

MEETING OF THE AUDIT, BUDGET, FINANCE, AND FACILITIES COMMITTEE

OF THE BOARD OF TRUSTEES OF THE UNIVERSITY OF ILLINOIS

September 13, 2010

APPROVED BY THE
COMMITTEE

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Michele M. Thompson
SECRETARY OF THE BOARD

This meeting of the Audit, Budget, Finance, and Facilities Committee was held on Monday, September 13, 2010, beginning at 1:00 p.m. via videoconference in Room 1030, National Center for Supercomputing Applications, 1205 West Clark Street, Urbana; Room 414, Administrative Office Building, 1737 West Polk Street, Chicago; and the Hatmaker Room, Room 550, Public Affairs Center, One University Plaza, Springfield. Trustee Edward L. McMillan, chair of the committee, convened the meeting and asked the clerk to call the roll. The following committee members were present: Mr. Edward L. McMillan, Mr. James D. Montgomery, Mr. Lawrence Oliver, and Mr. Charles L. Olivier. Ms. Pamela B. Strobel participated via telephone.

Also present were President Michael J. Hogan¹; Mr. Walter K. Knorr, vice president/chief financial officer and comptroller; Dr. Mrinalini C. Rao, vice president for academic affairs; Dr. Avijit Ghosh, vice president for technology and economic development; Mr. Thomas R. Bearrows, University counsel; Mr. Thomas P. Hardy, executive director for University relations; Ms. Katherine Laing, executive director for governmental relations; Dr. Lisa Troyer¹, executive assistant to the president and chief of staff, and Dr. Michele M. Thompson, secretary.

In addition, the following were present: Ms. Julie A. Zemaitis, executive director, University audits; Mr. Michael B. Bass, senior associate vice president for capital programs and real estate; Mr. Douglas E. Beckmann, senior associate vice president for business and finance; Dr. W. Randall Kangas, associate vice president for planning and budget; Ms. Maureen Parks,

¹ President Hogan and Dr. Troyer arrived at 1:10 p.m.

assistant vice president for human resources; Dr. Heather Haberaecker, executive assistant vice president for business and financial services, Chicago; Ms. Maxine Sandretto, assistant vice president for business and financial services, Urbana; Mr. Larry Altenbaumer, consultant; and Dr. Joseph Finnerty, professor of finance, College of Business, Urbana, representing the University Senates Conference.

Mr. McMillan thanked everyone for attending the meeting and said the first item on the agenda is to approve the minutes from the meeting held on July 12, 2010. On motion of Mr. Montgomery, and seconded by Mr. Oliver, the minutes were approved unanimously. Mr. McMillan then asked Ms. Jackie Dippel and Ms. Cathy Baumann, both from KPMG, to provide the external audit scope presentation (materials on file with the clerk).

REPORTS ON EXTERNAL AND INTERNAL AUDITS

KPMG External Audit Scope Presentation

Ms. Dippel reviewed the audit scope and deliverables for the fiscal year that ended June 30, 2010, objectives of the audit, and the responsibilities of KPMG. She described the audit methodology, the need to rely on other independent external auditors for some University related organizations, preliminary risk assessments in a variety of areas, and compliance with both federal and State regulations. Lastly, Ms. Dippel provided an overview of the audit timing, which she stated is significantly earlier than last year, and encouraged trustees to utilize training provided by KPMG's audit committee institute. There were no questions for Ms. Dippel. Mr. McMillan then asked Ms. Zemaitis to present the summary of internal audit activity (materials on file with the clerk).

Summary of Internal Audit Activity – Fourth Quarter Ended June 30, 2010

Ms. Zemaitis stated that she would present a summary of audit activity for the fourth quarter, which ended on June 30, 2010, and performance metrics for the year. She provided an overview of the audit plan completion status through the fourth quarter, stating that 79 percent of the audits planned for this year are either in progress or are complete, and more hours have been spent on investigations and special projects than had been planned. She provided a summary of the 69 reports issued in fiscal year 2010 and said the results were typical. She compared direct audit hours by type of project and by campus in fiscal year 2010 and 2009. Ms. Zemaitis then presented fourth quarter audit report findings by risk level and high and moderate risk audit report findings by campus. She provided a chart depicting fourth quarter high and moderate risk audit issues concentrated in several areas, and committee members discussed the nature and impact of information technology security and streamlining audit findings, as well as the connection to enterprise risk assessment. Ms. Zemaitis also responded to questions regarding the audit process and explained the way investigations are initiated. Ms. Donna McNeely, University ethics officer, provided additional information regarding the relationship between the University Ethics Office and the office of University audits.

