

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

Agenda Item Summary Sheet

Committee: Audit Committee

Date of Meeting: January 19, 2010

Agenda Item: Review Internal Auditing Annual Report.

Proposed
Policy Change

Approvals
Required by
Policy

Other
Approvals

Monitoring

Information

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

Board Policy 1D requires an annual report from the Office of Internal Auditing.

Scheduled Presenter(s):

John Asmussen, Executive Director, Office of Internal Auditing

Outline of Key Points/Policy Issues:

- Internal Audit activities were consistent with the audit plan for fiscal year 2009.
- The status of prior audit findings has been incorporated as an integral part of the annual Internal Auditing report.

Background Information:

- The audit plan approved by the Board of Trustees in October 2008 provided the foundation for the internal auditing activities carried out in fiscal year 2009.

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

BOARD INFORMATION

REVIEW INTERNAL AUDITING ANNUAL REPORT

The annual report for fiscal year 2009 is attached.

Date Presented to the Board of Trustee: January 20, 2010



Minnesota
STATE COLLEGES
& UNIVERSITIES

Internal Auditing Annual Report Fiscal Year 2009

Office of Internal Auditing
Reference Number 2010-01-002

January 4, 2010

January 4, 2010

Members of the Board of Trustees

I am pleased to submit the annual report on the Office of Internal Auditing for fiscal year 2009 as required by Board Policy 1D.1 part 8. The report demonstrates that Internal Auditing has continued to help the Minnesota State Colleges and Universities build a strong foundation for integrity and reliable information. We have talented and dedicated professional staff members who take great pride in their work. The office complies fully with the professional practices of internal auditing. Our compliance was reaffirmed by a recent internal quality assessment.

I also wish to reiterate my commitment to managing an office that provides you with credible, professional services. Organizationally, the Office of Internal Auditing is structured to ensure its independence by reporting directly to the Audit Committee. Personally, I take great care to avoid assignments or relationships that would compromise my independence. Accordingly, I pledge to you that I remain independent and objective pursuant to the professional practices of internal auditing.

Thank you for your confidence and support in our work.

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Summary

The audit plan approved by the Board of Trustees in September 2008 provided the foundation for the internal auditing activities carried out in fiscal year 2009. Some noteworthy activities included:

- A system-wide study for the Board of Trustees on Auxiliary and Supplemental Revenues cited issues related to bookstores and health services that needed attention. The Audit Committee referred policy related issues to the Finance, Facilities & Technology Committee and the Academic & Student Affairs Committee.
- The principal external auditor cited significant deficiencies in two areas at the system-level. For information technology, improvement was needed for tracking and resolving prior audit findings and user level security over current web applications. The other deficiency cited three colleges which had not reconciled their local bank accounts timely.
- The Legislative Auditor cited some chronic audit findings that needed attention throughout the System, including controls over access to business systems, credit cards, equipment inventories, and leave accounting.
- The Legislative Auditor released a program evaluation report on Occupational Programs and initiated a new study on the Office of the Chancellor.
- During 2009, 78% of prior audit findings were resolved fully.
- Due to budget constraints, the Office of Internal Auditing eliminated its consulting services.
- An internal quality assessment identified some opportunities to improve the internal audit function.

John Asmussen, Executive Director, had lead responsibilities for this report.

I. Assurance Services

The Office of Internal Auditing spent the majority of its time working on assurance services which, depending on the scope of the audit, may focus on the quality and reliability of information, legal and policy compliance, and operational efficiency and effectiveness. The following assurance service projects were conducted during fiscal year 2009.

System-wide Report: Auxiliary and Supplemental Revenues

At the October 13, 2009, Audit Committee meeting, the Office of Internal Auditing released its report on auxiliary and supplemental revenues (Report No. 2010-09-001). The report scope included bookstore operations, student health services operations, and academic program resale activities. Internal Auditing offered a range of observations and recommendations for these three areas. The Audit Committee asked the Executive Director of Internal Auditing to ensure that college and university presidents received copies of the final report and initiated any corrective actions for any relevant audit findings. The committee also identified particular issues that warranted oversight from the Chancellor or represented potential policy issues for consideration by the Leadership Council and board policy committees.

The Audit Committee directed the following corrective actions to be undertaken with the oversight of the Chancellor.

