MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES
AUDIT COMMITTEE
MEETING MINUTES
November 18, 2009

Audit Committee Members Present: *Trustees Scott Thiss, Chair; Jacob Englund, Dan McElroy, David Paskach, and James Van Houten.*

Audit Committee Members Absent: *none.*

Other Board Members Present: *Trustees Cheryl Dickson, Christopher Frederick, and Tom Renier.*

Leadership Council Committee Members Present: *Chancellor McCormick, John Asmussen, President Pat Johns, Laura King, Ken Niemi, and Gail Olson.*

The Minnesota State Colleges and Universities audit committee held its meeting on November 18, 2009, at Wells Fargo Place, 4th Floor, Board Room, 30 East 7th Street in St. Paul. Chair Thiss called the meeting to order at 8:03 a.m.

Approval of the Audit Committee Meeting Minutes
Chair Thiss called for a motion to approve the October 13, 2009, audit committee meeting minutes. There was no dissent and the motion carried.

1. **Audit Update** (Information Item)

   Mr. John Asmussen, Executive Director of the Office of Internal Auditing, explained that findings from both the September Legislative Audit report and the Internal Audit report on auxiliary services had been referred by the audit committee to other policy committees.

2. **Approval of Contract with Legislative Auditor for Financial Audits** (Action Item)

   Mr. Asmussen reviewed the details of the 2010 contract with the Office of the Legislative Auditor. He reminded members that the committee had a strategic external audit plan which utilized the legislative auditor to review the internal controls and finances of the smaller colleges on a scheduled three year rotation.

   Mr. Asmussen stated that the Office of the Legislative Auditor had been experiencing the same stress on its resources as other state agencies and it was concerned about being able to provide the same level of audit as in the past. He stated that three years without audit coverage for an institution was the outer limit of his comfort level and he would be reluctant about extending it to a fourth year.

   Mr. Asmussen stated that the legislative auditor had agreed to cover at least five of the six colleges that had not had an audit during the last three years, in a more targeted, surgical approach than they had taken in the past. It would review the higher risk areas such as security and access controls, equipment inventories, and credit cards. Mr. Asmussen added that he had committed to augmenting the legislative auditor coverage with internal audit resources to ensure that all six colleges were reviewed.

Mr. Asmussen reminded members that the Office of the Legislative Auditor had autonomous statutory authority to select audits and had expressed an interest in auditing some of the larger institutions, particularly the state universities. He stated that the legislative auditor had reserved the prerogative to go to one or more of the state universities this year.

Trustee Thiss asked if the legislative auditor would use a targeted approach to avoid a duplicative process to the work of the external auditors. Mr. Asmussen assured members that the legislative auditor would start by looking at the external auditor's working papers and build from there.

Trustee Van Houten stated that CFI ratings ought to be taken into consideration in the selection of colleges for the legislative auditor to review. He added that colleges with the weakest CFI ratings ought to get some sort of an annual review, until they worked their way up.

Ms. Laura King, Chief Financial Officer, stated that there would be occasion to discuss how colleges were selected for audit when the committee discussed the fiscal 2011 audit strategy and audit plan. She added that it had never been an objective in the five year audit strategy plan to target financial condition, but rather to target institutions from an internal control cycle standpoint. She questioned whether the legislative auditor would have the staff support to do the kind of work around financial condition, but she added that it would be a great conversation about audit strategy objectives going forward. Trustee Van Houten added that at a minimum the three campuses with negative unrestricted net assets ought to be on the audit list.

Trustee Van Houten made the motion, Trustee McElroy seconded. The Audit Committee recommends that the Board of Trustees approve the following motion:

RECOMMENDED COMMITTEE ACTION:

The Audit Committee has reviewed this proposal for audit coverage of the six colleges during fiscal year 2010. The committee recommends that the Board of Trustees adopt the following motion:

RECOMMENDED MOTION:

Based on the review and recommendation of the Audit Committee, the Board of Trustees approves the Executive Director of Internal Auditing and Vice Chancellor for Finance making arrangements with the Office of the Legislative Auditor to conduct financial audits of Central Lakes College, Inver Hills Community College, Pine Technical College, Ridgewater College, Riverland College, and, if resources permit, St. Cloud Technical College during fiscal year 2010. To the extent that the Office of the Legislative Auditor will not have sufficient time to audit St. Cloud

Technical College, the Office of Internal Auditing shall perform equivalent audit procedures on the college.

