MINUTES OF THE BOARD FINANCE & ADMINISTRATION
COMMITTEE MEETING
OREGON HEALTH & SCIENCE UNIVERSITY
APRIL 4, 2008

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BOARD FINANCE & ADMINISTRATION COMMITTEE MEETING
OREGON HEALTH & SCIENCE UNIVERSITY
APRIL 4, 2008

AGENDA

1. CALL TO ORDER/Roll Call/WELCOME

Chair Blair called the meeting to order at 9:04 a.m. Committee members present: Don Blair, Kirby Dyess, John von Schlegell, and Tony Van Vliet.

Staff present included Vice Chancellor Jay Kenton and Robert Simonton.

2. REPORT ITEM

a. Update on current capital projects (Simonton)

Bob Simonton, Director of Capital Construction, Planning, and budget, presented an update on current capital projects. At the present time, there are over 160 major projects under way on the campuses. Legislative spending authorizations in each capital budget lasts six years and for the period between 2003-2009, the budgets total approximately $1.9 Billion. Of that total, about 21 percent of the OUS capital budget is funded by the state. This is up from around nine percent at the beginning of the cycle. On this topic, President Ray observed that most of the general public do not understand how the funding occurs and that the largest percentage, by far, comes from avenues other than state support.

Continuing, Mr. Simonton indicated that there are three main objectives in spending capital money for quality facilities by: 1) trying to renew worn-out buildings; 2) allowing for program improvements; and 3) building or adapting buildings to meet a particular academic program or to accommodate access or growth in particular programs. “We want to do buildings that are good, fast, and cheap,” he quipped.

With all of the construction that is taking place, Director Blair questioned if there was human resource planning that accompanied it. “do you feel as if we have the right people in place to manage these projects?” he asked. Mr. Simonton replied that training is offered and the sessions are well attended by the campuses. He suggested that approximately 80 percent of the personnel involved in capital projects have participated in the training sessions.

UO Vice President Dyke added that, at least at the UO, the hiring standards are fairly strict. Therefore, usually they hire people who have already run capital projects either at a university, or in a major school district, or a good-sized city. Chair Blair underscored the importance of
having appropriately trained people to operate in this particular part the campus operation. On the smaller campuses, owner specific project managers have been hired to take on the duties of a large project.

One of the slides of in the presentation illustrated that to date, OUS has spent 65 percent of the monies they had requested. There are several reasons for this. First, if the campuses can’t raise the amount of money they had projected for a project, they can’t spend the money they have received from the state. Additionally, projects are planned several years in advance and when the time comes to actually implement them, priorities may have changed and the project is not what is need in the current environment. Another factor is that, before bonds can be sold, the Board must be confident they the project will be self-supporting and self-sustaining. If this cannot be assured, the projects are not put forward.

Chancellor Pernsteiner explained, “The ones that historically aren’t done (he pointed them out on the handout) are things that, because the cycle is so long, that for a campus to put together a project for ‘09-’11, for construction in ’11-’13 or ’13-’15, would have to have done its planning last year in order to get into the queue next month to come to you for something they don’t intend to actually complete for another seven years.” Many projects are abandoned because of this delayed timeline.

Calling on his experience at PSU, Vice Chancellor Kenton said that when he was vice president, he would put projects on the capital budget that would provide him with the flexibility to do things that might need to be done in the coming six years, but which he couldn’t always foresee. “It gives you a limitation you can work with and then, maybe, morph it to the actual need as it develops.”

Director von Schlegell pursued a line of questioning concerning how much the rules and regulations of the state acted as impediments to getting projects started and completed in a timely manner. He observed that some of these restrictions might prevent OUS from being as “nimble” as is optimal in large capital projects.

In terms of renovation monies, Mr. Simonton indicated that there are two parts to the equation: daily maintenance, such as replacing belts and filters and that kind of work and secondly, replacing the equipment. OUS is under-funded in both areas. “We just completed a study that showed that we should be spending $7.00 a square foot for maintenance. We spend about $5.00,” he added.

In summarizing the discussion, Chair Blair remarked that over the last several legislative sessions, OUS has done a better job of taking requests and submissions from the campuses and overlaying the strategic framework on that and then making decisions as to what should be funded. He suggested that there certainly are bottom-up requests but that perhaps the Board needs to be a little more proactive about where capital funds should be deployed in concert with the Board’s strategic agenda. “That is not just locations in the state, but just what types of
investments do we think we need to make in order for us to be serving the educational requirements of the state over the next ten-to-twenty years.”
President Ray concurred and added that from a Systemwide standpoint, everyone understands there is a big need for increasing the built capacity for instructional purposes if the System is to effective in providing the numbers of graduates that will be needed in the coming years. “there doesn’t exist this compatibility under the rules of the game between what the schools will bring to the System as viable and what the System understands needs to be done for us to be successful going forward,” he concluded.