Bookstore Operations

- The colleges and universities shall prepare accurate, full accrual financial statements for their bookstore operations. The financial statements should account for all direct and indirect costs associated with the bookstores.
- The colleges and universities shall prepare financial plans for how accumulated bookstore profits will be used.
- The Office of the Chancellor must develop standard procedures and guidelines for the preparation of income contracts, like the long-term contracts governing outsourced bookstore operations. It must ensure that these contracts undergo the appropriate review and approval processes.
- As part of the Students First initiative, the Office of the Chancellor will lead efforts to create a more efficient and effective interface between the financial aid system and bookstore operations. This interface should facilitate students applying financial aid funds toward the purchase of textbooks.

Student Health Services Operations

- Metropolitan State University must comply with the statutory obligation to offer health services to its students. The Office of General Counsel is reviewing whether the current situation complies with the statutory requirement.

- As required by statute, the health service financial activity must be reported to the Board of Trustees.
- College and university must purchase healthcare facilities medical professional liability insurance if they operate a health service clinic.

The Audit Committee referred the following issues to the Leadership Council and Finance, Facilities & Technology Committee of the Board of Trustees for further review and discussion:

- Board policies and system procedures regarding the standards for financial reporting, including charging indirect costs, for auxiliary enterprises and the acceptable level of their unrestricted net assets need consideration. The adequacy of these policies should be considered for both bookstore operations and health services.
- The optional arrangements for bookstore operation, e.g. college-operated, outsourced, collaborative solutions such as multi-campus cooperatives, need further analysis and consideration.

The Audit Committee referred the following issues to the Leadership Council and the Academic and Student Affairs Committee of the Board of Trustees for further review and discussion:

- The definition and scope of health services, including level and type of services and protocols for referring students to other health care providers, should be explored.
- Options for offering or mandating student health insurance coverage either generally or for particular subgroups, such as nursing students or athletes, needs further consideration. A pilot program in place at Minnesota State University Moorhead may offer some insights for extending mandatory insurance programs to other colleges or universities.

Audited Financial Statements

Fiscal year 2009 marked the ninth year that the Minnesota State Colleges and Universities contracted for an external audit of its financial statements. The external audit firm of Kern, DeWenter, Viere & Company provided an unqualified (clean) opinion on the system-wide financial statements. The Financial Reporting Unit of the Office of the Chancellor and the Office of Internal Auditing both worked very hard to deliver the audited financial statements. In fiscal year 2009, Internal Auditing spent 17% of its applied hours on assisting with the financial statement audits. This level of support provides two benefits: cost savings to make the external audit contracts affordable and strengthened external audit coverage by use of Internal Auditing's knowledge of the Minnesota State Colleges and Universities system and its business systems.

At the system-wide level, the external auditor also did not cite any “material weaknesses” in internal controls. The auditing literature considers a “material weakness” to be the most serious type of problem associated with an internal control structure, so the absence of “material weaknesses” is a positive indicator. Less serious, but noteworthy internal control considerations are referred to as “significant deficiencies.” The external auditor reported two “significant deficiencies” at the system-wide level:

- The System has not fully developed a process to adequately address prior year information technology comments that are essential to data security and business continuity in a timely manner. In addition, the System did not implement adequate user level security over current Web application environments.
- Three colleges had unreconciled or not timely reconciled local bank accounts as of June 30, 2009.

In addition, audited financial statements were developed for twelve of the largest institutions: the seven state universities and five two-year colleges. The financial statements for all twelve institutions received unqualified audit opinions from the CPA firms that the board appointed for the audits. Nine institutions also had no weaknesses or deficiencies noted in their internal controls. One college, Rochester Community & Technical College, was cited for a “material weakness” regarding its accounts payable cut-off and a “significant deficiency” regarding its supervision and approval process for accounting journal entries. Metropolitan State University was cited for a “significant deficiency” in its leave accrual process. Century College was cited for a “significant deficiency” in its year-end financial reporting processes, including adjustments and journal entries.

Internal Auditing will follow-up on all of the system-wide and institutional internal control problems to determine whether adequate corrective action is taken.

Office of the Legislative Auditor – Finance-Related Audits

The annual financial statement audit program ensures that the most significant internal control cycles are reviewed for universities and five of the largest colleges each year. To obtain assurances about the internal controls and fiscal compliance of the remaining colleges, the System has a contract 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 are to be audited by the OLA on a three year rotating schedule.

At the September 8, 2009, Audit Committee meeting, the Office of the Legislative Auditor released its financial audit of eight colleges (Report No. 09-30). Section A of the report cited seven findings that the auditor described as “significant internal control weaknesses and compliance concerns related to specific colleges and system weaknesses noted at a majority of the colleges we audited.” Section B of the report cited an additional 13 findings that had more isolated effects and could be “effectively resolved by college management.” The Audit Committee concentrated on the seven findings cited in Section A of the report and asked the Office of the Chancellor to recommend actions and policy referrals so that corrective actions, as necessary, would be taken by all colleges and universities in the system so that these findings would not reappear in future audits as systemic problems.

