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FOR
AUDIT, COMPLIANCE, AND RISK MANAGEMENT
COMMITTEE**

Committee Meeting: 2/26/2018

Board Meeting: 2/27/2018
Austin, Texas

David J. Beck, Chairman
Ernest Aliseda
Kevin P. Eltife
R. Steven Hicks
Janiece Longoria
Rad Weaver

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B. CONVENE JOINT MEETING WITH FINANCE AND PLANNING COMMITTEE			
8. U. T. System: Report on the Fiscal Year 2017 Annual Financial Report, including the report on the U. T. System Annual Financial Report Audit, and audits of U. T. Austin, U. T. M. D. Anderson Cancer Center, U. T. Southwestern Medical Center, and U. T. Medical Branch - Galveston financial statements and for funds managed by The University of Texas/Texas A&M Investment Management Company (UTIMCO)	3:15 p.m. Report/Discussion <i>Mr. Wallace</i> <i>Mr. Peppers</i> <i>Mr. Robert Penshorn,</i> <i>Ms. Tracey Cooley,</i> <i>Mr. Robert Cowley,</i> <i>and</i> <i>Mr. Blake Rodgers,</i> <i>Deloitte & Touche</i>	Not on Agenda	90
C. ADJOURN			
	3:45 p.m.		

1. **U. T. System Board of Regents: Discussion and appropriate action regarding Consent Agenda items, if any, assigned for Committee consideration**

RECOMMENDATION

The proposed Consent Agenda items assigned to this Committee are [Items 4 - 5](#).

2. **U. T. System: Report on the results of the Systemwide Quality Assessment Review of internal audit activities**

REPORT

Ms. Raina Rose Tagle and Mr. John Kiss, Baker Tilly, will report on the independent validations of quality assessment reviews conducted by the internal audit functions across the U. T. System.

The validations performed by Baker Tilly included an assessment of the level of conformance with The Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)*, the Generally Accepted Government Auditing Standards (GAGAS), and the relevant requirements of the *Texas Government Code*, Chapter 2102, Texas Internal Auditing Act (TIAA). In addition, leading practices and opportunities for enhancement were identified.

The Baker Tilly reports were distributed to the appropriate institutional chief audit executive, president, internal audit committee members, the U. T. System Chief Audit Executive, and the Audit, Compliance, and Risk Management Committee members.

A summary of the results can be found in the PowerPoint presentation set forth on the following pages.

BACKGROUND INFORMATION

The internal audit profession is guided by the IIA Standards, within which there is a requirement for all internal audit functions to have external assessments conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization.

For state agencies within the State of Texas, the TIAA establishes guidelines for state agencies' internal audit functions. The TIAA requires all state agencies to adhere to the U.S. Government Accountability Office Government Auditing Standards, which require a review at least once every three years by reviewers independent of the audit organization.

The University of Texas System

Report on the Independent Validations of the Internal Audit Functions' Quality Assessment Reviews (QAR)

The University of Texas System Board of Regents' Meeting
Audit, Compliance, and Risk Management Committee
February 2018



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This information has been prepared pursuant to a client relationship exclusively with, and solely for the use and benefit of, The University of Texas System Administration and is subject to the terms and conditions of our related contract. Baker Tilly disclaims any contractual or other responsibility to others based on its use and, accordingly, this information may not be relied upon by anyone other than The University of Texas System Administration.

Background



Objectives

- Validate the assertions made in the QAR self-assessments concerning conformance with the Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing and Code of Ethics, Generally Accepted Government Auditing Standards, and relevant requirements of the Texas Internal Auditing Act (*Standards*)
- Provide a fresh perspective on leading practices and opportunities to improve service delivery

Scope

- Conduct separate independent validations of the self-assessments for the 15 internal audit (IA) functions in The University of Texas (U. T.) System

Approach

- Leverage assistance of peer institution IA leaders
- Interview stakeholders and IA functions
- Review the self-assessments and a sample of IA documents



