



**AUDIT COMMITTEE  
JANUARY 18, 2011  
1:00 P.M.**

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

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

**Committee Chair Van Houten calls the meeting to order.**

- (1) Minutes of November 17, 2010** (pages 1-7)
- (2) Audit Risk Assessment Methodology Discussion (page 8-11)
- (3) Review External Audit Plan (pages 12-15)
- (4) Review Internal Auditing Annual Report (pages 16-24)

Members

James Van Houten, Chair  
Phil Krinkie, Vice Chair  
Dan McElroy  
Alfredo Oliveira  
Thomas Renier  
Michael Vekich

**Bolded** items indicate action required.

**MINNESOTA STATE COLLEGES AND UNIVERSITIES  
BOARD OF TRUSTEES  
AUDIT COMMITTEE  
MEETING MINUTES  
November 17, 2010**

**Audit Committee Members Present:** Trustees James Van Houten, Chair; Philip Krinkie, Dan McElroy, Alfredo Oliveira, and Thomas Renier.

**Audit Committee Members Absent:** Trustee Michael Vekich.

**Other Board Members Present:** Trustees Jacob Englund, Christopher Frederick, David Paskach, Louise Sundin, and Scott Thiss.

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

The Minnesota State Colleges and Universities Audit Committee held its meeting on November 17, 2010, 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 9:50 a.m. and reviewed the agenda.

**Approval of the Audit Committee Meeting Minutes**

*Chair Van Houten called for a motion to approve the September 14, 2010 audit committee meeting minutes. There was no dissent and the motion carried.*

**1. Review and Approve Release of the Audited Financial Statements (Action Item)**

Ms. Beth Buse, Executive Director of Internal Auditing began by introducing Mr. Eric Wion as the new Deputy Director of Internal Auditing. Ms. Laura King, Chief Financial Officer, introduced Mr. Colin Dougherty as the new Associate Vice Chancellor for Finance, and members of his finance team. Trustee Van Houten welcomed everyone.

Ms. Buse explained that Audit Committee members had received advance copies of all thirteen college and university financial statements, as well as the systemwide audit and the revenue fund. She explained the contents of the five documents that were handed out to the committee. Those documents included a copy of the systemwide financials, the supplement to the financial statements, fifteen coversheets that summarized the results of each audit, the required communications letter from LarsonAllen, and a copy of the presentation. She added that there was also a single page document related to the Office of the Legislative Auditor's evaluation of the system office.

Ms. Buse introduced Mr. Tom Koop, an audit partner with LarsonAllen. Mr. Koop introduced Ms. Brenda Scherer who was the audit manager for the college and university audits. Mr. Koop reminded members that their audit responsibility was to express an opinion on the overall systemwide financial statements for the year ended June 30, 2010 and to express an opinion on compliance with federal compliance parameters regarding the American Recovery and Reinvestment Act (ARRA) and the student financial aid programs. He noted that that opinion would be discussed early in 2011 when the process

was completed. In support of the audit effort, internal controls were reviewed for material weaknesses or significant deficiencies. He also noted that the internal controls over information technology were reviewed to support the systemwide audit and that a report had been issued to management containing housekeeping details. He added that it had been a positive report with no material weakness or significant deficiency in internal controls.

Mr. Koop informed the members that the audit opinion on the systemwide financial statement, as well as on the revenue fund statement, was unqualified, which was the highest level that could be issued. He added that there were no internal control written findings, and that it was notable and a cause for celebration within the Minnesota State Colleges and Universities.

Ms. Scherer stated that there was a \$9 million materiality threshold systemwide. She stated that they were issuing a clean unqualified opinion; there were no significant deficiencies or material weaknesses in the systemwide audit. She noted that the two prior year significant deficiencies related to access controls and bank reconciliations had both been tested and they had been cleared for the current fiscal year. She thanked the staff for all their hard work. Trustee Van Houten stated that the clean audit results represented a big achievement for the colleges and universities. Ms. Scherer continued by reviewing the required communications.

