MINUTES OF THE FINANCE AND ADMINISTRATION COMMITTEE
OF THE STATE BOARD OF HIGHER EDUCATION
OSU-CASCADES, BEND, OREGON
SEPTEMBER 7, 2007

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MINUTES

1. CALL TO ORDER/ROLL CALL

The Finance and Administration Committee of the State Board of Higher Education was called to order by Chair Donald W. Blair at 10:30 a.m. Committee members present included Don Blair, Henry Lorenzen, and John von Schlegell. Other Board members present included Kirby Dyess, Hannah Fisher, James Francesconi, Adriana Mendoza, Dalton Miller-Jones, Preston Pulliams, Howard Sohn, and Tony Van Vliet.

Chancellor’s staff present included: Michael Green, Ryan Hagemann, Jay Kenton, Glen Nelson, Patricia Snopkowski, and Marcia Stuart.

Others present included: Presidents Mary Cullinan (SOU), Dave Frohnmayer (UO), Dixie Lund (EOU), John Minahan (WOU), Ed Ray (OSU), Michael Reardon (PSU), and David Woodall (OIT). Also present were Vice Presidents Lindsay Desrochers (PSU), Frances Dyke (UO), and Mark McCambridge (OSU).

2. REPORT ITEM

a. OUS Internal Audit Progress Report

DOCKET ITEM:

Background:
As outlined in the Oregon State Board of Higher Education Audit Charter, the Oregon State Board of Higher Education (the Board) has oversight responsibility to ensure that Oregon University System (OUS) management is performing their duties of financial reporting, ensuring effective and efficient internal controls, and complying with laws, regulations, and ethics. This report provides information regarding the following audit charter provisions:

- The Board shall review, at least semi-annually, the results of Internal Audit recommendations and follow-up procedures. More frequent meetings will be held as deemed necessary.
- The Board shall have and exercise all other powers, as it shall deem necessary, for the performance of its duties.
• The Oregon State Board of Higher Education has delegated these audit duties to the Finance and Administration Committee. The Finance and Administration Committee shall report the results of internal and external audit findings to the full Board at least once a year.

**Quarterly Report Update – Audits issued from May 2007 through August 2007:**

During the period from May 2007 through August 2007, IAD issued four reports, including one management request engagements, one information technology project, and two campus reports on surplus property management.

The results of the two scheduled projects are summarized in the following table.

<table>
<thead>
<tr>
<th>Scheduled Audit Status</th>
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<tbody>
<tr>
<td>Audit Project Title</td>
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<tr>
<td>Surplus Property Management</td>
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<td></td>
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</tbody>
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**Ratings** – The rating relates to the selected financial, compliance, and operational areas tested. The rating is NOT a global performance rating. The rating corresponds to the level of management priority.

- **High** – Some controls exist, but they are generally not functioning as intended and additional controls are needed.
- **Medium** – Controls exist, but some controls are not functioning and/or additional controls are needed.
- **Low** – Controls are in place and functioning effectively. Additional control enhancements are outlined in the recommendation section of the report.

**COMMITTEE DISCUSSION:**

Director of Internal Audit Patricia Snopkowski said that she would review three items with the Committee. First, she discussed four reports issued over the past quarter. An information technology engagement relating to student grades performed at Southern Oregon University was the first report discussed with the Committee. This was a scheduled audit and the report was considered a mid-level risk and received a rating of ‘needs improvement.’ Essentially, the report outlined that management was taking measures to implement all of the recommendations, including enhancement of the security of student grades by eliminating the use of shared ID's, reducing the number of people who had access to change student grades, and documentation standards.

Internal Audit also issued one management request project at Western Oregon University where the campus had concerns related to a data security breach that had occurred. Internal
Audit noted that management did handle the breach in an appropriate manner and made recommendations for strengthening the security over data, which management has implemented.

The two final reports were scheduled audits issued at the University of Oregon and Southern Oregon University related to surplus equipment management. Both of these reports received a mid-level risk and a ‘needs improvement’ rating. The Department of Administrative Services requested the audit since OUS received authority to manage its own surplus equipment. A review of the controls over surplus equipment management was conducted and was expanded to review the controls over electronic data on all equipment that is disposed of through OUS. Ms. Snopkowski indicated that there were recommendations related to improving the audit trails of disposed equipment and some additional checks to assure that the data on the equipment are appropriately expunged. All of the recommendations are being implemented.

