

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES
Agenda Item Summary Sheet**

Audit Committee

Date: January 21, 2014

Title: Review and Approve Financial Audit Plan

Purpose (check one):

- | | | |
|---|--|---|
| <input type="checkbox"/> Proposed
New Policy or
Amendment to
Existing Policy | <input checked="" type="checkbox"/> Approvals
Required by
Policy | <input type="checkbox"/> Other
Approvals |
| <input type="checkbox"/> Monitoring /
Compliance | <input type="checkbox"/> Information | |

Brief Description:

In January 2012, the Board of Trustees directed the Executive Director of Internal Auditing and Vice Chancellor – CFO to complete a study and recommend, by January 2014, a financial audit plan for the future.

Scheduled Presenter(s):

Beth Buse, Executive Director, Office of Internal Auditing
Laura King, Vice Chancellor - Chief Financial Officer
Edna Szymanski, President - MSU Moorhead
Pat Johns, President - Lake Superior College

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

ACTION ITEM
REVIEW AND APPROVE FINANCIAL AUDIT PLAN

In January 2012, the Board of Trustees directed the Executive Director of Internal Auditing and Vice Chancellor – CFO to complete a study and recommend, by January 2014, a financial audit plan for the future. The report contains the following recommendations:

Financial Statement Audits:

- Move toward a goal to only complete an audit of the systemwide financial statements, revenue fund and federal student financial assistance (A-133).
- Transition period: complete stand-alone audits for fiscal years 2014 - 2016 of four universities (Bemidji State University, Metropolitan State University, St. Cloud State University, and Winona State University)
- Enhance the supplement to the annual systemwide financial report with additional college/university level detailed schedules.

Internal Control and Compliance Audits

- Increase internal control and compliance audit coverage.
 - Expand audit resources to enable 3-4 additional reviews annually
 - Explore alternative resources and/or methods to gain audit coverage and provide update to the committee by January, 2015
- Continue refinement of the risk assessment tool used for audit planning.

By January 2017, complete an analysis to determine:

- Whether a systemwide audit will meet the needs of all colleges and universities; and the four standalone university audits could be discontinued,
- Evaluate, from a risk perspective, the financial internal control and compliance universe. Include a review of the progress of the Campus Services Cooperative and other regional strategies in establishing common business practices and its impact on the risk equation.

The final report is attached.

RECOMMENDED COMMITTEE MOTION:

The Audit Committee recommends that the Board of Trustees adopt the following motion:

The Board of Trustees endorses the recommendations offered by the Executive Director of Internal Auditing and Vice Chancellor – CFO regarding a future plan for financial audits. It further authorizes the Executive Director of Internal Auditing and Vice Chancellor – CFO to take the following steps:

- *Initiate a competitive bidding process to select external auditors for the MnSCU system, revenue fund, federal student financial aid (A-133), Bemidji State University, Metropolitan State University, St. Cloud State University, Winona State University, and ISEEK for fiscal years 2014 to 2016.*
- *Initiate a competitive bidding process for required NCAA Agreed Upon Procedures engagements for the six state universities with intercollegiate athletics.*

RECOMMENDED BOARD MOTION:

The Board of Trustees endorses the recommendations offered by the Executive Director of Internal Auditing and Vice Chancellor – CFO regarding a future plan for financial audits. It further authorizes the Executive Director of Internal Auditing and Vice Chancellor – CFO to take the following steps:

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- *Initiate a competitive bidding process for required NCAA Agreed Upon Procedures engagements for the six state universities with intercollegiate athletics.*

Date Presented to the Board of Trustees: January 22, 2014

Financial Audits – Reflection and Looking to the Future

In January 2012, the Board of Trustees directed the Executive Director of Internal Auditing and Vice Chancellor – CFO to complete a study and recommend, by January 2014, a financial audit plan for the future. The study acknowledges that the system has been on the same financial statement audit program for over 10 years, our financial management and assurance operating environment has changed over this period, and it is timely to examine whether our investment of staff time (campus and system office) and audit resources is appropriately balanced. In addition, audit coverage has changed over the past few years over financial internal control and compliance audits and it is appropriate to review the changes.

Board Policy 7.4, Part 1 states that:

...It is the policy of the Board of Trustees to seek audited financial statements for the system as a whole and individual institutions as designated by Board action. To that end, the Board of Trustees has adopted a multi-year audit plan...

Other relevant board policies are included in Appendix A.