Reports and workpapers analyzed



Interviews conducted



Peer institutions' perspectives incorporated

Validation Team – Perspectives Incorporated



Baker Tilly

- Utilized extensive academic and healthcare risk expertise of senior practice leaders
- Leveraged experience in assessing IA functions at prominent higher education and healthcare institutions across the country
- Provided each institution in the U. T. System with tailored reports to address any conformance considerations and provide opportunities to evolve each function and incorporate leading practices

Peer Institutions

- Provided additional perspectives for innovative and leading practices for IA functions



Overall Results



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Conclusions

The IIA's Quality Assessment Manual suggests a scale of three ratings:

- > Generally Conforms (GC): is the top rating and means that an IA activity has a charter, policies, and processes that are judged to be in conformance with the *Standards*.
- > Partially Conforms (PC): means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the IA activity from performing its responsibilities in an acceptable manner.
- > Does Not Conform (DNC): means deficiencies are judged to be so significant as to seriously impair or preclude the IA activity from performing adequately in all or in significant areas of its responsibilities.

Quality Assessment Evaluation Summary	GC	PC	DNC
U. T. System Administration	✓		
U. T. Arlington		✓	
U. T. Austin		✓	
U. T. Dallas	✓		
U. T. El Paso	✓		
U. T. Permian Basin	✓		
U. T. Rio Grande Valley	✓		
U. T. San Antonio	✓		
U. T. Tyler	✓		
U. T. Southwestern Medical Center	✓		
U. T. Medical Branch - Galveston	✓		
U. T. Health Science Center - Houston	✓		
U. T. Health Science Center - San Antonio	✓		
U. T. MD Anderson Cancer Center	✓		
U. T. Health Science Center - Tyler	✓		

Overall Results (cont.)



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Institutions Assessed as Partially Conforming with the *Standards*

We concluded that the IA functions at U. T. Arlington and U. T. Austin partially conformed with the *Standards*. Recommendations to achieve general conformance included:

U. T. Arlington

- Add value through IA activities
- Effectively align IA's work with institutional priorities
- Ensure adequate IA resources

U. T. Austin

- Cultivate IA's strategic and independent outlook
- Strengthen overall IA knowledge and capabilities
- Strengthen the risk assessment process to further evolve the IA plan

Observations Across U. T. System



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In addition to assessing the IA functions' conformance with the *Standards*, the validation team leveraged their experience to highlight distinct strengths and opportunities related to innovative and leading practices at each institution. We tailored these observations specifically to each entity. During our review, we noted:

- 87 Internal audit strengths across U. T. System
- 78 Internal audit opportunities across U. T. System
- 45 Other considerations for management

Internal Audit Strengths Across U. T. System



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During our review, we noted common strengths across the U. T. System and its institutions. These strengths are a result of collaborative efforts across all of the IA functions and represent leading practices and a step forward since the last Quality Assessment Review.

Contributions to Evolution of Governance Structure

Each internal audit committee (IAC) includes at least three external members to support the direction and strengthen the independence of the IA function. Additionally, Institutional Chief Audit Executives and IAC chairs participate in retreats to further enhance education and collaboration in support of IAC effectiveness.

Common Framework and Language for Risk

U. T. IA functions use a consistent framework for conducting risk assessments and have developed a common language for discussing risk across the U. T. System.

Systemwide Audit Management Software Implementation

U. T. IA implemented a common instance of TeamMate audit management software, which should ultimately strengthen risk assessment and knowledge-sharing across the IA functions.

Internal Audit Opportunities Across U. T. System



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During our review, we noted opportunities to enhance IA’s work across the U. T. System. These opportunities are not specific to any one institution, but rather will require the collaborative efforts of all of the IA functions within the U. T. System to effect change.

Partnering on Strategic Plan

Engage institutions in a consensus-driven approach to develop the next iteration of the Systemwide IA strategic plan to benefit from their input, achieve buy-in, and support continued achievement of strategic objectives.

Leveraging Information Technology (IT) Risk Assessment Methodology

Continue to expand a Systemwide view of IT risks to, over time, support a Systemwide audit effort to address certain common IT risks across multiple institutions.

Exploring the Further Evolution Audit Plan Focus

Maximize risk-based audit efforts by continuing to reduce involvement in “mandatory audits” across the U. T. System.