The second broad category of the report focused on a performance indicator report. Ms. Snopkowski recognized the assistance of Carol Welsh, Chief Audit Executive at Nike Corporation, who provided a copy of Nike’s "score card," which was modified for use by OUS. The document provided a summary of IA’s customer service results. Using this instrument, year-to-date, it was noted that the audits were weighed more heavily on mid-level risks at 74 percent, compared to the five-year rating average that had more low risk ratings. There will be ten reports coming to the Board at the November meeting and that will probably shift to a more even distribution across all ratings.

Director Blair urged caution in not drifting to the middle ratings even though it is sometimes very difficult to convince people that they should receive a bottom rating. On the other hand, people can't be perfect all the time. The point he made was the importance of follow-up and assuring that when reports are issued, concerns are addressed, and resolution achieved.

Ms. Snopkowski highlighted a report on staffing levels in the Internal Audit Division. There are currently two openings on the IAD staff that occurred in July and active recruitment is underway to fill those positions.

Finally, the office formulates for fiscal year June 30, 2007, through June 30, 2008, were reviewed. These serve to keep the office focused on the forming areas of high-quality audit engagement performance, maintaining and retaining high quality staff, and maintaining quality in the processes to ensure compliance with auditing standards and to serve the educational outreach efforts with campus management.

Ms. Snopkowski indicated that IAD has just begun its planning process for the coming year.
3. **ACTION ITEM**

a. **Managerial Reporting - Quarterly Management Report**

**DOCKET ITEM:**

Attached are the quarterly management reports as of June 30, 2007. After reviewing the Budget Projections Summary received from each university and comparing prior year results, we noted the following:

**Education and General – Limited:** Systemwide, the adjusted budget anticipated an ending fund balance of $84 million, a decrease of $13 million from the prior year. The actual ending fund balance is $102 million, which is $5 million or 5.3 percent higher than the prior year.

The third quarter management report projected a $7 million decrease in fund balance compared to a year-end fund balance increase of $5 million resulting in a $12 million variance. This variance is primarily due to the following: a net $2.6 million one-time summer session accrual as required by our external auditors (Moss Adams); conservative spending in the fourth quarter resulting from the Co-Chairs initial budget released in March/April; and projection error. We also note that this $12 million variance represents 1.3 percent of total expenditures and transfers out.

To reduce the possibility of this type of variance from occurring in the future, we plan to take the following steps: 1) work with the institutions to better understand and fine tune the projection process and algorithms; 2) develop additional budget review and projection processes; and 3) create an ongoing communication process to discuss developing trends and their impact on the year-end projection.

Tuition and fee revenue of $464 million was up 7 percent from one year ago and was 102 percent of the adjusted budget. The Systemwide increase in tuition and fee revenue over the adjusted budget is primarily due to a $4.3 million one-time increase related to the recognition of a portion of 2007 summer session revenue in the current fiscal year.

Total expenses and transfers out of $927 million were up 4 percent from the prior year and were 99 percent of the adjusted budget.

The Systemwide fund balance, as a percentage of operating revenues, was consistent with the prior year at 10.9 percent. While the change in PSU’s fund balance accounted for the largest dollar change in the Systemwide fund balance, fund balances as a percentage of operating revenues changed significantly at some universities. From a year ago, the fund balance decreased 66 percent at EOU, 28 percent at SOU, 34 percent at the Chancellor’s Office, and increased 24 percent at PSU. Changes in the fund balance at the other universities ranged from flat to an increase of 17 percent.
Auxiliary Enterprises: Systemwide, Auxiliary Enterprises had total revenue of $306 million or 17 percent above the prior year and 13 percent above the adjusted budget. The increase in revenue over the adjusted budget is primarily due to proceeds from the sale of the UO’s Westmoreland property and football bowl game revenues at OSU and UO. With $306 million in revenue and $303 million in expenditures and net fund deductions, Auxiliary Enterprises’ unrestricted net assets increased $3 million or 5 percent over the prior year. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.

Designated Operations, Service Departments, and Clearing Funds: The ending fund balance is lower than the adjusted budget projection by $553,000. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.

Staff Recommendation to the Committee:
Staff recommended that the Committee accept the Quarterly Management Report for June 30, 2007. The next management reports for the first quarter ended September 30, 2007, are scheduled to be presented to the Board in November 2007.

Supporting documents for the managerial report may be obtained at: http://www.ous.edu/state_board/meeting/dockets/ddoc070907.pdf.

COMMITTEE DISCUSSION AND ACTION:

Controller Mike Green indicated in the Quarterly Management Report he would focus on two areas: variance of the year-end results to the adjusted budget as set in the first quarter and the variance between the third quarter projections for year-end results and the actual year-end results.

Before beginning his report, Controller Green mentioned that the adjustment for the summer session revenue and expense accrual had been made and was reflected in each of the reports.

