

Contact: Patrice Sayre

**MINUTES OF OCTOBER 29, 2008
AUDIT/COMPLIANCE AND INVESTMENT COMMITTEE
BOARD OF REGENTS, STATE OF IOWA
MEMORIAL UNION, SUN ROOM, IOWA STATE UNIVERSITY
AMES, IOWA**

Committee Members

Jack Evans (Chair)
Bonnie Campbell
Robert Downer

Michael Gartner
Ruth Harkin

David Miles
Rose Vasquez

Staff Members

Bob Donley, Patrice Sayre, Todd Stewart, Andrea Anania

The corresponding docket memorandum for each agenda item, an integral component of the minutes, is available on the Board of Regents website: www2.state.ia.us/regents. Copies of these memoranda can also be obtained from the Board Office by calling 515-281-3934.

Chair Evans called the meeting to order at 9:30 a.m.

Approve Minutes from September 17, 2008, Committee Meeting

- MOVED by CAMPBELL, SECONDED by HARKIN, to approve the minutes of the September 17, 2008, meeting. Motion APPROVED by GENERAL CONSENT.

Receive Reports on Internal Audit

Internal Audit Director Todd Stewart discussed the audit reports presented this month, highlighting the following:

- 1) **UI Health Care Integrated Call Center**
- 2) **UI Health Care Joint Office for Clinical Outreach Services**
- 3) **UI Health Care – EPIC Security**
- 4) **ISU Security of Internet-Initiated ACH Transactions**
- 5) **UNI – Central Revenue Processes**

Regent Downer, referring to the audit report on SUI Joint Office for Clinical Outreach Services, asked what steps were being taken in regards to the discussion on page 3; “through interviews performed and research of Outreach Services, it is difficult to determine where Outreach Services fits in the strategic plan of UI Health Care”.

Audit Director Stewart replied that follow up of this audit is not due as yet and that management intended to have a new action plan in place by July 1, 2009. Management noted that this service has gone through a lot of evolution, but agreed on the whole with the audit finding.

Regent Evans asked Stewart to comment on the UIHC Patient and Staff Safety report. Stewart said that the request for audit came from nursing services because of concern about nurses’

safety, as well as other staff and clients, when prisoner patients are brought for medical care. The audit found inconsistent processes among local law enforcement agencies in complying with UIHC Department of Safety and Security policies and procedures. The Department of Corrections has regimented policies of their own and provides officers to accompany patients. Safety and Security will work with UIHC staff to establish registration requirements and train local law enforcement agencies.

Stewart went on to say that Safety and Security forces are “lean” and suggested staffing levels may not be adequate. Management is reviewing officer levels in light of budget parameters.

Regent Downer asked for discussion on the UNItix Operations report finding on financial performance that indicated athletics was not charged the full budgeted ticket fee, possibly resulting in the \$15,825 cash deficit at the end of 2008. He queried if this matter was being addressed and expressed concern how this may be perceived due to the level of General Fund support for athletics at UNI. Stewart replied that part of this deficit can be attributed to that, but the deficit was an inherited one from prior operations. Tom Schellhardt clarified that this situation has been taken care of and was not meant to be a subsidy. This was the second year of an agreement to clear the deficit; Athletics has paid the \$15,825.

Receive Recommendation on Proposed Revised Format for Internal Audit Reports

Todd Stewart presented the revised format for the “dashboard” layout for the internal audit report summary pages. He noted questions had been raised about the current format and a meeting with President Miles, Regent Evans, and Board office staff was held last June to discuss revision. Stewart subsequently presented a new format to Regent Evans and, with some further modifications, it is now before the Board. Stewart walked the Board through the changes, noting that the greatest change was in the summary of audit presentation, which is modeled after Penn State. The report “Status of Audit Follow-Ups” had a column added: revised follow up date.

Regent Evans thanked Todd Stewart for his work and felt this was a good suggestion. Regent Harkin voiced her support for the revised format. Regent Evans stated that for items showing up in red in the follow-up report, the Audit/Compliance and Investment Committee would request an update from the referenced institutional head on the current status. In the future, this committee may have reports from Internal Audit and institutional leadership as appropriate.

Receive Recommendation on Proposed New Bond Audit Format

Patrice Sayre presented the proposed new bond audit format, saying that currently all the universities do separate bond audits even though this material is included in the year-end financial audit. The new format would eliminate these bond audits in favor of providing enhanced footnotes in the year-end financial statements, saving approximately \$100,000 dollars per year. This revised format has been under review for the past year with the State Auditor’s Office, Springsted and Ahlers & Cooney. All the universities and Board staff have worked on the enhanced footnotes and are asking the Board of Regents to approve this change in replacing separate audits with thorough footnotes in the year-end financial statements.

Regent Downer asked if there had ever been any circumstances where bond audits turned up anything improper with regard to violations with bond covenants or funds misplaced. Doug True

said "No". Regent Downer said this was a positive move and what we should be doing to make our operations as efficient as possible.

Receive Report on Fund Manager Evaluations

Regent Evans reported to the Board that the interinstitutional investment group, including himself, Regent Vasquez, and Wilshire Consulting representatives, Mark Brubaker and Mike Dudkowski, met with several fund managers on October 9, 2008. He called on the university financial officers to give the report.

