

BOARD OF REGENTS
BANKING COMMITTEE

July 18, 2002

The Banking Committee of the Board of Regents met on Thursday, July 18, 2002, at the University of Northern Iowa, Cedar Falls, Iowa.

Those present were:

Banking Committee members: Regents David Fisher (chair), Mary Ellen Becker, David Neil, and Owen Newlin.

Others in attendance were:

Institutional representatives: Mary Sue Coleman (arrived at 8:17 a.m.), Douglas True (arrived at 8:17 a.m.), Ann Madden Rice, Carol Senneff, Terry Johnson, Gregory Geoffroy (arrived at 8:18 a.m.), Ben Allen (arrived at 8:40 a.m.), Warren Madden (arrived at 8:40 a.m.), Mark Chidister (arrived at 8:40 a.m.), Sheryl Rippke, Robert Koob (arrived at 8:21 a.m.), Tom Schellhardt (arrived at 8:25 a.m.), Gary Shontz, Carla Kelley, Tim McKenna (excused at 8:20 a.m.), Jim Heuer (arrived at 8:17 a.m.) and Luann Woodward (arrived at 8:17 a.m.);

Barry Fick, Springsted, Inc.;

Ken Haynie and Ed Bittle, Ahlers law firm; and

Board Office: Pamela Elliott (arrived at 8:16 a.m.), Joan Racki, Deb Hendrickson, and Barb Briggie.

Regent Fisher called the meeting to order at 8:12 a.m.

APPROVE MINUTES OF THE JUNE 2002 BANKING COMMITTEE MEETING.

MOTION: Regent Neil moved to approve the minutes of the June 20, 2002, Banking Committee meeting, as written. Regent Becker seconded the motion.
MOTION CARRIED UNANIMOUSLY.

RESOLUTIONS FOR THE SALE AND AWARD OF \$7,000,000 ACADEMIC BUILDING REVENUE PROJECT NOTES, SERIES ISU 2002.

Mr. Haynie stated that Academic Building Revenue Project Notes for Iowa State University were planned to be issued in accordance with legislative action in the second extraordinary session of the 2002 General Assembly. He said the legislature transferred \$7 million of the 1997 appropriation from the State's Rebuild Iowa Infrastructure Fund for the Engineering

Teaching and Research, Phase II project at Iowa State University to the FY 2002 State General Fund. The legislature authorized the Board of Regents to issue Academic Building Revenue Bonds to complete the project and appropriated \$7 million from the Rebuild Iowa Infrastructure Fund for FY 2004 for repayment. The sale of Academic Building Revenue Project Notes would provide interim financing for the project, as permitted by Iowa Code. He said the project notes will have an 18-month maturity, at which time they will be repaid with the appropriated funds, or refinanced as Academic Building Revenue Bonds. He noted that the short maturity will have an impact on the interest rate received for the notes.

Mr. Fick stated that the rating agencies have different nomenclature for short-term financings of this type. He said both rating agencies gave their highest possible short-term rating to the notes. Both rating agencies confirmed the underlying ratings of the University's bonds with a stable outlook. Several of the potential bidders began the bidding process as a syndicate but then decided to bid separately. These short-term project notes will provide a cost-effective alternative to money market funds for investors. He anticipated strong demand for the notes when bids are taken.

Regent Neil asked if the notes will be reissued in 1-1/2 years. Mr. Haynie responded that they could be. He said it was anticipated that the notes will be paid from an appropriation, if the appropriation materializes, or from a bond issue, for which authority was given.