3. DISCUSSION ITEMS


DOCKET ITEM:

Background:
The Oregon University System has undergone tremendous change over the last 10 years, moving toward a more decentralized operating environment and moving transaction processing and approval from the Chancellor’s Office to the campuses. The implementation of the Banner Finance System also moved OUS from having one central finance system that was controlled by the Chancellor’s Office to eight separate finance systems operated by the institutions, with certain baseline structures to ensure consistent reporting. In addition, the development and implementation of the Resource Allocation Model, where the tuition earned is retained by each institution, moved each institution toward a more self-sustaining model. Consequently, with each institution being more on their own to generate sufficient revenues for operation and to manage and control expenditures, and be responsible for more of the day-to-day transaction processing, the financial risks for each institution have multiplied. All of these things together serve to change the risk profile surrounding the financial management of OUS and point out the need for a continued evaluation of the System’s financial infrastructure.

For the last several years, our auditors have stressed the importance of ensuring that an appropriate financial infrastructure is considered. In their communication to the Board relating to the audit of the 2006-07 financial statements, our auditors noted that a strong internal control environment requires adequate staffing levels at the Chancellor’s Office and at the universities. It also requires appropriately educated and experienced finance personnel, with ongoing training and mentoring. With that in mind, they made the following recommendation:

“We recommend the State Board of Higher Education and the System remain cognizant of appropriate financial operational infrastructure. A strong internal control environment is one of the cornerstones to all great organizations and will help the Board manage the System and its institutions efficiently and effectively. We acknowledge the System’s progress in this area and commend their review of the financial operational infrastructure during their human resource planning process.”
In addition, the OUS Board has been working over the last several years to amplify and clarify the statutory role of the Chancellor as the Chief Executive Officer of OUS. As such, ensuring that the organizational structure of OUS is consistent and complementary with this objective is a key step in furthering this goal. It is with this as a backdrop that the Oregon University System has undertaken this Human Resource Planning process.

**Objectives:**
The Human Resource Planning (HRP) process is intended to become an ongoing process to build and maintain a “best in class” finance function within OUS. The attributes of a strong finance function are:

- Financial performance – achievement of OUS financial goals, financial performance above peer benchmarks, and cost-effective finance functions
- Functional excellence/capability – core functions and specialist functions (treasury, tax, risk management, business recovery, internal audit) are strong at the institutions and Chancellor’s Office, and both core and specialist functions are focusing on mastering their related fundamentals, are credible and connected to the business, and are carried out in a professional and ethical manner
- Quality individuals in key finance positions – experienced leaders in the key finance positions set the tone, with the right mix of “pros” and “developing leaders,” taking action to help ensure the diversity (gender/race/nationality) of the group, and that staff stay motivated, loyal, passionate, and committed
- Effective and efficient systems and processes – continual improvement is made and measured in the cost-effectiveness of the key business systems and processes within OUS
- Positive work environment – taking action to ensure appropriate training and professional development opportunities are provided, career paths are more clearly delineated, staff is recognized for their achievement, and that compensation levels and plans are appropriate.

The HRP process will serve to strengthen the internal control structure of OUS by helping to ensure:

- Consistent application of policies
- Stronger adherence to System goals
- Sufficient “bench strength” for key finance positions.

In order to ensure that the objectives of the HRP process are achieved, it is critical that policies and standards are established that set the tone and expectations of the Board. These policies and standards are:
• A standard organization structure throughout the finance function of OUS that incorporates clearly delineated reporting relationships and desired segregation of key finance functions

• Standards for key finance positions within OUS, including basic roles and responsibilities, as well as required education and experience

• A more robust and inclusive recruitment, evaluation, and development process that is reflective of the finance organization structure and includes identification and assessment of bench strength for key finance positions

**Organization Structure:**
Attachment A illustrates the standard organization structure, with desired reporting relationships and segregation of functions. The key attributes of this structure are:

• Vertical integration of the finance function from each institution to the System’s Chief Financial Officer

• Separation of the control and financial planning functions

**Vertical Integrated Finance Function**
The organization structure illustrated in Attachment A shows each institution’s control and financial planning functions reporting both to their institution’s Chief Financial Officer and to their counterpart at the System office, the latter being via a dotted-line relationship. The dotted-line reporting is intended to portray primary responsibility to an institution’s business objectives while properly recognizing the responsibility to the System established policies and goals. Functionally, this dotted line relationship will occur via the hiring process, the evaluation process, and the continual coordination of policy setting and implementation of new processes and procedures. Additionally, these dotted line relationships provide an avenue for an institution to broaden the discussion within their institution to include counterparts at the Chancellor’s Office when working through challenging financial issues. Broadening the discussion in such cases helps ensure consistency and compliance.