Study Objectives

- Analyze the objectives, capacity and cost effectiveness of continuing to conduct 13 individual college and university financial statement audits.
- Evaluate the current process for auditing financial internal control and compliance of colleges and universities.
- Review enterprise risk management strategies for management of financial risk.
- Research practices of other higher education systems.
- Obtain input from the Board of Trustees and college and university senior management on desired assurances.

Background

External Audit Coverage

- The audit contracts for the systemwide audit¹, revenue fund audit, federal student financial aid, ISEEK, and 13 individual college and university (Table 1 contains audited institution names) audits expired at the end of the fiscal year 2013 audit.
 - The contract with the Minnesota State College and University system's principal auditor (CliftonLarsonAllen) required that the system contract for individual financial statement

¹ An unaudited supplement to the systemwide financial statements is produced each year that contains several schedules used for financial management purposes, including separate Statements of Net Position and Statement of Revenues, Expenses, and Changes in Net Position for all 37 accredited MnSCU institutions.

audits of colleges and universities so that at least 60% of the system-wide financial activity was covered by individual college and university audits.

- The 13 colleges and universities had been on different contractual cycles than the principal auditor. In 2011, all external auditor contracts were aligned to end after the fiscal year 2013 audit.
- In 2010, by mutual agreement a contractual arrangement with the Legislative Auditor that had been in place since shortly after the 1995 merger ended that provided for financial internal control and compliance audits of colleges without financial statement audits on a three year rotational basis. Mr. James Nobles, the Legislative Auditor, challenged the Audit Committee in 2010 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. Given limited resources, he wondered whether these resources should be focused on financial internal control and compliance audits. *[The OLA has substantially redirected resources away from MnSCU since the conclusion of the contractual relationship.]*

The last OLA internal control and compliance audit was of Metropolitan State University. The report was issued in January 2012 and included an audit scope of July 1, 2008 through March 31, 2011.

- Table 1 contains a summary of external auditor costs² for fiscal year 2013 audit work.

Table 1: Summary of External Auditor Costs for Fiscal Year 2013

Audit Firm	Audit	Cost	
CliftonLarsonAllen – Principal Auditor	Systemwide	\$146,000	System Audit Costs: \$210,000
	Revenue Fund	\$28,000	
	Federal Student Financial aid	\$28,000	
	ISEEK	\$8,000	
CliftonLarsonAllen	Southwest Minnesota State University	\$24,203	Institution Audit Costs: \$368,684
	Metropolitan State University	\$25,610	
	Rochester Community and Technical College	\$24,381	
	Minneapolis Community and Technical College	\$26,715	
Kern DeWenter Viere	St. Cloud State University	\$35,150	
	Minnesota State University, Mankato	\$32,300	
	Minnesota State University Moorhead	\$32,300	
	Winona State University	\$31,825	
	Normandale Community College	\$23,500	
	Hennepin Technical College	\$24,000	
Baker Tilly	Bemidji State University and Northwest Technical College	\$34,000	
	Minnesota State Community and Technical College	\$28,400	
	Century College	\$26,300	
Total External Audit Costs		\$578,684	

² System Office pays 1/3 of the cost of college and university external audit costs.

Previous Board of Trustees Decisions:

- July 1999 - the board received a report on obtaining audit financial statements for the system and individual colleges and universities. The report stated that:

The long-term goal is to prepare MnSCU financial statements, conforming to GAAP, which are sufficiently reliable to receive an unqualified audit opinion. It is the administration's goal to have some confidence in MnSCU's ability to obtain an unqualified audit opinion prior to undertaking the audit effort.

The Board of Trustees approved the following motion in July 1999:

The Board of Trustees, in exercising its fiduciary responsibilities, approves the following steps toward attainment of audited MnSCU and institutional financial statements:

- *Prepare unaudited consolidating financial statements for the fiscal year ended June 30, 1999 for the Minnesota State Colleges and Universities by November 30, 1999. These financial statements should include, at a minimum, a balance sheet and statement of revenues and expenditures by institution.*
 - *Preparation by the administration of appropriate FY2000 MnSCU-wide financial statements, including plant fund statements.*
 - *Contract with the Office of the Legislative Auditor (OLA) for examination of the FY2000 balance sheet.*
 - *Preparation by the administration of MnSCU-wide FY2001 financial statements.*
 - *Contract with the OLA for the audit of MnSCU-wide financial statements for FY2001.*
 - *Preparation of a plan for obtaining audited financial statements at the institutional level for FY2002.*
 - *Directs the Chancellor to incorporate the estimated cost of these efforts in the FY2000 and FY2001 budget planning.*
- December 2001 - the Board adopted the following alternative plan for external audit services:
 - *MnSCU office of Internal Auditing and MnSCU Finance Division would assess the accounting disciplines of individual colleges and universities to determine their readiness for a financial statement audit.*
 - *MnSCU will have to contract for individual audits of colleges and universities that account for 40% of MnSCU revenues and assets or incur additional audit costs of about \$80,000 per year for the MnSCU audit due to the structure of the contract with Deloitte and Touche.*
 - *Contracts for conducting fiscal year 2002 individual audits will be executed for any of the 12 largest MnSCU colleges and universities judged to be ready for an audit.*
 - *For colleges and universities that will not be audited in fiscal year 2002, the accounting procedures checklist will be completed at least quarterly until the college or university establishes the necessary accounting disciplines.*
 - *Individual audits of the remaining colleges and universities will be phased in during fiscal years 2003 and 2004.*