Mr. Koop stated that over the years, the colleges and universities had taken more ownership of financial statement process and it was clear that they understood them. They have responded to internal control audit findings and those have all been cleared. He stated that the challenge going forward would be to maintain those results, and he added that ensuring continuous training, retrained and reassessing the process would continue to be important. Mr. Koop stated that in difficult economic times, providing stable service levels, strong leadership, and enabling technology would be key to maintaining a strong financial process.

Trustee Renier asked if the strong audit results could be attributed to the investments the system had made in technology. Mr. Koop stated that there had been good leadership in responding to prior audit results by the investments that had been made in the technology effort, but he was not able to quantify which investments were responsible for the current results. He added that in general he thought those investments had contributed in a positive way.

Trustee Van Houten reminded members that the Office of Legislative Auditor had suggested that reassessing the system approach to risk management would be worth reviewing. He noted that the audit process and the positive results did not mean necessarily that the risk assessment approach was good enough. He asked if the system had adequately assessed the risk in assigning staff work. Mr. Koop stated that recent changes in the audit standards which required the organization to formally document the risks at each college and university and within the system and identify internal controls had pushed the system to do more risk assessment.

Trustee Van Houten asked if the match of staff work and budget to oversee accounting activities seemed to be in line with the risks that were in place. Mr. Koop agreed. Ms.

King agreed that the internal control documentation process that the colleges and universities went through had been very useful in explicitly examining and documenting processes and identifying areas of risk. But she did not conclude from that that the colleges and universities were staffed correctly with the right skills covering the right risk points. She stated that the system was thinly staffed in this area and that it was a continuous challenge to ensure that the right staff was in the right place, covering the right risk profiles. Trustee Van Houten thanked her for the clarification and agreed it was an important point.

Trustee Krinkie stated that the positive audit results were due primarily to those people who had handled the millions of transactions. He commended them and stated that it had taken collaborative efforts as well as meticulous work to ensure that the audit had come out clean. He stated that those people should be recognized by a letter from Chair Thiss and the Chancellor for their work.

Mr. Dougherty echoed Trustee Krinkie's compliments to the collaborative effort across the system, that not only contributed to the strong audit results, but also to the strong financial performance. He reviewed the highlights of the financial statements for the committee.

Mr. Dougherty stated that the system's composite financial index in the fiscal year just ended was 3.21 which was a healthy improvement over the prior year of 1.62. He reminded members that the Higher Education Learning Commission starts to pay attention to individual institution level when they fall into the 0-1 range. He noted that the net operating revenue was a key component driving the favorable results of the composite financial index. Mr. Dougherty explained the four key components of the composite financial index.

Trustee Van Houten commented that the composite financial index provided benchmarks that gave insight on how the system has performed versus other systems. He added that they were a set of criteria that were somewhat different than what was used in the private sector, so it was particularly helpful for the committee to see those numbers and understand them. Mr. Dougherty commented that three was a respectable number based on the analytical framework that had been developed through KPMG, Bearing Point and others.

Ms. King noted that if the system were to seek a credit analysis for a system issued debt offering, this rating would suggest that the system would be viewed by the rating agency as a Triple A credit. She stated that as the committee thought about the system's financial condition, the composite financial index provided a way to understand how the system was keeping up with the national trends and the national macroeconomic forces that were moving through higher education. Trustee Van Houten agreed that was helpful. Ms. King noted that Moody's indicated that the system revenue fund was even stronger than the system as a whole.

Trustee Van Houten noted that the standard deviation for the system could be wide and it could be that although the number looked strong at the system level, at certain individual institutions, a challenge would be much more difficult to protect with the reserves. Ms. King agreed.

