

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

**Agenda Item Summary Sheet**

**Committee:** Audit Committee

**Date of Meeting:** September 14, 2010

**Agenda Item:** Approval of FY 2011 Internal Auditing Annual Audit Plan

- 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.1, part 6, requires the Executive Director of Internal Auditing to present an Audit Plan for each fiscal year.

**Presenter at the Audit Committee meeting:**

Beth Buse, Executive Director, Office of Internal Auditing

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

- The plan presents an overview of how the Office of Internal Auditing plans to use its resources for fiscal year 2011.
- The plan also describes a timeline and key deliverables for the Audit Committee's priority goal, evaluating the system's audit approach.

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

<b>BOARD ACTION</b>
APPROVAL OF FY 2011 INTERNAL AUDITING ANNUAL AUDIT PLAN

**BACKGROUND**

According to Board Policy 1.D., Part 6, the Office Internal Auditing must submit an annual Audit Plan to the audit committee. The fiscal year 2011 Audit Plan is attached.

**COMMITTEE ACTION:**

On September 14, 2010, the audit committee reviewed the draft Fiscal Year 2011 Internal Auditing Plan and approved the following motion:

**RECOMMENDED MOTION:**

The Board of Trustees approves the Office of Internal Auditing annual Audit Plan for fiscal year 2011.

*Date Presented to the Board of Trustees: September 14, 2010*

**Minnesota State Colleges and Universities**  
**Office of Internal Auditing**  
**Fiscal Year 2011 Annual Audit Plan**

This document outlines the Office of Internal Auditing annual Audit Plan. It includes all internal and external audit activities planned for the ensuing fiscal year, as required by Board Policy 1D.1, Part 6. This document contains three sections:

- **Section I** - provides an overview of how the Office of Internal Auditing plans to use its resources.
- **Section II** - defines a timeline and key deliverables for the Audit Committee's priority goal, evaluating the system's audit approach.
- **Section III** - describes other monitoring activities.

**Section I: Use of Internal Auditing Resources**

For fiscal year 2011, the Office of Internal Auditing has identified the following priorities, with the estimated percentage of Internal Auditing staff resources noted for each area:

**Coordinate Financial Statement & Federal Financial Assistance Audits (20%):** Fiscal year 2010 marks the tenth year that the Minnesota State Colleges and Universities contracted for an external audit of its financial statements. The external audit firm of LarsonAllen is under contract to provide audit services for the system-wide financial statements, Revenue Fund financial statements, and federal financial assistance. This will be the first year that LarsonAllen provides these services. In addition, audited financial statements are generated for 13 of the largest institutions in the system.

The Office of Internal Auditing is obligated by current contracts to provide support to external auditors for financial audits.

**Monitor Progress toward Implementing Audit Findings (20%):** It is important that the Board of Trustees, Chancellor, and presidents have confidence that any problems revealed by audits or evaluations receive appropriate attention. Internal Auditing monitors progress toward implementing all audit findings. Internal Auditing provides status reports on prior audit findings to the presidents and vice chancellors in January and June of each year. The Chancellor is informed about any unresolved audit findings as part of the annual presidential and cabinet performance evaluation process. The Chancellor has made it a work plan priority to ensure that outstanding audit findings are resolved this year.

In the fall of 2009, the Chancellor and members of the Audit Committee expressed concern about the recurring nature of several audit findings and their expectation that all colleges and universities would assess their operations and ensure that similar problems were not evident. The Office of Internal Auditing is tracking the status of internal controls over the following processes at all colleges and universities:

- security controls over access to computerized business systems,
- faculty and administrator leave accounting,
- equipment inventories,
- college-issued credit cards,
- bank reconciliations, and
- approval of special course fees.

Finally, in its annual report to the Board of Trustees in January, Internal Auditing will report on the progress toward resolving prior findings.

**Assist with Fraud Inquiries and Investigations (20%):** Since the board approved Policy 1C.2 in June 2002, Internal Auditing has worked with the Chancellor's Cabinet and presidential executive teams to implement its provisions. On July 1, 2008, a new Code of Conduct for employees was enacted as Procedure 1C.0.1. Internal Auditing will continue to work with the Office of General Council on implementation of this procedure. In these times of great uncertainty and change, it is reasonable to expect an increase in the number of issues that will require inquiries and possibly investigations. Accordingly, the amount of time reserved for this activity has again been increased in this plan.

**Conduct Studies that have Significant System-wide Interest (25%):** In past years, Internal Auditing has scheduled a study of a topic of major system-wide interest. Recent studies have focused on undergraduate student credit transfer, auxiliary and supplemental revenues, affiliated foundations and implementation of student success systems.

A majority of resources for this priority will be set aside to focus on the Audit Committee's goal of completing an evaluation of the system's audit approach. A description of key deliverables and a timeline for the evaluation are described in Section II.