- *The Office of the Legislative Auditor would continue to examine the internal controls and fiscal legal compliance of MnSCU colleges and universities.*
- December 2002 - an additional change was made to the plan with a proposed goal of auditing individual college and university to obtain 60% of revenues audited by 2003 and 75% of revenues audited by 2004.
- January 2005 - the Board of Trustees approved a Strategic Plan for External Audit Services. The plan provided contracting with CPA firms to conduct annual financial statements audits of the larger colleges and universities. The plan provided that the annual audit of the system-level financial statements would be augmented with the stand-alone audits of twelve colleges and universities. This group of stand-alone audits was intended to account for approximately 60% of system-wide financial activity and, thus, improve the cost-effectiveness of the system-level audit.

In addition, the plan included contracting for financial internal control and compliance audits of colleges without financial statement audits through the Office of the Legislative Auditor.

- January 2009 - the Board of Trustees approved an amendment to the strategic plan for external audit services; Normandale Community College was added to the annual audit cycle for fiscal years 2010 and 2011.
- October 2011 – the Board of Trustees approved a new approach for auditing financial internal control and compliance at colleges and universities. The approach assumed some internal control and compliance audits by the Office of the Legislative Auditor and other audits being conducted by the Office of Internal Auditing based on an annual audit risk assessment that included limited college and university audits but rather focused audit resources on auditing financial internal control and compliance cycles.
- January 2012 - the board authorized the system continue with financial statement audits for the 13 colleges and universities for fiscal years 2012 and 2013, for the following reasons:
 - *The 13 colleges and universities have been on different contractual cycles than the principal auditor, it is difficult to make changes in audit coverage until all contracts are aligned to expire at the same time.*
 - *A number of shared services initiatives are currently being implemented and others are being planned, an evaluation will be necessary to determine where audits are appropriate in the future.*
 - *The change in how the system is obtaining financial internal control and compliance audits was implemented in fiscal year 2012, it is too early to know the impact of this change*

The motion instructed the Executive Director of Internal Auditing and Vice Chancellor – CFO to align the external audit contracts with for the systemwide audit work and the 13 colleges and universities to expire after the fiscal year 2013 audit.

In addition, the board instructed the Office of Internal Auditing to:

- *Evaluate the impact of changes in the audit approach for auditing financial internal control and compliance of colleges and universities,*
- *Evaluate the impact to colleges and universities on the shared services initiative,*
- *Further research practices in other systems across the country, and*
- *Develop alternatives for presidents and other system leaders to discuss and evaluate.*

Key Differences in Financial Assurance Methods

It is important to understand the distinction between the objectives of a financial statement audit versus a financial internal control and compliance audit. The objectives are distinctly different.

- Financial statement audits are intended to provide assurance concerning the reliability of the financial information contained in the statements, at a material threshold and do not provide an opinion on internal controls.
- Financial internal control and compliance audits are intended to provide assurance that the process that generates the numbers in the statements are appropriately designed and working as designed. Internal control and compliance audits also provide assurance that applicable finance related legal requirements are met by the procedure or process.

Both financial statement audits and internal control and compliance audits are tools in an effective financial assurance and risk management strategy.

Financial Risk Management

Management has designed a financial risk management program that is grounded in board policy and system procedure. It articulates standards of accountability for colleges and universities as well as members of the system office. The Vice Chancellor – Chief Financial Officer has day to day responsibility for monitoring and measuring compliance with the standards.