Expanding Knowledge Sharing and Enhancing the Approach to Specialized Services

Evolve the current facilitated approach to knowledge sharing to support sharing directly amongst institutions by identifying subject matter experts.

Other Considerations for Management



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Although our assessment was of IA, IIA *Standards* require validation teams to consider the intersection of IA activities with risk management and compliance activities across the institution. During our review, we noted enhancement opportunities across the U. T. System for leadership's consideration, such as:

Developing an Enterprise Risk Management Framework

Capitalize on institutional readiness to embrace an enterprise-wide view of risks.

Integrating IA and Compliance Risk Assessment Efforts

Support collaborative risk assessment and planning between the two functions to optimize resources and avoid duplication of efforts, consistent with leading practices.

Clarifying the Intersection of IA and Compliance

Clearly delineate the division of responsibilities between IA and Compliance to eliminate confusion and support effectiveness.

Key Words from Interviews



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Note: The relative size of the words correlates to their occurrence/use by interviewees to describe the IA functions.

Contact Information



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3. **U. T. System: Report on the Systemwide internal audit activities, including results of the presidential and executive travel and entertainment expenses audits, and the status of Priority Findings**

REPORT

Chief Audit Executive Peppers will present the results of the presidential and executive travel and entertainment expenses audits that were conducted across U. T. System. Summaries of the results for these audits were provided to the Audit, Compliance, and Risk Management Committee members prior to the meeting. Mr. Peppers will also report on the status of Systemwide Priority Findings, using a PowerPoint presentation set forth on the following pages.

BACKGROUND INFORMATION

A Priority Finding is defined as “an issue identified by an audit that, if not addressed timely, could directly impact achievement of a strategic or important operational objective of a U. T. institution or the U. T. System as a whole.” A Priority Findings Matrix is used by the chief audit executives to aid in the determination of a Priority Finding. The matrix provides three categories of standard factors to consider, each alone with the potential to result in a Priority Finding. They are: Qualitative Risk Factors (evaluates the probability and consequences across seven high risks), Operational Control Risk Factors (evaluates operational vulnerability to risks by considering the existence of management oversight and effective alignment of operations), and Quantitative Risk Factors (evaluates the level of financial exposure or lost revenue).

U. T. Systemwide Priority Findings

Mr. J. Michael Peppers, U. T. System Chief Audit Executive

U. T. System Board of Regents' Meeting
Audit, Compliance, and Risk Management Committee
February 2018



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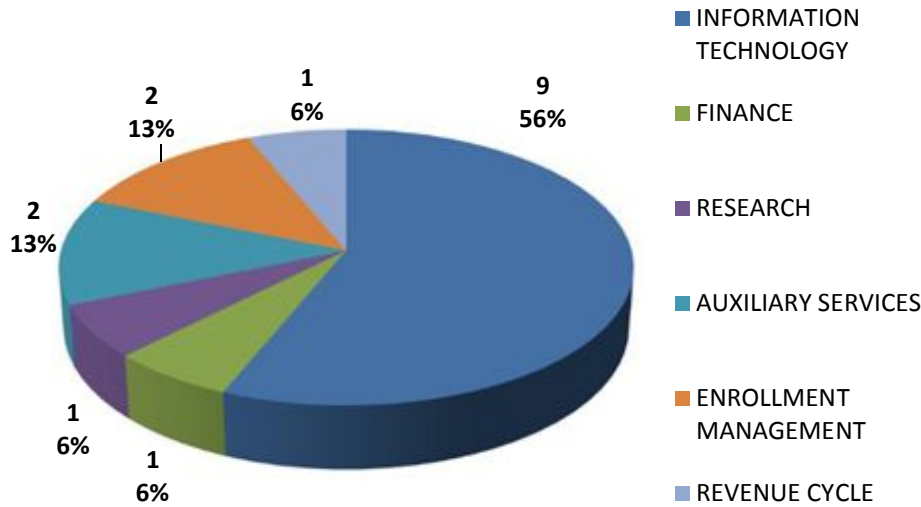
Priority Findings Status – Changes Since Last Report