**Separation of the Control and Financial Planning Functions**
The organization structure illustrated in Attachment A separates the control and financial planning functions at each institution and the Chancellor’s Office. This separation serves to more clearly focus the roles that each party fills, allowing a narrower set of fundamentals that must be mastered and fostering a productive tension between these two different functions that can help produce an environment of “controlled” innovation/change. While on their face these two functions are not necessarily incompatible from an internal control perspective, it is recognized that the performance measures that may be employed to drive and evaluate performance may create undesired incentives that can weaken internal controls if the functions were combined.
Standards for the Key Finance Positions within OUS:
Attachment B delineates a set of roles and responsibilities and required education and experience for the key finance positions within OUS. This document is initially limited to the key finance positions within OUS, with possible future expansion to include other positions within each campus. With regard to the roles and responsibilities listed, the intent was not to be all inclusive; rather, the roles and responsibilities listed are the key responsibilities necessary to help ensure a sound internal control structure. This matrix has been reviewed and discussed by the Administrative Council (the Vice Presidents for Finance and Administration from each institution and the Vice Chancellor for Finance and Administration).

All position descriptions for the key finance positions (CFO, Control, and Financial Planning) will need to be updated to reflect these standards. In addition, a review of the résumés/vitae of the incumbents in these positions to determine areas for focused training will be undertaken.

Recruitment, Development, and Evaluation Process:
A key to ensuring a high quality finance function is a human resource management process that hires the right people, provides development opportunities and identified career paths, including identification of bench strength for the key finance positions, and evaluates performance against clear performance goals and specific development plans. Recognizing the goal of a more vertically integrated finance function, the recruitment, development, and evaluation process for key finance functions within OUS will include both campus and Chancellor’s Office representatives, based primarily on the reporting structure delineated in Attachment A. Recruitment, development, and evaluation of key Chancellor’s Office personnel may include, at the Board’s discretion, a member(s) of the Board’s Finance and Administration Committee.

Conclusions:
Implementation of this plan will make certain implied relationships express and codify protocols that are currently informal. It will also bring new requirements to the key finance positions within OUS. Implementation of a robust HRP will require additional allocation of resources to the administrative functions within each institution and the Chancellor’s Office.

Future Steps:
- Board approval of HRP policies (May)
- Status report on implementation and any additional policy issues to be addressed (June/July)
Attachment A