Elements of the Current Financial Management Program

- Financial Health and Compliance Measures Oversight – System Procedure 7.3.16
- CFI calculation and review
- Annual review of all colleges and universities (trends and highlights meetings)
- Other Activities
 - Vice Chancellor watch list – monitoring actions
 - Project 2020 - enrollment projection monitoring
 - Institution CFO onboarding/mentoring
- Data reporting, review and input (operating budgets, enrollment outlook, financial outlook, auxiliary program health, etc)

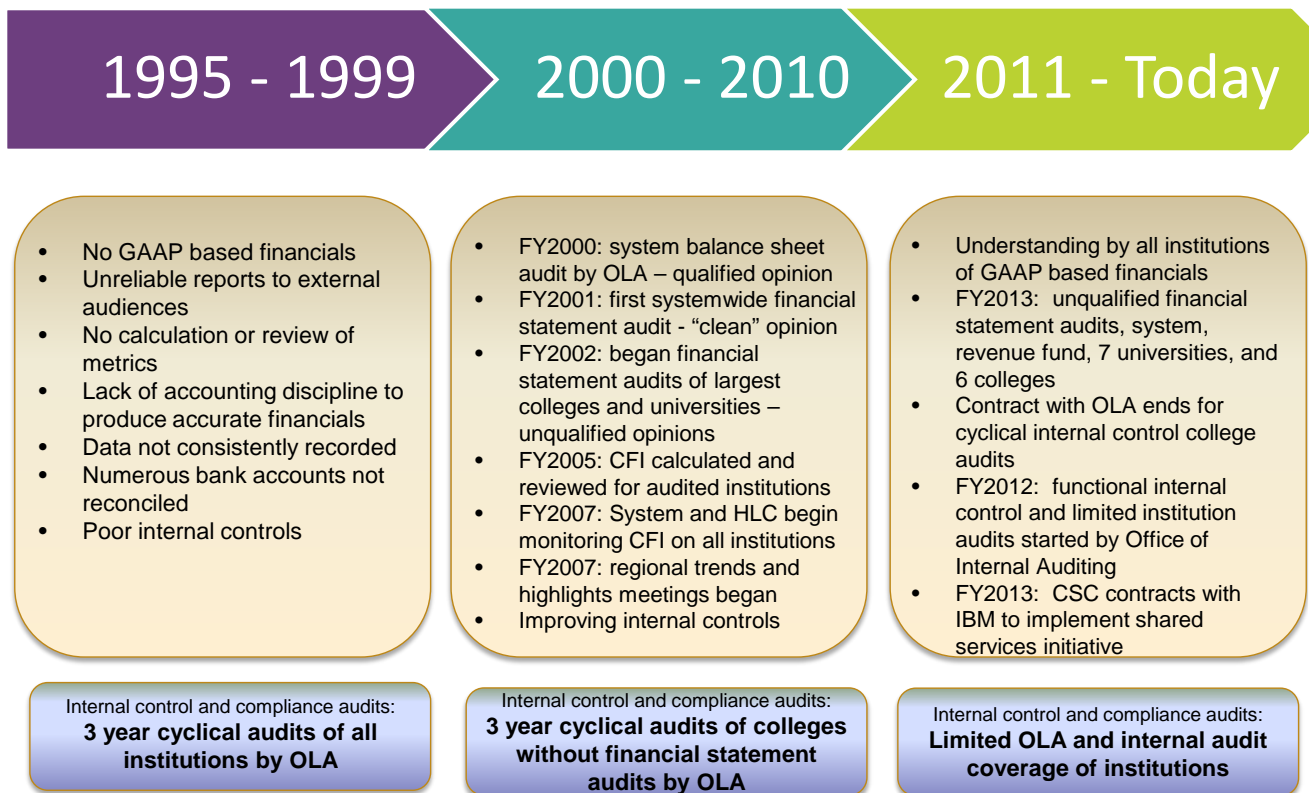
Audit Program

Board policy authorizes the Office of Internal Auditing to provide assurance services that inform interested stakeholders about the reliability and accuracy of information and information systems. The policy directs Internal Auditing to coordinate all audit-related activities conducted

by the Legislative Auditor and external auditors, including follow-up on unresolved audit findings. The Board of Trustees also approves an annual audit plan based on a risk assessment. As discussed earlier, in October 2011, the Board of Trustees adopted a new approach for auditing financial internal controls and compliance. The new approach significantly reduced the number of internal control and compliance audits being conducted at individual colleges and universities. Under the past contract with the Legislative Auditor, approximately eight individual college audits were occurring a year. Under the current approach, one or two audits are occurring each year.

Figure 1 depicts a timeline of financial risk management in the system. In the first few years after the system merged the financial management environment was weak and the board had little or no reliance on financial information that was presented nor in the internal controls that existed. In July 1999, the Board of Trustees put an external audit approach in motion. Over the next decade many improvements were made to the financial management program to lower risk.

Figure 1: Financial Risk Management Timeline



There is no doubt that there has been substantial improvement in the financial management of the system and the colleges and universities since fiscal year 2000.