Eastern Oregon University revenues and transfers-in were $1 million below the adjusted budget, primarily due to a 5.7 percent drop in enrollment, greater than anticipated decline in graduate enrollment, and Eastern's share of the OSU-Cascade program declines. Management had anticipated a recovery of winter term enrollment declines; however, spring enrollment actually ended much lower than a 9.6 percent decline. EOU had presented a preliminary estimated ending fund balance of $323,000 and the actual ending fund balance was $592,000, the difference resulting from the summer session adjustment. Auxiliary operations continue to maintain positive cash and working capital balances. However, Eastern has projected its housing operations will see significant losses in the future.

Director Blair asked Mr. Green if, in the future for all the reports, a student FTE column could be added as a reference point and both Vice Chancellor Kenton and Controller Green agreed they would explore including it in future reports.
President Lund, responding to a query from Director von Schlegell, noted that there is a new era at Eastern. She and her staff are carefully reviewing expenses and stepping up efforts to recruit students and are optimistic about stability in the future.

Revenues and transfers at Oregon Institute of Technology were $116,000 below the adjusted budget, primarily due to lower than anticipated enrollment and lower revenue from the Boeing program, partially offset by higher other revenue and transfers in. It was noted that the Boeing program is a fairly significant source of OIT’s revenue and when it is doing well, it tends to have a corollary effect, because people are working and not going to school. OIT’s overall decrease in budgeted revenues was more than offset by a reduction in expenditures and transfers out of $560,000 below the adjusted budget. Reduced spending resulted primarily from slow hiring of new and vacant positions and the use of more adjunct faculty. The ending fund balance was 12.4 percent of revenues compared to the prior year of 11.8 percent and adjusted budget of 10.9 percent. Auxiliary operations continue to mean positive cash and working capital balances.

It was highlighted by Director Blair that there seemed to be a bit of good news/bad news in a number of the reports in that all institutions took some steps to limit spending when it appeared there might be a budget shortfall. However, the bad news, he pointed out, is that OUS lost an opportunity to deploy resources in a way that would have been beneficial to the faculty and students. He expressed hope that, beyond the people at the institutions, there was recognition of the fact that while the System ended up looking marginally better on the financial-side, it was not necessarily a good thing. The present uncertainties meant that institutions could not invest in some of the very items that would have helped them.

Total revenues and transfers in for Oregon State University ended at $3.3 million or 1 percent higher than the adjusted budget. This increase in revenue was primarily due to higher than budgeted tuition and resource fees, higher undergraduate enrollment, and E-campus revenue. OSU’s ending fund balance, as a percent of operating revenues, was 9.6 percent compared to the adjusted budget of 8.5 percent and the prior year of 8.7 percent. In the auxiliary area, the net from operations and transfers ended at an increase of $824,000, which is relatively comparable to the adjusted budget increase of $2 million.

For Portland State University, Education and General Funds, total revenues and transfers in were above the adjusted budget by $2.3 million, primarily due to a $1.6 million summer session adjustment and lower utilities and other expenses such as professional and custodial services. PSU experienced a significant increase in vacancies beginning in the third quarter of FY 2007. This increase in vacancies appeared to be the primary reason for the unexpected variance. Total vacancies in the fourth quarter of FY 2007 in the Education and General Fund increased approximately 50 percent compared to the prior year. The ending fund balances, as a percent of operating revenues, was 13.6 percent. Without the summer session adjustment, it was 12 percent, compared to the adjusted budget of 8.8 percent and the prior year of 11.8 percent. The auxiliary areas, net from operations, and transfers, ended in an increase of $2.4 million compared to the adjusted budget decrease of $370,000. The difference was due to lower housing costs, lower than anticipated labor and capital outlay for the Smith Memorial Student
Union, and lower expenses for several student center activities. Auxiliary operations continue to mean positive cash and working capital balances.

For Education and General Funds for Southern Oregon University, the total revenues and transfers in were $667,000 below the adjusted budget, primarily due to a decline in enrollment, decreased revenue from nonresident students due to the expansion of the WUE program, and the reclassification of a transfer in as an internal sales reimbursement. The decreases in revenue were partially offset by a $376,000 summer session adjustment. Total expenditures and transfers out were $1 million below the adjusted budget, primarily due to lower personnel costs resulting from SOU's retrenchment plan. The net reduction in fund balance was $626,000, compared to the adjusted budget spend-down of $959,000. Fund balance as a percentage of operating revenues ended at 4.1 percent compared to the adjusted budget of 3.2 percent and the prior year of 5.9 percent.