At its October 13, 2009 meeting, the Audit Committee reviewed the actions and referrals recommended by the Office of the Chancellor. The committee concurred with the recommendations, but added another referral to the Human Resources Committee (see item related to Finding #7 below).

The Office of the Chancellor distributed copies of the final report to all presidents, Chief Finance Officers, and Chief Human Resources Officer. The Chancellor also emphasized to the presidents at the November 2009 Leadership Council meeting that it was essential for them to learn from the audit findings cited at other institutions. The Vice Chancellors for Finance and Human Resources planned to review the Section A findings with campus representatives at system-wide meetings held during the year.

The Audit Committee referred three findings to the Finance, Facilities & Technology Committee for further review and discussion:

- Finding #1 cited poor controls over granting security clearances to the business applications run on the Integrated Statewide Records System (ISRS). Board Policy 5.23 governs the Security and Privacy of Information Resources.
- Finding #3 cited deficiencies in recording equipment. Board Policy 7.3 and System Procedure 7.3.6 govern the accounting for capital assets, including equipment.
- Finding #4 cited weaknesses with managing employee use of college-issued credit cards. Board Policy 7.3 and System Procedure 7.3.3 govern the use of credit cards.

The Audit Committee referred three findings to the Human Resources Committee for further review and discussion:

- Finding #2 cited widespread problems with accounting for administrator and faculty leave. Labor agreements govern the eligibility for leave accruals; no board policies or system procedures address accounting for employee leave.
- Findings #6 and #7 raised questions about early separation incentives paid to former faculty members. Board Policy 4.6 establishes limitations on the re-employment of employees who have received such payments. Recently Policy 4.11 was approved to offer a new program for early separation incentives, as authorized by the 2009 Legislature. The findings cited by the Legislative Auditor pertained to incentive programs authorized by the Minnesota State College Faculty bargaining agreement.
- Finding #7 also mentioned the role of “past practice” related to applying labor contract provisions. The Audit Committee members referred to the Human Resources Committee concerns about how “past practices” and negotiated letters of understanding affect interpretation and implementation of the contracts (*Item added by the Audit Committee at its October 13, 2009 meeting.*)

As part of its mid-year (January) and year-end (June) monitoring of prior audit findings, the Office of Internal Auditing planned to review the Section A finding areas at each institution, as well as the progress being made by the audited institutions on resolving any respective Section B findings.

Office of the Legislative Auditor - Program Evaluations

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division that conducts evaluations of topics selected annually by the Legislative Audit Commission. In fiscal year 2009, the OLA issued one evaluation report and began fieldwork on a second evaluation that affected the System.

Evaluation of Occupational Programs

On March 16, 2009, the OLA released an evaluation of the System’s occupational programs. The evaluation examined the criteria and processes the System used to add, change, and close occupational programs. It assessed the roles of individual colleges, the Office of the Chancellor, and the Board of Trustees, as well as the impact of state and federal laws. It also examined how factors, such as employment trends, affect academic programming for these programs.

The evaluation team reported that generally the two-year colleges did a good job of assessing the economic conditions and student skill sets needed in the workplace. It added, though, that the colleges did not consistently assess the availability of jobs for the types of occupations that were related to programs. Further, it found that although the colleges had a wealth of information to help students explore careers and look at job opportunities, there were gaps in the information on job prospects for students. The final report cited seven recommendations.

The Executive Committee for the Board of Trustees, in consultation with the Audit Committee, referred four recommendations to the Academic & Student Affairs Committee for further consideration:

- All college statements of mission, vision, and purpose, as well as their high-level planning documents, should clearly reflect the priorities set in state law and decisions of the Board of Trustees.
- MnSCU colleges that currently do not assess labor market data when conducting program reviews should change their review policies to require assessing how well the supply of graduates and workers matches demand for occupations related to a program.
- MnSCU should explore improvements to assessing graduates’ success at finding employment related to their chosen occupation.
- When reviewing its cap on enrollments for construction electrician programs, MnSCU’s Office of the Chancellor should take local economic conditions into greater account.

The Office of Internal Auditing was directed to follow-up on progress for resolving one of the recommendations:

- Colleges should provide better oversight of program advisory committees and take steps to improve those that are not fulfilling their potential.

