

# Innovation and Advanced Education— For-profit and Cost Recovery Ventures at Post-secondary Institutions

## SUMMARY

The Department of Innovation and Advanced Education provides funding for post-secondary institutions in Alberta. As part of its mandate to improve Alberta's performance in advanced education, the department made financial sustainability for institutions a priority in its 2015–2020 business plan.<sup>1</sup> The government recently announced a review over the next two years of the funding model for institutions, reinforcing the importance of stable and predictable funding for post-secondary institutions.<sup>2</sup>

Management of institutions are also examining alternative sources to generate additional revenue. One such alternative is revenue from for-profit and cost recovery ventures. Examples of these ventures include land trusts to develop an institution's vacant land holdings for commercial or residential purposes, and retail selling of by-products produced from instructional programs. Some institutions have already entered into these ventures, although they currently represent a small percentage of their consolidated revenues. An increasing number of Alberta's post-secondary institutions are examining these ventures as an opportunity to achieve greater funding stability for their institutions.

With opportunity, however, comes increased risk that must be effectively managed.

For-profit and cost recovery ventures pose unique financial, reputational, legal and operational risks to institutions. They also require management and oversight expertise distinct from that typically required for a publicly funded post-secondary institution.

The board of governors and management of an institution are directly responsible for any venture entered into and for considering the unique risks carefully, given the potential diversity of these ventures. Ineffective risk management could increase the likelihood of both financial loss requiring additional taxpayer money and reputational damage of perceived undesirable ventures. The board and management may also divert attention away from the institution's primary operations and may be inexperienced with complex operating decisions required in these ventures.

The department's board oversight processes are critical in safeguarding Albertans' investment in its post-secondary institutions. The department must ensure the board's oversight of the institution's management includes appropriately balancing the increased risk with the expected benefits of these ventures. As the potential for institutions to apply these ventures increases, the department must ensure its oversight processes effectively manage the overall increased risk to Albertans.

We would expect the department to have documented expectations of its desired results and risk management along with supporting guidelines. These expectations and guidelines would assess the strengths, weaknesses, opportunities and threats with respect to the ventures institutions seek approval

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<sup>1</sup> Alberta Innovation and Advanced Education Business Plan 2015-2020.

<sup>2</sup> 2015 news release - <http://www.iae.alberta.ca/ministry/news/2015/tuition-and-fees-frozen.aspx>

to enter. We would also expect the department to oversee that boards and management have the experience necessary to effectively manage the ongoing operational risk of these ventures.

### What we examined

We examined whether the department has documented its expectations and guidelines for post-secondary institutions entering into for-profit and cost recovery ventures. We also examined whether the department has processes to provide effective oversight of boards entering into, and monitoring the success of, these ventures in their institutions.

### Overall conclusion

The department does not have adequate processes to oversee the unique risks that post-secondary institutions take on when they generate revenue from for-profit and cost recovery ventures.

As a result, ventures with the intended purpose of reducing an institution's reliance on public funding could, in fact, increase the risk exposure and ultimate cost to Albertans.

### What we found

Department expectations and approved guidelines for institutions that seek to participate in for-profit and cost recovery ventures do not exist. Without these expectations and guidelines, the department's oversight processes of boards' monitoring the risk management of these ventures is not effective.

### What needs to be done

The department must document its expectations in terms of desired results and risk management, and formalize guidelines to support these expectations for institutions participating in for-profit and cost recovery ventures. The department must develop and follow a process for ongoing communication of these expectations and guidelines to all institutions.

The department must strengthen its processes to assess whether boards have ensured that their institution's management have appropriate policies and controls to mitigate risks regarding for-profit and cost recovery ventures. Effective department oversight must include obtaining, from institutions, complete information about proposed ventures and the results of their subsequent operations.

### Why this is important to Albertans

An increasing number of institutions are looking for new revenue sources to reduce their reliance on government funding. Without adequate expectations, guidelines and oversight from the department, ventures designed to reduce institutional reliance on public funds will result in unjustifiable risk exposure or cost to Albertans.

## AUDIT OBJECTIVE AND SCOPE

Our audit objective was to determine if the department has developed and communicated:

- expectations and guidelines related to for-profit and cost recovery ventures
- well-designed systems to oversee the quality of board oversight of the accountability for results of these ventures at the institution

We limited our scope to the department's processes and did not audit the individual post-secondary institutions. We excluded ancillary services, which serve to facilitate student inputs to their institution, such as bookstores, parking, food services, memberships, residence rentals and non-credit courses.

