

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES**

Agenda Item Summary Sheet

Committee: Audit Committee

Date of Meeting: August 19, 2010

Agenda Item: Discuss Optional Approaches for Future Audit Coverage

- Proposed Policy Change Approvals Required by Policy Other Approvals Monitoring
- Information

Cite policy requirement, or explain why item is on the Board agenda:

Due to audit resource changes and the economic realities facing the System, the Audit Committee will be confronted with several audit coverage decisions during fiscal year 2011. This agenda item will help committee members understand how the Office of Internal Auditing has used internal and external resources in the past, laying appropriate context for future decisions.

Scheduled Presenter(s):

Beth Buse, Executive Director, Office of Internal Auditing

Outline of Key Points/Policy Issues:

- During fiscal year 2011, the Audit Committee needs to take action on future audit coverage. This includes internal control and compliance audits, college and university financial statement audits, and information technology audits.

Background Information:

- By mutual agreement, the contractual relationship with the Office of the Legislative Auditor to conduct internal control and compliance audits had ended.
- Mr. James Nobles, the Legislative Auditor, challenged the Audit Committee to consider the value and role of obtaining annual financial statement audits for individual colleges and universities.
- An approach for auditing information technology has not been defined.

**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES**

BOARD INFORMATION

Discuss Optional Approaches for Future Audit Coverage

BACKGROUND

During 2011, the Audit Committee will be faced with a number of decisions on future audit coverage for:

- internal control and compliance audits,
- college and university financial statement audits, and
- information technology audits.

Decisions need to be made on the scope of audit coverage and how to obtain the coverage. Options include hiring additional internal auditing staff, redirecting existing internal audit priorities, outsourcing the audits to public accounting firms, or a combination.

Below is a summary of services provided by the Office of Internal Auditing. In addition, a summary of audits conducted by external audit resources is provided. A brief description of future audit coverage decisions that need to be made is located at the end of this document.

Office of Internal Auditing Services

Table 1 provides a summary of how internal auditing staff resources were used during fiscal years 2009 and 2010.

- **Follow-up on Prior Audit Findings:** The Chancellor and the Board of Trustees expect timely resolution of audit findings. Accordingly, Internal Auditing maintains a database of audit findings and tracks finding resolution. In about January of each year, Internal Auditing assesses the status of prior audit findings and submits a mid-year follow-up report to each president. In June, Internal Auditing prepares year-end follow-up reports and also submits copies to Chancellor McCormick for consideration during his annual performance evaluations of presidents and vice chancellors.
- **Audited Financial Statements:** The Office of Internal Auditing supports external audit firms in their financial statement audits. This level of support provides two benefits: cost savings which make the external audit contracts affordable and strengthen external audit coverage through use of Internal Auditing's knowledge of the Minnesota State Colleges and Universities system and its business processes.

**Table 1: Percentage of Internal Auditing Technical Service Staff¹ Hours
Fiscal Years 2009 and 2010**

Service	Fiscal Year 2010	Fiscal Year 2009
Follow-up on Prior Audit Findings	28%	21%
Audited Financial Statements	23%	16%
OLA: Internal Control and Compliance Audits	14%	3%
Fraud Inquiry and Investigation Support	11%	12%
System-wide Audits	9%	22%
Professional Advice	8%	7%
Other Internal Auditing Assurances	7%	6%
Consulting Services	0	13%

- **Office of the Legislative Auditor – Finance-Related Audits:** The Office of Internal Auditing helps facilitate audits conducted by the Office of the Legislative Auditor (OLA). By mutual agreement, the contractual arrangement with the OLA is ending. The current contract provided for a transition year in which the OLA contributed approximately 50 percent fewer resources as compared to prior years. The OLA is in the process of completing audits of five colleges with the assistance of the Office of Internal Auditing. Due to the limitation in OLA resources, the Office of Internal Auditing conducted an internal control and compliance audit of St. Cloud Technical and Community College in fiscal year 2010.
- **Fraud Inquiry and Investigation Support:** Internal Auditing assists with conducting fraud inquiries and investigations. When evidence of fraud is identified it must be dealt with appropriately. The results of most fraud inquiries and investigations are reported to affected presidents or the Chancellor for action. Board policy requires that only significant violations of board policy or law, be communicated to the Board of Trustees. The Executive Director of Internal Auditing advised the Chair of the Audit Committee about fraud investigations and reported potential fraud incidents to the Legislative Auditor, as required by state law.

In these times of great uncertainty and change, it is reasonable to expect an increase in the number of issues that will require inquiries and possibly investigations.

