

**MINNESOTA STATE COLLEGES AND UNIVERSITIES  
BOARD OF TRUSTEES  
AUDIT COMMITTEE  
MEETING MINUTES  
May 17, 2011**

**Audit Committee Members Present:** Trustees James Van Houten, Chair; Christopher Frederick, Philip Krinkie, Dan McElroy, Alfredo Oliveira, and Michael Vekich.

**Audit Committee Members Absent:** Trustee Thomas Renier.

**Other Board Members Present:** Trustees Duane Benson, Cheryl Dickson, David Paskach, Louise Sundin and Scott Thiss.

**Others Present:** Chancellor McCormick, Beth Buse, Laura King, Gail Olson, and President Pat Johns.

The Minnesota State Colleges and Universities Audit Committee held its meeting on May 17, 2011, at Wells Fargo Place, 4<sup>th</sup> Floor Board Room, 30 East 7<sup>th</sup> Street in St. Paul. Chair Van Houten called the meeting to order at 12:36 p.m. and reviewed the agenda.

Trustee Van Houten noted that at the Audit Committee had invited Presidents Anderson and Collins to return at the May meeting, but it was later decided that invitation should be pushed back to the June meeting after they had completed their work on resolving outstanding audit findings.

**Approval of the Audit Committee Meeting Minutes**

*Chair Van Houten called for a motion to approve the March 16, 2011 audit committee meeting minutes. There was no dissent and the motion carried.*

1. Review Results of Annual Student Financial Aid Audit (Information Item)

Mr. Eric Wion, Deputy Director of Internal Auditing, introduced Mr. Christopher Halling, System Director for Financial Aid, Mr. Craig Popenhagen, Principal Auditor with the firm of LarsonAllen, and Ms. Brenda Scherer, Lead Auditor on the financial aid work that was done for the system.

Mr. Wion provided background on the Minnesota State Colleges and Universities Schedule of Expenditures of Federal Awards for the Year Ended June 30, 2010. He stated that the State of Minnesota uses a federal formula to determine major programs. The federal student financial aid program and the American Recovery and Reinvestment Act of 2009 (ARRA) were determined to be major programs for the system in 2010.

Mr. Wion stated that student financial aid and student loans had consistently grown each year, but there had been significant growth in 2009 and 2010. Other federal grants had remained fairly consistent; however in 2010 they increased significantly due to the ARRA monies. He stated that there were no findings in that area.

Mr. Wion stated that the PELL grant program increased 67% from 2009. The increase could be contributed to several different factors including the increase in student enrollment, changes in the eligibility requirements that resulted in more students being eligible for financial aid, and also the maximum PELL grant increased in 2010. He stated that the Federal Family Education Loans (FFEL) decreased in 2010, but that direct loans increased substantially.

Mr. Christopher Halling explained that the FFEL program was being phased out by the federal government and would be replaced by the direct loan program. He stated that the decrease did not mean that the colleges and universities were approving fewer loans, but rather a shift to the direct loans program. He noted that the benefit to the system was that with the direct loan program was that the opportunity to work directly with the Department of Education rather than with 2000 different banking entities. He further noted that would likely be opportunities for simplification and exploration of shared cooperative services which could generate efficiencies and cost savings.

Mr. Craig Popenhagen reviewed the audit opinion and stated that extensive sample sizes were pulled from across the system for the Single Audit. He stated that the four findings in the report were not systemic in nature. He stated that LarsonAllen was issuing a clean opinion on compliance. Mr. Popenhagen stated that the audit results were very favorable overall. He further stated that any findings that had been reported on last year's audit had been resolved.

Ms. Buse reminded members that this was the first year with the firm of LarsonAllen as the principal auditor. There were also changes in auditing standards that required larger sample sizes. Finally, she reminded members that the conclusions of the report would be wrapped into the State of Minnesota's Single Audit report which would likely be issued by the end of the month.

Vice Chancellor Laura King noted that there was about a billion dollars of federal funds that flowed through the financial statements annually. She stated that it was a testimony to the work of the financial aid directors, the campus financial aid staff, the business officers and the academic affairs staff that there were only four modest findings in a program area that was the subject of high pressure continuous improvement efforts over the last five years. She extended her thanks to the campus staff for these results.

Trustee Van Houten stated that the findings would not require systemwide training and could be corrected individually. He stated that the Audit Committee could receive the report with pleasure knowing that the complex work was handled so well.

## 2. Audit Planning Related to Systemwide Risk Assessment (Information Item)

Trustee Van Houten stated that the audit plan recommendation would change the assignment of audit work, and he urged members to engage in an in depth discussion of the direction of the audit work that would give trustees comfort with their fiduciary responsibilities. He noted that members would also need to consider options for making changes if the new audit approach did not work well.