The Executive Committee, in consultation with the Audit Committee, referred two recommendations to the Advancement Committee for further consideration:

- The Board of Trustees should by policy require colleges to ensure that information on career exploration and job opportunities is getting to the occupational program students who need it.
- Especially for occupations with mixed expectations for regional job opportunities, MnSCU colleges should make certain that pertinent students are informed of job prospects.

Evaluation of System Office Services and Expenditures

In March 2009, Board of Trustees Chair David Olson and Chancellor James McCormick sent a letter to the Audit Commission requesting an evaluation of the extent to which the Minnesota State Colleges and Universities system had achieved administrative efficiencies and ensured effective operations. In April 2009, the Audit Commission authorized an evaluation of the Minnesota State Colleges and Universities system office.

The evaluation is examining various system office activities and considering their interactions with services provided directly by the colleges and universities. Evaluators intend to review the purposes of system office activities, trends in spending and staffing, and evidence regarding outcomes. Evaluators also might make comparisons with system offices in selected other states. The evaluation team will use interviews and surveys to consider the opinions of people with direct knowledge of system office services, including college and university presidents, administrative staff in the system office and at campuses, members of the Board of Trustees, and representatives of faculty and students. A final evaluation report is expected to be released to the Legislative Audit Commission in February 2010.

Other Internal Auditing Assurances

The Office of Internal Auditing also provides other assurance services as requested by the board, Chancellor, or presidents. Some recurring projects, include:

- 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.

II. Consulting Services

Through the end of fiscal year 2009, the office supplemented its traditional audit skills with the services of an organizational improvement professional for consulting projects. Consulting engagements were accepted as long as no conflict was created with auditing responsibilities.

During fiscal year 2009, Internal Auditing provided the following consulting services at the request of presidents:

- Administered employee climate surveys for two colleges and one state university.
- Facilitated the design of an improved budget process for a college.
- Facilitated a project to review and improve student services processes for a college.
- Facilitated a project to review and improve business services processes for a college.
- Assisted a division of the Office of the Chancellor in assessing its services.

At the end of the fiscal year, the office eliminated its consulting services, due to budget difficulties. It has assisted, and will continue to assist, past clients with finding new providers for their consulting service needs.

II. 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 to follow-up on audit findings and tracks their 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. In fiscal year 2009, Internal Auditing spent about 22% of its applied hours on following up on prior audit findings.

As a result, the timely resolution of audit findings is taken seriously. In fiscal year 2009, 78% of college and university audit findings were resolved. As of June 30, 2009, Internal Auditing was continuing to monitor 92 unresolved audit findings at the colleges and universities. Internal Auditing classified five of the unresolved findings as critical issues that warranted immediate attention. Some of the more significant unresolved audit findings included:

- Fond du Lac Tribal & Community College had 13 unresolved audit findings. One finding was classified as critical and pertained to the need for improved purchasing controls. The new college president has put significant emphasis on resolving these findings. He hired a new chief financial officer who has made steady progress toward implementing corrective actions.

- Computer security clearances need improvement at eight institutions, including a long-standing problem that has remained unresolved at Northland Community & Technical College. In its September 2009 audit report, the Legislative Auditor cited this area as a chronic problem that needs attention system-wide.
- As discussed earlier in this report, some colleges have not been able to reconcile their local bank accounts. The bank reconciliation at Inver Hills Community College has been a problem for over a year. The college president and chief financial officer have placed renewed emphasis on reconciling the bank account.
- Six institutions have unresolved findings related to their affiliated foundations. Most commonly, these foundations have not addressed material weaknesses in their internal controls. In November 2009, the Board of Trustees enacted an amended board policy that included more rigorous oversight for ensuring that affiliated foundations address any material weaknesses cited in their audit reports.
- Fourteen colleges had unresolved findings from the Office of the Legislative Auditor's program evaluation of occupational programs. These findings cited the need to strengthen program advisory committees. It should be noted, though, that these findings were reported near the end of fiscal year 2009 and most colleges did not have sufficient time to deploy corrective actions. The January 2010 follow-up procedures should provide a better indication of progress toward resolving these findings.

In addition, some audit findings are directed at the Office of the Chancellor for resolution. Unresolved system-wide audit findings pertain primarily to information technology security and data warehouse controls. As cited earlier in this report, the principal external auditor for the System has cited a significant deficiency in internal controls due to the lack of progress in resolving these information technology findings. The Information Technology Services division has placed renewed emphasis on resolving these findings.