Trustee McElroy stated that historically there had been larger enrollment growth in slower economies and slower enrollment growth in growing economies. He added that there had been a slow decline in the overall numbers of high school graduations that started after the 2009 class and according to the state demographer, that decline would likely continue for 10 years. He asked how comfortable the system was that it would continue to see the enrollment increases that had contributed to the increased performance in the last three years. He stated that he was concerned that a two percent growth was not sustainable overtime. Mr. Dougherty stated that for the most part, the colleges and universities had managed the fine performance and control of expenses in fiscal year 2010 with the use of adjuncts and resources that gave them more flexibility in a very dynamic enrollment environment.

Trustee McElroy agreed the growth was dynamic, but noted that some of the increase in financial aid was due to a significant increase in federal PELL grant, in both funding and maximums, and that it was not certain that that would continue over time. He noted that growth was good news, but he added that the system needed to exercise caution. Trustee McElroy further noted that if the colleges and universities were to continue to be successful in increasing retention and completion rates, that would have the effect of increasing enrollments, as students stayed longer and completed programs. He added that he was excited about the financial results, and particularly excited about the strong performance of the audit. But he added that the purpose of the system was at least partially measured by completion, graduation and retention, and those were not as strong as the financial results.

Ms. King stated that they had identified the financial aid trends as one of the areas for additional analytical work before the January meeting, and they could add to that a more extensive understanding of what was happening around the enrollment forecasting.

Ms. King thanked the college and university financial staff and the presidents for their hard work. She noted that she was very pleased with the level of adoption of this effort by the campuses, and their commitment to it and their growing sophisticated use of the information. She thanked LarsonAllen for a very strong first year and added that it gave value to the Board's position that lead auditors be rotated periodically to bring new questions and new perspective. She thanked Normandale Community College and President Opatz. She added that it was not easy work but that the college had done a terrific job, and produced an unqualified opinion their first year out, which was a material accomplishment. She thanked the financial reporting staff and the Office of Internal Auditing for all their efforts. She extended her appreciation to Darrel Huish and Carolyn Parnell and their staff. She noted that they had received a message from the Chancellor and from the Chair of the Board that cleaning up the technology issues was a priority, and they staffed it hard until those problems were resolved. Finally, she congratulated the college and university leadership for the positive audit results. She stated that it provided a strong foundation to have the discussion this committee wanted to have in January about the audit strategy for the future.

Chair Thiss commented that he had seen a steady progression toward the use of data to support progress rather than quantitative comments and he complemented the staff. He added that the Chancellor had clearly driven the message of continuous improvement all

the way down through the system, and Chair Thiss acknowledged his efforts.

Trustee Dickson stated that while it may not be appropriate for the system to issue a press release about the wonderful audit results, she encouraged the auditors to spread the word when they could about the hard work and wonderful results happening within the system.

Trustee Krinkie suggested that the Government Relations staff should share the audit results with legislators. He noted that twenty-five percent of the legislators would be arriving in January as first term members. He noted that those legislators would be making decisions in the future and would need to know that the system's fiduciary responsibility had been fulfilled and that outstanding work had been done.

Mr. Koop introduced Mr. Craig Popenhagen, the principal in charge of the Revenue Fund stand alone audit. Mr. Popenhagen stated that an unqualified opinion had been issued on the Revenue Fund financial statements. They were fairly stated in accordance with accounting principles. No significant deficiencies or material weaknesses had been identified in internal controls. He stated that the control environment was very strong.

Mr. Koop presented information on the financial statement audits that his firm conducted for Metropolitan State University, Minneapolis Community and Technical College, Rochester Community and Technical College and Southwest Minnesota State University. Some of the key points shared by Mr. Koop were as follows:

- Unqualified Opinions issued for all audits.
- No internal control, compliance, material weakness or significant deficiencies.

Mr. Koop noted that in the prior year there had been a material weakness at Rochester Community & Technical College with regards to accounts payable cut off. The college had a very intense response to ensure that finding had been addressed. He stated that there were internal control findings in the current year.

Chair Thiss asked if the Board should be concerned about the three years of operating losses at Rochester Community & Technical College. Ms. King stated that there had been some large onetime events working through their books because of an asbestos expense project and that her office had been working with the college.