Ms. Buse stated that part of the Audit Committee's goal was to evaluate the audit

approach based on a risk assessment. She stated that the risk assessment was based on three separate components; enterprise risks, financial risks, and information technology risks. System leaders were consulted extensively to build out the enterprise strategic risk assessment, and Ms. Buse noted that three themes emerged from the conversations.

The first concern for system leaders was how to manage complex colleges or universities given less resources and increased enrollment. Another concern was the loss of knowledge due to turnover of key staff. Finally she noted that leaders were concerned about having insufficient personnel in some key areas. As turnover and layoffs occur, staff has been asked to do additional functions, resulting in the loss of depth of knowledge. Discussions with leaders identified a list of risks and Ms Buse highlighted five risk areas for the committee.

Mr. Wion reviewed the three different categories of metrics to assess fiscal focused risk factors at each institution; Audit, Financial Condition and Business Operations. He noted that each metric had been assigned points values to determine an overall ranking for each institution. He further noted that there was also an “other” category where risk factors could be added if they were significant and not otherwise considered within the model.

Trustee Van Houten noted that changes in the audit cycle, outstanding audit findings, unsatisfactory progress, as well as changes in key personnel could impact the formula and increase the risk factor. Mr. Wion agreed. Ms. Buse stated that, for those reasons, the risk model would need to be repopulated annually.

Trustee Van Houten stated that it would be helpful to see how likely it was for these risk factors to change. Vice Chancellor King noted that this model should be viewed as a dynamic design, and added that it might be discovered that there was some other variable that was introducing risk that was not being captured.

Trustee Paskach noted that how the factors were weighted was also extremely impactful. He asked if a poor financial condition could drive an institution to the top of the list each year by itself. Ms. Buse stated that no one individual item would move an institution to the top. Mr. Wion presented the results of the assessment work. He noted that there was not a single factor that weighed heavily enough to move an institution into the list of the top ten, but rather it was a combination of factors.

Trustee Vekich asked if resource restrictions influenced the development of the risk assessment. Trustee Van Houten stated that staff was directed to first identify the risks to the system, secondly to consider what it might take to oversee those risks and then finally to design the budget and the audit activities in response to what was necessary to oversee it. The budget would come out of the assessment. Trustee Vekich stated that the budget should not drive enterprise risk assessment. He added that the Audit Committee could determine priorities and decide how much risk it was willing to assume after the risks were fully known. Ms. Buse stated that audit resources were not considered in what was presented as part of the results of the risk assessment. The question of resources was taken into account when the different approaches were reviewed to gain coverage on internal control and compliance.

Trustee Van Houten reminded members that if there was discomfort on the part of the

Audit Committee, Ms. Buse would reconsider the priorities, the staffing and the budget and return with something for the committee to approve at the June meeting.

Vice Chancellor King noted that the five universities got points because they had not had an internal control and compliance audit, which was a management decision when those universities began having financial statement audits. She asked the committee to consider what threshold of assurance it was seeking to gain in this audit design.

Mr. Wion reviewed the pros and cons of structuring an audit that focuses on an individual college or university, and the pros and cons of structuring an audit that focuses on a single functional area across multiple institutions, such as payroll.

Trustee Van Houten noted that past operational audits had turned out well based upon systemwide identification and then focused education plans to correct problems before they showed up at other institutions. Vice Chancellor King stated that she believed operational audits of higher risk areas based on materiality would work, but that the trade off would be the campus auditor presence. She noted that it was important to understand what the committee was seeking from an assurance standpoint. She stated that there were several different objectives that could be appropriate.

Trustee Van Houten added that the use of the new Cooperative would be helpful as priority was given to new audit approaches around consolidated functions. In addition he noted that the new Chancellor might have areas where he would want some special audit work done.

Chancellor McCormick praised staff for all the work that had been done over the years. He stated that it had always been important to him as the Chancellor to have a report from the Office of Internal Auditing to use during presidential evaluations each year. He noted that it was a way to put pressure on colleges and universities that were not making satisfactory progress on audit findings but it was also an opportunity to highlight those colleges and universities that were doing an outstanding job on their campuses. He further stated that he appreciated that the Executive Director of Internal Audit worked directly for the Board of Trustees, but that the Chancellor and the presidents could also make requests for special audit projects over the years.