MOTION:

Regent Neil moved to recommend that the Board adopt the following resolutions, subject to receipt of acceptable bids: (1) A Resolution providing for the sale and award of \$7,000,000 Academic Building Revenue Project Notes, Series I.S.U. 2002, and approving and authorizing the agreement of such sale and award. (2) A Resolution authorizing and providing for the issuance and securing the payment of \$7,000,000 Academic Building Revenue Project Notes, Series I.S.U. 2002, for the purpose of financing all or part of the cost of completion of the Engineering Teaching and Phase II Project on the campus of the Iowa State University of Science and Technology, and paying certain costs of issuance. Regent Newlin seconded the motion. **MOTION CARRIED UNANIMOUSLY.**

**RESOLUTION AUTHORIZING THE EXECUTIVE DIRECTOR TO EFFECT THE
ISSUANCE OF UP TO \$25,000,000 UNIVERSITY OF IOWA FACILITIES
CORPORATION REVENUE BONDS (ROY J. AND LUCILLE A. CARVER
BIOMEDICAL BUILDING), SERIES 2002A.**

Vice President True stated that the project to be funded by this bond sale used to be called the Medical Education and Biomedical Research Facility-Building B. It is now called the Roy J. and Lucille A. Carver Biomedical Building. University officials, along with the Board's bond and financial advisors, have developed a comprehensive financial plan for construction of this facility. Much discussion has taken place about the use of the building which will be principally, but not entirely, for research. There will be a taxable bond issue and a tax-exempt bond issue. The bond issue will be insured. He said the issuance of these bonds, anticipated for September, will allow the project to be bid soon.

Regent Fisher asked if a lease obligation will fund the bond payments. Vice President True responded affirmatively, noting that the debt service will be paid from the University's lease obligation. Lease payments are equal to the interest and principal on the bonds.

Mr. Haynie pointed out that most of the sponsored research activity to be undertaken in this building is for private use. For that reason, there needs to be a taxable component and a tax-exempt component of the financing. If a good overall estimate of the project cost and the allocations of space between components can be determined in the near future, then a decision could be made about whether or not the September bond sale could totally be a tax-exempt financing. Otherwise, the September bond issuance might be split into two series – a taxable series and a tax-exempt series – which, he said, is not uncommon. He noted that there was a large state appropriation component to the financing of Building A of the Medical Education and Biomedical Research Facility. The state appropriation component was allocated to the sponsored research portion of the building. However, state appropriations are not available for construction of the Roy J. and Lucille A. Carver Biomedical Building (formerly known as Building B of the Medical Education and Biomedical Research Facility). Consequently, both the sponsored research component of the building and the medical education component of the building will have to be financed. Bond counsel is working to determine an allocation which is defensible between the taxable and tax-exempt components of the project.

Regent Fisher asked if the difficulties in the equities market will help in marketing these bonds. Mr. Fick responded affirmatively. He said there has been a flight to quality; people are more apt to transfer money from equities to the fixed income market. The difference in interest rates between taxable and tax-exempt bonds is compressed dramatically compared to historical spreads.

MOTION: Regent Neil moved to recommend that the Board adopt A Resolution authorizing the Executive Director to take any and all action deemed necessary to effect the issuance of not to exceed \$25,000,000 University of Iowa Facilities Corporation Revenue Bonds (Roy J. and Lucille A. Carver Biomedical Building), Series 2002A. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

RENEWAL OF BOND-ASSOCIATED CONTRACTS.

Director Elliott stated that, last year, Requests for Proposals were issued to solicit bond counsel, financial advisor, and arbitrage rebate services. In past years, the arbitrage rebate services had been included in services provided by the bond counsel or financial advisor. She said the current contracts with the Board's bond counsel, financial advisor, and arbitrage rebate services provider commenced on September 1, 2001, for a one-year initial period, with provision for annual renewal thereafter through August 31, 2006, subject to mutual consent of the parties. The Board Office recommended that all terms of the contracts be extended through the annual renewal period ending August 31, 2003. She noted that there were no billings related to the Berens-Tate arbitrage rebate services during FY 2002.

Regent Fisher asked if Springsted, Inc., performs the same services as those provided by Berens-Tate. Mr. Fick responded affirmatively, noting that Springsted performs those services for a number of its clients under separate contract. Berens-Tate's sole practice is arbitrage rebate calculations. He noted that Springsted was one of the proposers for the arbitrage rebate service.

Regent Fisher asked if Berens-Tate's services are utilized very often. Mr. Bittle responded that, in January or February, a meeting took place with Berens-Tate representatives, the universities' financial officers and accounting officials, and bond counsel to discuss arbitrage rebate issues. He said he routinely sends the bond documents to Berens-Tate after a bond sale is closed. He believes the university financial officers have had more contact with Berens-Tate than has bond counsel.