Building Functional Excellence Across OUS Finance

Box delineates initial stage
## Attachment B

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<th>Position Title</th>
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| Vice President for Finance and Administration - and - Vice Chancellor for Finance and Administration | • Establish and maintain internal control as defined and delineated by the COSO integrated framework  
• Ensure financial statements accurately reflect the university's/System's financial position in accordance with Generally Accepted Accounting Principles (GAAP)  
• Ensure the overall financial health of the university/System  
• Develop comprehensive annual and long-range fiscal plans, including operations, facilities development, physical plant design, construction and renovation to support the long-range plan of the university/System  
• Develop operating and capital budget monitoring process to help ensure achievement of the institution's/System's long range plan  
• Report any significant fiscal challenges within operating units of the institution/System to the Chancellor's Office/Board's Finance and Administration Committee, along with the institution’s corrective action plan  
• Develop, implement, and maintain appropriate controls. | • Master’s degree in finance, accounting, business administration, public administration, or related field (Professional licensure with experience may be substituted) | • Earned doctorate in finance, accounting, business administration, public administration, or related field  
• CPA or CMA | • 10+ years of progressively responsible administrative management experience with 7+ years senior financial management experience  
• Proven record as an effective leader | • Significant higher education or administrative management experience, including positions at large, complex organizations | • Excellent management and interpersonal skills  
• Knowledge of GAAP for higher education  
• Knowledge of internal control principles (COSO)  
• Knowledge of finance, business law, auditing, IT, capital construction, budgeting and human resources  
• Ability to communicate complex issues in a manner understandable to a broad range of constituents  
• Demonstrated commitment to ethical management and diversity |
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<th>Position Title</th>
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<th>Required Skills/Knowledge</th>
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<tr>
<td>Associate/Assistant Vice President For Finance</td>
<td>Establish and maintain internal control as defined and delineated</td>
<td>Bachelor’s degree in finance, accounting</td>
<td>CPA</td>
<td>Master’s Degree in</td>
<td>7+ years of progressively</td>
<td>Higher education or administrative</td>
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Administrative computing systems and ensure data integrity and security
- Ensure compliance with state and federal laws, rules, and regulations, as well as Board, System, and institution fiscal, human resource, and information technology policies
- Develop and maintain institution/System fiscal policies
- Recommend different forms of capital financings
- Oversee management of all aspects of fiscal affairs of the institution including, but not limited to, cash, accounts receivable, accounts payable, purchasing, capital construction, auxiliary enterprise management, grant and contract management, risk management, financial aid, and human resources, including employee relations and collective bargaining
- Disclose financial irregularities and data breaches in accordance with established policies and procedures
- Annually certify management representations made to external auditors
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<td>Director of Business Affairs / Chief Business Officer / Controller</td>
<td>Establish and maintain internal control as defined and delineated by the COSO integrated framework</td>
<td>Bachelor’s degree in finance, accounting, business administration, or related field</td>
<td>CPA</td>
<td>5+ years progressive experience in business/financial services, including accounting and financial reporting</td>
<td>Higher education or administrative management experience, including positions at large, complex organizations</td>
<td>Thorough knowledge of internal control principles (COSO)</td>
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<td>Ensure financial statements accurately reflect the university’s financial position in accordance</td>
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<td>Thorough knowledge of GAAP for public higher education institutions</td>
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<td>and Administration / Controller</td>
<td>by the COSO integrated framework</td>
<td>business administration, or related field</td>
<td>Finance, accounting, business administration, or public administration</td>
<td>responsible administrative management experience with 3+ years senior financial management experience</td>
<td>management experience, including positions at large, complex organizations</td>
<td>Thorough knowledge of GAAP for public higher education institutions</td>
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<td>• Ensure financial statements accurately reflect the university’s financial position in accordance with GAAP and OUS Policy</td>
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<td>• Proven record as an effective leader</td>
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<td>Excellent oral and written communication and interpersonal skills</td>
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<td>• Ensure the overall financial health of the university</td>
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<td>• Report any significant fiscal challenges within operating units of the institution to the Vice President for Finance and Administration and the System’s Associate Vice Chancellor for Finance and Administration and Controller</td>
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<td>Ability to lead and motivate staff and manage personnel matters</td>
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<td>• Develop and maintain institution fiscal policies</td>
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<td>• Ensure compliance with state and federal laws, rules, and regulations, as well as Board, System, and institution fiscal, human resource, and information technology policies</td>
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<td>Excellent oral and written communication and interpersonal skills</td>
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<td>Developing, and administering fiscal plans, financial systems, policies and procedures.</td>
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Oregon State Board of Higher Education
Finance & Administration Committee
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<td>with GAAP and OUS Policy</td>
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<td>• Developing and administering fiscal plans, financial systems, and policies and procedures.</td>
<td>• Ability to lead and motivate staff and manage personnel matters.</td>
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<td>• Report any significant fiscal challenges within operating units of the institution to the Vice President for Finance and Administration and Associate Vice Chancellor for Finance and Administration and Controller.</td>
<td>• Grant and contract management</td>
<td>• Ability to research and formalize accounting treatment of significant transactions.</td>
<td>• Demonstrated commitment to ethical management and diversity</td>
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| Associate / Assistant Director of Business Affairs | • Establish and maintain internal control as defined and delineated by the COSO integrated framework  
• Ensure financial statements accurately reflect the university’s financial position in accordance with GAAP and OUS Policy  
• Ensure the overall financial health of the university  
• Report any significant fiscal challenges within operating units of the institution to the Director of Business Affairs  
• Ensure compliance with state and federal laws, rules, and regulations, as well as Board, System, and institution fiscal, human resource, and information technology policies  
• Develop and maintain institution fiscal policies                                                                 | Bachelor’s degree in accounting, finance, business administration, or related field                                                 | CPA or CMA                                                                                      | 5+ years experience in business/financial services, including accounting and financial reporting  
• Developing, implementing, and maintaining internal controls and related policies and procedures                                                                 | Higher education or administrative management experience, including positions at large, complex organizations | Thorough knowledge of internal control principles (COSO)  
Thorough knowledge of GAAP for public higher education institutions  
Demonstrated commitment to ethical management and diversity |
| Associate / Assistant Chief Business Officer      |                                                                                                                                                                                                                         |                                                                                                  |                                                                                                |                                                                                                          |                                                                                                          |                                                                                                          |
