

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES
AUDIT COMMITTEE
MEETING MINUTES
October 13, 2009**

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

Audit Committee Members Present by Phone: Trustee David Paskach.

Audit Committee Members Absent: Trustee Dan McElroy.

Other Board Members Present by Phone: Trustees Christopher Frederick.

Leadership Council Committee Members Present: Chancellor McCormick, John Asmussen, President Pat Johns, Gail Olson, Laura King and Lori Lamb.

The Minnesota State Colleges and Universities audit committee held its meeting on October 13, 2009, at Wells Fargo Place, 4th Floor, Board Room, 30 East 7th Street in St. Paul. Chair Thiss called the meeting to order at 8:30 a.m.

Chair Thiss stated that new legislation passed in January made it possible for members to attend board meetings by phone. He noted that this was the first committee meeting where trustees would be attending by phone, and he welcomed Trustees Paskach and Frederick.

Approval of the Audit Committee Meeting Minutes

Chair Thiss called for a motion to approve the September 8, 2009 audit committee meeting minutes. There was no dissent and the motion carried. Trustee Van Houten emphasized the importance for the audit committee to identify precise actions and referrals for audit report findings that come before the committee. Chair Thiss agreed and commented that the next agenda item, in fact, cited the specific follow-up actions and referrals to other committees from the Legislative Audit Report reviewed by the audit committee last month.

1. Review Action Plan to Address Legislative Auditor Findings (Information Item)

Ms. Laura King, Chief Financial Officer, stated that the audit committee asked for staff to draft an action plan to address the findings in the legislative auditor report issued in September 2009. Ms. King reviewed the action plan. She stated that the recommendations in section B of the audit report would be easily handled through ordinary channels, but the recommendations in section A of the report would require additional attention. Ms. King added that staff had good direction from the committee discussion last month and the action plan would refer specific findings either to the finance committee or to the human resources committee for tracking and follow-up, and for monitoring.

Ms. King reported that the Chancellor had been in communication with the presidents shortly after the September committee meeting and that he had conveyed his expectations

that the findings in the most recent audit would be resolved, and that the next round of audits would show a better result.

Chair Thiss asked how staff would deal with the issue of following contract language versus following a letter of understanding. Ms. Lori Lamb, Vice Chancellor for Human Resources, stated that one option would be to comply with the letter of the contract, and a second option would be to enter into a written memorandum of agreement that indicates that there's a mutual agreement to administer the contract in a different way. She stated that in the past there had been agreements which had not been documented and going forward mutually agreed upon understandings would be in writing.

Chair Thiss asked if the human resources committee should review memorandums of understanding that would alter approved contract language. Ms. Lamb stated that it has been the responsibility of staff to enter into memorandums of understanding and that they have not gone before the human resources committee. She added that the system executed hundreds of such memorandums annually which did not rise to board policy level issues. Ms. Lamb stated that she intended either to ensure that the system was complying with the contracts or that there was a documented mutual agreement to some other method of implementing a particular provision.

Trustee Van Houten stated that as fiduciaries, the board of trustees should be charged with approving any changes in a labor agreement. He added that if there were some reason for a benefit to be different than what had been negotiated then it should be clarified with the union, brought back to the board, and approved as a change in the contract.

Chancellor McCormick stated that there may be other considerations, and added that if the Board of Trustees were to have a formal vote to change a labor agreement, then the union would likely want time to send the change out to its members for a vote as well. He added that there may be a way to achieve transparency without having to send all issues out to be re-voted. Ms. Lamb agreed and stated that many memorandums of agreement addressed one-time non-precedential changes to the contract and that other letters of understanding changed contract provisions going forward. She suggested that there should be a conversation in the human resources committee about how to balance the importance of transparency with needs of getting things accomplished.

Chair Thiss agreed that finding the right balance was important and he stated that the issue should be further discussed within the human resources committee. He added that if there were an issue that needed to go to the full board, it would come out of the human resources committee. Trustee Van Houten agreed that was a good suggestion.

Mr. John Asmussen, Executive Director of the Office of Internal Auditing, stated that he would work with Vice Chancellor Lamb to add a bullet point on the role of memorandums of agreement, how they would be interfaced with labor contracts and when it may be merited that the human resources committee be advised.

Chair Thiss stated that the audit committee would carry the recommended referrals forward to the full board at the November meeting. He thanked Vice Chancellor King and Vice Chancellor Lamb for their work.