Vice President Madden stated that Berens-Tate provides a very specialized service, for which it has the necessary expertise.

MOTION: Regent Neil moved to recommend that the Board approve the annual renewal of the contracts with 1) Ahlers Law Firm as bond counsel to the Board of

Regents; 2) Springsted, Inc., as financial advisor to the Board of Regents; and 3) Berens-Tate Consulting Group for arbitrage rebate services. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

Regent Fisher encouraged the Board's financial advisor and bond counsel to keep up the good work, noting that their efforts were appreciated.

FY 2003 INTERNAL AUDIT PLANS.

Director Elliott stated that, each year, the Regent universities compile and submit audit plans to the Banking Committee. In accordance with Board policy, these plans review accomplishments for the last several years and identify the next fiscal year's internal audit focus. She said all three universities have internal auditors. The University of Iowa provides audit coverage for the Iowa School for the Deaf and Iowa State University provides audit coverage for the Iowa Braille and Sight Saving School. She noted that the internal audit staff made progress toward completing the internal audit plans for FY 2002. She stated that the three internal auditors were present, and prepared to present their reports.

Director Senneff stated that the internal audit departments of the University of Iowa and the University of Iowa Hospitals and Clinics have been combined for one year, and it is working well. The internal audit office serves the entire University and Hospital environment, although some staff are housed at Seashore Hall and some are at the Hospital. Auditors are cross-trained to work at both locations.

Director Senneff stated that the internal auditors perform risk assessments to identify areas that represent the greatest risks and where resources are most needed in the given environment. With regard to staff, she said her office recently lost two auditors to large corporations. There is continued reorganization within the internal audit office because she believes there are areas where value can be added and where they can become more efficient. This year will probably see the completion of the internal audit office reorganization. She noted that, last year, she talked with the Banking Committee members about information technology auditing.

In the last year, University of Iowa internal auditors took a three-part approach to auditing. First are annual audits, which Director Senneff said, are a very important part of what is done. She provided examples of the diverse audit subjects that were covered in FY 2002. More comprehensive departmental audits have recently been undertaken and will be continued, including in the Otolaryngology Department, the University Bookstore, and the Graduate College. Internal auditors have worked with University of Iowa Hospitals and

Clinics officials on the combined business office system at the Hospital. Internal auditors have also worked with the Health Insurance Portability and Accountability Act (HIPAA) teams at the Hospital. She said the internal auditors have made a strong effort to get the word out that they are available to help clients with questions about internal controls and other matters related to their departments.

With regard to the FY 2003 audit plan, Director Senneff said there has been much consultation. She asked the question of those with whom she consulted, "What keeps you awake at night?" regarding control areas where the internal auditors can be helpful. Many responses were received from people identifying areas they felt deserved a closer look. Risk assessment of those issues was then performed in the following six basic areas: cash and asset handling, regulatory compliance, general control environment, change, information technology, and, complexity of operations. This year's plan includes five NCAA audits, three of which are small and two which are larger. In FY 2003, the internal auditors will remain very involved in the patient billing and registration system at the hospital.

In the past year, Director Senneff has met with representatives of as many parts of the University as possible to discuss internal audit and internal controls, and to ask how her office can be of assistance in managing risk.

President Newlin asked what keeps Director Senneff awake. Director Senneff responded that the most important activity she can do to manage risk is to get the word out that there is risk. Cash management is one of the greatest risks.

President Newlin referred to the national scene regarding Enron, Arthur Anderson, etc., and said there is greater sensitivity in society to the need for internal auditing. He asked if Director Senneff's clients are sensitized in that area.

Director Senneff said that was an interesting question. From the feedback she receives, she believes that is starting to happen. She noted that there will likely be more internal auditors leaving the universities for corporate positions. She said that what happened with Enron and WorldCom was very sad, but it raised awareness.

