

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

**Agenda Item Summary Sheet**

**Committee:** Audit Committee

**Date of Meeting:** January 18, 2011

**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):**

Beth Buse, Executive Director, Office of Internal Auditing

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

- Internal Audit activities were consistent with the audit plan for fiscal year 2010.

**Background Information:**

- The audit plan approved by the Board of Trustees in July 2009 provided the foundation for the internal auditing activities carried out in fiscal year 2010.

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

**BOARD INFORMATION**

REVIEW INTERNAL AUDITING ANNUAL REPORT

The annual report for fiscal year 2010 is attached.

*Date Presented to the Board of Trustee: January 18, 2011*



Minnesota  
STATE COLLEGES  
& UNIVERSITIES

# Internal Auditing Annual Report Fiscal Year 2010

Office of Internal Auditing  
Reference Number 2011-01-001

January 7, 2011

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Members of the Board of Trustees

I am pleased to submit the annual report on the Office of Internal Auditing for fiscal year 2010 as required by Board Policy 1D.1 part 8. While I did not begin my appointment as Executive Director until July 21, 2010, I did play an integral part in completing the activities of fiscal year 2010 in my role as Deputy Director. 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.

I 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 continue to remain independent and objective pursuant to the professional practices of internal auditing in my new role as Executive Director of the office.

Thank you for your confidence and support in our work.

Beth Buse, CPA, CIA, CISA  
Executive Director

## CONTENTS

2	Assurance Services
6	Fraud Inquiry & Investigation Support
7	Professional Advice
7	Analysis of Staff Hours

## Summary

The audit plan approved by the Board of Trustees in July 2009 provided the foundation for the internal auditing activities carried out in fiscal year 2010. Some noteworthy activities included:

- The Legislative Auditor released two program evaluation reports that impacted the system; *MnSCU System Office* and *Workforce Programs*.
- Systemwide report on Undergraduate Student Credit Transfer. The report found that credits were transferring successfully at a very high proportion for students in the system but some fine tuning should be done.
- The Legislative Auditor issued financial internal control and compliance reports for St. Cloud State University and five colleges. The auditor highlighted some areas with systemic issues. In addition, the auditor questioned to what extent colleges and universities should conduct risk assessments to examine the effectiveness of their internal controls.
- LarsonAllen, the principal auditor for the system, and two other audit firms gave unqualified (clean) financial statement audit opinions for the system and 13 colleges and universities. Notably, no material weaknesses or significant deficiencies were reported.

*Beth Buse, 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 2010.

### **Systemwide Report: Undergraduate Student Transfer**

In a February 17, 2010 letter to trustees, former Board Chair David Olson assigned the responsibility for studying student credit transfer to the audit committee to address findings identified in the Office of the Legislative Auditor’s program evaluation report, *MnSCU System Office*. The Office of Internal Auditing conducted a quantitative analysis of fiscal year 2009 student records to identify the extent that credits may not have transferred between MnSCU colleges and universities and the reasons for any unsuccessful credit transfer. Part of the testing focused on a stratified random sample of students entering a MnSCU college or university after having earned credits previously at another MnSCU college or university. A second test analyzed the transfer experience of students who earned a baccalaureate degree in either Psychology or Accounting in 2009.

Overall, the results of the study showed that student credit transfer was a complex process and it could be fine tuned, but credit transfer within the Minnesota State Colleges and Universities was not broken, and that credits were transferring successfully at a very high proportion for students in the system.

In addition to the study completed by Internal Auditing, the Minnesota State College Student Association (MSCSA) and Minnesota State University Student Association (MSUSA) joined together to research student transfer concerns. MSCSA and MSUSA asked Chancellor McCormick for assistance to conduct a survey of students about their experience with transferring credits.

Internal Auditing and the student associations jointly presented the results of their respective studies to the Audit Committee at the May 19, 2010 meeting.

### **Audited Financial Statements**

Fiscal year 2010 marked 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 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 2010, Internal Auditing spent 23 percent 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” or “significant deficiencies.” 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.”

In addition, audited financial statements were developed for 13 of the largest institutions: the seven state universities and six two-year colleges. The financial statements for all 13 institutions received unqualified audit opinions from the CPA firms that the board appointed for the audits. Notably, all 13 institutions had no “material weaknesses” or “significant deficiencies.” in internal controls. This is a significant accomplishment and the first time this has occurred. Normandale Community College should be commended for this accomplishment since it was a first time audit for the college.

### **Financial Internal Control and Compliance Audits**

The annual financial statement audit program ensures that the most significant internal control cycles are reviewed for universities and six of the largest colleges each year. To obtain assurances about the financial internal controls and compliance of the remaining colleges, the System has had a contract with the Office of the Legislative Auditor. The Legislative Auditor audit coverage has complemented the institutional financial statement audits conducted by CPA firms. Basically, the colleges not subject to an annual financial statement audit were to be audited by the Legislative Auditor on a three year rotating schedule.

By mutual agreement, the contractual arrangement with the Legislative Auditor ended after the fiscal year 2010 audits. The last contract provided for a transition year in which the Legislative Auditor contributed approximately 50 percent fewer resources as compared to prior years. Due to the limitation in Legislative Auditor resources, the Office of Internal Auditing helped conduct audits of five colleges and conducted an internal control and compliance audit of St. Cloud Technical and Community College in fiscal year 2010. Internal Auditing spent 14 percent of its applied hours on this effort.