Warren Madden reported that the group reviewed the performance of financial fund managers, stating that universities have essentially two sets of funds to be managed: short-term/intermediate and long-term endowments. The Regents investment program tries to meet all the needs of the institutions. Recently, there has been a challenge with fund management, as well as liquidity issues for many entities. Fortunately, liquidity has not been a problem for Regents institutions; there is no immediate short term cash issue, nor is a problem foreseen. Long-term investments under the approved asset allocation plan are suffering as market conditions worsen. It is believed that the market will stabilize. Investment operations are under review and because of the security valuation issue, one of the concerns that has been raised is if funds are protected and safeguarded. The answer is Yes. Iowa has a public funds protection procedure that was enacted statutorily. The State Treasurer administers the program and any public funds held in Iowa financial institutions that become at risk may be made whole. This process doesn't deal with market fluctuations that occur. In term of asset protection and the financial institutions university financial staff we are working with, there is no major risk. Financial staff believe they have moved ahead appropriately.

Doug True continued the report by discussing two fund managers in particular, Artisan and LSV, both of whom have been on a watch list for performance. There have been extensive discussions with them and financial advisors from Wilshire Consulting leading up to the face-to-face meeting in October. Financial staff will bring recommendations for change, particularly in the area of small cap investment, to the Board in December.

Regent Evans called for questions, and hearing none, asked the financial officers to report on the status of Commonfund. Warren Madden noted that a portion of institutional assets is cash that may be managed through intermediate fund managers until needed; one of those funds being the Commonfund Intermediate Fund. The Commonfund is a pooled program holding assets of numerous large institutions. As liquidity in the marketplace changed over the last few weeks, notification was received on September 29 that due to Wachovia Bank issues, the depository bank for Commonfund, the Fund was freezing the withdrawal of cash from their intermediate fund. As the Wachovia Bank closed, it affected Commonfund's short-term fund, which in turn affected their intermediate fund. The liquidity challenge that was created caused Commonfund to restrict the withdrawal of intermediate funds to 30% of the balance. The three public universities withdrew the maximum 30%, investing that sum in Iowa financial institutions.

The balance of funds still with Commonfund are approximately \$34 million for SUI, \$54 million for ISU and \$20 million for UNI. Over the last week or two, Commonfund has been working with our institutions and roughly ten other large colleges and universities that together compose the majority of that fund. All participants have been given the choice to sell securities and take

whatever proceeds are received or let the fund continue to mature - maturity being reached in six to twelve months. The majority of the institutions in the fund do not have immediate cash needs, and believing that the marketplace values will come back to where they were, have elected to withdraw funds in an orderly way as they mature. Removing cash today would give a poor return on funds that have generally generated a 3-5% return. Commonfund has been cooperating with our institutions and is in regular contact. Financial officers believe this is a rational plan.

Regent Gartner noted that the beneficiaries of the withdrawal from Commonfund are Wells Fargo Bank and US Bank. Madden added that Bankers Trust was also included, and that all were protected under the State Treasury program.

Regent Gartner asked for disclosure if anyone at the universities or the Board of Regents was on the board of financial institutions whose deposit limits were being raised today. Madden noted that all disclosures were on file with the Board Office. No disclosures were made during this committee meeting.

Tom Schellhardt said that he appreciated the investment committee involvement and reinforced Madden's comment that we are staying in close touch with our financial advisors, as well as the Commonfund. Further, he expressed appreciation for the work of the investment staff at the campuses.

Madden noted that we also are in touch with bond counsel, as well as our financial advisors, and they all support the general plan. If circumstances change, recommendations will be brought to the Board for appropriate action.

Regent Downer mentioned one concern with regard to modification of the Banking and Brokers Relation report to which he hoped the institutions were sensitive. Recognizing that most relationships listed are in Iowa, when institutions headquartered outside Iowa have their limits substantially raised, Iowa-based institutions should also be considered. He noted that bigger is not necessarily better and Iowa institutions should not be short-changed.

Regent Gartner noted that Wells Fargo, while based in San Francisco, has more employees in Iowa.

Madden pointed out that since Iowa-based financial institutions have to pledge securities to the state when they accept public deposits, some Iowa banks don't have the capital structure for large balances. While the universities would do more business with these institutions, some are not willing or able to do so, leaving larger financial institutions being listed.

True agreed that there was an issue for some banks with 100-110% collateralization. These amounts may exceed their capital. Foremost in financial staffs' strategy over the last 2-3 months has been preservation of principal and rethinking of where safe harbors are; making sure university funds are secure. Working closely with the Board office, committee Chair Jack Evans, and Wilshire, recent focus has not been as heavily on returns but on security during this period of instability, as well as close examination of the state's sinking fund program.

- MOVED by GARTNER, SECONDED by CAMPBELL, to:
 - 1) Accept the Internal Audit Report and the Revised Format for Internal Reports
 - 2) Approve the Fund Manager evaluation report
 - 3) Approve the new Bond Audit Format
 - 4) Approve the revision of Banking and Broker Relationships

Discussion: President Miles wished to return to Regent Gartner's comment on disclosures and asked if we had gotten appropriate disclosures for Wells Fargo, Bank of America, US Bank and First National. While disclosures may be filed with the Board office, President Miles requested that disclosures be appended to the Banking and Broker Relationships report itself.

MOTION APPROVED by GENERAL CONSENSUS.

Warren Madden made one further comment about market fluctuations and what happens with endowment earnings. He reminded us that endowment funds are managed under a set of asset allocation policies that the Board has approved, or in the case of university foundations, their boards have approved. These asset allocation plans are diversified to modify market fluctuations. All institutions use three years, 12 quarters, averages to smooth market gains and losses which will prevent a negative impact on the current budget year's spending plan.

Meeting adjourned at 10:05 a.m.