III. 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 were 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.

Internal Auditing received reports on 136 incidents of potential fraud or dishonest acts during fiscal year 2009. The vast majority of these incidents related to theft of public property. These matters were reported to local law enforcement officials for investigation. Internal Auditing assisted with investigations for a few remaining incidents, primarily centering on allegations of employee misconduct or misuse of property. In fiscal year 2009, Internal Auditing spent about 9% of its applied hours on fraud inquiries and investigations.

IV. Professional Advice

Internal Auditing also makes itself available to offer professional advice on topics within its expertise. During fiscal year 2009, Internal Auditing fielded 152 questions dealing with various topics. Common questions pertained 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, Staff and Leadership Development Committee, Chief Information Officers, Students First working groups, and the Affiliated Foundation Policy Task Force. In 2009, Internal Auditing spent about 6% of its applied hours on professional advice services.

V. Internal Quality Assessment

The Institute of Internal Auditor (IIA) has established a set of standards that govern the professional practice of internal auditing. IIA Standard 1300 – *Quality Assurance and Improvement Program* – requires the chief audit executive to develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The program should be designed to ensure that the internal audit activity is in conformance with IIA Standards and the Code of Ethics, and should assist the internal audit activity in adding value and improving the organization’s operations. According to the IIA Standards, a comprehensive quality assurance and improvement program must include internal and external assessments.

The Office of Internal Auditing developed an internal guideline to provide guidance on how it will comply with the IIA Standard 1300. The guideline identifies how periodic assessments will be conducted and ensures its quality assessment program remains up-to date. The guideline suggests that internal periodic assessments be conducted every two years with arrangements to be made for an independent reviewer or review team to conduct an external assessment every fourth year.

In early calendar year 2007, the Office of Internal Auditing underwent its first external quality assessment, using the self-assessment with independent validation model. Independent validators obtained through the Twin Cities Chapter of the Institute of Internal Auditors affirmed the reliability of the self-assessment and the results were reported to the the audit committee and senior management in a final report, dated March 7, 2007.

During calendar year 2009, Internal Auditing completed an internal self-assessment and released the results in a report dated January 4, 2010. As part of this assessment, members of the Leadership Council were asked to complete a short survey regarding the value of internal auditing services. Also, internal auditing staff reviewed the quality of the working papers supporting internal audit projects. The assessment concluded that the activity of the Office of Internal Auditing generally conformed to the IIA Standards. In addition, it found opportunities for further improvement in three areas:

- The Office of Internal Auditing’s Charter (Board Policy 1.D.1) was not up-to-date and did not reflect recent changes to professional standards.

- Periodic assessments of information technology risks should be communicated to the Audit Committee as part of the audit planning process.
- Internal Auditing should evaluate the effectiveness and contribute to the improvement of risk management process.

To address the first observation, Internal Auditing plans to review Board Policy 1.D.1 before the end of the fiscal year and suggest any necessary changes to the Audit Committee. The other two observations should be considered as part of the fiscal year 2011 internal auditing plan.

VI. Analysis of Staff Hours

For 2009, Internal Auditing had a staff complement of ten professional auditors and consultants and one administrative assistant. The majority of its professional staff, regional audit coordinators, is located on college or university campuses throughout the system. The audit coordinators serve multiple colleges or universities located in their regions.

The office had maintained the same size and structure since shortly after it was created in 1997. Due to budget challenges, though, the office reduced its staff complement by 1.5 positions at the end of fiscal year 2009. Staffing capacity to provide core assurance services were maintained, but consulting services were eliminated. Also, the budget reductions resulted in sharing an IT analyst position with the Information Technology Services division, thereby diminishing the office’s capacity for data analysis.

Each year the Board of Trustees approves an audit plan for the ensuing fiscal year. In September 2008, the board approved the plan for fiscal year 2009. Table 1 shows how actual use of staff time compared to the audit plan for technical services.

**Table 1: Percentage of Internal Auditing Technical Service Staff Hours
July 1, 2008 to June 30, 2009**

Activity	Percentage of Staff Hours	
	Audit Plan	Actual
Technical Services		
Assurance Services	64%	68%
Inquiry/Investigations Support	8%	9%
Consulting Services	12%	13%
Professional Advice	11%	6%
Planning & Development	5%	3%
Percentage of Total Applied Hours	100%	100%

The Future

In July 2009, the Board of Trustees approved the audit plan for fiscal year 2010. That plan and other information on Internal Auditing projects are available at the Office website, www.internalauditing.mnscu.edu.