Mr. Wion highlighted the information technology risk component, specifically in the area of student data. Chancellor McCormick noted that the Information Technology group had recently hired a new staff member to work specifically on security issues. He noted the importance of protecting credit card data of students on campus. Mr. Darrel Huish, Vice Chancellor for Information Technology and Chief Information Officer, confirmed that although coverage in all areas was important, the new staff member would be focusing primarily on the payment card industry standards because student data and credit card data were both high priorities. Mr. Wion agreed and stated the system had made significant investments to ramp up compliance in this area.

Trustee Vekich asked about penetration testing to the information technology systems. Vice Chancellor Huish stated that they had recently contracted with an outside vendor to begin penetration testing, and he stated that testing would begin in the coming weeks. Trustee Vekich asked if any of that testing would get at the social engineering aspect of

security to ensure that individuals were keeping passwords and data secure. Vice Chancellor Huish stated that the current contract would be to do external penetration of the networks, not of individuals. Trustee Van Houten noted that there should be communications between that division and the Office of Internal Audit regarding the information technology audit. Ms. Buse stated that she and Vice Chancellor Huish would work together on the comprehensive information technology risk assessment and would take into consideration the work that the Information Technology Division was doing that might influence the types of activities and the types of risks within information technology.

Ms. Buse stated that part of the recommendation was to conduct a specific information technology audit, but that they were also holding several technical hours available to look into other information technology.

Trustee Vekich expressed concern that the social engineering side should not be left out of the testing process. He stated that the committee needed a risk assessment for the enterprise, regardless of the resources available to handle those risks. He stated that it was important for the Audit Committee to have discussion around its risk profile. After that discussion, the committee could make a decision about the level of risk it was willing to assume based on available resources or it would have to find additional resources.

Vice Chancellor Huish stated he would work with Ms. Buse to bring back responsive information at the June meeting of either the Audit Committee or the Information Technology Committee. Ms. Buse concurred and stated that they would work with the committee chairs to bring the information back in June. Vice Chancellor King agreed and stated that it was incumbent on the system to continue to improve the methodologies so that the committee could have a conversation about scaling the activities and the risks that are related to information technology. She stated that it was an important objective, but that the system was still in the early days from an internal audit perspective.

Trustee McElroy stated that the Center of Excellence in data and system security could be a helpful resource. He also noted that when password security systems get too complex, individuals revert to manual methods of remembering codes which adversely makes systems less secure. He noted that there was some limit to the complexity and frequency that individuals were able to securely remember passwords. Finally, he noted that the system should begin to think in terms of payment systems rather than credit cards. He noted that the majority of payment cards were actually debit cards now and other technologies were continuing to emerge as well. He cautioned that the risk in these areas should not be underestimated.

Ms. Buse continued with the audit resources discussion. She stated that the committee wanted to know how the system would get coverage on financial internal control and compliance audits in the absence of the contract with the Office of the Legislative Auditor.

Ms. Buse reviewed the Office of Internal Audit staffing resources. She stated that in 2009 the office had eleven employees but a fifteen percent reduction in the budget resulted in the loss of a position and a half in 2010. She noted that the office is currently budgeted for that same staffing level. However, due to the change of Executive

Directors, the need to fill the Deputy position and some other restructuring, the office has only had about eight FTE in fiscal 2011. Ms. Buse stated that she was proposing that in fiscal 2012, the Office of Internal Audit would go back up to ten positions, which would include the addition of an Information Technology Audit Coordinator and another position to focus on internal control and compliance audits. Ms. Buse informed the members that there had been a failed search for the new Information Technology Audit Coordinator, but added that she was working with the Human Resources division and networking with peers to develop an approach to filling that position.

Ms. Buse explained that fewer hours would be spent on audit follow-up in the next fiscal year because there would not be as many outstanding audit findings and, without a contract with the Office of the Legislative Auditor, there should be fewer new findings being put into the database. She explained that she was planning to eliminate the support that the Office of Internal Auditing had provided to external auditors in the past. She stated that the office devotes over a position each year to that work and that time could be redirected to more value added work for the committee and for system leaders. She did note, however, that there were still contractual obligations with the audit firms and it would take three years to rotate out of those commitments.

Ms. Buse stated that in addition to adding new staff, they may use contractors to supplement the information technology audit approach. She stated that the hiring market has been tight and they would need to look at different approaches. She told members that she and Vice Chancellor King had met with Audit Committee Chair Van Houten and Vice Chair Krinkie about carrying forward the salary savings from fiscal year 2011 which has been a transition year, into fiscal 2012 in order for us to jumpstart the information technology audit program. Finally, she stated that she wanted to explore the use of other resources such as student internships and faculty sabbaticals.