2. Review Internal Audit of Supplemental and Auxiliary Revenues

Mr. Asmussen introduced Ms. Beth Buse, Deputy Director of Internal Auditing and Ms. Melissa Primus, lead developer on the project. He stated that there were three categories of issues that came out of the Supplemental and Auxiliary Revenues report. The first set of issues could be resolved at that presidential level. The second set of issues could require intervention by the Chancellor to oversee the appropriate actions. The final category of issues were policy issues that would need further consideration at the Leadership Council before being referred back either to board committees for policy amendments or to the chancellor for system procedure amendments.

Ms. Buse reminded the committee that there had been two phases to the project. In the first phase the auditors visited all the campuses to identify the various kinds of auxiliary and supplemental revenues. The information had been presented to the committee in May and based on direction from the committee, the second phase of the project looked more closely into bookstore operations, health services operations, and academic resale operations. She added that the report also summarized related policy and procedure provisions that were reviewed.

Mr. Asmussen gave an overview of the bookstore operations. He stated that all of the colleges and universities had some arrangement for a bookstore operation. He stated that thirty institutions ran their own bookstore and seven institutions outsourced their bookstore operations. Five of the state universities received a percentage of sales as a commission from their outsourcing arrangement with a private bookstore. Of the two colleges that had outsource arrangements, one college had an arrangement with an online bookseller and the other college's foundation operated the bookstore, with the profits going to a student scholarship fund.

Mr. Asmussen noted that fifty of the fifty-four bookstore operations made a profit, though he added that the amount of profit might be slightly lower than reported because not all of the costs of operation were included in those calculations. He advised that it was a reasonable expectation that these operations be managed to generate at least a modest profit in order to minimize the risk of having a losing operation that would drain educational resources away from the college or university.

Mr. Asmussen reported that that the accumulated unrestricted net assets from the bookstore operations had grown to be substantial. In fiscal 2008, unrestricted net asset from bookstore operations accounted for almost a quarter of the total unrestricted net assets for those colleges and universities. He stated that it was somewhat concerning that those profits had accumulated without sufficient planning being in place for their use. He stated, however, that there were some good examples of the benefits of planned use of these profits. In one instance, a college had consciously accumulated profits from its bookstores and put over a million dollars into a new student services building. That same degree of planning, though, was not present at all institutions, and could be an area of

vulnerability to be addressed.

Mr. Asmussen stated that the majority of state universities had a long standing practice of outsourcing their bookstore operations. He suggested that the question of whether an operation should be outsourced and where the profitability might lie could be an issue for the board to refer to the leadership council for further study.

Finally Mr. Asmussen stated that there were a number of operational issues within the bookstore operations which presented unique challenges. The system used a budget based accounting system which was not structured to be an accounting tool for retail operations, so each of the campuses had to purchase a point-of-sale accounting package in order to run their bookstore operations. Another challenge for bookstore operations was obtaining timely book orders from faculty members.

Trustee Englund asked if there were clear definitions or advice for improvement that the colleges and universities bookstores could use as a benchmark, rather than giving a broad based recommendation for general financial reporting improvement. Chair Thiss added that there should be accounting principles that would create standards of consistency. Mr. Asmussen explained that system procedure contained a provision that required auxiliary enterprises to be accounted for consistent with generally accepted accounting principles. He added that the procedure also required that a financial plan be developed for auxiliary enterprises, however, that there was not a widespread awareness of the procedure, so it was not having the intended effect.

Mr. Asmussen further explained that system procedure required that indirect costs be measured and allocated to the bookstore operations, but may not have to be charged against its profits. Ms. King stated that she was comfortable that the current policy and procedure were sufficient, but she added that more training and coaching on how to apply the policy and the procedure needed to take place on the campuses. She stated that she would resist a recommendation that the board adopt a policy that would require the colleges and universities to charge indirect costs.

Chair Thiss asked if generally acceptable accounting principles required indirect costs be charged to auxiliary enterprises. Ms. King stated that indirect costs must be measured, but whether they were attributed for cost allocation purposes was a discretionary decision.

Trustee Van Houten expressed concern that in the absence of good accounting data regarding indirect costs, the system could not be certain it was maximizing the performance of its bookstore operations, and further, it could not be sure if funds were being transferred out inappropriately. He stated that it was important that the flow of funds between public funds meant for the educational mission be clearly documented and calculated.

Trustee Paskach also expressed concerns that bookstore profits were being overstated by not including indirect costs, then unrestricted net assets were also being overstated. He agreed that it could lead to an inappropriate use of the money. He stated that a better understanding about how profitable the bookstores were would be needed before good

decisions could be made about how best to operate them.