- **System-wide Audits:** Each year, Internal Auditing schedules a study of a topic of major system-wide interest. Selected past studies have included:
 - Undergraduate Student Credit Transfer
 - Auxiliary and Supplemental Revenues
 - Affiliated Foundations
 - Student Success
 - Underrepresented Student Populations
 - Post Secondary Enrollment Options

¹ Excludes Executive and Deputy Director hours.

- **Professional Advice:** Internal Auditing also makes itself available to offer professional advice on topics within its expertise. Common questions pertain to compliance with board policies and best practices. Internal Auditing representatives also sit on various MnSCU task forces and committees including: Security Steering Committee, Finance User Group, Chief Information Officers, Students First working groups, and the Affiliated Foundation Policy Task Force.
- **Other Internal Auditing Assurances:** The Office of Internal Auditing also provides other assurance services as requested by the Board of Trustees, Chancellor, or college and university presidents. Some recurring projects include:
 - Transition reviews: Internal Auditing staff facilitate institutional reviews when there is a change of presidents.
 - Testing the compliance of expenses incurred by the Chancellor and Board of Trustees.
 - Compiling the results of the Chancellor’s annual performance evaluation for the Board of Trustees.
- **Consulting Services:** Due to budget constraints, the Office of Internal Auditing eliminated this service line in Fiscal Year 2010.

External Audit Coverage

- **System-wide Audited Financial Statements:** Fiscal year 2010 marks the tenth year that the Minnesota State Colleges and Universities contracted for an external audit of its financial statements. The external audit firm of LarsonAllen is under contract to provide audit services for the system-wide financial statements, Revenue Fund² financial statements, and federal financial assistance. This will be the first year that LarsonAllen provides these services.
- **College and University Audited Financial Statements:** Audited financial statements are generated for 13 of the largest institutions in the System. Table 2 lists the colleges and universities that have financial statement audits.
- **College Internal Control and Compliance Audits:** The annual financial statement audit program ensures that the most significant internal control cycles are reviewed for universities and six of the largest colleges each year. To obtain assurances about the internal controls and fiscal compliance of the remaining colleges, the System has contracted with the Office of the Legislative Auditor (OLA). The OLA audit coverage complements the institutional financial statement audits conducted by CPA firms. Basically, the colleges not subject to an annual financial statement audit and the Office of the Chancellor have been audited by the OLA on a three year rotating schedule.

² The Revenue Fund was created for purposes of financing resident halls, dining halls, student union buildings, parking facilities, wellness/athletic facilities and other revenue-producing buildings as deemed necessary for the good and benefit of students.

By mutual agreement, the contractual arrangement with the OLA is ending. The current contract provided for a transition year in which the OLA contributed approximately 50 percent fewer resources when compared to prior years. The OLA is in the process of completing audits of five colleges with the assistance of the Office of Internal Auditing.

Table 2: Colleges and Universities with Audited Financial Statements

College or University Name	Fiscal Year 2009 Total Operating Expenses ³	Audit Firm for Fiscal Year 2010 Audit	Number of Years Audited
St. Cloud State University	193,695,000	Baker Tilly	9
Minnesota State University, Mankato	181,211,000	Kern, DeWenter & Viere	9
Winona State University	120,662,000	Kern, DeWenter & Viere	9
Minnesota State University Moorhead	88,744,000	Kern, DeWenter & Viere	9
Bemidji State University	76,130,000	Baker Tilly	9
Century College	65,250,000	Baker Tilly	8
Minneapolis Community & Technical College	64,235,000	LarsonAllen	8
Metropolitan State University	60,047,000	LarsonAllen	8
Normandale Community College	57,808,000	Kern, DeWenter & Viere	1
Rochester Community & Technical College	49,292,000	LarsonAllen	8
Minnesota State Community & Technical College	49,191,000	Baker Tilly	9
Southwest Minnesota State University	47,214,000	LarsonAllen	8
Hennepin Technical College	44,688,000	Kern, DeWenter & Viere	8

Other Audit Activities

A variety of other external audits, evaluations, and reviews occur. Accordingly, Internal Auditing monitors the results from the following activities and recommends corrective actions to the Chancellor, college and university presidents, or the Board of Trustees, as warranted.

- Legislative Auditor Financial Audits:** The Legislative Auditor conducted an internal control and compliance audit of St. Cloud State University that was released on June 15, 2010. The OLA had not audited a state university for about ten years and determined that it needed to have some coverage of at least one university. The Office of the Legislative Auditor conducted this audit on its own authority; it was not part of the services contracted for with the Office of the Chancellor.
- Legislative Auditor Program Evaluations:** In addition to its financial audit coverage, the Legislative Auditor may conduct periodic program evaluations, as selected by the Legislative

³ System-wide total operating expenses were \$1.7 billion for the year ended June 30, 2009.