Institutions have traditionally provided these services directly to students and we expect they have well established processes.

We interviewed staff and reviewed documentation to understand the department’s expectations, guidelines and oversight processes. We examined business cases and the department’s approval processes for the creation of subsidiary corporations that institutions set up for their for-profit ventures.

We conducted our field work in July 2015. We substantially completed our audit on August 20, 2015. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set out in the CPA Canada Handbook—Assurance.

## BACKGROUND

### Mandates of publicly funded post-secondary institutions

The post-secondary system provides Albertans with a comprehensive range of learning opportunities from a variety of publicly funded institutions. The *Post-secondary Learning Act* and its regulations recognize distinct types of learning opportunities, through individual institutional mandates. Collectively, institutional mandates define the publicly funded post-secondary system’s purpose and range of programming and activities.<sup>3</sup>

The department seeks to improve Alberta’s performance in advanced education, in part by working with institutions to plan for the long-term, stable and predictable funding that makes it possible for them to fulfill their legislated mandates.

### Funding and revenue sources

The department provides public funds to support post-secondary institutions in Alberta. In June 2015 the government announced it intended to spend the next two years reviewing the funding of institutions. Government will review taxpayer funding through operating and capital grants, as well as user based revenues such as tuition, fees and other revenue sources. The goal is to achieve stable and predictable funding for post-secondary institutions.<sup>4</sup>

The department’s 2015–2020 business plan supports financial sustainability for post-secondary institutions by building a system that is more self-sufficient and less reliant on government funding.<sup>5</sup>

Post-secondary institutions traditionally generate revenue from various sources to supplement the amount of public funding received. These revenue sources directly relate to operating activities of the institution or providing educational programming core to their mandate, such as:

- tuition and other student fees
- ancillary services
- sponsored research
- portfolio investments
- donations

<sup>3</sup> Alberta Innovation and Advanced Education Post-secondary Institutional Mandates  
<http://www.iae.alberta.ca/post-secondary/institutions/public/mandates.aspx>

<sup>4</sup> 2015 news release - <http://www.iae.alberta.ca/ministry/news/2015/tuition-and-fees-frozen.aspx>

<sup>5</sup> Alberta Innovation and Advanced Education Business Plan 2015–2020.

Institutions are increasingly exploring new sources of revenue that are outside an institution's core mandate to supplement funding to deliver more programs or make them more accessible for Albertans.

For the purpose of this audit, these revenue sources are:

- for-profit ventures (government business enterprises, government business partnerships)
- cost recovery ventures

### For-profit ventures

For-profit ventures are entrepreneurial activities that institutions engage in for the primary purpose of generating a profit. Government business enterprises and government business partnerships require the creation of a subsidiary corporation.<sup>6</sup> Institutions are restricted from using government funding for these ventures. These enterprises and partnerships, although affiliated with their sponsoring institutions, are separate legal entities that can sign contracts in their own name, and can sue and be sued.

An institution which does not create a subsidiary corporation to segregate its for-profit ventures from normal operations risks not complying with legislation and losing its charitable organization status. Alberta's post-secondary institutions have commonly used land trusts as a government business enterprise vehicle to develop vacant land holdings of the institution for commercial or residential purposes. Institutions that have already created land trusts for development include Keyano College, University of Calgary and most recently the University of Alberta. Olds College also has a land trust for commercial development, primarily the trust's joint venture agreement with a hotel chain to build and operate a hotel and convention centre.

### Cost recovery ventures

Cost recovery ventures involve the retail sales of goods or services including by-products produced from institutional programs. These revenues help offset the direct costs of the institution; any surplus revenue must also support the institution's mandate. Examples of cost recovery ventures include the following:

- livestock sales from Lakeland College's agricultural program
- meat processed and sold through the NAIT retail meat store
- alcohol produced and sold from Olds College's brewmaster program
- room, suite and conference facility rentals at the University of Calgary's Hotel Alma

### Risk management

For-profit and cost recovery ventures currently represent a small percentage of institutions' consolidated revenues. However, these ventures pose increased financial, reputational, legal and operational risks to the institutions and the department, as they may not be typical to the operation of all publicly funded educational institutions. Without an effective risk management plan that includes risk mitigation strategies, realization of these risks is more likely.