- The system has had unqualified audit opinions every year since 2001 and individual colleges and universities with audited financial statements have had unqualified audit opinions since the audits began. The program was begun in 2000 in part to instill the discipline, rigor, and

financial management knowledge now found present in the financial procedures of the system office and the colleges and universities.

- Further enhancements to the financial management program, most notably the addition of the CFI metric, have improved the capacity at colleges without individual financial statement audits.
- In the early years of internal control and compliance audits, individual colleges and universities had many audit findings that were classified as ‘critical’³. While there are fewer college and university internal control and compliance audits, the significance of the issues have substantially lessened and very few ‘critical’ audit findings are identified.
- Over the past couple of years, the system has invested resources into the Campus Services Cooperative. A major strategy of the CSC is the Shared Services initiative which plans to transform business processes and non-strategic activities across the system to achieve: economies of scale, standardized processes, efficient and effective service, improved data quality, leveraged skills and investments. Currently, the internal control and compliance environment is complex since each college and university defines its own business practices.

Research

Higher Education Systems:

Financial Statement Audits: The hybrid approach used by the Minnesota State Colleges and Universities (some institutions with stand-alone financial statement audit and others without separate audits) was not used by any other higher education system. For example our research found that:

- University of Minnesota: includes five accredited institutions, only a systemwide audit is conducted by Deloitte. An addendum to the financials contains separate statements on the five institutions.
- University of Wisconsin System: includes 13 universities that are separately accredited and 13 colleges that are accredited together, only a systemwide audit is conducted by the State of Wisconsin Legislative Audit Bureau. Separate unaudited financial statements are prepared for each university and one combined financial statement for the colleges.
- California State University System: includes 23 accredited state universities. Prior to fiscal year 2012, state law required that at least 10 universities have a separate financial statement audit each year. State law was modified to eliminate this language and beginning in fiscal year 2012 a systemwide audit was only conducted by KPMG. A supplement to the financials contains separate unaudited financial statements for the 23 universities.

Internal Control and Compliance Audits: it is difficult to complete a comparison of financial internal control and compliance audit approaches due to a few factors:

³ Internal Auditing classification of audit findings, a critical classification is one that merits immediate attention and remedy. Without prompt corrective action the reliability or integrity of information vital for making significant decisions or having a material impact on external reporting is questionable, or a high risk of potential loss exists.

- **Legislative or State Auditor Coverage:** some systems have significant audit coverage by their state auditor.
- **Internal Audit Structure:** some systems have substantially more resources invested in internal audit and may for example have internal auditors located at each college or university. In these cases, the internal auditors determine their own audit scopes.
- **Audit Universe Definition:** systems define their audit universe differently, for example, some systems may delineate departments or colleges within an institution as an auditable unit rather than the institution itself.

A comparison of higher education system internal audit staffing resources completed by the Association of College and University Auditors shows that the MnSCU internal audit function is in the bottom third based on various metrics.

Higher Learning Commission: Audited financial statements are very useful for satisfying accreditation requirements. Accrediting agencies use audited financial statements as evidence of fiscal accountability and sound financial management. The agencies are amenable, however, to accepting alternative forms of evidence, such as supplemental financial schedules, in lieu of audited financial statements.

The HLC specifically states that institutions are to undergo an external audit by a certified public accountant or a public audit agency that reports financial statements on the institution separately from any other related entity or parent corporation. For private institutions the audit is annual; for public institutions it is at least every two years. We consulted with leadership at the HLC to determine if they would have concerns if we changed our current practice of having standalone financial statements audits of 13 of our 37 accredited institutions. The leadership did not express any concern if we chose to limit the number of standalone audits.

Minnesota Management and Budget: The Minnesota State Colleges and Universities system level financial activity is incorporated and reported as a part of the state's larger Comprehensive Annual Financial Report. The CAFR represents the state's audited annual statements for all activity. The information is audited either by the state's auditors, or incorporated after reliance on the work of other auditors. Since the inception of MnSCU's annual audit program, the Office of the Legislative Auditor has relied upon the work of MnSCU's external auditors in its rendering of an opinion on the CAFR. Were MnSCU to cease attainment of an annual opinion on the systems' financial activity, MMB would have to expand its audit engagement with the OLA to obtain acceptable assurance levels.

Input from Key Stakeholders

Presidents were asked to consult with their leadership teams at each college and university on both financial statement audits and financial internal control and compliance audits. We received a response from 25 of 30 presidents, a summary of their responses were:

- Generally in favor of completing a systemwide financial statement audit only; and expanding internal control and compliance reviews for colleges and universities.