3. **Review and Approve Release of the Audited Financial Statements** (Action Item)

Mr. Asmussen explained the contents of the four documents that were handed out to the committee. The documents included summaries of the fiscal 2009 audit and financial audits, the annual financial report for the system, the supplement to the annual financial report and finally the required communications letter from Kern, DeWenter, Viere. He explained that the objective for the committee would be to identify any issues that should be referred to other policy committees, and decide if it had enough comfort and assurance to recommend to the full board that the financial results be released publicly.

Mr. John Asmussen, introduced the system-level auditor, Mr. Steve Wischmann, audit partner with the firm of Kern, DeWenter, Viere. Mr. Wischmann presented the reports that his firm issued for the system-level financial statements. He stated that the other reports were referenced in the system-level audit report, including the reports from the individual university and college auditors as well as the component unit auditors for the foundations. Mr. Wischmann explained that the role of the system-level auditor was to pull together the individual audits, conduct systemwide audit testing and provide assurances on a systemwide level**.**

Mr. Wischmann informed the members that the audit opinion on the system-level financial statement, as well as on the revenue fund statement, was unqualified, which was the highest level that could be issued. He added that this was the same level of audit opinion that the system had received in the past from his firm.

Mr. Wischmann reviewed the report on compliance and internal controls. He indicated that there were no findings of material weaknesses for 2009, but there were two significant deficiencies. He also noted that there were a couple of carryover comments in the communication letter from the prior year. Trustee Van Houten noted that there were three significant deficiencies at the campus level. Mr. Wischmann clarified that the two significant deficiencies he reported were at a system level. He stated that there may have been significant or material reporting items at the campus level which did not rise to that same level of significance at the system level.

Mr. Wischmann stated that GASB Statement 45, which had been implemented last year, contained an updated actuarial report for the 2009 audit that changed the level of contribution or liability that was accrued. As a result, he noted that the actual amount of the liability increase was lower this year than it was in 2008. Mr. Wischmann stated that GASB Statement 49 accounted for and reported other pollution remediation obligations. An analysis was performed and no material liabilities were accrued at June 30, 2009

Mr. Wischmann outlined some of the accomplishments and challenges. Trustee Thiss noted that there were warning signs in the performance deterioration at some of the colleges and universities. Mr. Wischmann agreed, stating that the broad indicators showed that the system had gone from a slight operating surplus to a slight operating loss systemwide.

Mr. Wischmann reviewed the significant deficiencies:

- **Systemwide Information Technology –** A process to adequately address prior year Information Technology comments that were essential to data security and business continuity in a timely manner had not been fully developed. Adequate user level security over current web application environments had not been implemented.
- **Reconciliation of Campus Local Bank Accounts –** Four campus local bank accounts were not reconciled or not timely reconciled at June 30, 2009. Failure to accurately reconcile all local bank accounts increased the risk of misstatements of financial statement amounts.

Trustee Van Houten noted that some of the same information technology comments had carried forward from prior years. Trustee Thiss added that the prior year security comments should be forwarded to the finance, facilities, and technology committee to be resolved. Mr. Wischmann noted that the comments had risen to a new level of reporting because they had not been fully addressed, but that the significance of the comments had stayed relatively constant. He added that the majority of the user level security issues had already been addressed by the information technology staff

Mr. Ken Niemi, Vice Chancellor for Information Technology Services, stated that the entire platform had undergone a change and he noted that it would not have been a good use of resources to put significant effort into building a recovery strategy for a platform that would no longer exist in six months. He further stated that during the conversion to the new platform, progress was continually made in every area, mitigating some factors, but that with the changing environment it had been difficult to resolve all the findings. Mr. Niemi stated that he had assigned this effort to his top level deputy, and a tracking process was in place to assign specific individuals with the responsibilities for resolving issues and reporting back.