For the University of Oregon, total revenues and transfers in were $6.5 million above the adjusted budget, primarily due to the summer session adjustment of $1.6 million, greater than anticipated enrollment in non-resident students and master's level programs, and increases in spring term and continuing education enrollment, and a budget error of $1.4 million related to the student loan program. The third quarter projected net from operations and transfers was a loss of $2.7 million, compared to an actual loss of $138,000, an increase of $2.5 million in the fourth quarter. This increase was primarily due to a net $1.1 million summer session adjustment, greater than anticipated enrollment, and several other offsetting variances. Ending fund balance as a percent of operating revenues was 10.8 percent compared to the adjusted budget of 8.6 percent and the prior year of 11.4 percent. In the auxiliary area, revenues and expenses both ended significantly higher than the adjusted budget and the prior year. This increase in revenue is attributed to the proceeds from the sale of the Westmoreland property, revenue from the Las Vegas Bowl, and other post-season play, increased housing occupancy, and increased facility rental income.

Total revenues and transfers for Western Oregon University were at $504,000, lower than anticipated due to enrollment declines and a decrease in revenue from the non-resident students. The lower revenue was partially offset by a $222,000 summer session adjustment. Total expenditures and transfers out were $1.8 million lower than the adjusted budget, due primarily to vacancies, restructuring classes with low enrollment, lower than anticipated PEBB costs, lower than anticipated retirement costs, and the attainment of S&S [supplies and services] expenditure reduction. The third quarter projected net from operations and transfers was a loss of $60,000, compared to an actual ending increase of $617,000, a variance of $677,000 in the fourth quarter. This increase resulted primarily because of higher than projected internal cost recovery, increased foundation support, and personnel services savings due to vacancies. There was an ending fund balance of 12 percent compared to the prior year fund balance of 11.1 percent and the adjusted budget of 8.6 percent.

The Chancellor's Office ending fund balance was $5.8 million or 33 percent of operating revenues compared to the adjusted budget of $8.8 million or 55.8 percent.
In summary, Systemwide, the third quarter management report projected a $7 million decrease in fund balance for the year, compared to a year-end fund actual fund balance of $5 million, which is a $12 million variance from the third quarter projections. This variance, according to Mr. Green, is primarily due to a net $2.6 million one-time summer session adjustment, conservative spending in the fourth quarter resulting from the Co-Chair's initial budget release in March and April, and a projection error. This $12 million variance represents 1.3 percent of total expenditures and transfers out. Mr. Green explained that to reduce the possibility of this type of variance occurring in the future, there would be work with the institutions to improve the projection algorithms and estimates. Additionally, a significant amount of time at the quarterly meeting of the institution budget and business officers will be devoted to discussing the estimate of projection algorithms that are used to try to gain knowledge on best practices, learn from each other and, hopefully, produce more accurate projections.

Additionally, work is underway on major components of OPE [Other Personnel Expenses] within the accounting system so that information can be used better to project those costs.

A discussion of whether or not a one or one-and-a-half percent variance was significant followed. Mr. Green observed that it was not, “but when we're going before the legislature representing a projection of where our fund balance is going to be based on third quarter projections all within the fourth quarter, it becomes fairly significant.” Director Blair highlighted that the people who lose in this, unfortunately, are the people who are giving OUS the resources to get something done. “If we can't get it done because we're afraid we're not going to have the resources then that's the real loss. So I think your point here is, in absolute terms, 1 percent is not that significant. In the fourth quarter, however, it has implications for people's perception of what we're doing and how well controlled our System is. But the real tragedy is if we can't use our scarce resources to advance our mission—that's the loss.”

Chancellor Pernesteiner opined that part of the variance relates to enrollment and the declines in both winter and spring terms that were totally unanticipated. Another factor is that for the last several years, OUS has been subject to changes in accounting standards imposed by the Government Accounting Standards Boards. Finally, the shift in the summer session accounting accounted for a large percentage of the variances.

It was moved by Chair Blair and seconded by Director Lorenzen to accept the Quarterly Report. Those voting in favor of the motion included Directors Blair, Lorenzen, and von Schlegell. Those opposed or abstaining: none.

Chair Blair added that he was very pleased with the strides the institutions and staff have made in the last several years. He suggested that an important element of continuing to strengthen financial management is to put more structure around the human resource side of the equation. This would include developing finance and administration personnel, providing opportunities for cross-fertilization, and educational opportunities. He requested a proposal be developed for the November meeting on how a human resource planning process around the
finance and administrative functions might be carried out. “I would like to put some more formality around how we define roles, how we train and develop people in the finance and administration area, and how we select when we have openings,” to name a few.

4. **ADJOURNMENT**

Chair Blair adjourned the meeting at 11:29 a.m.