Mr. Koop noted that there were no findings at Southwest Minnesota State University. The university had improved its bottom line from a significant \$3.1 million loss last year to a \$1.3 loss in the current year, but they were still in the red.

Trustee Van Houten welcomed Mr. Steve Wischmann, partner with the firm of Kern, DeWenter and Viere. Mr. Wischmann presented information on the financial statement audits that his firm conducted for Hennepin Technical College, Minnesota State University, Mankato, Minnesota State University Moorhead, Normandale Community College and Winona State University. Some of the key points shared by Mr. Wischmann were as follows:

- Unqualified Opinions issued for all audits.
- No internal control, compliance, material weakness or significant deficiencies.

Mr. Wischmann stated that this was the first year audit of Normandale Community College. He stated that his firm had reviewed the balance sheet for the college last year to obtain assurance on the beginning balances. He stated that there can be a large learning curve with first year audits, but he stated that the college had done a fantastic job of dedicating the resources they needed to ensure an efficient and effective campus audit. He thanked them for all their hard work.

Trustee Van Houten welcomed Mr. Darrel DeKam, partner with the firm of Baker Tilly Virchow Krause. Mr. DeKam presented information on the financial statement audits that his firm conducted for Bemidji State University, Century College, Minnesota State Community and Technical College and St. Cloud State University. Some of the key points shared by Mr. DeKam were as follows:

- Unqualified Opinions issued for all audits.
- No internal control, compliance, material weakness or significant deficiencies.

Mr. DeKam noted that in prior years there have been some challenges with regards to credit cards and journal entries at Bemidji State University. He stated that the issues had been cleared and that there were no internal control findings in the current year.

Mr. DeKam noted that there had been one significant deficiency with regards to materiality of journal entries at Century College in the prior year, but that finding had not reoccurred in the current year.

Mr. DeKam stated that a tornado had come through the northern part of the state just before the end of the year. He stated that the firm had been concerned that Minnesota State Community and Technical College's ability to provide all of the information that was required for the audit work would be impacted. Mr. DeKam stated that they were particularly pleased that the audit was able to proceed as scheduled. He noted that there were some unusual audit entries in order to ensure that the impact of the tornado was appropriately recorded, but the audit went very smoothly.

Trustee Van Houten called for a motion to approve the Release of the Audited Financial Statements. *Trustee Krinkie made the motion, Trustee Renier seconded. The Audit Committee recommends that the Board of Trustees approve the following motion:*

**COMMITTEE ACTION:**

*The Audit Committee has reviewed the fiscal year 2010 audited financial statements and discussed them with representatives of management and the external auditing firms. The committee recommends that the Board of Trustees adopt the following motion:*

**RECOMMENDED MOTION:**

*Based on the review and recommendation of the Audit Committee, the Board of Trustees approves the release of the fiscal year 2010 audited financial statements as submitted.*

2. Follow-up to OLA Evaluation of the System Office (Information Item)

Ms. Buse referred to the one page summary of the recommendations from the Office of the Legislative Auditor. She stated that members would be discussing the summary in the upcoming study session of the Board and that the summary would likely be attached to the letter that Chair Thiss and Chancellor McCormick would be sending to the Legislative Audit Commission.

Ms. Buse stated that members had heard discussion in each committee of the Board on the actions taken by individual committees and staff in following up on the recommendations from the report. The one page status summary was based on those discussions. Ms. Buse highlighted the discussion in the Academic and Student Affairs Committee related to online education and the cost effectiveness. She noted that particular recommendation was incorporated in the summary of office organization and that the status of that particular recommendation was in progress.

Trustee Van Houten thanked her for her report and stated that it would be helpful in the next session.

3. Progress on Committee Goals (Information Item)

Trustee Van Houten stated that in January the committee would need to consider whether to hire audit firms for six audits. He noted that the committee would also need to start serious work on the risk assessment plan, which would include discussion on the number of audits that should take place.