The minister appoints board of governor members based on their abilities to oversee the operation of an educational institution. Members may not necessarily have the expertise or experience with for-profit or cost recovery ventures.

<sup>6</sup> Section 80 of the *Financial Administration Act* indicates an order in council approval is required to incorporate, acquire, dissolve, liquidate, wind up or dispose of a subsidiary corporation.

The institutions have direct responsibility for making the decision to enter into ventures and monitor the venture's ongoing operations to the institution's desired results. The department provides oversight of the institution's board, on behalf of the minister, to ensure the board holds management accountable for ensuring these operations will not interfere with the mandate of the institution or result in unjustifiable risk exposure and cost to Albertans.

## FINDINGS AND RECOMMENDATIONS

### Documented expectations and guidelines

#### Background

The department should articulate its expectations and these expectations should support the institution's board in overseeing the institution's results, while also achieving the department's desired results.

Guidelines support those who are trying to meet an expectation. They do this by streamlining particular processes according to a routine or sound practice. Guidelines make the actions of department employees and agencies more efficient and predictable.

Communication is effective when it is clear, concise and easily understood. Effective communication saves time, reduces conflict, strengthens relationships and aids in achieving desired results. The department's processes to communicate expectations and guidelines will result in institutions adopting consistent approaches that align with the department's expectations.

#### RECOMMENDATION 1: DOCUMENT AND COMMUNICATE EXPECTATIONS AND GUIDELINES

We recommend that the Department of Innovation and Advanced Education:

- document its expectations in terms of desired results and risk management for institutions participating in for-profit and cost recovery ventures
- establish approved guidelines for cost recovery ventures, to support best practices and align with the department's expectations
- update and approve for-profit venture guidelines, to support best practices and align with the department's expectations
- develop a process to communicate the department's expectations and guidelines to all institutions

#### Criteria: the standards for our audit

The department should have expectations and guidelines that institutions can apply within their mandate when operating for-profit and cost recovery ventures.

#### Our audit findings

##### KEY FINDINGS

The department:

- has not documented its expectations relating to for-profit and cost recovery ventures
- does not have guidelines for cost recovery ventures
- has had draft guidelines related to for-profit ventures, since December 2011. The department acknowledges they are not comprehensive.
- informally communicates its expectations to institutions; however, these are not documented

The department has not documented its expectations in terms of desired results and risk management for institutions participating in or considering for-profit and cost recovery ventures. The department has delegated this responsibility entirely to each institution to individually determine the proper course of action.

The department provides the following overall planning and reporting guidelines to institutions:

- Comprehensive Institutional Plan Guidelines (2015–2018)—provide a framework for developing institutional plans that integrate institutional and government goals and priorities
- Annual Report Guidelines (updated June 2015)—identify the information institutions must provide in their annual report and associated submissions to the department

However, these guidelines do not specifically identify, nor are they directly applicable to, for-profit and cost recovery ventures.

The department has not developed guidelines for cost recovery ventures.

The department created Subsidiary Approval Guidelines in February 2009, which they were to update every two years. The department completed these updates in December 2011 and February 2013, but both remain in draft status. Effective June 1, 2015, the department drafted new Approval Request Guidelines to provide a general understanding of the post-secondary legislation and the approval procedures the department will use to make sure institutions comply with legislation. These guidelines are not comprehensive, as they do not incorporate requirements for ongoing monitoring and reporting.

The department informally communicates its expectations to the institutions with respect to for-profit and cost recovery ventures. The department expects each institution to be aware of, understand and abide by applicable legislation and regulations. The department was not able to provide evidence of this informal communication.

#### **Implications and risks if recommendation not implemented**

Without clearly defining and effectively communicating the department's expectations and guidelines on ventures, boards and management will expose their post-secondary institutions to risk that, if not managed properly, may result in financial loss, reputational damage and legal exposure.

### **Department oversight of boards of governors**

#### **Background**

Every public post-secondary institution in Alberta operates within the oversight of a minister-appointed board of governors. The board is accountable to the minister, through the department, for overseeing that institution management is monitoring operations and assessing how effectively it is achieving accountability for results in fulfilling the institution's mandate.