Chancellor McCormick noted that larger institutions had more options available to them in terms of outsourcing, than smaller institutions. He stated that some smaller institutions would not generate enough income to interest a vendor to come on-site to manage a bookstore operation. Mr. Asmussen agreed that the size of the institution was a factor in terms of their options for outsourcing. He added that there may be an opportunity for leveraging across the system to entice an outsource operation that would reach beyond one campus. Mr. Asmussen cautioned however, a limited analysis showed that institution operated bookstores may be as profitable, and perhaps even more profitable, than outsourced bookstores. He suggested that more study should be done to determine the best options.

Chancellor McCormick asked about the tax exempt status of institution bookstores. Mr. Asmussen stated that an outsourced bookstore operation may have to pay income tax on its profits, but that within the confines of the IRS regulations, colleges and universities were not subject to pay unrelated business tax on their bookstore operations. He added that it was an area where the outsourced operations may actually have a disadvantage to the institution operated bookstores.

Trustee Paskach asked whether a larger bookstore entity would have buying opportunities to purchase books at lower costs.

Mr. Asmussen stated it was difficult to compare book prices at each campus because standard titles often were not used, even for the same courses. He added that when comparisons were able to be made, the prices were fairly comparable between the outsourced and the operated bookstores, but that book prices may be significantly lower when purchased through a private online vendor. Trustee Fredrick commented that as a student he would typically go online to find discounted books.

Dr. Baer commented that most bookstore profits came from the sale of items other than books, such as logo apparel and supplies. Mr. Asmussen agreed, stating that the markup on apparel items was in the 40-50% range. He added that Winona State University, which had just won some national championships, saw a significant spike in apparel sales which made their bookstore quite profitable during that timeframe.

Trustee Thiss asked if the colleges and universities which were currently contracting with Barnes and Nobles and Follett had considered combining their contracts to leverage for more buying power. Ms. King stated that it had not been explored but that it was something that could be reviewed.

Trustee Englund stated that financial aid delays often created problems for students to buy books in a timely way. He asked if there was some way to standardize some of the best practices to make it possible for students to get their books in a more efficient way. Ms. King stated that the Students First initiative would eliminate most of the manual labor involved with determining if a student had a legitimate financial aid application being processed, which would allow them to get their books in advance of financial aid. Dr. Baer stated that there were five pilots on textbooks, and there had been some testing

of alternative ways of making books available to students. Mr. Asmussen agreed that there were innovations going on at the campuses, and that there needed to be a forum for conversations to take place between bookstore managers.

President Pat Johns, Anoka Ramsey Community and Technical College, stated that there needed to be flexibility for institutions to have a bookstore operation that worked for each institution. He agreed that finding the right balance between profitability and a reasonable cost to students was important.

Trustee Van Houten commented that nobody benefited from a bookstore that was run inefficiently. He stated that an advantage to an outsourced bookstore might be in having professional management in place. He suggested that it may be beneficial to have a nonprofit cooperative in place on behalf of all of the campuses which had the tax advantage of being a nonprofit, but would be large enough to hire a professional bookstore manager.

Trustee Frederick asked when the universities had thoroughly reviewed their decisions to outsource bookstore operations. Mr. Asmussen stated that decisions were made on campuses as long ago as thirty years ago, and he added that it was time for a more collaborative study, and an open exchange of information.

Trustee Van Houten asked if board policy would limit the length of time a college or university could contract with a single outsourced bookstore operation. Ms. King stated that there was a gap in policy and procedure around the term limitations on income contracts. She added that those policies and procedures would be reviewed.

Ms. Buse reviewed the section of the report on student health service operations. She stated that seventeen colleges and universities charged a health service fee. Six state universities and three colleges operate student health service clinics, the remainder had nurses on staff that would do education and wellness training, but wouldn't actually see patients.

Ms. Buse stated that there was a Minnesota law that required the board to offer student health services at the state universities and may offer them at the two-year colleges. She added that student health services were not currently addressed in board policy. Ms. Buse stated that there was a question as to whether Metropolitan State University was meeting the requirements in state statute. She stated that students did have an option to purchase the system endorsed student health policy which allowed them to use Boynton Health Service at the University of Minnesota, though she noted that relatively few students purchased the insurance policy. Ms. Buse further noted that state statute also required reporting to the board on health service money, and she added that there had not been a report made to the board.

Ms. Buse reported that there was a variance in student health services operations. She stated that some state universities had physicians and pharmacists on staff, other universities outsourced physicians and pharmacists. She noted that some state universities outsourced for psychiatric services. She reported that some clinics were accredited by a national accrediting agency and other clinics were not accredited. Ms.