Ms. Zemaitis continued the presentation and provided audit report findings by risk level and by campus for fiscal year 2010, including a chart with areas of concentration. She reviewed a trend analysis and aging analysis of the implementation of internal audit recommendations, noting its upward trend. Committee members discussed concern over the growing backlog of outstanding audit recommendations and requested additional information pertaining to moderate and high risk findings by campus. With no additional questions on internal audits, Mr. McMillan

asked Mr. Knorr to present on the fiscal year 2011 budget proposal and the fiscal year 2012 operating and capital request (materials on file with the clerk).

REPORTS TO THE COMMITTEE

FY 2011 Operating Budget Proposal

and FY 2012 Operating and Capital Request

Mr. Knorr began his presentation and referred to materials that will be mailed to trustees in advance of the Board meeting on September 23, 2010. He started his presentation on the fiscal year 2011 operating budget with a discussion of state budget shortfalls throughout the country and the national economic conditions. He discussed the finances of the State of Illinois, including the \$13.0 billion deficit, and said that State revenue declines appear to have stabilized. He predicted that payments from the State would continue to be delayed in fiscal year 2011, and said that unpaid State vouchers from fiscal year 2010 currently equal \$120.0 million. Next, he referred to the 6.2 percent decrease in the State appropriation for fiscal year 2011 and noted that the "Maintenance of Effort" (MOE) for the federal stimulus program expires after this fiscal year. He also mentioned efforts throughout the University in response to delayed State payments.

Mr. Knorr then presented data concerning State appropriation revenue billings and collections from 2008 through September 6, 2010, and the month end general revenue fund receivable from fiscal year 2007 through fiscal year 2010. He provided an overview of the fiscal year 2011 operating budget and reviewed upcoming cost expectations. Next, he presented reports outlining the operating budget summary and unrestricted and restricted revenue components for fiscal year 2006 through 2011. Committee members discussed the ramifications of an income tax increase, the impact of the expiration of the Maintenance of Effort funding, and

expectations for State support. They inquired about the cost for payments on behalf, which they noted had doubled since 2006. Mr. Knorr, Mr. Beckmann, and Dr. Kangas explained that this increase was due to the cost of health care and State efforts to adequately fund the pension system.

Next, Mr. Knorr reviewed the fiscal year 2012 operating budget request, which he explained is a \$71.1 million request that will be forwarded to the Illinois Board of Higher Education upon Board approval. He also reviewed the campus capital priority request and combined capital budget request for fiscal year 2012, as well as the fiscal year 2010 State capital budget.

State Pension Plan for New Employees

Mr. McMillan then asked Ms. Maureen Parks to present on the recently passed State Universities Retirement System (SURS) pension reform (materials on file with the clerk). Ms. Parks stated that Governor Quinn signed Senate Bill 1946 into law on April 14, 2010, which impacts all SURS-eligible employees who are hired on or after January 1, 2011. She noted this is substantial pension reform and stated that the University hired Buck Consultants, a human resources consulting firm, to assist in the analysis of its impact. She outlined the major changes to the program, which include increasing the salary averaging period to eight years; limiting final average earnings; raising the normal retirement age to 67; and delaying and reducing cost of living adjustments. She stated that Buck Consultants provided four options in response to these changes, and said that three of the options are not practical because of the University's financial constraints. She explained that the fourth option promotes awareness of the SURS Self-Managed Plan (SMP) through careful recommendations and education, and noted that those involved in hiring and recruiting would also need education or training about this plan. She emphasized that

there is no change to pensions for current employees, and said that some details have not yet been determined. She concluded by referring to a chart comparing retirement plans among Big Ten Universities and said other institutions may also be considering pension reform. Committee members briefly discussed the presentation.

Derivative Transactions for Energy Procurement

Mr. Altenbaumer thanked the committee and said that energy matters have been an area of focused attention across all segments of the University in recent years. He described progress that has been made in this area and mentioned previous action taken by the Board of Trustees to formalize and enhance the role of Prairieland Energy as the primary procurement interface between the energy markets and the University. He noted that this is consistent with the recommendations of the Energy Task Force, and he provided additional information regarding Prairieland Energy. He then highlighted policy refinements regarding energy procurement that have been approved over the last two years and said the objective is to continue to improve the effectiveness of energy procurement processes at the University.