| Associate Vice Chancellor for Finance and Administration and Controller | • Establish and maintain internal control as defined and delineated by the COSO integrated framework  
• Develop and maintain System fiscal policies  
• Ensure the financial statements accurately reflect the System’s financial position in accordance with GAAP  
• Ensure the overall financial health of each university within OUS                                                                 | Bachelor’s degree in finance, accounting, business administration, or related field  
• CPA                                                                                                              | Master’s degree in finance, accounting, business administration, or public administration | 7+ years of progressively responsible administrative management experience with 3+ years senior financial management experience  
• Proven record as an effective leader                                                                 | Higher education or administrative management experience, including positions at large, complex organizations | Effective management and interpersonal skills  
Excellent oral and written communication skills  
Extensive knowledge of GAAP for higher education  
Extensive knowledge of internal control principles (COSO)  
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| Director of Accounting and Reporting   | • Establish and maintain internal control as defined and delineated by the COSO integrated framework  
• Ensure financial statements accurately reflect the System’s financial position in accordance with GAAP, including developing fiscal monitoring processes to help ensure the compliance with accounting principles and policies and the continued fiscal health of  
• Bachelor’s degree in finance, accounting, business administration, or related field  
• CPA                                                                 | • Master’s degree in finance, accounting, business administration, or related field                                                                                                                                  | • 5+ years of progressively responsible administrative management experience with 3+ years senior financial management experience  
• Proven record as an effective leader                                                                 | • Higher education or administrative management experience, including positions at large, complex organizations  
• Effective management and interpersonal skills  
• Excellent oral and written communication skills  
• Extensive knowledge of GAAP for higher education  
• Extensive knowledge of internal control principles (COSO)  
• Knowledge of finance, business law, auditing, IT, capital construction, budgeting and human resources  
• Ability to communicate complex issues in a manner understandable to a broad range of constituents  
• Demonstrated commitment to ethical management                                                                 |
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<td>Budget Director</td>
<td>Establish and maintain internal control as defined and delineated by the COSO integrated framework</td>
<td>Bachelor’s degree in finance, accounting, business administration, or related field</td>
<td>Master’s degree in finance, accounting, business administration, public administration, or related field</td>
<td>5+ years progressive experience in accounting and budgeting operations</td>
<td>Higher education or administrative management experience, including positions at large, complex organizations</td>
<td>Knowledge of GAAP for Higher Education, Knowledge of financial analysis and research procedures, Ability to: o design, analyze and use databases and spreadsheets for financial analysis o prepare, interpret, review, reconcile, analyze, maintain and report, Ability to communicate complex issues in a manner understandable to a broad range of constituents, Demonstrated commitment to ethical management</td>
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<td>Develop and monitor operating budgets for all major operating units of the institution, including auxiliary enterprise operations</td>
<td>CMA or CPA</td>
<td>Enterprise computing systems</td>
<td>Ability to research and formalize accounting treatment of significant</td>
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<td>Develop, implement, and maintain appropriate administrative computing systems and ensure data integrity and security</td>
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|                | • Provide analytical support for budget development and analysis and feasibility studies. | transactions | Experience in policy development | retain comprehensive financial statements, technical documents, records, accounts and reports  
  o analyze fiscal reports, spreadsheets, charts, graphs, tables and other materials and draw logical conclusions  
  o develop and present recommendations and solutions to financial problems  
  o prepare clear and concise reports  
  o communicate complex issues in a manner understandable to a broad range of constituents  
  o lead and motivate staff and manage personnel matters | • Excellent oral and written communication and interpersonal skills  
  • Developing and administering fiscal plans, financial systems, and policies and procedures  
  • Demonstrated
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| Assistant Budget Director | - Establish and maintain internal control as defined and delineated by the COSO integrated framework  
- Perform complex financial analyses including:  
  o extracting, interpreting and analyzing internal & external financial and organizational data from a multitude of sources  
  o collecting, compiling, and analyzing data related to students, faculty, staff, facilities, and other institutions of higher education  
  o building, maintaining, and enhancing computer models and applications  
- Perform director level duties when necessary | - Bachelor’s degree in finance, accounting, business administration, or related field  
- Master’s degree in finance, accounting, business administration, or public administration  
- CMA or CPA | - Same experience as financial analyst plus  
- Experience interacting with senior leadership and external constituencies | - Higher education or administrative management experience, including positions at large, complex organizations  
- Experience in policy development | - Knowledge of GAAP for Higher Education  
- Knowledge of financial analysis and research procedures  
- Ability to:  
  o design, analyze, and use databases and spreadsheets for financial analysis  
  o prepare, interpret, review, reconcile, analyze, maintain, and retain comprehensive financial statements, technical documents, records, accounts, and reports  
  o analyze fiscal reports, spreadsheets, charts, graphs, tables, and other materials and draw logical conclusions  
  o develop and present recommendations and solutions to financial problems  
  o prepare clear and concise reports |
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- Communicate complex issues in a manner understandable to a broad range of constituents
- Lead and motivate staff and manage personnel matters
- Excellent oral and written communication and interpersonal skills
- Developing and administering fiscal plans, financial systems, and policies and procedures
- Demonstrated commitment to ethical management and diversity
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<td>Assistant Vice Chancellor for Budget Operations</td>
<td>Establish and maintain internal control as defined and delineated by the COSO integrated framework</td>
<td>Bachelor’s degree in finance, accounting, business administration, or related field</td>
<td>Master’s degree in finance, accounting, business administration, public administration, or related field</td>
<td>5+ years progressive experience in accounting and budgeting operations</td>
<td>Higher education or administrative management experience, including positions at large, complex organizations</td>
<td>Knowledge of GAAP for Higher Education</td>
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<td>Develop the Systemwide operating budgets for the university System including education and general fund limited, other funds limited, and other funds non-limited</td>
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<td>Experience as Board staff</td>
<td>Previous campus leadership experience</td>
<td>Knowledge of financial analysis and research procedures</td>
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<td>Ensure compliance with budget notes, and DAS and Board policies</td>
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<td>Experience representing institution to external constituents such as state government</td>
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<td>Ability to:</td>
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<td>Provide analytical support for various budget and cost feasibility studies</td>
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<td>Experience generating timely and accurate financial information and reports</td>
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<td>o design, analyze, and use databases and spreadsheets for financial analysis</td>
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<td>Monitor and report on financial performance of System and campuses verses budget and legislative limitation.</td>
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<td>Enterprise computing systems</td>
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<td>o prepare, interpret, review, reconcile, analyze, maintain, and retain comprehensive financial statements, technical documents, records, accounts, and reports</td>
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<td>Ability to research and formalize accounting treatment of significant transactions</td>
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COMMITTEE DISCUSSION:

One concern that was raised with this type of reporting was the issue of divided loyalties. There was some concern that key finance staff on campuses would have divided loyalties between the campus and the system. Another concern was a possible degrading of the authority of campus staff. “Some feel that dotted line reporting relationships and the expanded goal setting and evaluation process related to their direct reports will serve to reduce their authority and make it difficult to recruit to fill those positions,” Mr. Green observed. Under this system, the way System staff are hired may have to change and part of the background for the System would be campus experience. There was general agreement that there needs to be campus input into hiring in the Chancellor’s office.

Mr. Green reminded the Committee that some of these steps have already been taken, but what might be needed is a codification of the expectations and having a clear policy that will assist in making sure that certain steps are taken. Taking his own position as an example, Mr. Green observed that he would have greater responsibility to assure that campus employees in his parallel position are in a position have mastered the fundamentals of that position. “Putting the dotted line responsibility in place would require a more proactive process of evaluating risks, working through the control self-assessments with the campuses and making sure the key controls are in place in each of the major processes at the campuses.

President Ray reported that the President’s Council had not had any discussions on the job descriptions and reporting responsibilities and thought that was needed in order to move forward. Ms. Dyke, Vice President at the UO echoed President Ray’s comments, indicating that there needed to be more conversation between campuses and with System staff before the concept moved forward. “I guess my bottom line request on behalf of President Frohnmayer and myself is for more time to work through this because, while in some ways it appears to be a fundamental change, it will impact how we do business with each other – and hopefully improve it. But we need to get it right before we implement anything,” she concluded.

President Lund offered that there is an economy of scale that regional institutions are already looking at to find efficiencies by cutting things like student service personnel and other functions. “It isn’t going to go over well on our campuses if we are seen as adding layers of administration. And some of the titles on the flow chart may be well beyond what is really necessary at the regional institutions.” President Manahan explained his position by saying that if the changes enhances the responsiveness of the campus to problems and the System responsiveness to campus problems and doesn’t diminish the authority of staff to do the job, then he would approve of it.

Chair Blair thanked presidents for their feedback and responded that he was unaware that they had not had an opportunity to thoroughly review and discuss the plan. He also expressed a desire to articulate, from his point of view, what the plan is not. “This is not a reaction to feeling as if people are hiding things or that there is some sort of lack of communications. It’s not about that at all. This is about a mindset, it’s about creating a community here in the finance
area, it’s about attracting the right people. It’s about building career paths for people.” It was agreed that there had been a lot positive progress in the last four years in the finance and administration areas. There continues to be positive feedback from outside auditors about the quality of the people and work in the finance areas.

b. New Debt Management Approach

DOCKET ITEM:

In order to improve the management of the System’s Article XI-F (1) debt, we plan to begin managing this debt on a portfolio basis, rather than on a transactional or project-specific basis. The System will take on an appropriate amount of variable rate debt to lower its overall cost of capital. In addition, we plan to begin utilizing a commercial paper program to provide interim financing for capital construction projects. The benefits of these changes are:

- **Minimizing the cost of capital**
- **Managing volatility in interest rates**
- **Providing greater flexibility and clearer planning horizons**
- **Maximizing allowable arbitrage earnings**
- **Simplifying the administration of the debt portfolio**

**Conceptual Framework:**
Currently, the System finances capital construction of its self-supporting and self-liquidating facilities exclusively with long-term fixed rate debt. Typically, the System issues long-term debt once or sometimes twice per year. This is done to spread the cost of such issuance over a larger pool of debt. Debt is issued in anticipation of campus needs and the proceeds, along with the obligation to make the debt service payments related to a particular debt issuance, are allocated to particular projects at a particular campus. The System simply acts as a conduit for the campuses to the capital markets. In addition, up until this point in the history of the System, no interim financing vehicles were available to fund construction costs in advance of long-term debt issuance or during construction, and the System did not have authority to issue variable rate debt or interest rate swaps. The current structure has the following disadvantages:

- Each campus takes market interest rate risk with each project financing, being captive to the interest rate at the time of debt issuance (with possible future reduction if the interest rate market allows for a refunding of the original debt)
- Issuance of long-term debt before a project has been started and/or in amounts that are not needed immediately to fund construction costs exposes the System to unnecessary interest costs and higher project costs
- Direct linkage of the debt service payments on a particular allocation of bond proceeds to the campus:
• eliminates the ability to take advantage of the lower costs of variable rate debt as the volatility risk of variable rate debt would not be spread over a sufficient base
• creates a significant accounting and processing burden to manage these distinct allocations (see diagram below)

- Not having an interim financing vehicle available has created unnecessary project timing constraints due to the timing of long-term debt issuance

Below is an illustration of the current debt repayment related to the 70 discrete allocations of bond proceeds to the corresponding universities for the four most recent issuances of F-Bonds.

**Current Operating System of Recent Series F-Bonds:**

With the passage of House Bill (HB) 2199 during the 2007 legislative session, OUS now has the ability to issue variable rate debt, thus permitting a blended portfolio approach with variable and fixed rate debt. Also permitted under HB 2199 is the ability for OUS to enter into short-term financing vehicles and interest rate swap agreements. With these new authorities, the System plans to implement a commercial paper (CP) program to provide interim financing for construction projects and to begin pooling and managing its Article XI(F)1 debt as a portfolio. Under this approach, utilizing low cost CP, campuses would be able to begin their capital projects on a time schedule that is uninhibited by the timing of long-term debt issuances. The System would time and structure the underlying long-term debt issuance to provide for the lowest cost of capital, utilizing a mix of fixed and floating rate debt. The System would provide the funds to repay the CP and/or fund the remainder of the construction costs to the campus via a loan from the System to the campus at a cost of capital that is established based on the interest costs of the entire portfolio of debt—a blended cost of capital. This will effectively de-link the debt payments by the campuses to the System from the debt service payments from the System to the bond-holders. As this approach is implemented, the System will act less like a
pass-through vehicle for the universities to the capital markets. Instead, the System will act more like an active financing vehicle strategically managing the debt portfolio via continuous management of the entire debt portfolio and setting an equitable blended rate to all universities.

This new approach to the management of long-term Article XI-F(1) debt will have the following advantages:

**Minimizing the Cost of Capital**
The System will minimize its cost of capital by utilizing a commercial paper program for interim financing to lower interest costs during construction and minimize the portion of taxable debt and maintaining a portion of the System’s outstanding debt on a floating rate basis.

The System will manage its debt portfolio to minimize its taxable component. Unlike tax-exempt debt, taxable debt will not be considered a perpetual component of the System’s liabilities. Taxable debt will be utilized to fund projects ineligible for tax-exempt financing or for those projects for which the System wants to preserve maximum operating flexibility.

Due to the financing flexibility and typically low interest cost associated with variable rate debt, it is desirable to maintain a portion of the System’s aggregate debt on a floating rate basis. However, variable rate debt also introduces volatility to the System’s debt service obligations. Therefore, the System will balance the mix of variable and fixed rate debt according to a target guideline that will be established based on the System’s ability to hedge such exposure either through interest earned on its operating cash balances, through reserves maintained for that purpose, or some combination thereof. The actual percentage of variable rate debt outstanding will fluctuate from time-to-time due in part to financing needs, utilization of the CP program, and prevailing market interest rates.

The use of interest rate swaps will be employed primarily to manage the System’s variable rate exposure. The System will utilize a framework to evaluate potential interest rate swaps through the evaluation of its variable rate allocation, market and interest rate conditions, the compensation for undertaking counterparty exposure, and their costs and benefits. Under no circumstances will an interest rate swap be utilized that is not fully understood by the System or that imposes inappropriate risk on the System. The OUS’ swap activity will follow the parameters outlined in the State of Oregon’s swap policy, which is incorporated by reference in the System’s debt policy.

**Managing Volatility**
The System will manage interest rate volatility by establishing a standard “blended cost of capital” charged to the campuses that is sufficient to cover debt interest costs, fund the administrative costs of debt management, and build a reserve to hedge variable rate movement.
Providing Greater Flexibility and Clearer Planning Horizons

The System will provide greater flexibility and clearer planning horizons to the campuses by de-linking the actual debt service payments on outstanding debt from the campus projects that the debt funded. Utilizing internal loans from the System to fund their capital projects, campuses can:

- better predict their debt service costs at the beginning of a project
- take out debt on terms more tailored to their specific project
- repay debt early
- focus their concern on managing the project and less on the financing

By establishing a blended cost of capital, campuses can worry less about the interest rate markets and the timing of bond issuances, focusing instead on the project itself.