	Nov 2017	Implemented	New	Feb 2018	Past Due
U. T. Arlington	3	(2)	-	1	-
U. T. Austin	3	-	-	3	-
U. T. El Paso	2	(2)	-	-	-
U. T. Permian Basin	1	-	-	1	1
U. T. Rio Grande Valley	1	-	-	1	-
U. T. San Antonio	2	-	-	2	-
U. T. Health Science Center at San Antonio	2	(1)	-	1	-
U. T. M. D. Anderson Cancer Center	6	-	1	7	-
Totals	20	(5)	1	16	1

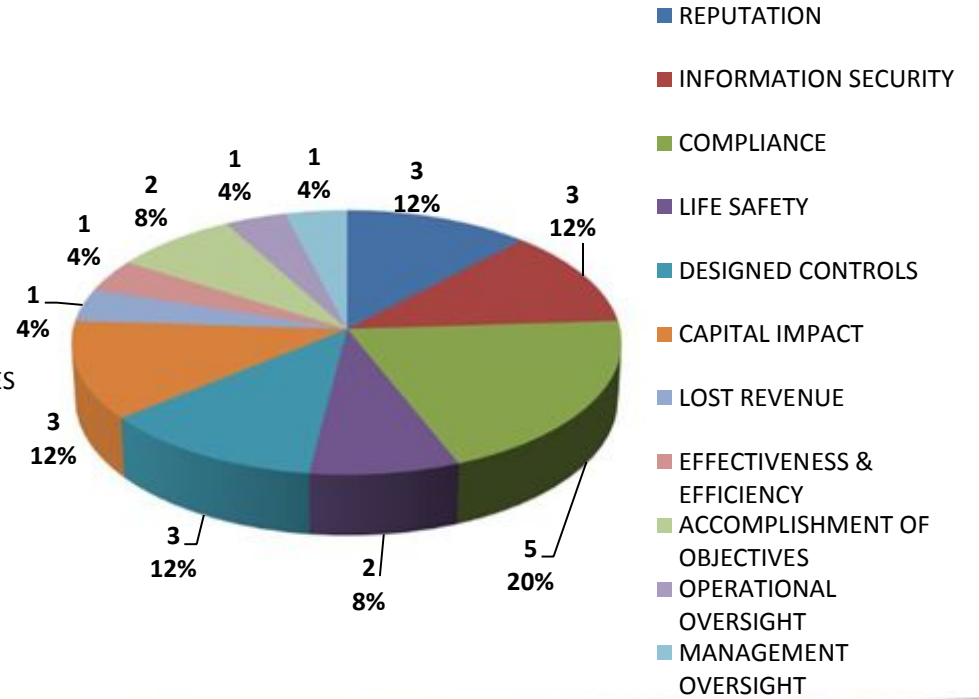


Priority Findings

Operational Area



Risk Factors



4. **U. T. System Board of Regents: Discussion and appropriate action regarding proposed amendments to Regents' Rules and Regulations, Rule 10402 (Committees and Other Appointments), Section 1.6, regarding duties of the Audit, Compliance, and Risk Management Committee, and Rule 20401 (Audit and Compliance Programs)**

RECOMMENDATION

The Chancellor concurs in the recommendation of the Deputy Chancellor, the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Health Affairs, and the Vice Chancellor and General Counsel that proposed amendment to Regents' *Rules and Regulations*, Rule 10402 (Committees and Other Appointments), Section 1.6, regarding duties of the Audit, Compliance, and Risk Management Committee, and Rule 20401 (Audit and Compliance Programs) be approved as set forth in congressional style on the following pages.

BACKGROUND INFORMATION

As part of a continuing review of Regents' Rules, the provision regarding the duties of the Audit, Compliance, and Risk Management Committee (ACRMC) in Regents' Rule 10402 and Regents' Rule 20401 related to Audit and Compliance programs were fully reviewed.

The primary purpose of these revisions is to (i) emphasize the role of the ACRMC and its risk oversight role, (ii) streamline the rules under which the ACRMC operates by eliminating the ACRMC Charter and instead relying directly upon the Regents' Rules in the same way as all other Board Standing Committees, (iii) elevate the function of Risk Management through its inclusion in the Regents' Rule, and (iv) place the ACRMC in a position to be able to address risk and risk oversight in a flexible manner.

