



**AUDIT COMMITTEE  
JANUARY 19, 2010  
1:30 P.M.**

**BOARD ROOM  
WELLS FARGO PLACE  
30 7TH STREET EAST  
SAINT PAUL, MN**

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Please note: Committee/Board meeting times are tentative. Committee/Board meetings may begin up to 45 minutes earlier than the times listed below if the previous committee meeting concludes its business before the end of its allotted time slot.

**Committee Chair Thiss calls the meeting to order.**

- (1) Minutes of November 18, 2009** (pages 1-9)
- (2) Establish the Search Process for the Executive Director of Internal Auditing Position** (pages 10-11)
- (3) Review Internal Auditing Annual Report** (pages 12-25)

Members

Scott Thiss, Chair  
James Van Houten, Vice Chair  
Jacob Englund  
Dan McElroy  
David Paskach

**Bolded** items indicate action required.

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

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***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, 4<sup>th</sup> Floor, Board Room, 30 East 7<sup>th</sup> 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 Related 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

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

**Agenda Item Summary Sheet**

**Committee:** Audit Committee

**Date of Meeting:** January 20, 2010

**Agenda Item:** Establish the Search Process for the Executive Director of Internal Auditing Position

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 1A.2, Part 5, Subpart E stipulates that the audit committee oversees the internal audit activity. Board Policy 1D.1, Part 6 stipulates that the Executive Director of Internal Auditor reports directly to the Board of Trustees through the Chair of the Audit Committee.

**Scheduled Presenter(s):**

Lori Lamb, Vice Chancellor, Human Resources

**Outline of Key Points/Policy Issues:**

- Delegation of authority to the Chancellor to support the board with the search to hire a new Executive Director of Internal Auditing.

**Background Information:**

- John Asmussen, the Executive Director of Internal Auditing, has resigned from his position, effective July 20, 2010.
- The Executive Director of Internal Auditing reports directly to the Board of Trustees.

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

**BOARD ACTION**

**ESTABLISH THE SEARCH PROCESS FOR  
THE EXECUTIVE DIRECTOR OF INTERNAL AUDITING POSITION**

**BACKGROUND**

The Board of Trustees approved the hiring of John Asmussen as its first Executive Director of Internal Auditing in November 1997. Mr. Asmussen has resigned from his position, effective July 20, 2010. The Board of Trustees wishes to initiate a search process in order to hire a new Executive Director of Internal Auditing. The board wishes to delegate authority to the Chancellor to assist with conducting the search.

**RECOMMENDED COMMITTEE ACTION:**

*The committee recommends that the Board of Trustees adopt the following motion:*

**RECOMMENDED MOTION:**

*The Board of Trustees delegates authority to the Chancellor to initiate a search process to hire a new Executive Director of Internal Auditing. The search process should culminate in identifying up to three candidates to fill this position. The Board of Trustees reserves its authority to make the final selection for filling the position.*

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

**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
<b>Technical Services</b>		
Assurance Services	64%	68%
Inquiry/Investigations Support	8%	9%
Consulting Services	12%	13%
Professional Advice	11%	6%
<b>Planning &amp; Development</b>	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](http://www.internalauditing.mnscu.edu).