Audit Committee Members Present: Trustees Scott Thiss, Chair; Jacob Englund, Dan McElroy, David Paskach and James Van Houten.

Audit Committee Members Absent: none.

Other Board Members Present: Trustees Cheryl Dickson, Tom Renier, and Terri Thomas.

Leadership Council Committee Members Present: Chancellor James McCormick, John Asmussen, Gail Olson, and Laura King.

The Minnesota State Colleges and Universities audit committee held its meeting on November 18, 2008, at Wells Fargo Place, 4th Floor, Board Room, 30 East 7th Street in St. Paul. Chair Thiss called the meeting to order at 8:05 a.m.

Approval of the Audit Committee Meeting Minutes
Chair Thiss called for a motion to approve the September 16, 2008 Audit Committee Meeting minutes and the October 8, 2008 Audit Committee Meeting minutes. The Chair moved to approve the minutes, there was no dissent and the motion carried.

1. Review and Approve Release of the Audited Financial Statements (Action Item)

Committee Chair Scott Thiss stated that the members of the audit committee had received all thirteen audit reports. He explained that the committee had split into two teams, with each team reviewing at least six reports in depth. Mr. John Asmussen, Executive Director of the Office of Internal Auditing, introduced the system-level auditor, Mr. Steve Wischmann, audit partner with the firm of Kern, DeWenter, Viere. Mr. Wischmann presented the reports that his firm issued for the system-level financial statements. He stated that the other campuses reports had also been referenced in the system-level audit report, including the individual university and colleges auditors as well as the component unit auditors for the foundations. Mr. Wischmann explained that the role of the system-level auditor was to pull together the individual audits, conduct systemwide audit testing and provide assurances on a systemwide level.

Mr. Wischmann informed the members that the audit opinion on the system-level financial statement, as well as on the revenue fund statement, was unqualified, which was the highest level that could be issued. He added that this was the same level of audit opinion that the system had received for the past five years from his firm.

Mr. Wischmann reviewed the report on compliance and internal controls. He announced there were no findings of material weaknesses or significant deficiencies. He reminded members that there had been four significant deficiencies at the system and revenue fund level in the previous year, but he stated that those deficiencies had been corrected.
Mr. Wischmann explained that there had been changes to the audit scope due to new risk assessment standards which required analysis of the internal controls in more detail than in prior years. He noted that the Minnesota State Colleges and Universities had invested a considerable amount of time to document the internal control cycles at the twelve audited campuses and at the Office of the Chancellor. He further noted that additional documentation of mitigating controls at the non-audited institutions may be beneficial.

Mr. Wischmann stated that GASB Statement 45 had been issued this year. The new statement accounted and reported Other Postemployment Benefits Other than Pensions for employers. Note 13 to the financial statements described the benefits provisions, and related to postemployment health care coverage that was paid 100 percent by retired employees.

Mr. Wischmann reviewed the other system-level board comments:

- **Security Access** – Incompatibilities remain at campus and system level and remains an important long term issue to resolve. Although complete resolution to incompatibilities may not be achievable, continue to work with Information Technology to design new systems with reduced incompatibilities. Documentation of mitigating controls is an important step that MnSCU should continue to implement.
- **Financial Reporting** – All 12 campuses continued primary responsibility for their financial statement preparation for 2008. Emphasis should continue on hiring of qualified individuals and ongoing training to reduce the inconsistencies between the level of technical knowledge at the campus level and to further the understanding of results at the campus level.
- **Leave Benefit Accounting** – Continue to refine the leave balance reporting and accounting function to improve accuracy of the estimated liability, currently at $126 Million.

Mr. Wischmann stated that in 2008 they had devoted more time to look at the information technology plan, the results of prior year audits, and the risks associated with some of the new on-going initiatives for 2008 and 2009. Kern, DeWenter, Viere recommended that the system continue to follow up on outstanding security issues, develop a comprehensive plan to properly test the conversion of accounting data from the old system to the new systems and continue to analyze disaster recovery plans and test as deemed appropriate.