Limited resources will be available to conduct other system-wide studies in fiscal year 2011.

**Perform Ad-hoc Services to Address Immediate Concerns or Interests (13%):** Planning cannot anticipate all future needs or interests. Accordingly, some audit resources must be reserved to direct Internal Auditing services to important issues that arise throughout the year. These services may take the form of participation on task forces, providing professional advice, or scheduling special projects when warranted.

- **Management Priorities** – The Office of Internal Auditing serves the Board of Trustees, Chancellor, and presidents. Accordingly, this plan allows for the Chancellor and presidents to request Internal Auditing services that address particular risks that they wish to be examined. To the extent that Internal Auditing has available resources after serving the interests of the Board of Trustees, it will undertake projects requested by the Chancellor and presidents.
- **Emergent Issues** – Internal auditing is constantly scanning the environment to be alert for risks that may require audit resources. Unforeseen programmatic or compliance matters may emerge and merit attention. As a result, some residual time must be reserved

in this audit plan to allow for the use of Internal Auditing resources when important issues arise.

**Test Board and Chancellor Expenses for Legal Compliance (2%):** Internal Auditing conducts periodic reviews of expenses incurred by the Board of Trustees, and submits an annual audit report to the Executive Committee of the board through the Board Treasurer. It also examines the Chancellor’s expense reimbursements and special expenses on an ongoing basis to ensure compliance with fiscal policies.

**Section II: Audit Approach Evaluation**

A number of factors are resulting in fiscal year 2011 being a year of transition for the Office of Internal Auditing. A significant change occurred in the leadership of the office. With the retirement of John Asmussen in July, Beth Buse began her role as Executive Director of Internal Auditing on July 21, 2010. Given this leadership change, it is an appropriate time to reflect on the work of the Office of Internal Auditing to determine if any changes are needed to position the office for the future. In addition, the Audit Committee has made it a priority to evaluate the audit approach within the system as a whole. Finally, with uncertain economic times and the substantial budget deficit the State of Minnesota is facing, it is important to consider the audit approach needed to provide the Board of Trustees and leadership appropriate independent assurance on operations within the system.

In August 2010, the Audit Committee approved the following committee goal for the year:

*Complete a thorough evaluation of the audit approach for the Minnesota State Colleges and Universities. The evaluation should:*

- *Be based on a risk assessment and include a plan for obtaining internal control and compliance audit coverage given that the contractual relationship with the Office of the Legislative Auditor has ended.*
- *Consider the value and role of obtaining annual financial statement audits for individual colleges and universities.*
- *Determine a strategy for an information technology audit approach.*

The objective of the evaluation needs to consider the system’s responsibility, the public’s expectation, and current budget constraints. Figure 1 outlines a timeline for key deliverables in completing an audit approach evaluation. In addition, a description of each deliverable is provided below.

**Figure 1: Audit Approach Evaluation Timeline**



**Risk Assessment Approach** (November 2010)

Professional internal auditing standards require that the audit plan be based on a risk assessment to ensure that audit resources are focused on the most critical projects. Given the size and complexity of the system and limited audit resources, it is critical to allocate internal auditing resources on areas with high risk exposures. A number of considerations should be taken into account when conducting a risk assessment, including: auditable units definition, audit history, alignment with system strategic plan, known or perceived control weaknesses, compliance with laws, regulations, contracts, policies, and procedures, leadership turnover, effectiveness and efficiency of operations, external factors, and management’s risk appetite

<p style="text-align: center;"><b>Methodology to Determine Risk Assessment Approach</b></p> <ul style="list-style-type: none"><li>• Conduct research on risk assessment best practices and methodologies, including timelines and resource estimates.</li><li>• Meet with senior leadership to discuss risk management and risk appetite.</li><li>• Review risk assessment practices and past assessments completed in the system.</li><li>• Determine available audit resources.</li></ul>
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**Internal Control and Financial Statement Interim Approach** (January 2011)

The Audit Committee revisits the external audit plan each year, before authorizing audit contracts to be renewed. Contracts for the five largest state universities and Minnesota State Community and Technical College expire after the fiscal year 2010 audit. A decision will need to be made in January 2011 whether to renew these contracts for a standard three year contract or determine an alternative approach until the analysis of the system’s audit approach is complete. Internal auditing will interview key decision makers, including presidents and chief financial officers, at each of these institutions prior to the January 2011 decision.

By mutual agreement, the contractual arrangement with the Office of the Legislative Auditor to conduct internal control and compliance audits of colleges that do not have financial statement audits is ending. On September 14, 2010, the Audit Committee will review the results on the last round of college audits under the contractual arrangement. The Audit Committee will need to work with the Executive Director of Internal Auditing to determine whether to conduct any internal control and compliance reviews in fiscal year 2011.