- A few state universities have a specific campus or community need for continuing a standalone financial statement audit
- Generally support continued production of supplement schedules to the annual systemwide financial statement to assure college and university level schedules for campus use.

Conclusion and Recommendations

Recommendations

Financial Statement Audits:

- Move toward a goal to only complete an audit of the systemwide financial statements, revenue fund and federal student financial assistance (A-133).
- Transition period: complete stand-alone audits for fiscal years 2014 - 2016 of four universities (Bemidji State University, Metropolitan State University, St. Cloud State University, and Winona State University)
- Enhance the supplement to the annual systemwide financial report with additional college/university level detailed schedules.

Internal Control and Compliance Audits

- Increase internal control and compliance audit coverage.
 - Expand audit resources to enable 3-4 additional reviews annually
 - Explore alternative resources and/or methods to gain audit coverage and provide update to the committee by January, 2015
- Continue refinement of the risk assessment tool used for audit planning

By January 2017, complete an analysis to determine:

- Whether a systemwide audit will meet the needs of all colleges and universities; and the four standalone university audits could be discontinued,
- Evaluate, from a risk perspective, the financial internal control and compliance universe. Include a review of the progress of the Campus Services Cooperative and other regional strategies in establishing common business practices and its impact on the risk equation.

Appendix A - Relevant Board Policies

- Board Policy 1A2 Board of Trustees, Part 5, Subpart E,

The audit committee is responsible for overseeing the service of internal and independent auditors. Policy 1D governs the Office Internal Auditing. The committee has the following responsibilities for independent auditors:

- 1. Oversee the process for selecting independent auditors. The committee shall select one or more independent auditors to audit system-level or institutional financial statements and recommend their appointment to the board. An independent audit firm may not be appointed to a particular engagement for more than six consecutive years.*
- 2. Review any non-audit services proposed by independent auditors under contract for audit services. The board must approve in advance any non-audit services to be provided by independent auditors under contract for audit services unless the scope of non-audit services is completely distinct from the scope of the audit engagement.*
- 3. Review and discuss the results of each audit engagement with the independent auditor and management prior to recommending that the board release the audited financial statements.*

- Board Policy 1D.1 Office of Internal Auditing, Part 7

The Executive Director of Internal Auditing shall present to the Audit Committee and annual audit plan based on a systemwide risk assessment. The plan shall include all Internal Auditing and external audit activities planned for the ensuing fiscal year.

- Board Policy 7.4 Financial Reporting states

Part 1. Policy Statement. It is the policy of the Board of Trustees to provide financial statement information that is accurate, timely, reliable and consistent. Information provided to the state as part of the state-wide financial audit will be of high quality and consistent with standards of excellence. The chancellor and presidents will be dedicated to continuous improvement of financial reporting.

It is the policy of the Board of Trustees to seek audited financial statements for the system as a whole and individual institutions as designated by Board action. To that end, the Board of Trustees has adopted a multi-year audit plan. The chancellor shall periodically advise the Board of progress toward the Board's audit plan.

Part 2. Responsibilities. All financial reports shall be prepared in accordance with the provisions of Minnesota Statutes, official directives of Minnesota Management and Budget, and in conformity with the guidelines of the Governmental Accounting Standards Board (GASB), and the guidelines of the National Association of College and University Business Officers (NACUBO). The colleges and universities must provide accurate, timely, reliable and consistent financial information necessary for the prudent stewardship of the colleges and universities and for systemwide reporting. The reports shall be approved by the vice chancellor - chief financial officer.

The annual Minnesota State Colleges and Universities financial report shall be prepared under the direction of the vice chancellor - chief financial officer and filed with Minnesota Management and Budget as specified by law and governmental accounting standards.

Part 3. Accountability/Reporting. Financial statements will be presented annually to the Board of Trustees for its review and authorization to release.

- Board Policy 8.3, Part 4 sets forth foundation audit requirements:

Subpart D. Foundation reports. The contract shall require that the related foundation annually provide to the college or university and the system office a report as set forth below. The chancellor shall establish the deadline for filing the report and any provision for filing extensions in system procedure. The annual report shall include the following information:

- 1. A copy of the annual report required to be filed with the attorney general pursuant to Minnesota Statutes 309.53. A related foundation that is not required to file audited financial statements with the attorney general pursuant to Minnesota Statutes 309.53, Subd. 3, shall submit an audited financial statement and the information in Subpart D(2) at least once every three years.*
- 2. Any written communication from an independent auditor that discloses any material weakness in internal controls identified in conjunction with the audit of financial statements. For any material weakness reported, the related foundation shall provide a written response which includes its explanation for accepting the risks associated with the weakness or its plans to implement corrective action.*
- 3. A report on return of value for the prior fiscal year, including the value of administrative support received and the value returned to the college, university, or system and its students.*

Financial Audits – Reflection and Looking to the Future



Beth Buse, Executive Director, Internal Auditing
Laura King, Vice Chancellor Finance/CFO
Edna Szymanski, President MSU Moorhead
Pat Johns, President Lake Superior College

January 21, 2014

Minnesota State Colleges and Universities

The Minnesota State Colleges and Universities system is an Equal Opportunity employer and educator.