In addition, the Legislative Auditor conducted an audit of St. Cloud State University on its own authority; it was not part of the services contracted for from the Office of the Chancellor. The Legislative Auditor had not audited a state university for about ten years and determined that it needed to have some financial coverage of at least one university.

- **Office of the Legislative Auditor – St. Cloud State University**

At the June 15, 2010, Audit Committee meeting the Office of the Legislative Auditor released its financial audit of St. Cloud State University (Report No. 10-20). Mr. James Nobles, Legislative Auditor, stated that the internal controls at the university were adequate, and that generally the university had complied with finance related legal requirements and Board policies. However, the report contained 17 findings. Key issues were highlighted, including the responsibilities for assessing the adequacy of internal controls throughout the System.

The Audit Committee was challenged to consider the following questions:

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

- **Office of the Legislative Auditor - Five Colleges**

At the September 14, 2010, Audit Committee meeting, the Office of the Legislative Auditor released its financial audit of five colleges (Report No. 10-29). The report stated that the colleges generally had adequate internal controls over their major financial activities. Section A of the report cited six findings that the auditor described as “significant and systemic findings.” Section B of the report cited an additional six findings that had more isolated effects.

At the September Audit Committee meeting, Mr. Nobles specifically reviewed finding one in the report with the committee; the colleges did not adequately assess their business risks or monitor the effectiveness of their internal controls. He stated that it would not be possible to achieve good internal controls and good financial management with audits alone because the audit function was limited to a snapshot of time. The role of management and the Board was to ensure that on a daily basis people were thinking with a mindset of risk assessment and internal control. He stated that the Minnesota State Colleges and Universities had done a lot, but that they could do more.

### **Office of the Legislative Auditor - Program Evaluations**

The Office of the Legislative Auditor also has a Program Evaluation Division that conducts evaluations of topics selected annually by the Legislative Audit Commission. In fiscal year 2010, the Legislative Auditor issued two evaluation reports that affected the System.

- **Evaluation of MnSCU System Office**

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 examined the following questions:

- How has the system office’s spending and staffing changed over time, and what accounts for those changes?
- To what extent does the system office deliver services efficiently and effectively, and to what extent are those services critical to MnSCU’s core mission?
- Are there good working relationships between the system office and trustees, campus officials, and legislators?

The Legislative Auditor publicly released the evaluation report on the *MnSCU System Office* on February 9, 2010. The Legislative Auditor acknowledged that the system had made considerable

progress as a system since his last evaluation in 2000. The auditor found that a system as large and complex as ours requires a sizeable system office to administer its functions. The auditor made several suggestions and 12 specific recommendations. Most troubling to the former board chair was the concerns over student credit transfer.

The Board of Trustees, as well as the Chancellor, took all recommendations very seriously and required each committee of the board to track progress on specific recommendations. In November 2010, the Board Chair and the Chancellor sent a status letter to the Chair of the Legislative Audit Commission reporting on the status of each recommendation. The letter stated that all recommendations were implemented or would be substantially completed by June 2011.

- **Evaluation of Workforce Programs**

The Legislative Auditor released an evaluation report on Workforce Programs in February 2010. Most of the report did not specifically deal with the Minnesota State College and University System. However, the evaluation did have one specific recommendation to the system:

*The Minnesota State Colleges and Universities (MnSCU) system should identify academic programs that help laid-off workers and assist its colleges to determine whether to offer more such programs.*

The Chancellor did provide a written response that was incorporated into the evaluation report.

### **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 2010, increased emphasis was placed on follow-up on outstanding audit findings. In particular, the office followed up at all colleges and universities on specific areas noted by the Legislative Auditor in fiscal year 2009 as systemic internal control issues. Internal Auditing spent about 28% of its applied hours on following up activities.

### **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:

- Facilitating transition reviews of colleges and universities when there is a change of presidents.
- Testing the compliance of expenses incurred by the Chancellor and Board of Trustees.

- Compiling the results of the Chancellor’s annual performance evaluation for the Board of Trustees.

### **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 146 incidents of potential fraud or dishonest acts during fiscal year 2010. 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 2010, Internal Auditing spent about 11% 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 2010, Internal Auditing fielded 129 questions dealing with various topics. Common questions pertained to compliance with board policies and best practices.

Internal Auditing representatives also sit on various system task forces and committees, including: Security Steering Committee, Finance User Group, Chief Information Officers, and Students First working groups. In 2010, Internal Auditing spent about 8% of its applied hours on professional advice services.

### **VI. Analysis of Staff Hours**

For 2010, Internal Auditing had a staff complement of 8.5 professional auditors and one administrative assistant. The majority of its professional staff, regional audit coordinators, are located on college or university campuses throughout the system. The audit coordinators serve multiple colleges or universities located in their regions.

Due to budget challenges, the office reduced its staff complement by 1.5 positions in fiscal year 2010. 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.

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

**Table 1: Percentage of Internal Auditing Technical Service Staff<sup>1</sup> Hours  
Fiscal Years 2009 and 2010**

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

## The Future

In September 2010, the Board of Trustees approved the audit plan for fiscal year 2011. That plan and other information on Internal Auditing are available at the Office website, [www.internalauditing.mnscu.edu](http://www.internalauditing.mnscu.edu).

<sup>1</sup> Excludes executive and deputy director hours.