Trustee McElroy asked if individual student data would be potentially exposed by this level of risk and Chancellor McCormick stated that students might be concerned that their transcripts or personal data might be exposed. Mr. Niemi stated that most of the comments were related to best practices in areas such as disaster recovery and business continuity. He added that password security was really the only issue that went toward security of data, but he further added that data was password protected. Current standards required strong passwords to be a certain length and included special characters. He stated that the new environment allowed for requirements for strong passwords, which were not possible in the old environment. He assured the committee that those requirements were the process of being implemented as part of the identity and access management project that had begun.

Ms. King noted that the finance, facilities and technology committee was scheduled to hear an update in January on the enterprise technology plan which would include an update on user level security as well.

President Pat Johns, Anoka-Ramsey Community College, stated that when the campus had staffing turnover, there had not been backup plan for reconciling the local bank accounts and keeping them up to date, and a backlog was created that took new staff some time to reconcile. He added that the challenge was to set up a system that would allow other staff to keep up with the daily work load as well as with the monthly reconciliations, even when turnover occurred.

Trustee England asked if reconciliations would be simpler if the accounts were under one banking structure as opposed to numerous local banks. Ms. King stated that it would not necessarily be simpler to have one bank account. She stated that bank reconciliations were very complicated because campuses had to interact with the state accounting system.

Trustee McElroy noted that in the past there had been a large number of bank accounts at some campuses. Ms. King stated that her office had worked with campuses after the merger to substantially reduce the number of accounts at each campus. She stated that campuses now had two or three accounts, down from eight or nine accounts at the time of the merger.

Mr. Wischmann reviewed the other system-level board comments:

- **Security Access –** Incompatible duties remained at campus and system level and remained an important long term issue to resolve. When complete resolution to incompatible duties was not achievable, documentation of mitigating controls was an important step.
- **Leave Benefit Accounting –** The leave balance reporting and accounting function continued to need improved accuracy of the estimated liability, which was currently estimated at $132 Million.

Mr. Wischmann noted that the conversion of the accounting data from the old system to the new system had been successful. In terms of data integrity, he stated that his firm was comfortable that everything flowed over into the new system. Trustee Thiss complimented the team for its hard work and success.

Mr. Wischmann reviewed the affiliated foundations financial statements included in the report as required by GASB Statement 39 as component units.

Mr. Wischmann continued by reviewing the three upcoming standards:

- GASB Statement 51 - *Accounting and Financial Reporting for Intangible Assets,*
- GASB Statement 53 - *Accounting and Financial Reporting for Derivative Instruments,*
- Statement on Auditing Standards 115 - *Communicating Internal Control Relate matters Identified in an Audit*.

Mr. Wischmann reviewed the required communications letter for the committee and indicated that there were no exceptions or problems to report.

Trustee Thiss asked if unresolved audit findings from prior years were being cleared. Mr. Wischmann stated that the comments were being addressed from an audit campus perspective and from a system financial reporting perspective. He stated that there were a few that were outstanding, but that generally they were being resolved in a timely and effective manner. He added that some resolutions took longer to implement fully, but that internal audit tracked those findings and they were reviewed every audit year to ensure that they were being addressed.

Finally, Mr. Wischmann summarized some of the key indicators from the revenue fund financial statements. He stated that the operational aspect of the revenue fund had remained fairly consistent and had grown slightly.

Mr. Asmussen introduced Mr. Tim Stoddard, Associate Vice Chancellor for Financial Reporting. Mr. Stoddard reviewed the highlights of the financial statements for the committee. He stated that the capital asset activity remained strong, but he pointed out that there were signs of weakness, as unrestricted cash and unrestricted net assets were slowing down from prior years.