Maximizing Allowable Arbitrage Earnings

The System will maximize allowable arbitrage earnings by more strategically entering the capital markets and by more strategic management of debt sinking funds to help avoid arbitrage rebate.

Simplifying the Administration of the Debt Portfolio

The System currently maintains separate accounts within its sinking funds for each bond allocation within each debt-paying entity for each institution. Implementation of a pooled debt management approach will allow the elimination of these separate accounts and streamline the flow of funds and the accounting for those transactions.

The following diagram illustrates the simplification of the debt repayment process that this approach affords.

Central Bank Blended Cost and Pooled Funding Approach:
Estimated Cost Savings:
A recent study performed by PFM, the System’s financial advisors, shows that, with a 30 percent variable rate debt exposure, the System could achieve average annual debt service savings of approximately $1.7 million (based on the actual debt issued and the interest rate environment over the past three years). Currently, OUS does not retain the investment earnings on its operating cash balances, which prevents the traditional approach of utilizing this natural hedge against variable rate debt volatility. The System plans to ask the 2009 Legislature for the authority to retain the interest on its operating cash balances. The inability to retain interest on the operating cash balance does not change the underlying fundamentals—that exposure to the variable rate debt market will lower the overall cost of capital. It does, however, change the manner in which the System will hedge such exposure and the planning horizon within which a large variable rate exposure can be undertaken.

Conclusion:
OU S has been given new tools by the Legislature with which to manage its Article XI-F(1) debt. The ability to utilize interim financing, issue variable rate debt, and enter into interest rate swap agreements provides the System the flexibility to reengineer its debt management process and improve its financial performance by:

- Minimizing the cost of capital
- Managing volatility
- Providing greater flexibility and clearer planning horizons
- Maximizing allowable arbitrage
- Simplifying the administration of the debt portfolio

Over the next several months, we will move toward implementation of these new strategies through work sessions with the State Treasurer’s office, the Department of Administrative Services, the Legislative Fiscal Office, and campus administrators. Over those months, we will bring proposed changes to existing policy and new policy constructs that will provide the framework for this structure to the Board for discussion and implementation.

Next Steps:
- April – Meeting(s) with the State Treasurer’s office, the Department of Administrative Services, and the Legislative Fiscal Office to ensure the ultimate viability of the program
- April/May – Meeting(s) with campus administrative leaders to develop a detailed implementation plan, including identification of needed new policies and/or changes in existing policies. Examples include:
  - Governance and administration
  - Setting of blended cost of capital
  - Type and level of reserves needed
  - Level of variable rate debt exposure
- May/June – Implementation plan discussion and first read of policy changes with Finance and Administration Committee
- June/July – Policy approval by Finance and Administration Committee
COMMITTEE DISCUSSION:

Mike Green reminded the Board that the 2007 Legislature gave the System some new tools with which to manage debt. The ability to utilize interim financing, issue variable rate debt, and enter into interest rate swap agreements provided the System the flexibility to reengineer its debt management process. Not having an interim financing vehicle available has created unnecessary project timing constraints. The new authority permits managing our debt in a more strategic manner.

Mr. Green pointed out that a recent study performed by Rowan and PFM indicated that a 30 percent variable rate debt exposure would reduce the annual debt service cost by approximately $1.7 Million, based on the actual debt issued and the actual interest rate environment over the last three years. Over the next several months, staff will work with Treasury, DAS, and LFO to ensure the ultimate viability of the program. There are still parts of the new plan to be worked out, but Mr. Green expressed confidence that the changes would occur.

Director von Schlegell asked if the reserves could be passed back onto the campuses. Mr. Green responded that under this plan, reserves are either built for strategic uses by the campus president, in the case of a specific campus or by lowering the cost of capital they could lower the cost on future projects. There are still some aspects of the plan that need to be worked through. Vice Chancellor Kenton added that with the volatility in the financial markets today, the System is moving slowly and as the plan is refined, it will be brought back to the Finance and Administration Committee.

Director Fox asked if there was an expectation of any push-back or resistance from the Treasurer’s Office or from LFO on the new plan. In replying, Mr. Green indicated that he had been working with the Treasurer’s debt manager, and they are 100 percent behind the approach.

Vice Chancellor Kenton introduced Paul Siebert who is the new LFO analyst assigned to work with the System. He is replacing Steve Bender has been the analyst for a number of years. Mr. Siebert has approximately ten years of state experience.

4. ADJOURNMENT

Chair Blair adjourned the meeting at 10:39 a.m.