Consistent with the recent addition of Section 4 to Regents' Rule 10101 regarding Board self-evaluation, Rules 10402 and 20401 will be reviewed at least every two years.

These revisions do not impact the full-time equivalent count Systemwide and are budget neutral. The proposed amendments were reviewed by the U. T. institutional presidents and representatives of the Student Advisory Council, the Faculty Advisory Council, and the Employee Advisory Council.

**The University of Texas System
Rules and Regulations of the Board of Regents**

Rule: 10402

1. Title

Committees and Other Appointments

2. Rule and Regulation

...

1.6 Duties of the Audit, Compliance, and Risk Management Committee. The Audit, Compliance, and Risk Management Committee (ACRMC) shall:

(a) Be primarily responsible for the Systemwide risk oversight function of the Board of Regents. Provide relevant information from risk management activities, risk assessments and reviews, and reports both internal and external to the Board of Regents.

(b) Direct, advise, and review the U.T. System Audit Office in the exercise of Systemwide internal audit, a primary source of independent and objective risk information. By extension, each institution's audit committee chair is considered a risk advisor to the chair of this committee and their authority is derived from the Board of Regents. The ACRMC Chairman approves the appointment of institutional audit committee chairs.

(c) Consider, review, and when appropriate refer to the full Board of Regents matters regarding the activities of the Office of Systemwide Compliance, as an integral component of Systemwide risk oversight.

(d) Consider, review, and when appropriate refer to the full Board of Regents matters regarding the activities of the Office of Risk Management, Office of Information Security, the External Auditor and any other management function with a significant Systemwide risk oversight role.

(e) Consider, review, and recommend to the full Board of Regents factors to be considered in establishing Board and Board Committee risk tolerance and risk mitigation strategies.

~~(a) Recommend an Audit Charter for the Audit, Compliance, and Risk Management Committee for review and approval by the Board and oversee all internal and external auditing and compliance functions within The University of Texas System.~~

**The University of Texas System
Rules and Regulations of the Board of Regents**

Rule: 10402

- ~~(b) Recommend the approval of the hiring of the Chief Audit Executive after nomination by the Chancellor.~~
- ~~(c) Recommend the approval of the annual Systemwide risk assessment and annual internal auditing plan.~~
- ~~(d) Initiate System Administration and institutional audits, compliance activities, and operations management reviews as deemed necessary to ensure appropriate risk management and control processes within The University of Texas System.~~
- ~~(e) Provide the Board with relevant information obtained from ongoing reviews of auditing, compliance, and operations activities and reports of internal auditors, external auditors, and the State Auditor's Office.~~
- ~~(f) Meet with external auditors, internal audit directors, and compliance officers as deemed necessary to discuss specific risk management and control issues.~~

**The University of Texas System
Rules and Regulations of the Board of Regents**

Rule: 20401

1. Title

Audit, ~~and~~ Compliance, and Risk Management Programs

2. Rule and Regulation

Sec. 1 Audit Program. The Chancellor, as chief executive officer of the U. T. System, is responsible for ensuring the implementation of appropriate audit procedures for the U. T. System. Accordingly, the U. T. System Chief Audit Executive (CAE) prepares an executive summary of all internal audit activity by the U. T. System internal auditors and the institutional internal auditors for the Chancellor, and functions as a primary source of independent and objective information to the Audit, Compliance, and Risk Management Committee (ACRMC) of the Board of Regents.

1.1 The CAE plays an important role in enabling the ACRMC to achieve its objectives through:

(a) Facilitating, as needed, the ACRMC Chairman's interactions with Institutional Audit Committee Chairs and enabling robust sharing of risk and issue information.

(b) Assisting the ACRMC in following leading practices through the establishment of necessary formal meetings, executive sessions, and other important protocols.

(c) Recommending practices to improve the ACRMC.