Mr. Wischmann reviewed the component units:

- Required by GASB Statement 39.
- Includes University Foundations that are “Significant”. Includes Southwest, Winona, Metropolitan State, Mankato, Bemidji, Moorhead, Century, Fergus Area and St. Cloud.
- Total Assets at June 30, 2008 totaled $169,897,000 compared to 2007 amount of $159,166,000.
- Total Revenues recognized for the year ended June 30, 2008 totaled $35,998,000, a decrease from 2007 amount of $44,097,000. Unrealized investment loss in 2008 was ($7,027,000) versus a gain in 2007 of $3,993,000.
• Shown as separate statement in the consolidated MnSCU report to allow the financial statement readers to distinguish between MnSCU and the Foundations.

Ms. Laura King, Chief Financial Officer, stated that there had been discussions during each of the university exit conferences about the risk the market losses posed to the university’s scholarship programs. She noted that the universities were well aware of those risks and had developed planning exercises on the campuses to respond to it, as had the foundations.

Trustee Van Houten stated that the system had a legitimate interest in how funds were invested by the foundations so that there was some protection that the resources would be available in the future. He stated that the committee should receive information regarding the mix of investments and the type of investment advice that was taking place at the foundations. Trustee Paskach agreed and stated that there was investment policy to assure that the investments were protected, but he added that the committee should have assurance that those investments were, in fact, within the parameters outlined in policy. Ms. King stated that her office communicated annually with the foundations about the expectations for the investment process. She stated that they would incorporate the request into that communication.

Mr. Wischmann continued by reviewing the three upcoming standards:

• **GASB Statement 49 - Accounting and Financial Reporting for Pollution Remediation Obligations**
  – This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The effect this statement will have on fiscal year 2009 basic financial statements has not been determined.

• **GASB Statement 51- Accounting and Financial Reporting for Intangible Assets**
  – This statement was issued in June 2007. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets (such as software costs, patents and trademarks to MnSCU) to reduce reporting inconsistencies. The effect GASB Statement No. 51 will have on the fiscal year 2010 basic financial statements has not yet been determined.

• **GASB Statement 52 - Land & Other Real Estate Held as Investments by Endowments**
  – This statement was issued in November 2007 and requires that land and real estate held as investments in endowments to be recorded at fair market value. Changes in fair value during the period will be reported as investment income. GASB Statement No. 52 is effective for Minnesota Colleges and Universities for fiscal year 2009. The effect this statement will have on fiscal year 2009 basic financial statements has not been determined.
Trustee McElroy stated that there would have to be some discussion about what the term “held for investment” meant. He noted that there were cases where a foundation owned a dormitory or a student center that was leased to a university as a financing transaction rather than an investment. He stated that there should be a policy discussion in the finance committee so that the policy was applied consistently across the system.

Chancellor McCormick stated that the system had a conservative program for building new buildings, using the revenue fund but only if the debt level wasn’t too high. He added that the revenue fund may not always be able to fund all the necessary projects and that the foundations may be able to borrow the necessary funds. The Chancellor expressed concerns about system accountability for the debt a foundation may enter into on behalf of an institution. Trustee Van Houten added that it was common in commercial real estate to attach to the debt instrument, a representation that included the contract with the party who had committed to use that property. He agreed there would be an implied liability just by committing to use the property.

Ms. King suggested that the topic be referred to the finance committee for a policy discussion. Trustee Thiss agreed.

Mr. Wischmann reviewed the required communications letter for the committee and indicated that there were no exceptions or problems to report.

Trustee Van Houten stated that when asked in an earlier conversation about the improved audit results, Mr. Wischmann had commented that the improvement to the audit performance was a result of changes and training that had taken place at the campuses. Mr. Wischmann agreed and further noted that it was evident that procedures had been implemented and the appropriate time had been invested to make those performance improvements. Trustee Van Houten stated that improvements like these were difficult and he thanked the staff or their hard work.

Mr. Asmussen added that the new risk assessment standard required the finance staff and the staff on the campuses to put forth an extreme effort to document controls above and beyond where they had been in the past. In addition to meeting that challenge, there were no significant deficiencies or material weaknesses reported. He credited Ms. King and her staff for the emphasis they put on the process and the campus staff for putting forth the added effort to get it done. He stated that it had been a remarkable year. Chair Thiss congratulated the staff as well.

Chancellor McCormick stated that next year’s challenge would be the conversion to Oracle. Mr. Asmussen stated that Mr. Wischmann and his IT audit staff had been asked to come in earlier next year because of the conversion.