Buse reported that there was variability in clinic facilities ranging from a new wellness center at one state university, to another state university that operated its clinic from the first floor of a residency hall that was never built to function as a clinic. There was also variability on funding sources.

Ms. Buse stated that the recommendation in the report was for the board to discuss and determine if board policy should define what it means to offer student health services.

Ms. Buse reported that all of the institutions had the required general liability insurance and medical professional liability insurance for student interns through the Risk Management Division of the Minnesota Department of Administration. She added, however, that it was an option whether they purchased health care facilities medical professional liability insurance and some institutions did have the coverage. Ms. Buse stated that board policy did not require this type of insurance.

Ms. Buse stated that some states require students to have health insurance when enrolled in an educational institution, but currently board policy did not require health insurance. She noted that Minnesota State University Moorhead was conducting a pilot program, which required insurance for students who take six or more credits onsite at the Moorhead campus. Ms. Buse stated that there was also variability for insurance requirements for student athletes. She noted that board policy was being reviewed to determine whether it should require student athletes to have insurance. Finally, she noted that there was variability related to student health insurance within academic programs. Some institutions required students in particular academic programs to have insurance.

Ms. Buse stated that the recommendation in the report was for the board to discuss and determine if there should be a policy regarding student health insurance.

Finally Ms. Buse reviewed the financial management for student health service operations. She stated that there was no requirement for reserves. She noted that some institutions found it difficult to build up the necessary reserves, and she further noted that there was a need for those reserves for facilities, equipment replacement, and new requirements related to electronic medical records. Ms. Buse stated that there may need to be further policy discussion and possibly specific requirements for reserves.

Trustee Van Houten stated that he was surprised, given the potential for high costs if the system were to have a malpractice incident, that professional liability coverage had not been recommended or reviewed by the risk management team. Ms. King agreed and expressed surprise as well. She stated that the colleges and universities had used the Risk Management Division of the Minnesota Department of Administration, and have received very good service from them. She stated that she would be reviewing the topic more closely with them. Trustee Paskach agreed and stated that unless there was some other coverage, he would expect that the board would want to require this level of professional liability insurance in the future.

Trustee Van Houten cautioned that requiring students to spend additional money on health insurance might prevent some students from enrolling full-time or attending college at all. He stated that an increase of a couple hundred dollars in tuition could

impact student decisions, and he argued that other outside costs could have the same effect. Trustee Van Houten stated that a board policy on student health insurance requirements would be troublesome as it would increase the cost of education and it may not fit with the changing way that education was being delivered.

Chair Thiss commented that there needed to be more discussion about what it means to offer health services on campuses. Ms. Baer commented that campuses were doing more to educate students on overall wellness. She added that the colleges and universities were also working on the at risk behavior sometimes seen on campuses. They have developed some outstanding programs about drug and alcohol abuse abatement programs.

Chair Thiss asked about college and university responsibilities and liabilities in terms of psychiatric care for students. Ms. Baer stated that there had been a task force on mental health to better prepare and alleviate some major problems that can happen on campuses. She noted that the issue with offering more mental health services centered on the how to pay for them. Chancellor McCormick noted that after the terrible tragedy at Virginia Polytechnic Institute there was quite a bit of interest about getting the right help to students before it would become a crisis. He added that it was not possible to have a psychiatrist available on every campus. Ms. Baer stated that the mental health task force report had concluded that information could be missed because of a lack of coordination between agencies, clinics and caregivers who weren't able to talk to one another. She added that the Students First project may have the data capacity to assist with that coordination of student information. Trustee Van Houten cautioned that it might be valuable to have careful guidance in terms of the liability implications for the system when services are available.

President Johns commented that the colleges and universities were primarily in the business of education, but that through these auxiliary services they also touch on many different aspects of societal issues and support. Trustee Van Houten agreed and commented that there was a danger of mission creep, if these auxiliary enterprises become expanded operations.

Chair Thiss stated that it was important to raise the level of discussion to address all the points that had been brought up, as well as the unique differences between campuses.

Finally Mr. Asmussen gave a brief overview of the academic program resale activities. He stated that they had found relatively few resale activities systemwide, and that the funds accounted for a very small part of the operation. He noted that most of the revenues were being generated in seven technical program areas. He further stated that the profits were gross revenues and did not include the cost of operations, which suggested that there was very little net profit being generated out of the academic programs.

Mr. Asmussen stated that the low profits suggested that the programs were being run primarily with an academic objective in mind. Mr. Asmussen added that there were no issues related to the academic program resale activities that would rise up to the policy level for the board, nor were there any issues that would require intervention by the Chancellor. He stated that there were some control weaknesses that should be tightened, but that those issues would be communicated directly to the presidents.