Director Rippke presented the internal audit report for Iowa State University. She said that, during FY 2002, seven of the planned audits were completed, and two more are near completion. Two audits were cancelled and one was deferred because of the mid-year elimination of one of the internal auditor positions. She said the internal auditors continually assess risks throughout the year. In April, the internal auditors began inviting discussion of concerns and suggestions for audits. After compiling a list of potential audit areas for the coming year, those were ranked according to risk. In formulating the FY 2003 internal audit plan, priority was given to projects ranked as high risk.

Current areas of emphasis include new technologies and systems as well as regulatory compliance. Director Rippke noted that e-commerce security was an audit area requested by the University Treasurer. One of Iowa State University's internal auditors is seeking information technology training and certification. The audit of the Facilities Planning and Management Prism System was delayed until FY 2003, as mentioned earlier, due to the elimination of one internal auditor position. She said NCAA compliance audits are ongoing. University legal counsel indicated that conflict of interest is an area of great risk; therefore, an audit of that area is included for FY 2003. A sample of sponsored programs will be examined in FY 2003.

Director Rippke identified two significant special reviews for FY 2003: 1) endowment expenditures and 2) a self review of the internal audit office. She said her office tries to help the University keep costs down and insure compliance with rules and regulations. She stated that one of the largest challenges faced in internal auditing is confusion over rules.

Regent Fisher asked for the University's responsibility in the auditing of federal grants. Director Rippke responded that the State Auditor's office spends a great deal of time auditing federal grants. Iowa State University internal auditors add detail on the operational processes for the audit while the State Auditor's staff review the financial aspect. Director Senneff responded that the University of Iowa internal auditors look at how departments handle federal grants including compliance with federal regulations and recording of expenses.

Regent Neil asked if federal officials re-audit the state audit of federal grants. Controller Johnson responded that the federal government usually does more focused audits. Last fall, the Department of Health and Human Services performed a cash management audit. He said federal audits happen fairly regularly, and have a somewhat different focus than the A-133 audit.

Vice President Madden stated that Iowa State University receives federal audits in specific areas, such as by the Department of Agriculture and the Department of Energy.

Internal Auditor Kelley introduced Brooke Lacoste, a student intern in the University of Northern Iowa's internal audit office. She stated that she did not have a formal presentation, noting that Operations Auditor McKenna was unable to attend this part of the Banking Committee meeting. She said the FY 2003 internal audit plan was provided in the meeting materials.

Regent Fisher addressed the internal auditors, and asked if there was anything in their work the past year about which they felt the Banking Committee members needed to know in their fiduciary responsibility to the state of Iowa. Director Senneff responded that there was nothing about which the Banking Committee had not already been notified. Director

Rippke responded that there was nothing about which she needed to inform the Banking Committee.

Regent Becker noted the difference in the number of internal audit staff at the University of Iowa versus Iowa State University, and asked if that was primarily because of the Hospital component at the University of Iowa.

Director Senneff responded that internal auditors are certainly needed for the Hospital. The reorganization of the internal audit office is placing more emphasis on the Hospital. She said she believes the number of staff in the University of Iowa internal audit office (seven) plus two vacancies is appropriate for the risk.

Vice President Madden stated that judgments are made about using resources and about the appropriate number of auditors. He said Director Rippke needs additional staff. As University officials have dealt with budget cuts, the internal audit unit has shared in those with the loss of a position. President Geoffroy stated that the number of staff in the Internal Auditor's Office at Iowa State University is the absolute minimum. If the budget situation were different, there would be another auditor position.

Regent Fisher asked about the relationship of the internal auditors with the State Auditor, and whether good services are being provided to the universities.

Director Rippke stated that her office is in contact with the State Auditor's office quite frequently. Sometimes their audits review similar areas but in different aspects. University internal auditors try to be more proactive, such as by forwarding documents electronically to the State Auditor's staff. Another example would be when she is asked by a client for input, and she suggests involving the State Auditor, which may avoid problems later.

Director Senneff stated that the University of Iowa internal auditors have a very good relationship with the state auditors. University auditors do footwork for the state auditors every year. She noted that the state auditors are much more financial focused in their audits and the internal auditors are more operational and process focused. The two audits, then, are complementary.

Internal Auditor Kelley stated that University of Northern Iowa internal auditors share work papers with the state auditors, especially on investments.