Mr. Asmussen introduced Mr. Tim Stoddard, Associate Vice Chancellor for Financial Reporting and reminded the committee that the financial statements were the responsibility of management and that it was the external auditor’s role to provide the committee with assurances that the financials were accurate and reliable. Mr. Stoddard began by introducing his staff and thanking them for the hard work they had done on the
financial statements. He then reviewed the highlights of the financial statements for the committee.

Mr. Stoddard stated that the primary driver of change is capital asset development and renewal. He pointed out that there had been a $129 million increase in capital assets, net of accumulated depreciation and $202 million in new construction and progress.

He stated that between 2007 and 2008 the primary reserve stayed steady at about 2.5 months. Trustee Thiss noted that the primary reserve ratios at several individual campuses were at 1.5 months or below, with one community and technical college as low as .8 months. He asked if the system should assist a college or university that was so far below the average to increase their reserve ratio. Mr. Stoddard noted that campuses with a low primary reserve tended to have difficulties generating a positive operating margin.

Ms. King stated that the Chancellor and the system had fought to create and maintain a separate system reserve account. She noted that the system would usually attempt to work with and counsel the college or university about how to improve the margins, but she added that on occasion, the system also had funded a reserve at the campus level.

Trustee Van Houten noted that the system debt has increased 50% in the last three years which would indicate that the revenue fund was responsible for the net worth of the system. Ms. King stated that the net asset improvement was mostly related to the capital appropriations for the general obligations bond and that the revenue fund assets and liabilities basically matched because the debt was so new. Mr. Stoddard added that the operating margin of the revenue fund as a standalone entity exceeded the operation margin of the system as a whole. He explained that if the revenue fund were removed, the rest of the system would be in a slight deficit at the operating margin line.

Mr. Stoddard reviewed the additional operating revenue generated against the additional operating expenses and he noted that there was a very thin margin. Trustee Van Houten stated that the information about the interrelationship between the capital asset issues was very helpful and suggested that it would be a useful conversation to have in the finance committee. Ms. King stated that the material would go to the finance committee in January.

Mr. Stoddard reviewed the revenue fund. The revenue fund statement of net assets reflected $46.5 million of new construction and the net of accumulated depreciation increased $38.5 million. So the revenue bond debt increased $39 million. He stated that the primary reserve for the Revenue Fund increased to 9.7 months up from 9.3 months in fiscal year 2007. When the revenue fund was removed, the primary reserve for the system dropped from 2.5 months to roughly 2 months.

Ms. King noted that by national standards, the system revenue fund was under resourced. She added that the system fee structure was lower so even though it was the principle source of annual income, that income remained depressed by national standards.

Mr. Steve Wischmann presented information on the financial statement audits conducted for Southwest Minnesota State University, Rochester Community and Technical College,
Winona State University, Minnesota State University Moorhead, Minnesota State University Mankato. Some of the key points shared by Mr. Wischmann were as follows:

- Unqualified Opinions issued for all audits.
- No internal control, compliance, material weakness or significant deficiencies.

Mr. Wischmann presented a summary of the financial results at each of the colleges and universities that were audited, including the potential high risk areas. He noted that those potential risks related to some litigation and foundation related party transactions. He informed the committee that there was nothing that needed to be communicated to the committee.

Mr. Wischmann stated that Rochester Community College had a joint use agreement with the City of Rochester for the sports complex and they had also used some dollars for capital items as well which caused their primary reserve ratio to decline slightly. Minnesota State University Moorhead, Southwest Minnesota State University and Winona State University had foundation disclosures. Minnesota State University, Mankato had a contingent liability in excess of $100,000 which was disclosed in the footnote and their foundation was also included in the campus report.

Trustee Thiss asked for a clarification between budget reserves and primary reserves. He noted that it was important to look at both numbers. Ms. King stated that she could modify the tracking sheet to show them both in the future.

Chancellor McCormick noted that the presidents would feel pressure to spend reserves as they make difficult financial decisions on their campuses. He stated that it would be an important discussion for the board to have in the future. Ms. King added that in the past, the reserve discussion had been linked to long-term financial planning. She noted that it was not impossible to take labor expenses out quickly, so the board’s discussion in the past had been to recognize that and to provide for some one-time use of reserves, to transition expenses down to a new equilibrium.

