status which was located behind the activity outline in the Briefing Booklet. The Audit Plan Status indicates where we stand on all of the audits included in the FY2012 Audit Plan. The shaded areas in the report represent the areas that have been completed and the footnotes in the other columns indicate the various stages of those engagements. A brief discussion followed.

Chancellor Khator made brief comments regarding the Briefing Booklet. On the first page of the report, risk items were categorized as high, medium and low. All risk items were low except for the UH Texas Learning & Computation Center (TLC2). Chancellor Khator noted that we have approximately \$300 million in Federal funds. Whether it is in financial aid, the research area or wherever, whenever there is any abuse of fraud or misuse, the university could jeopardize the entire \$300 million that we have from the Federal government. Chancellor Khator stated that due to the fact that the TLC2 was listed as a high risk item, she placed the TLC2 center into receivership until all issues have been resolved.

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

### 7. Report on Institutional Compliance Status Report for the Three Months Ended March 31, 2012 – University of Houston System, Item I – AUDIT-I181-190.

Mr. Guyton stated this report referred to the Institutional Compliance Status Report for the three months ended March 31, 2012. This report lists activities which included risk assessments, compliance audits, compliance committee meetings, risk mitigation, and hot-line reports.

In this report, the Chancellor's email to the University of Houston System community supervisors dated March 12, 2012 regarding their responsibility to report any unacceptable or inappropriate incident or behavior and act on every recommendation and finding made at the formal conclusion of the investigation. Supervisors were reminded to take these matters extremely seriously. This communication was a follow-up to the Chancellor's November 16, 2011 email to the University of Houston System community to report instances of non-compliance, abuse, fraud or retaliation. Chancellor Khator made remarks and a brief discussion followed.

The remainder of this report also summarized the information provided for each institution for their compliance functions.

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

8. Report on UH System Support Organizations – University of Houston System, Item J – AUDIT-J191-195

- Compliance Review of UH System Support Organizations
- UH System Support Organization Report

Mr. Guyton introduced this item which referred to the Compliance Review of UH System Support Organizations and the UH System Support Organizations Report. The Compliance Review of the UH System Support Organizations indicated the status of the receipt of this information. It was noted that some of the information from some of the foundations has not been received. The UH System Support Organizations Report was a compilation of information from audited financial statements, IRS Forms 990, investment reports and other information furnished to the University of Houston System by the support organizations and compiled by Eli Cipriano, Associate Vice President for University Advancement.

The purpose of this report was to provide information on support organizations' activities and the Board of Regents' and University of Houston System's responsibilities with respect to the foundations. The regents' fiduciary responsibilities to the University of Houston System related to these organizations was addressed in the agreements between the UH System and the organizations. In meeting the requirements of the Board of Regents' policy on support organizations, the UH System implemented a policy on support organizations which required them to furnish certain information to the UH System. This requirement was spelled out in the UH System agreements with the support organizations. A discussion followed.

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

There being no further business to come before the committee the meeting adjourned at 10:17 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  
Philip Castille  
William Flores  
William Staples  
Rathindra Bose  
Grover Campbell

Don Guyton  
Ed Hugetz  
Michelle Dotter  
T. J. Meagher  
Elaine Charlson  
Kevin Klotz  
Lauren Francis  
Jeffrey Cass  
Eli Cipriano

Russ Hoskens  
Raymond Bartlett  
Darren Dunne  
Georgeann Smith  
David Ellis  
Turner Harris  
Cedric Bando  
Wayne Beran  
Dan Maxwell

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Others Present (cont'd)

Eloise Dunn Stuhr  
Richard Walker  
Tom Ehardt  
Craig Ness  
Monica McHenry  
Phil Aldrich  
Gerry Mathisen

Chris Stanich  
Brian Mikell  
Toni Messer  
Jonathan Thurston  
Matt Malinsky  
Ed Jones

Mike Glisson  
Sabrina Hearn  
David Bradley  
Oscar Gutierrez  
Jon Aldrich  
Marquette Hobbs