1.2 U. T. System Chief Audit Executive's Responsibilities. The U. T. System CAE is charged with assuring that an effective internal audit function is in place Systemwide. The U. T. System CAE accomplishes this through oversight of the following activities at U. T. System Administration and all U. T. System institutions:

~~(a) Proposing a charter for the Audit, Compliance, and Risk Management Committee (ACRMC) to be reviewed and approved by the Committee.~~

~~(b)~~ Developing a Systemwide internal audit plan based on a comprehensive risk assessment and coordinating the implementation of the audit plan with the chief audit executives at all U. T. System institutions.

**The University of Texas System
Rules and Regulations of the Board of Regents**

Rule: 20401

- (~~eb~~) Providing support and advice to each institution's internal audit committee. This includes:
 - (i) interviewing all candidates for an open institutional CAE position,
 - (ii) participating in the annual performance review for each institution's CAE, and
 - (iii) participating, with the institution's president and chair of the institution's audit committee, in any decision to terminate the employment of an institution's CAE.

- (~~ec~~) Establishing the standards and methodology to be followed by all U. T. System internal auditors in:
 - (i) preparation of the annual institutional audit plan,
 - (ii) documentation required for all internal audit work papers,
 - (iii) establishment of a standard internal audit reporting format, and
 - (iv) provision of direction concerning findings that must be reported to the ACRMC.

- (~~ed~~) Establishing a quality assurance and improvement program that includes monitoring and assessments, to the extent considered necessary by the CAE, to evaluate the internal auditors' conformance with prescribed standards.

- (~~ee~~) Providing audit assistance to the Chancellor, the Deputy Chancellor, the Executive Vice Chancellors, and the Vice Chancellors in the exercise of their responsibilities.

- (~~ef~~) Providing information to the ACRMC in Executive Session concerning personnel matters relating to appointment, employment, evaluation, assignment, duties, discipline, or dismissal of individual U. T. System employees involved in internal audit functions.

**The University of Texas System
Rules and Regulations of the Board of Regents**

Rule: 20401

1.32 Appointment and Evaluation of the CAE. The CAE shall be appointed by the ACRMC after nomination by the Chancellor. The CAE shall hold office subject to the pleasure of the ACRMC and the Chancellor. The Chancellor's actions regarding the CAE are subject to review and approval by the ACRMC.

1.43 The U. T. System internal auditors are the internal auditors for the U. T. System and augment the audit work of the institutional internal auditor and the State Auditors at the institutions of the U. T. System.

Sec. 2 Compliance Program. The Chancellor, as chief executive officer of the U. T. System, is responsible for ensuring the implementation of a Systemwide compliance program for the U. T. System. U. T. System Administration shall adopt a policy further implementing the Systemwide compliance program.

The Systemwide compliance program shall be headed by a Chief Compliance and Risk Officer (CCRO) and is a fundamental part of the management structure of U. T. System Administration. The primary responsibility of the CCRO is developing the infrastructure for the effective operation of the Systemwide compliance program. The CCRO is also responsible for apprising System Administration and the ACRMC of the compliance functions and activities at System Administration, The University of Texas/Texas A&M Investment Management Company (UTIMCO), and each institution.

Sec. 3 Risk Management. The Chancellor, as chief executive officer of the U. T. System, is responsible for ensuring Risk Management principles are integrated within leadership operation, practice, and activities. Accordingly, the Office of Risk Management (ORM) headed by the CCRO is a fundamental part of the management structure of U. T. System Administration. The primary responsibility of ORM is to provide the Chancellor and leadership with risk information, education, and the forum, when necessary, to encourage consideration of the most important risks. ORM will foster elements of prudent risk management including the structure for Executive Risk discussion, collaboration with risk assessing functions, and resolution of activities that mitigate important risks.

5. **U. T. System: Discussion on Enterprise Risk Management leading practices and plan for program development**

DISCUSSION

Chief Compliance and Risk Officer Dendy and Chief Audit Executive Peppers will facilitate a discussion on the concepts of Enterprise Risk Management (ERM) to obtain guidance and direction from the Audit, Compliance, and Risk Management Committee (ACRMC) on processes to enhance information available to the Board of Regents in support of its oversight of enterprise risk. Additional information on the value proposition for ERM was provided to the ACRMC members prior to the meeting.