Today's Agenda

- Project Description
- Background
 - Financial Audit Comparison
- Finance – Risk Management
- Research
 - Comparisons to Higher Education Systems
 - Requirements for Accreditation
- Survey of Colleges and Universities
- Recommendations
- Next Steps



Project Description

- In January 2012, the Board of Trustees requested a study **with recommendations** by January 2014, on a financial audit plan for the future.
- The study included:
 - Analyzing the objectives, capacity and cost effectiveness of continuing to conduct 13 individual college and university financial statement audits (*7 universities, Century, Hennepin, Minneapolis, M State, Normandale, and Rochester*).
 - Evaluating the current process for auditing financial internal control and compliance of colleges and universities.
 - Reviewing enterprise risk management strategies for management of financial risk.
 - Researching practices of other higher education systems.
 - Obtaining input from the Board of Trustees and senior management on desired assurances.
 - Consulting with groups impacted by recommendations.



3

Recommendations

- **Financial Statement Audits:**
 - Move toward a goal to only complete an audit of the systemwide financial statements and revenue fund.
 - Transition period: complete stand-alone audits for fiscal years 2014 - 2016 of four universities (*Bemidji State University, Metropolitan State University, St. Cloud State University, and Winona State University*)
 - Enhance the supplement to the annual financial report with additional 'Trends and Highlights' schedules.
- **Internal Control and Compliance Audits**
 - Increase internal control and compliance audit coverage.
 - Expand audit resources to enable 3-4 additional reviews annually
 - Explore alternative resources and/or methods to gain audit coverage and provide update to the committee by January, 2015
 - Continue refinement of the risk assessment tool used for audit planning
- **Future: By January 2017, complete analysis to determine:**
 - Whether a systemwide audit will meet the needs of all colleges and universities; and the four standalone audits could be discontinued.
 - Evaluate, from a risk perspective, the financial internal control and compliance universe to determine appropriate internal audit investment. Include a review of the progress of the Campus Services Cooperative in establishing common business practices and regionalizing some practices and its impact on the risk equation.



4

Background: Financial Audit Comparison

- **Financial Statement**
 - Provides an opinion on whether financial statements are presented fairly, in all material respects.
 - Audit focus is primarily on largest financial activities.
 - Materiality varies - institutions between \$500,000 and \$2 million.
 - Audits consider internal controls over financial reporting but do not express an opinion on their effectiveness.
 - Audited financial statements contain a management analysis and detailed information in notes to the statements.
- **Internal Control and Compliance**
 - Provides for a tone at the top.
 - Greater flexibility in determining audit scope.
 - Provides assurance that internal controls are appropriately designed and working.
 - Provides assurance that MnSCU policies and finance-related legal provisions were complied with.
 - Identifies weaknesses in internal controls.
 - Identifies opportunities to improve business processes.



5

Financial Risk Management Timeline

1995 - 1999

2000 - 2010

2011 - Today

- No GAAP based financials
- Unreliable reports to external audiences
- No calculation or review of metrics
- Lack of accounting discipline to produce accurate financials
- Data not consistently recorded
- Numerous bank accounts not reconciled
- Poor internal controls

- FY2000: system balance sheet audit by OLA – qualified opinion
- FY2001: first systemwide financial statement audit - "clean" opinion
- FY2002: began financial statement audits of largest colleges and universities – unqualified opinions
- FY2005: CFI calculated and reviewed for audited institutions
- FY2007: System and HLC begin monitoring CFI on all institutions
- FY2007: regional trends and highlights meetings began
- Improving internal controls

- Understanding by all institutions of GAAP based financials
- FY2013: unqualified financial statement audits, system, revenue fund, 7 universities, and 6 colleges
- Contract with OLA ends for cyclical internal control college audits
- FY2012: functional internal control and limited institution audits started by Office of Internal Auditing
- FY2013: CSC contracts with IBM to implement shared services initiative

Internal control and compliance audits:
3 year cyclical audits of all institutions by OLA