Mr. Stoddard presented the statement of revenues, expenses and changes in net assets. The net operating revenue went from a positive $8.4 million to a negative $9.3 million in 2009. Though not significant against the total $1.8 billion budget, Mr. Stoddard pointed out that the loss impacted the Composite Financial Index (CFI) and the component ratios by reducing both the net operating revenue ratio and the return on net assets ratio. Trustee Thiss asked if the net operating revenue loss be greater if it had not contained the profit from the revenue fund. Mr. Stoddard agreed that it would.

Trustee Van Houten noted that a president might improve the financial net worth of the institution from a balance sheet perspective, by building a building. Mr. Stoddard agreed but cautioned that not all financial strength was equal. Trustee Van Houten suggested that it might be necessary to pull the capital appropriation out of the available net worth of a college or university for the presidential assessment. Ms. King noted that producing a positive margin and increasing resources into the primary reserve would be the best way for a president to improve the CFI of a college or university.

Mr. Stoddard explained that the Composite Financial Index (CFI) consisted of four basic financial ratios and a standardization formula that converted a ratio to a strength factor that allowed a weighting and then a summation into a single financial health value. He stated that financial reporting had been using the CFI with the colleges and universities for several years. He added that the Higher Learning Commission had begun requiring all member institutions to report the financial data necessary to compute CFI, and had begun evaluating CFI by institution.

Mr. Stoddard stated that Moody's Investor Services published the annual public college and university mediums, which rated 190 entities nationwide. He stated that consistent with Moody's underlying ratios, the System's individual and composite (CFI) values include component units as reported in this report; component units reduced CFI from 1.87 to 1.62 due primarily to the foundations' collective realized and unrealized losses on investments.

Ms. King stated that the Higher Learning Commission had begun a new review process for colleges and universities reporting a CFI value less than 1.0. Colleges and universities that reported a CFI of zero to 1.0 for two years or more may receive an inquiry from the Higher Learning Commission. She stated that if an institution reported a CFI value less than zero for any one year, it would automatically get an inquiry from the Higher Learning Commission. Chair Thiss stated that it seemed appropriate that any college or university with a CFI value less than 1.0 and a negative fund balances ought to be on a watch list. Ms. King agreed.

Ms. King stated that Lake Superior College had experienced a sharp financial decline in 2009, resulting from budget over commitments and revenue forecast errors. The college required a $350,000 cash flow assistance loan from System reserves at year end, and closed with a CFI value of a -0.53, which would trigger a special Higher Learning Commission review. The college had prepared a financial work-out plan which had been reviewed by the finance division. The division would be working with the administration at Lake Superior College and she was confident that it could improve its financial position quickly. Ms. King stated that this event had been added to the project that was underway in the finance division to target the development of financial health monitoring indicators. This project would incorporate both budget and accrual measurements concerning reserves and financial health and develop more early warning methods.

Trustee McElroy stated that the CFI discussion was helpful but he cautioned that with any single number indicator it would be important to pay attention to the components and to the impact to foundations. He was concerned about how relatively fragile the health of a single college could be, and added that this work of the audit committee and finance, facilities and technology committee was very important.

Trustee Van Houten stated that further discussion about the financial health indicators needed to take place. Ms. King stated that the finance committee had this work on its agenda for January. Trustee Thiss stated that it might be beneficial for audit committee members to have a broader discussion with the finance committee at that time. Trustee Thiss thanked Mr. Stoddard for the great information and encouraged the finance division to continue going forward and keeping this information visible.

Trustee Van Houten stated that the CFI became an even more important measure when the number of potentially high risk items grew at colleges and universities, such as the partnerships with foundations. Trustee Thiss stated that it was likely the CFI would be the strategic target to measure performance against in the future.

Mr. Wischmann presented information on the financial statement audits that his firm conducted for Hennepin Technical College, Minnesota State University, Mankato, Minnesota State University Moorhead, and Winona State University. Some of the key points shared by Mr. Wischmann were as follows:

- Unqualified Opinions issued for all audits.
- No internal control, compliance, material weakness or significant deficiencies.