BACKGROUND INFORMATION

Boards and management of any organization can most effectively perform their respective roles and maximize their ability to achieve strategic objectives when they have comprehensive, insightful, and accurate information regarding the risks faced by the entity. The discipline of ERM seeks to put in place a structure for risk consideration that more consistently leverages risk expertise and information to better inform leadership as it sets strategies and considers opportunities to create value.

6. **U. T. System Board of Regents: Discussion and appropriate action regarding proposed amendments to Regents' Rules and Regulations, Rule 20402 (Provision of Audit and Non-Audit Services by External Audit Firms), Section 1.3(a), regarding lead partner rotation**

RECOMMENDATION

The Chancellor concurs in the recommendation of the Deputy Chancellor, the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Health Affairs, the Vice Chancellor and General Counsel, and the Chief Audit Executive that the proposed amendment to Section 1.3(a) of Regents' *Rules and Regulations*, Rule 20402 (Provision of Audit and Non-Audit Services by External Audit Firms) to increase the time period between the rotation of the lead audit partner be approved as set forth below in congressional style:

- 1.3 Conflict of Interest Provision. Neither U. T. System nor any of the institutions may engage an external audit firm for audit services unless the contract includes an acceptable conflict of interest provision approved by the Vice Chancellor and General Counsel.
 - (a) Lead Partner Rotation. The lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit shall not have performed audit services for the institution(s) in each of the ~~five~~ten previous fiscal years.

BACKGROUND INFORMATION

The Securities and Exchange Commission requires that public companies rotate audit engagement partners every five years, which may have been the origin of the period established in the Regents' Rule 20402. There are no requirements for non-public companies or not-for-profit organizations to rotate audit engagement partners. U. T. System's current external audit firm self-imposes a mandatory partner rotation every ten years. This is considered a reasonable period of time and results in the proposed amendment.

These revisions do not impact the full-time equivalent count Systemwide and are budget neutral. The proposed amendment was reviewed by the U. T. institutional presidents and representatives of the Student Advisory Council, the Faculty Advisory Council, and the Employee Advisory Council.

7. U. T. System Board of Regents: Approval to renew the contract with Deloitte & Touche LLP to provide financial auditing services for Fiscal Years 2018 and 2019

RECOMMENDATION

Acting Committee Chairman Weaver recommends approval for Deloitte & Touche LLP (Deloitte) to provide independent auditing services for the Fiscal Year 2018 and Fiscal Year 2019 financial statement audits of the U. T. System, U. T. Austin, U. T. Southwestern Medical Center, U. T. Medical Branch - Galveston, U. T. M. D. Anderson Cancer Center, and the funds managed by The University of Texas/Texas A&M Investment Management Company (UTIMCO). In addition, auditing services are proposed to be conducted at multiple institutions, including U. T. Permian Basin, U. T. Rio Grande Valley, U. T. San Antonio, U. T. Tyler, U. T. Health Science Center - Houston, and U. T. Health Science Center - Tyler to satisfy Southern Association of Colleges and Schools (SACS) accreditation requirements.

Approval is requested for U. T. System staff to negotiate and enter into an auditing services contract amendment with Deloitte & Touche LLP to renew the contract for a two-year term pursuant to delegation of authority from the State Auditor's Office.

BACKGROUND INFORMATION

The contract with Deloitte & Touche, effective June 30, 2016, to provide audit services for Fiscal Years 2016 and 2017 will expire on May 30, 2018, and has an option to renew for four additional years.

The source of funding for this contract is primarily Available University Funds, as approved for the prior contracts. Proposed funding for the contract is included in Consent Agenda Item 5 on Page 335.

8. **U. T. System: Report on the Fiscal Year 2017 Annual Financial Report, including the report on the U. T. System Annual Financial Report Audit, and audits of U. T. Austin, U. T. M. D. Anderson Cancer Center, U. T. Southwestern Medical Center, and U. T. Medical Branch - Galveston financial statements and for funds managed by The University of Texas/Texas A&M Investment Management Company (UTIMCO)**

REPORT

See Item 1 beginning on [Page 93](#) of the Finance and Planning Committee.