Mr. Altenbaumer referred to an item that will be presented to the Board of Trustees at its meeting on September 23, 2010, that will request approval for the use of certain financial transactions to support the ongoing performance of energy procurement activities. He noted that this follows recent work advanced by the University's Enterprise Risk Management on the Derivatives Use Policy, which was approved by the Board of Trustees in July, 2010. He described the policy provisions and types of financial transactions that can be used and provided the rationale for their usage. He emphasized that financial transactions will be used as a substitute for a physical purchase, which he said creates opportunities for a larger market of

possible transactions and the ability to better match specific University requirements with available market offerings. He stated that these transactions can help the University take advantage of market price differentials between electricity and natural gas that might be better than what exists for a specific period for the University under its established position. He also referred to price cap or pricing collar mechanisms to effectively provide insurance against significant pricing changes in a volatile energy market, and cautioned that the use of these types of transactions will require specific analytic support and review.

Mr. Altenbaumer stressed that the use of financial transactions will only be done in a manner to address the effective procurement of energy to meet the University's requirements, and said there is no provision for any market speculation. He stated that each financial transaction that is utilized is a substitute for a physical transaction counterpart that is permissible under the current procurement policy, with the exception of possible use of insurance pricing mechanisms. He said it is expected that financial transactions will provide a broader portfolio and greater depth of procurement options than what is available in the physical markets, and the procurement policy addresses the preparation of appropriately detailed reports to reflect all procurement activities, including both physical and financial transactions. He said this will include the availability of information regarding the current status of all open financial transactions. The committee discussed Mr. Altenbaumer's presentation, and Ms. Strobel stressed the importance of communicating an emphasis on energy efficiency. She stated that she is in favor of the item before she left the meeting at 2:45 p.m.

REVIEW OF PROPOSED AGENDA ITEMS

FOR THE SEPTEMBER 23, 2010, BOARD MEETING

Mr. Knorr reviewed the following draft items that fall within the purview of the Audit, Budget, Finance, and Facilities Committee that will be recommended to the Board for consideration at the next Board meeting, September 23, 2010, barring objection from the committee:

- Project for Urbana-Champaign Big Broadband, Urbana
- Purchase recommendations: equipment for the Department of Chemistry, Chicago;
information technology services for the University of Illinois Medical Center;
equipment for the Department of Physics, Chicago
- Operating Budget for Fiscal year 2011
- Academic and Administrative Appointments for Contract Year 2010-2011
- Requests for New Operating and Capital Appropriations, Fiscal year 2012
- Resolution for MAFBE Procurement Goals for Construction
- Clarify Dollar Limits on Purchases, Leases, Contracts, and Other Actions Requiring
Specific Board of Trustees Authorization – Emergency Procurements
- Policy for the Use of Financial Derivatives for Energy Commodity Procurement

Mr. Knorr asked Mr. Bass to comment on the resolution concerning Minority and Female Business Enterprise (MAFBE) goals. Mr. Bass explained that the resolution contains high aspiration goals that provide guidance and direction for increasing diversity, and he thanked Mr. Thomas Bearrows, Mr. Scott Rice, and others who assisted in the development of the resolution. He stated that the goals for participation of minority and female owned subcontractors in construction contracts for Chicago would be established at 22 percent, and 15 percent at all other locations. He emphasized that these are high aspiration goals, and said the process includes

required documentation of a good faith effort for contractors and complies with the State procurement code. He outlined the process by which a good faith effort would be assessed, emphasizing that the process includes justification for discarding a bid due to lack of demonstration of a good faith effort on the part of the contractor. Mr. Montgomery expressed concern that the resolution is restricted to construction contracts, and Dr. Haberaecker stated that work is underway to obtain the assistance of a consultant to assist the University in its efforts to increase diversity in other areas of purchasing and contracting. No committee member was opposed to the resolution being presented to the Board at its September 23, 2010, meeting.

After a brief discussion regarding the other proposed agenda items, no committee member opposed the recommendation of these items and placement of these on the Board's agenda for the September 23, 2010, Board meeting.

COMMITTEE MEETING ADJOURNED

There being no further business, Mr. McMillan requested a motion to adjourn the meeting. The motion was made by Mr. Montgomery, seconded by Mr. Oliver, and approved unanimously.

The committee meeting adjourned at 3:10 p.m.

Respectfully submitted,

Michele M. Thompson
Clerk

Edward L. McMillan
Chair

Eileen B. Cable
Assisting