**Risk Assessment Results** (May 2011)

Based on the risk assessment approach determined in November, the Office of Internal Auditing will deliver the results of a system-wide risk assessment that will support the audit approach recommendations.

**Audit Approach Recommendations (June 2011)**

The Audit Committee targeted three specific areas to evaluate when reviewing the audit approach:

- **Internal Control and Compliance Audit Approach** - Internal controls are expected to provide reasonable, but not absolute assurances about their effectiveness. This debate, thus, centers on how much and what kind of emphasis on internal controls is necessary and prudent. In answering these questions, a significant factor that needs to be taken into consideration is obtaining assurance against the cost of gaining that assurance.

**Methodology to Determine an Internal Control and Compliance Audit Approach**

- Determine audit scope:
  - Individual college and university audits
  - System-wide audits of specific internal control cycles.
- Determine desired assurances from Trustees and system leadership.
- Review college and university assessments of risk.
- Analyze past audit findings.
- Determine audit resources.

Leadership in the public arena has a higher standard of care and due diligence since public funds are at risk. The question for the Audit Committee concerns whether the current internal control system sufficiently balances the risk, the investment required and the obligation as a public steward.

- **External Audit Approach** – A key component of the system’s financial management program includes hiring CPA firms to conduct annual audits of the financial statements for the system and 13 of its largest colleges and universities. Those audits have produced evidence that the financial statements are reliable and have highlighted any deficiencies in internal controls that warranted the attention of the Board of Trustees, Chancellor, or presidents. At the Audit Committee’s June 2010 meeting Mr. James Nobles, the Legislative Auditor, challenged the Audit Committee to consider the value and role of obtaining annual financial statement audits for individual colleges and universities. He based his challenge, in part, on questioning whether there were external audiences for whom these audits were prepared.

**Methodology for Evaluating the External Audit Approach**

- Survey key decision-makers at colleges and universities and the Office of the Chancellor on the current approach and the potential impacts of a change in the external audit approach.
- Make inquiries to external monitoring agencies, such as bond rating agencies and accreditation agencies, about the role and value of audited financial statements for both the system and its individual colleges and universities.
- Analyze cost of preparing and obtaining external audit resources for college and university financial statement audits.
- Analyze the relationship and impact between the 13 individual college and university audits, the system-wide audit and the state’s consolidated financial statements.
- Research best practices in the higher education community on obtaining audited financial statement audits.

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

**Methodology to Determine a Strategy for an IT Audit Approach**

- Complete an IT audit risk assessment which will include:
  - Definition of an IT audit universe.
  - Identification of know IT threats and vulnerabilities.
  - Survey and discussions with system key information technology leaders.
- Review IT audit requirements referenced in auditing standards.
- Review best practices in IT audit methodologies.
- Determine IT audit resources.

➤ **Other Considerations** – An important factor that should to be taken into account when determining an audit approach for the future is determining what services the Office of Internal Auditing provides that are most valued by Trustees and system leadership.

**Section III: Monitoring Other External Audits, Evaluations, and Reviews**

In addition to the audit activities discussed in the previous sections, a variety of other external audits, evaluations, and reviews occur. Accordingly, Internal Auditing will monitor the results from the following activities and recommend corrective actions to the Chancellor, presidents, or the Board of Trustees, as warranted.

**Audits of Grants and Special Financing Arrangements** – Some special grant or other funding sources have certain audit requirements that must be satisfied. State law requires that the Legislative Auditor review any audit contracts prior to their execution. The most common source of these requirements is the Minnesota Job Skills Partnership (MJSP) grants. Because of the volume and routine nature of the MJSP grants, the Legislative Auditor has agreed in the past to permit Internal Auditing to review those audit contracts on its behalf. Other unique audit requirements, such as an audit arranged by Itasca Community College for a housing project financed with bonds sold by a County Housing and Redevelopment Agency, must be submitted directly to the Legislative Auditor for review.

**Reviews Conducted by State and Federal Student Financial Aid Authorities** – The Minnesota Office of Higher Education conducts periodic reviews of the state grant and loan programs being administered by the colleges and universities. Most colleges and universities are examined once every three years as part of that process. Internal Auditing reviews these reports to determine whether findings indicate more systemic issues needing attention. Also, the U.S. Department of Education conducts ad-hoc program reviews and investigations of federal



financial aid programs. The department schedules its reviews based on a risk assessment process and does not schedule routine reviews of each college and university.

**Audits of Affiliated and Associated Organizations** – Board Policy 8.3 requires periodic financial audits of affiliated foundations. Also, other related organizations, such as the statewide student associations submit annual audited financial statements to the Office of the Chancellor. Internal Auditing will review these audit reports and determine the need to recommend any action by the Chancellor, presidents, or Board of Trustees.