Mr. Wischmann stated that the required communication for the system level applied to the campus level as well. There were no items of notation about any disagreements or any difficulties in any of the audit processes at any of the campuses.

Finally, Mr. Wischmann commented that there were talented staff at the campus level to prepare the financial statements and he recommended continuing to train for the next level of review and interpretation of the financial statements.

Mr. Asmussen introduced Mr. Tom Koop, an audit partner with Larson Allen, who presented information on the financial statement audit conducted at Century College.

Mr. Koop informed the committee that the required communications had been appropriately communicated by Mr. Wischmann previously. He informed the committee that Century College had received an unqualified opinions on financial position & results of operations.

Mr. Koop noted that there had been three significant deficiencies at Century College in the previous year, but that all of them had been corrected. He stated that Larson Allen
was very positive about the improvements made at Century College and over the six years they had audited the college. Mr. Koop stated that there was one contingent liability reported in the notes to the financial statements.

Trustee Van Houten noted a difference in the level of detail reported by the different audit firms on the component units. He further noted that Century College had the highest cost per revenue raised by its foundation at about 54%. He asked what percentage should be raised by the foundation as a maximum. He added that the finance committee, the advancement committee and the audit committee had questioned the right way to measure and interact with the foundations. Mr. Asmussen stated that it would not be possible to directly derive out of those audited foundation financial statements the match that is required in board policy. He noted that the contribution by the state university or college is not reflected in the financial statements of the foundation. He added, however, that the topic was a policy issue that should be further discussed.

Mr. Asmussen introduced Mr. Daryl DeKam, an audit partner with Virchow, Krause & Company, who presented information on the financial statement audits conducted at Bemidji State University, Hennepin Technical College, Metropolitan State University, Minneapolis Community and Technical College, Minnesota State Community and Technical College and St. Cloud State University. Mr. DeKam informed the committee that the colleges and universities audited by Virchow, Krause & Company were all receiving unqualified opinions. He noted that three of the colleges had significant deficiencies.

Mr. DeKam commended and thanked the staff for their work in the area of risk assessment. There had been a lot of time consuming, detailed oriented effort put forth by the system staff and by the staff at each one of the colleges. He reviewed the internal control, compliance and other communications. Mr. DeKam continued by reviewing the potential higher risk areas for the campuses. Finally, Mr. DeKam noted that Minnesota State Community and Technical College’s primary reserve ratio was the lowest in the system at .8 months.

Trustee Thiss thanked the three audit firms for their presentations and for their hard work.

Mr. Stoddard stated that the finance committee had a discussion in July about the post employment benefits and they would continue to monitor that as this area evolved. He stated that there was a new actuarial study that would be conducted in a few months. He noted that there had been a discussion on reserves in September which would continue as an ongoing discussion. He stated that they would be looking in the area of board reserves to bring the colleges that are lagging a bit up to the minimum levels, and that they would look at developing a guideline for primary reserve.

Trustee McElroy stated that the liability of the system in joint ventures should also be referred to the finance committee. He noted that the footnote disclosed fifteen joint ventures of various kinds, some of which had expenses and excessive revenue, the largest one being the PALS library system. He stated that it made sense to look at the liability of the system in these partnerships.
Trustee Thiss concurred. He further stated that testing of the system backup systems should be referred to the technology work group. He noted that there was a plan in place for backup and recovery, but that it had never been tested. Trustee Van Houten stated that gathering information on the investment performance of the foundations should also be referred to the finance committee.

Trustee Englund made the following motion and it was seconded by Trustee McElroy: 

*The Audit Committee has reviewed the fiscal year 2008 audited financial statements and discussed them with representatives of management and the external auditing firms. The committee recommends that the Board of Trustees adopt the following motion:*

**RECOMMENDED MOTION:** 

*Based on the review and recommendation of the Audit Committee, the Board of Trustees approves the release of the fiscal year 2008 audited financial statements as submitted.*

The motion passed.

Chair Thiss thanked the audit firms for their presentations. Trustee Paskach added that the process worked well, it was helpful to have the audited financial statements in plenty of time to review before the committee meeting and the one-page summary was very helpful. Ms. King and Mr. Asmussen thanked their staff for the quality work that had been done within tight timelines to produce the financial statements. The committee applauded the effort of the staff.

The meeting adjourned at 9:58 a.m.

Respectfully submitted,

Darla Senn, Recorder