Trustee Van Houten expressed his surprise that there not more issues surrounding the academic program resale activities. He asked if the revenues coming in from these program areas were being consistently charged back so that the instructional costs of the programs were not being overstated. Mr. Asmussen stated that revenues being generated were being appropriately offset in the institutional cost study. He added that the budget staff in the Office of the Chancellor had a very good awareness of this kind of activity and some of the unevenness that may result, so they had taken great care to make sure that it was being handled properly.

Trustee Paskach asked if overall, the internal controls in the area of supplemental revenues were adequate for the activity. Mr. Asmussen stated that given the small amount of money that flowed through the programs, it became a cost benefit decision. He stated that he was satisfied with the effort being put forth in the area, but recommended that the chief financial officers have an awareness for any revenue collection points on their campuses and an awareness of how those funds were being handled in order to overt problems.

Trustee Van Houten asked if there had ever been an audit of faculty members who had the option to take a contract personally, and whether that income had to be declared and reviewed, to ensure that the system's involvement, expenses, and interests were being protected by faculty and independent contracts. Mr. Asmussen stated that they had not been audited, but he added that it was an area that had received attention through the code of conduct training, under the leadership of the General Council's Office. Ms. Gail Olson, General Council, stated that faculty members were required to avoid any conflicts of interests in the work that they took on, and that would include competition with the college or university. She added the employee was obligated to identify any potential conflicts.

Based on the committee discussion, Mr. Asmussen recapped the actions and policy discussions that needed to occur.

For bookstores, several items needed oversight from the Office of the Chancellor. Improvement was needed for financial reporting and measuring profits. Financial plans must be established for any reserve funds. The Student's First Initiative should address the interface between financial aid and bookstores.

Mr. Asmussen identified two policy issues related to bookstore operations that needed further discussion at the Leadership Council. First the level and use of unrestricted net assets should be reviewed. Second, analysis and discussion about outsource versus operated bookstores, particularly among the state universities, should be reviewed.

Chancellor McCormick added that the message to the Leadership Council should be that indirect costs should be charged against bookstore operations in order to gain a full understanding about the profits that were generated. Ms. King stated that existing procedures on cost allocation and the financial planning requirements needed to be reviewed to ensure that they were being fully executed at the campus level. She added that a new conclusion would come from that analysis about unrestricted net assets and a

new conversation about what the right amount to carry for financial management purposes. Ms. King further added that there were a series of questions about contract management relationships with the vendors.

Trustee Van Houten suggested that the research ought to be done by qualified consultants in the industry before being taken to the Leadership Committee for decisions.

Mr. Asmussen reviewed the recommendations in the category of health services operations. He noted there were a few statutory compliance issues that the Office of the Chancellor should intervene on to ensure compliance. There would need to be a determination on the issue of Metropolitan State University's compliance with student health service availability. There would need to be reporting on health services financial activity. Finally, the issue sufficiency of medical professional liability insurance must be ensured.

Mr. Asmussen reviewed the policy issues related to health services that needed further discussion at the Leadership Council. First, the whole question of student health insurance requirements needed discussion. Second, what it means for a campus to offer health services operations needed definition.

Ms. King added that there needed to be a policy amendment to include health services explicitly to the auxiliary services policy.

Chair Thiss stated that there was these topics presented opportunity for good discussion. He complimented the Office of Internal Auditing staff for their good work on the report. Trustee Van Houten added that it was impressive for an organization to look into its own operations and look for opportunities for improvement.

3. Discuss the Roles and Responsibilities of the Audit Committee

Mr. Asmussen reminded the committee that in November, members would receive the twelve colleges and universities audited financial statements as well as the system financial statements. He reviewed the plan for distributing those statements to the members. Mr. Asmussen stated that it had worked well in the past to divide the reports into two groups, with three members assigned to review one group of reports and two members to review the second group of reports. All of the five members were asked to review the systemwide audited financial statements.

Mr. Asmussen stated that coordination with the financial reporting group would make the reports available to be sent out in two batches again this year. He added that he and Ms. King, and her staff would be available to meet with members to discuss any issues before the November audit committee meeting.

Ms. King added that the packages would also contain a one-page trends and highlights summary document for each audit.

Trustee Van Houten asked that all audit committee members review any institution audit that included a material weakness. He stated that a material weakness was

likely to be a topic of more discussion at the November meeting. Mr. Asmussen agreed.

The meeting adjourned at 10:30 a.m.

Respectfully submitted,
Darla Senn, Recorder