Mr. Wischmann noted that Hennepin Technical College and Minnesota State University Moorhead had improved operations, and Minnesota State University, Mankato and Winona State University had declined in operations from an operating margin standpoint.

Mr. Wischmann commented that this was his firm's first year auditing Hennepin Technical College. He stated that even with new staff at the campus, the audit went very well and he was pleased with the results.

Mr. Asmussen introduced Mr. Tom Koop, an audit partner with LarsonAllen, who presented information on the financial statement audit conducted at Metropolitan State University, Minneapolis Community and Technical College, Southwest Minnesota State University, and Rochester Community and Technical College. Some of the key points shared by Mr. Koop were as follows:

- LarsonAllen first time auditing all four institutions
- Unqualified Opinions issued for all audits.

Mr. Koop informed the committee that the required communications had been appropriately communicated by Mr. Wischmann previously.

Mr. Koop stated that there was a significant deficiency at Metropolitan State University related to calculation of accrual leave, compensated absences. He stated that his firm was satisfied with management's response to how the deficiency would be rectified.

Mr. Koop stated that there was a material weakness at Rochester Community and Technical College that involved material dollars related to an accounts payable cut-off and accrual process error. The finding was easily corrected with additional training and more monitoring. Mr. Asmussen commented that he and Chair Thiss had met with President Suppalla to talk about the material weakness at Rochester Community and Technical College. He agreed with the confidence expressed by Mr. Koop that this would be dealt with promptly by the college. Mr. Koop also cited a significant deficiency at Rochester Community and Technical College regarding inadequate supervision and approval of the journal entry process.

Mr. Asmussen introduced Mr. Daryl DeKam, an audit partner with Baker, Tilly, Virchow, Krause who presented information on the financial statement audits conducted at Bemidji State University, Century College, Minnesota State Community and Technical College and St. Cloud State University. Some of the key points shared by Mr. DeKam were as follows:

- Unqualified Opinions issued for all audits.
- Three of the four colleges and universities had no internal control, compliance, material weakness or significant deficiencies.

Mr. DeKam stated that a significant deficiency was reported at Century College for inadequate controls over year-end financial reporting processes such as adjustments, journal entries, etc.

Trustee Thiss asked if there were possible systemic issues related to journal entry findings. Ms. King stated that the problems resulted primarily from turnover. Trustee Thiss stated that staffing turnover would always occur. Ms. King agreed and one of the projects that the financial reporting group undertook was to work with the campuses to document control cycles. Ensuring that procedures were in writing would create a routine process that would alleviate some of the risk associated with staffing turnover.

Trustee Dickson asked if the turnover reported at the colleges and universities would indicate that there may be a shortage of accounting programs to meet the needs. Mr. Wischmann noted that although things had changed over the years, he thought there was an ample supply of graduates for the accounting needs. Ms. King added that many of the positions available were in entry level career positions, which meant that after staff gained experience they would move on to other career options.

Trustee Van Houten commented that one of the issues that ought to be on the agenda at the system level was whether or not certain financial duties could be consolidated in larger campuses on a partnership basis. Ms. King stated that shared services was one of the six profile projects that would be reviewed in the upcoming year as a part of Students First.

Trustee Thiss congratulated Mr. Stoddard, Ms. King and the staff for their good work. Ms. King thanked her staff and the auditors for all their hard work. She added that there had been a lot of work in a tight window of time, and she was very pleased with the results.

Trustee Van Houten made the motion, Trustee Englund seconded. The Audit Committee recommends that the Board of Trustees approve the following motion:

RECOMMENDED COMMITTEE ACTION:

The Audit Committee has reviewed the fiscal year 2009 audited financial statements and discussed them with representatives of management and the external auditing firms. The committee recommends that the Board of Trustees adopt the following motion:

RECOMMENDED MOTION:

Based on the review and recommendation of the Audit Committee, the Board of Trustees approves the release of the fiscal year 2009 audited financial statements as submitted.

The meeting adjourned at 10:00 a.m.

Respectfully submitted,
Darla Senn, Recorder