The department is responsible for overseeing whether the boards are effectively overseeing the operations of Alberta's publicly funded institutions. Increasingly, these operations include for-profit and cost recovery ventures.

**RECOMMENDATION 2: IMPROVE DEPARTMENT'S OVERSIGHT OF INSTITUTION'S RISK ASSESSMENT OF VENTURES**

We recommend that the Department of Innovation and Advanced Education improve its oversight processes to ensure that boards of governors oversee management's assessment of the risks associated with for-profit and cost recovery ventures by:

- tailoring board training to examine these ventures
- maintaining relevant documentation of the institution's risk assessment and venture approval requests
- requiring the institution to comply with the department's expectations and guidelines
- requiring the institution to report on venture results on an ongoing basis
- providing effective feedback and ongoing guidance to the boards

**Criteria: the standards for our audit**

The department should have adequate processes to oversee that boards of governors of institutions generating alternative revenues are overseeing those activities within the department's expectations and guidelines. The department's oversight<sup>7</sup> should include:

- being vigilant in ensuring the institution's board is ensuring that management is identifying and mitigating risks from for-profit and cost recovery ventures
- checking to confirm the institution's board has processes and systems working well to mitigate risks
- signaling preferred behaviour through open communication and guidance to the institution's board

**Our audit findings****KEY FINDINGS**

The department:

- provides training to board audit committees on risk management policies and controls but it does not include for-profit or cost recovery ventures
- was not able to provide documentation for all for-profit ventures and cost recovery ventures we tested
- approved business cases for four ventures without complete supporting documentation
- does not have processes to effectively oversee the institution's results of these ventures
- does not include for-profit and cost recovery ventures in its processes for feedback and guidance to institutions

**Training for boards of governors**

The department's guidelines for board members include an introduction to board governance at Alberta's public post-secondary institutions. In addition, it provides training manuals for board audit committees. The audit committee training manual includes risk management policies and controls to mitigate risk. However, it does not provide information specific to board oversight of risk management related to for-profit and cost recovery ventures.

**Application of guidelines**

The department assesses whether an institution's board has an appropriate risk management approach, by reviewing the documents the institution provides when asking for the department's approval to set up a subsidiary corporation.

The department uses its draft Subsidiary Approval Guidelines to review and approve the business case and supporting documents for each request. We requested business cases and other supporting documents for nine for-profit approval requests on which the department concluded. The department

<sup>7</sup> Report of the Auditor General of Alberta—July 2014, page 25.

was only able to provide us with information for six of nine of these assessments. The department provided documentation for an additional venture after our initial examination was completed.

We examined the business cases and supporting documents for six approval requests against the department's draft guidelines. The department did not apply the guidelines consistently. Four of the six approval requests did not contain documentation specified in the guidelines. The primary documentation missing was financial information. The two most recent approval requests, both made in fiscal year 2015, met the requirements outlined in the draft guidelines.

The department was unable to provide a list of existing cost recovery ventures at post-secondary institutions. The department must compile this list to ensure it knows and understands the risks monitored by institutions.

#### Reporting and analyzing achievement of desired results

The department oversees a board's oversight activities at an overall institutional level. The department's oversight is not specific to an institution's for-profit or cost recovery ventures. This oversight includes the department's reviews of:

- comprehensive institutional plans
- annual reports
- information reported by institutions in the department's financial information reporting system

The department reviews take place formally, through regularly scheduled and ad hoc meetings, as well as informally, through conversations, phone calls and email. The department indicated these reviews could help them to indirectly identify items for further investigation related to for-profit or cost recovery ventures. However, these high level reports do not provide details of cost recovery ventures.

#### Feedback and guidance to boards of governors

The department has no formal process for providing feedback and guidance to an institution's board specific to the institution's for-profit or cost recovery ventures.

The department attends various meetings with the institutional management about capital items and grants. During these meetings the department may ask questions on the status of for-profit ventures. However, this occurs on an ad hoc basis.

The department does not have specific meetings related to cost recovery ventures.

#### Implications and risks if recommendation not implemented

Without effective department oversight of whether a board is overseeing that its institution's management has appropriate policies and controls to mitigate risks on these ventures, there is an increased likelihood of unjustifiable exposure and cost to Albertans.