Ms. Buse reviewed the proposed audit priorities which would include the continuation of the core assurances services, flexibility for a system project, and an information technology risk assessment audit project. Finally, she recommended three specific audits. The recommendation would include an internal control and compliance audit at Southwest Minnesota State University, and Ms. Buse reminded members that the Office of the Legislative Auditor would also begin conducting an internal control and compliance audit at Metropolitan State University soon, the results of which would come to the Audit Committee in the fall. In addition the office would conduct business cycle audits of state university payroll and ISRS security. And the last specific audit that was proposed for fiscal 2012 would be an audit of vulnerability management.

Ms. Buse stated that she would bring the audit plan for fiscal 2012 as an action item for the June Audit Committee meeting. In addition, she would formulate a recommendation for financial statement audit work.

Trustee Van Houten reminded members that the system would plan to continue the same large college and university audits and the system financial audits, but the internal control and compliance audits at the smaller colleges would be done differently. Ms. Buse agreed, stating that there would not be a three-year audit cycle of those two-year institutions. She noted that in the future, there would be more business control cycle audits in combination with audits at individual institutions when a risk profile would

indicate that an audit of a particular college or university would be beneficial.

Trustee Van Houten stated that instead of auditing everything, the system would audit those areas where experience had indicated were most likely to have problems. He added that the campuses would still have an audit presence. The suggestion to the Audit Committee would be that, as time goes by, if the system had not been able to accurately identify those issues appropriately or if there were some need to do a different kind of audit, then the Audit Committee would agree to revisit what would need to be done to achieve the appropriate level of comfort. He stated that he believed that was a stronger approach than to over staff an area or hold reserve funds in the budget.

Trustee McElroy asked how other higher education systems addressed their risks. Ms. Buse stated that different approaches depended on available resources. She did note, however, that best practices in the internal audit industry were starting to move toward more horizontal business practices approaches.

She stated that the University of Minnesota had identified about fifty different entities that they would try to get audit coverage on and they determined a model where they would try to get to their highest risk entities once every three years. Vice Chancellor King stated that when they were designing the financial statement audit strategy they had looked at national patterns and found that it was typical that a system either did a system level enterprise financial statement audit, or they did entity level financial statements audits, but they seldom did both. She noted that this proposed approach was a hybrid of both approaches that would likely be without par around the country. She stated that she liked the approach because it provides audit presence on the campuses and it offers the opportunity to spread discipline, knowledge and competence for financial statement work at the largest entities.

Trustee Krinkie stated that he would like to see the Technology Committee offer their advice and input as to what areas of vulnerability exist and what should be done, not only on the front end, but then also in terms of audit afterwards. Trustee Van Houten agreed, especially with the changes that would be happening with the security efforts in the Information Technology division.

Trustee Vekich stated that he was generally comfortable with the approach, however, he commented that if the committee had not already done so, he would like to have sufficient time at the June meeting for that discussion. He stated that he liked what was in the plan, but that it was incumbent upon the Audit Committee to understand its risk profile and where it wanted to go before it considered the budget constraints. Trustee Paskach noted that a risk profile or a strategic risk assessment, should be about the overall business and the risks that could really damage the business. He agreed with Trustee Vekich, that a conversation about the system's risk profile would be valuable.

Vice Chancellor King stated that the Finance Committee had a discussion in March about the enterprise risk management project that has been started but she stated that those results would not be available in time for the June discussion. She noted that the system did have an appreciation of reputational risks and of student risks, but were in the very early days of trying to design an enterprise risk management program. She added that when that program was fully matured, it would make sense for the audit plan to flow

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directly from that program. But she added that until then, the system would need to rely on its best judgments about risks. Trustee Paskach agreed that in the interim, as that program developed, the current recommendations would be useful and should be approved.

Trustee Van Houten stated that the committee understood that should they determine at a later date that the recommended approach did not afford the appropriate comfort level, then the committee would not be held by the initial decisions and could make adjustments. He added that if the committee were not comfortable with the recommendation at the June meeting, then adjustments could be made before the July meeting, and if there was a need to develop an initial budget for the beginning of the fiscal year, the committee could develop an arbitrary budget with the understanding that it would revise it after further exploration.

President Pat Johns, Lake Superior College, noted that the system had matured a great deal in its audit processes. He stated from a president's perspective, having a regular audit presence had offered him a level of security to know that processes would be reviewed and best practices were communicated. He stated that there was a good system in place that worked well, and he cautioned that it would not be appropriate to ease up on the audit practices or exercises. President Johns stated that he liked the recommended approach, and the idea that the approach could be amended if necessary at a later date. Finally, he noted that just like finance and technology, academic quality should be considered as well because it was the core of the system.

The meeting adjourned at 2:40 p.m.

Respectfully submitted,  
Darla Senn, Recorder