Ms. Buse stated that the information from the audit plan that was presented in September was also included in this month's packet materials. The timeline related to the committee's goal indicated that the committee would receive more information related to a risk assessment approach in November, but Ms. Buse stated that there had not been enough time in the last couple of months to put together a report that was worthy of the committee's consideration. She stated that she would present that information to the committee in January. She noted that the six college and university audits that would be discussed in January were the largest six college and university audits related to the financial statement audits. Trustee Van Houten noted that the only issue that had a specific deadline for January was the hiring of the audit firms.

Trustee Van Houten thanked the committee members for their work of reading through the fifteen individual audits, and he thanked the staff for putting together a set of reports and summaries that were clean and uncomplicated. He noted that it was clear that the organization took its financial responsibility seriously and that the Audit Committee took its work seriously as well.

The meeting adjourned at 11:18 a.m.

Respectfully submitted,  
Darla Senn, Recorder



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

**Agenda Item Summary Sheet**

**Committee:** Audit Committee

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

**Agenda Item:** Audit Risk Assessment Methodology Discussion

Proposed Policy Change       Approvals Required by Policy       Other Approvals       Monitoring

Information

**Cite policy requirement, or explain why item is on the Board agenda:**

As part of the Fiscal Year 2011 Audit Plan, the Office of Internal Auditing proposed conducting a risk assessment.

**Scheduled Presenter(s):**

Beth Buse, Executive Director, Office of Internal Auditing

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

- Overview of system risk management practices.
- Coordination with Finance division, Information Technology division, and Office of General Counsel.
- Proposed methodology for determining risk factors for development of fiscal year 2012 audit plan.

**Background Information:**

- As part of the Audit Plan for Fiscal Year 2011, presented to the Audit Committee in September 2010, the Office of Internal Auditing proposed an Audit Approach Evaluation which included determining a risk assessment methodology.
- 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 and value-added projects.

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

**BOARD INFORMATION**

**AUDIT RISK ASSESSMENT METHODOLOGY DISCUSSION**

Professional internal auditing standards require; the chief audit executive (CAE) to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organizations goals.<sup>1</sup> Guidance on this standard states that the CAE should prepare the audit plan based on the audit universe, input from senior management and the board, and an assessment of risk and exposures affecting the organization.

When a formal process or Enterprise Risk Management (ERM<sup>2</sup>) program exists, internal audit is able to leverage the results to limit additional risk assessment. However, a mature process does not exist within the Minnesota State College and University system.

**Overview of Risk Management in the Minnesota State College and University System**

Every day system leaders and managers make risk based decisions in the day to day activities that are common on college and university campuses:

- Should we expand the number of employees that have purchasing cards?
- When it is snowing, how often should we remove the snow from walkways?
- Should we allow student workers to file student and parent tax forms in financial aid files?
- How many employees should have access to make student grade changes?

The board’s current expectations regarding risk management are contained in Board Policy 5.16 – Risk Management and Insurance:

*Part 2. Responsibilities: The chancellor for the office of the chancellor and the presidents for the colleges and universities are responsible for effectively managing risks in order to conserve and manage the assets of the office of the chancellor, colleges and universities and minimize the adverse impacts of risks or losses.*

The Office of the Internal Auditor, the General Counsel’s office and the Finance Division have participated in a structured approach to risk assessment and mitigation that includes:

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<sup>1</sup> Institute of Internal Auditors, International Standards for the Professional Practice of Internal Auditing 2010 - Planning.

<sup>2</sup> The Committee of Sponsoring Organizations (COSO) of the Treadway Commission defines ERM as a "...process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”

- Regular and repeated training programs available to the campuses concerning systems, policies, procedures and guidelines
- Cascading monitoring and reporting protocols that culminate in Board Audit and Finance and Facilities Committee oversight
- Regular review of policy and procedures for refreshment and identification of new or emerging best practices and risks.

The Finance division also requires all colleges and universities to document and assess risk on their key financial internal control cycles. Internal controls are expected to provide reasonable, but not absolute assurances about their effectiveness.