Regent Fisher pointed out that at one time there was some frustration with the State Auditor's Office. He said it sounded like that situation was much better.

ACTION: Regent Fisher stated the Banking Committee, by general consent, (1) received the progress reports for the universities' FY 2002

audit plans and (2) received the universities' internal audit plans for FY 2003.

STATE OF IOWA AUDIT REPORTS.

Director Elliott stated that two annual state of Iowa audit reports, which contain information regarding the five Regent institutions, the Board Office, and the rest of state government, were presented.

ACTION: Regent Fisher stated the Banking Committee, by general consent, received the following State of Iowa audit reports for the fiscal year ended
June 30, 2001: the Comprehensive Annual Financial Report and the Single Audit Report.

STATE AUDITOR REPORTS.

Director Elliott said the State Auditor provided written reports on certain aspects of the Regent institutions and Board Office for which it believes that corrective action is necessary. The State Auditor's reports for FY 2001 contained comments on findings related to internal control, statutory requirements, and other matters. Although none were considered significant, corrective actions are being taken on all findings. She said the Board Office recommended that Iowa State University officials formulate legislative proposals for Board consideration to eliminate obsolete statutory provisions for two programs and one laboratory that no longer exist.

Vice President Madden stated that Iowa State University officials will submit the requested legislative proposal this fall.

ACTION: Regent Fisher stated the Banking Committee, by general consent, (1) received the following State Auditor's reports for the fiscal year ended
June 30, 2001: University of Iowa, Iowa State University, University of Northern Iowa, Iowa School for the Deaf, Iowa Braille and Sight Saving School, and Board Office; (2) again requested institutions to consult with the Board Office on preliminary auditor comments and responses, as required by Board policy; and (3) requested ISU to formulate legislative proposals for Board consideration to eliminate obsolete statutory provisions for two programs and one laboratory that no longer exist at the University.

REVENUE BOND FUNDS AUDITS.

Director Elliott stated that the revenue bond fund audit reports of the University of Northern Iowa for the year ended June 30, 2001, indicated that the financial statements of each of the revenue bond funds were presented fairly in all material respects.

ACTION: Regent Fisher stated the Banking Committee, by general consent, received the following University of Northern Iowa Revenue Bond Fund Audit Reports for the fiscal year ended June 30, 2001:
Academic Building and Residence System
(Dormitory).

EXTERNAL AUDIT – TRI-STATE GRADUATE CENTER.

Director Elliott stated that the Siouxland Interstate Metropolitan Planning Council audit report included audited financial statements of the Tri-State Graduate Center. There were no reported findings.

ACTION: Regent Fisher stated the Banking Committee received the Siouxland Interstate Metropolitan Planning Council audit report for the fiscal year ended June 30, 2001, which includes the Tri-State Graduate Center, by general consent.

INTERNAL AUDIT REPORTS.

Director Elliott stated that this month's report included new audit reports from the University of Iowa and follow-up reports from the University of Iowa and Iowa State University.

Regent Fisher stated that the University of Iowa's outstanding internal audits were in much better shape than previously. He noted that Director Senneff was "on top of it" and had made a great improvement.

ACTION: Regent Fisher stated the Banking Committee, by general consent, (1) received the following seven internal audit reports from the University of Iowa:
UNIVERSITY OPERATIONS: Credit Programs – Division of Continuing Education, Department of Otolaryngology – Sponsored Programs Activity; Graduate College – Departmental Audit; Information Technology Decentralized Operations; Inventory Purchase Activity; and Transporting of Cash;

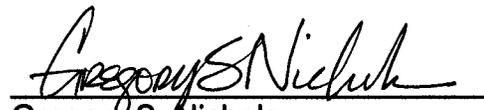
HOSPITAL OPERATIONS: Transporting of Cash; and (2) received the report on the Status of the Internal Audit Follow-up reports, including three follow-up reports.

ADJOURNMENT.

The meeting of the Regents Banking Committee adjourned at 9:04 a.m. on July 18, 2002.



Pamela M. Elliott
Director, Business and Finance



Gregory S. Nichols
Executive Director