Internal control and compliance audits:
3 year cyclical audits of colleges without financial statement audits by OLA

Internal control and compliance audits:
Limited OLA and internal audit coverage of institutions

6

Finance – Risk Management

- **Current audit approach began with Board of Trustees direction in July 1999**
 - Goal of program was attainment of unqualified opinion on systemwide financial statements
 - Progressive financial statement audit program expansion between 1999 and 2009 (*Since 2003 – audits of 12 largest colleges and universities, representing 60 percent of financial activity*)
 - For past four years, audited financial statements: systemwide, revenue fund, seven universities, and six colleges
 - FY2013 external audit costs were \$580,000; not including internal staff costs
- **Financial management improvements since 1999**
 - Financial health and compliance measures oversight
 - CFI calculation and review
 - Annual review of all colleges and universities (*trends and highlights meetings*)



7

Finance – Risk Management

(continued)

- **Financial internal control and compliance**
 - Current State – variable business practices at colleges and universities
 - Planned State – Campus Services Cooperative and regional collaborations
 - Align business practices
 - A timeline and scope is not set
 - **Audit Coverage**
 - Office of the Legislative Auditor:
 - Three year cyclical college internal control and compliance audits by Legislative Auditor ended in 2010
 - January 2012 – Metropolitan State University
 - Future: limited coverage
 - Internal Audit: Annual audit plan based on a risk assessment
 - Institution audits: 2012 – Southwest Minnesota State University, 2013 – Bemidji State University and Northwest Technical College, 2014 - Minnesota State University Moorhead (planned)
 - Functional area audits: 2012 – State University Payroll, 2013 – Banking Controls, 2014 - Purchasing Cards (In progress) and Grant Management (planned)
 - Audit finding follow-up



8

Research

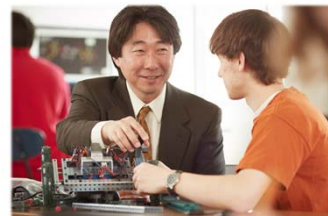
- Higher Education Systems
 - Separate financial statement audits of some colleges and universities is unusual
 - Example systemwide audit only systems:
 - University of MN
 - University of WI system
 - California State University System
 - Difficult to compare internal control and compliance audit approaches
 - Legislative/State Auditor coverage
 - Size and structure of internal audit offices
 - MnSCU staffing in bottom third compared to other systems
- Higher Learning Commission
 - Finance related criteria
 - Supplement should be sufficient



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Survey of Colleges and Universities

- Past Surveys
- Current Survey Results
 - Received responses from 25 of 30 presidents
 - Generally in favor of completing a systemwide financial statement audit only; and expanding internal control and compliance reviews for colleges and universities.
 - A few state universities have a specific campus or community need for continuing a standalone financial statement audit
 - Generally support continued production of supplement schedules to the annual systemwide financial statement to assure college and university level schedules for campus use.



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Recommendations

- **Financial Statement Audits:**
 - Move toward a goal to only complete an audit of the systemwide financial statements and revenue fund.
 - Transition period: complete stand-alone audits for fiscal years 2014 - 2016 of four universities (*Bemidji State University, Metropolitan State University, St. Cloud State University, and Winona State University*)
 - Enhance the supplement to the annual financial report with additional 'Trends and Highlights' schedules.
- **Internal Control and Compliance Audits**
 - Increase internal control and compliance audit coverage.
 - Expand audit resources to enable 3-4 additional reviews annually
 - Explore alternative resources and/or methods to gain audit coverage and provide update to the committee by January, 2015
 - Continue refinement of the risk assessment tool used for audit planning
- **Future: By January 2017, complete analysis to determine:**
 - Whether a systemwide audit will meet the needs of all colleges and universities; and the four standalone audits could be discontinued.
 - Evaluate, from a risk perspective, the financial internal control and compliance universe to determine appropriate internal audit investment. Include a review of the progress of the Campus Services Cooperative in establishing common business practices and regionalizing some practices and its impact on the risk equation.



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Next Steps

- **January 2014** – Board approval of financial audit plan
- **February and March 2014** – Complete RFP for external audit services for FY 2014 - 2016
- **April 2014** – Board approval of external audit firm(s)
- **January 2017** – Analysis and proposed recommendation for future financial audits



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Recommended Motion

- **RECOMMENDED COMMITTEE ACTION:**
 - The Audit Committee recommends that the Board of Trustees adopt the following motion:
- **RECOMMENDED MOTION**
 - The Board of Trustees endorses the recommendations offered by the Executive Director of Internal Auditing and Vice Chancellor – CFO regarding the future financial audit plan for the system.