The system is in the beginning phases of developing a more formalized risk assessment strategy. A risk assessment strategy is a key management tool for protecting an organization. A formal risk assessment and management strategy is a process-driven tool that enables senior management to visualize, assess, and manage significant risks that may adversely impact the attainment of key organizational objectives; ideally, it is integrated with the strategic planning process.

While this process will likely take several years until it is fully implemented, as the systemwide risk assessment program is formalized and matures, the Office of Internal Auditing will be able to leverage the results in future annual risk assessments. However, in the near-term, the Office of Internal Auditing will coordinate with the Finance Division and Office of General Counsel to conduct initial risk assessment meetings. Coordination of initial meetings should help reduce duplication of effort and eliminate confusion related to the dual-purpose of collecting the information.

### **Research on Higher Education Internal Audit Risk Assessment Processes**

The Office of Internal Auditing conducted research on internal audit risk assessment best practices and methodologies to provide insight in determining a methodology for supporting the Audit Committee's goal of reevaluating the audit approach for the system. We reviewed materials and held conversations with internal audit employees from many higher education systems and institutions to determine the processes used for their annual audit risk assessment. In the end, we determined that there are a variety of methods used in conducting risk assessments for building annual audit plans. A number of factors come into play in determining a risk assessment process including: the maturity of an enterprise risk management program, available audit resources, complexity of the organization, and auditor professional judgment.

### **Proposed Audit Risk Assessment Methodology**

We recommend a three-staged approach to conduct our audit risk assessment as depicted and described below. In stage one, systemwide meetings to identify risk factors would be conducted jointly with the Finance Division, Office of General Counsel and the Office of Internal Auditing. The remaining two stages would be facilitated by the Office of Internal Auditing.



- **Systemwide Risk Factors**

Representatives of the Finance division, Office of Internal Audit, and Office of General Counsel will meet with senior leadership and others to discuss risk factors.

Regional meetings will take place in February 2011 in conjunction with Vice Chancellor King's Trends and Highlights sessions with the leadership at 25 colleges that do not have an annual financial statement audit. In March, meetings will be held with a sampling of leadership from the 13 largest colleges and universities.

Other meetings will include representatives from Board of Trustees, Chancellor and his executive leadership, external auditors, and other focused groups to be determined (may include, for example, groups of chief financial officers, financial aid directors, and registrars).

- **Fiscal-Focused Risk Factors**

Internal Audit will assess individual college and university fiscal internal controls based on several factors that may include: financial activity, transaction volume, prior audit findings, exception reporting, staff size and turn-over, and systems security access. We will begin to build and use data analysis techniques to identify potential vulnerabilities.

- **Information Technology Risk Factors**

Internal Audit will develop an initial methodology for conducting an information technology audit risk assessment. The first two stages may include information technology components as they relate to key activities.

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

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

**Agenda Item Summary Sheet**

**Committee:** Audit Committee

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

**Agenda Item:** Review External 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:**

According to Board Policy 1A2, Part 5, Subpart E, the Audit Committee oversees the work of external auditors. The audit contracts for six individual college and university audits have expired.

**Scheduled Presenter(s):**

Beth Buse, Executive Director, Office of Internal Auditing  
Laura King, Vice Chancellor - CFO

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

- The contract with the principal auditor, LarsonAllen, requires that the system contract for individual financial statement audits of colleges and universities so that at least 60% of the system-wide financial activity is covered by individual college and university audits.
- There are five universities and one college whose contracts have expired. This group includes the largest universities in the system and collectively accounts for 40% of system assets and 41% of system operating expenses (based on fiscal year 2010 data).
- The Office of Internal Auditing and the Finance Division recommend continuing financial statement audits of the six institutions.

**Background Information:**

In August 2010, the Audit Committee approved a committee goal for the year that included a consideration of the value and role of obtaining annual financial statement audits for individual colleges and universities. Although, this decision does not satisfy the goal, it is an interim step to a June 2011 recommendation to the Board of Trustees.