Audit Commission. In February 2010, the Legislative Auditor released an evaluation on the “MnSCU System Office”.

- **Audits of Grants and Special Financing Arrangements:** Some special grant or other funding sources have certain audit requirements that must be satisfied. State law requires that the Legislative Auditor review any audit contracts prior to their execution. The most common source of these requirements is the Minnesota Job Skills Partnership (MJSP) grants. Because of the volume and routine nature of the MJSP grants, the Legislative Auditor has agreed to permit Internal Auditing to review those audit contracts on its behalf. Contracts for services which satisfy other unique audit requirements, such as an audit arranged by Itasca Community College for a housing project financed with bonds sold by a County Housing and Redevelopment Agency, must be submitted directly to the Legislative Auditor for review.
- **Reviews Conducted by State and Federal Student Financial Aid Authorities:** The Minnesota Office of Higher Education conducts periodic reviews of the state grant and loan programs being administered by the colleges and universities. Most colleges and universities are examined once every three years as part of that process. Internal Auditing reviews these reports to determine whether findings indicate more systemic issues needing attention. Also, the U.S. Department of Education conducts ad-hoc program reviews and investigations of federal financial aid programs. The department schedules its reviews using a risk assessment process and does not schedule routine reviews of each college and university.
- **Audits of Affiliated and Associated Organizations:** Board Policy 8.3 requires periodic financial audits of affiliated foundations. Also, other related organizations, such as the statewide student associations submit annual audited financial statements to the Office of the Chancellor. Internal Auditing reviews these audit reports and determines the need to recommend any action by the Chancellor, college and university presidents, or the Board of Trustees.

Future Audit Coverage Considerations

- **College and University Internal Control and Compliance:** By mutual agreement, the contractual arrangement with the Office of the Legislative Auditor to conduct internal control and compliance audits of colleges that do not have financial statement audits is ending.

An internal control and compliance audit conducted on St. Cloud State University by the Office of the Legislative Auditor was presented to the Audit Committee at the June 15, 2010 meeting. The Audit Committee was challenged to consider the following questions:

- To what extent shall colleges and universities conduct risk assessments to examine the effectiveness of their internal controls?
- To what extent should the Board of Trustees rely on the work of the CPA firms who audit the system-wide and institutional financial statements for assurances about internal controls?

It is an appropriate time for the Board of Trustees to reflect on the best approach for obtaining audit coverage on internal control and compliance within the System. In order to obtain college and university internal control and compliance audit coverage in fiscal year 2011, a decision will need to be made in September 2010 on the scope and how to obtain audit coverage.

- **College and University Financial Statement Audit Coverage:** At the Audit Committee's June 2010 meeting Mr. James Nobles, the Legislative Auditor, challenged the Audit Committee to consider the value and role of obtaining annual financial statement audits for individual colleges and universities⁴. He based his challenge, in part, on questioning whether there were external audiences for whom these audits were prepared.

The Audit Committee revisits the external audit plan each year, before authorizing audit contracts to be renewed. The next review is expected to occur in January 2011.

- **Information Technology:** Information technology (IT) controls are subject to basic audit coverage as part of the annual audit of the system-wide financial statements. This IT audit coverage does not, however, address broader IT risks related to operations. In prior years, the Legislative Auditor had been able to supplement that coverage and conduct periodic audits of higher risk IT operational areas. Staffing turnover, though, has limited the IT audit capacity of the Legislative Auditor and it has not examined MnSCU IT controls since 2006. Since that time, IT operations have undergone significant structural changes and have taken on increased organizational importance.

In November 2009, the principal MnSCU external auditor included an observation in their management letter citing that comprehensive risk-based IT audits of ITS business functions and systems have not been performed since the Legislative Auditor's withdrawal of IT audit resources from MnSCU.

During calendar year 2009, Internal Auditing completed an internal self-assessment and released the results in a report dated January 4, 2010. A recommendation in the self assessment was the Office of Internal Auditing should develop a process for assessing information technology risks and planning IT audits.

The extent, timing, and resources of audit coverage for information technology areas has not been determined. An audit plan for IT areas could either be incorporated into the annual internal auditing plan or created as a more strategic long-term plan, similar to the approach taken for external auditors.

Date Presented to the Board of Trustee: August 19, 2010

⁴ The annual audit of the system-wide financial statements is not subject to discretion. It is required in order to support the preparation of the State of Minnesota financial statements. If the institutional financial statement audits were discontinued, the audit fees for the system-wide audit would increase dramatically.