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

<b>BOARD INFORMATION</b>
REVIEW EXTERNAL AUDIT PLAN

In 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. In 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. 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.

The contract with the Minnesota State College and University system’s principal auditor, LarsonAllen, LLP, requires that the system contract for individual financial statement audits of colleges and universities so that at least 60% of the system-wide financial activity is covered by individual college and university audits. Two years remain on the current three-year contract.

In August 2010, the Audit Committee approved a committee goal for the year of completing a thorough evaluation of the audit approach for the Minnesota State Colleges and Universities. Included in the evaluation is a consideration of the value and role of obtaining annual financial statement audits for individual colleges and universities.

Table 1 shows six of the largest institutions that have expired contracts. These institutions accounted for approximately 40% of system financial activity in fiscal year 2010.

**Table 1: College or University Financial Statement Audits with Expired Contracts**

Audited Institution	% System Assets	% System Operating Expenses
Bemidji State University	3.84%	4.36%
Minnesota State Community & Technical College	1.88%	2.89%
MSU, Mankato	10.85%	10.18%
MSU Moorhead	5.17%	5.33%
St. Cloud State University	9.49%	11.14%
Winona State University	8.74%	6.78%
Total	39.97%	40.67%

Note: Percentages are based on fiscal year 2010 financial statements.

## Survey of Six Institutions

For the six institutions with expired contracts, presidents and chief financial officers were surveyed to assess their opinions on the value of audited financial statements. They were asked to rate the usefulness of audited financial statements for meeting the needs of external and internal audiences.

- Generally, the audited financial statements were viewed as very valuable information for accreditation agencies and potential donors.
- Presidents and chief financial officers had some notable differences on the value of audited financial statements for internal audiences. Presidents found this information very valuable for administrators; while chief financial officers found this moderately valuable. Presidents also found it valuable for the audited statements to demonstrate fiscal accountability and stewardship to faculty and students, however, the chief financial officers thought that the information had limited value for faculty and students.
- Both the presidents and chief financial officers generally agreed that financial statements were valuable for a wide range of fiscal information needs: providing a comprehensive financial picture, monitoring financial results, establishing fiscal discipline, evaluating the effectiveness of fiscal controls, and assessing business office performance. However, while presidents rated these items as “very valuable”, most CFOs rated these items as “somewhat valuable”.
- In addition, the survey asked the following open ended question:

*If the individually audited statements were no longer required by the Office of the Chancellor, would you consider continuing to have an externally audited financial statement?*

All participants responding to this question indicated that they would consider having an external audit even if not required. However, they did suggest that the audit costs would factor into their decision making. Most desired to see the process continue as it has. One university is required to have an audit due to a unique financing arrangement with another governmental entity. One chief financial officer commented, at a minimum, there is a need for periodic reviews and testing of institutional internal controls. Another chief financial officer suggested that some transactions with its foundation could be impacted without audited financial statements.

## Next Steps:

In order to have contracts in place to audit financial activity for fiscal year 2011, the Office of Internal Auditing and the Finance Division need to proceed with the following steps.

- January and February 2011 – The Office of Internal Auditing and the Finance Division will prepare a request for proposal (RFP) to solicit interest from external audit firms for financial statement audits for the five universities and one college with expired contracts for fiscal years 2011, 2012, and 2013.

The Office of Internal Auditing, Finance Division, and the six institutions will evaluate the proposals to develop a recommendation to the Board of Trustees. The evaluation criteria will include: qualifications, understanding of objectives, work plan and cost.

- March 2011 – The Board of Trustees will take action on a recommended motion for the appointment of external audit firms for the six institutions.
- June 2011 – As part of the Audit Committee’s goal for the fiscal year, the Office of Internal Auditing, in consultation with the Finance Division, will recommend a new Strategic Plan for External Audit Services to the Board of Trustees.

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



**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  
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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

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## 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.