

Minnesota State Colleges & Universities
Office of Internal Auditing

Independent Validation of the Internal Auditing Self-Assessment

Final Report
March 7, 2007

Reference Number: 2007-03-004

**INDEPENDENT VALIDATION OF THE
INTERNAL AUDITING SELF-ASSESSMENT**

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
OFFICE OF INTERNAL AUDITING**

MARCH 2007

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INDEPENDENT VALIDATION REPORT

March 7, 2007

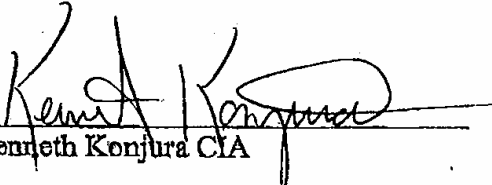
John Asmussen, Executive Director
Office of Internal Auditing
Minnesota State Colleges and Universities

Dear John,

As representatives of the Twin Cities Chapter of the Institute Auditors (IIA), we were engaged to conduct an independent validation of the Office of Internal Auditing for the Minnesota State Universities and Colleges (MnSCU) self-assessment. The primary objective was to verify the assertions made in the attached self-assessment report, concerning adequate fulfillment of the organization's basic expectations of the MnSCU's Office of Internal Auditing and its conformity to the IIA's Standards for the Professional Practice of Internal Auditing. Other matters that might have been covered in a full independent assessment, such as in-depth analysis of best practices, governance, consulting services, and use of advanced technology, were excluded from the scope of this independent validation.


In acting as independent validators, pursuant to the framework approved by the Board of Governors of the Twin Cities Chapter of the IIA, we are fully independent of the organization and have the necessary knowledge and skills to undertake this engagement. Our validation, conducted on March 5-6, 2007, consisted primarily of a review and testing of the procedures and results of the self-assessment. In addition, we conducted interviews with the Associated Vice Chancellor of Financial Reporting, Vice Chancellor and Chief Financial Officer, Vice Chancellor and CIO, The Chancellor of MnSCU, and the chairman of the audit committee (to whom the CAE reports.). These interviews help us in gaining a better understanding of the internal control environment and the environment in which The Office of Internal Audit operates.

We have reviewed the results of the validation with the concurring reviewer on the engagement, Brent Brickman, Director of Internal Audit for Valspar. The independent validation team concurs with self assessment performed by The Office of Internal Audit for MnSCU that its practices are in conformance with the IIA Standards for the Professional Practice of Internal Auditing.



Kenneth Konjura CIA

3/7/07
Date



Karen Marquardt

3/7/07
Date

BACKGROUND

In January, 2002, the Institute of Internal Auditors (IIA), the professional organization responsible for promulgating the professional standards for the practice of internal auditing, added *Standard 1312 – External Assessments*. This standard requires internal audit organizations to undergo an external quality assessment review at least once every five years. For reasons of practicality, the IIA has provided an alternative method to comply with *Standard 1312*, designated as a “self-assessment with independent validation”.

The principal features of the self-assessment with independent validation are similar to those followed by an independent reviewer or review team, however the self-assessment is performed under the direction of the chief audit executive by competent in-house professionals. The self-assessment must be adequately documented. Conclusions reached as to conformity to the *Standards*, recommendations for improvement and plans for their implementation should be drafted in a report. This report would be presented to the audit committee and senior management after a review by the independent evaluator.

Qualified, independent evaluators conduct interviews with the audit committee chair, key senior executives and perform limited tests of the self-assessment. The evaluators draft a report to the board and senior management to validate the results of the self-assessment, and if appropriate, provide additional recommendations and express an opinion as to the adequacy of the self-assessment process and indicate the level of the internal audit activity’s conformity to the *Standards*.

As directed by professional standards, the Minnesota State Colleges and Universities (MnSCU) Office of Internal Auditing (Internal Auditing) has completed and fully documented a self-assessment process. This report serves as the final product of that self-assessment of the Office of Internal Auditing. The principal objectives of the self-assessment were (1) to assess conformance to the IIA’s *Standards for the Professional Practice of Internal Auditing (Standards)*, (2) evaluate the internal auditing activity’s effectiveness in carrying out its mission, as set forth in its charter and expressed in the expectations of the management, and (3) identify opportunities to enhance its management and work processes, as well as its value to MnSCU.

The environment of Internal Auditing is well-structured and progressive, where *IIA Standards* are understood and its management endeavors to implement appropriate practices. Among these practices are the following:

- The mission, values and principles and vision statements of the Office of Internal Auditing are defined in Board Policy and are understood and practiced by the organization.
- The Executive Director reports directly to the Board of Trustees through the Chair of the Audit Committee. This is considered the optimum reporting arrangement,

- giving the right and responsibility to report directly to the Board of Trustees any circumstances that are significant violations of MnSCU controls or policies/procedures, and any other matters that warrant Trustee notification.
- In addition, Internal Auditing partners with management. The Executive Director reports administratively to the Chancellor of the Minnesota State Colleges and Universities system. The Executive Director is a member of the Chancellor's cabinet, which meets weekly, and also attends monthly Leadership Council meetings which include the Chancellor's cabinet and all college and university presidents. Because the internal audit function is shared with the Chancellor and the presidents, the Executive Director also has the right and responsibility to report any matters to the Chancellor and the presidents that warrant notification or to assist them in improving operations.
 - The Executive Director has built an internal audit staff to support the needs of the system and to become a value-added knowledge resource center. This includes the hiring of experienced professionals from a variety of backgrounds, promoting professional certifications, and supporting professional development and training.
 - In order to facilitate compliance with certain IIA *Standards*, the Office of Internal Auditing has developed internal guidelines for clarification and guidance on how it will comply with the *Standards*.

The Office of Internal Auditing has built a good reputation and credibility within the MnSCU system. Consequently, comments and recommendations are intended to build on the foundation already in place. Recommendations are set forth below in the *Observations and Conclusions* section of this report.

METHODOLOGY

Planning and Preparation

In January, 2006, the MnSCU Audit Committee accepted a proposal that the Office of Internal Auditing undergo an external assessment using the alternate self-study option with independent validation services procured through the Twin Cities Chapter of the IIA. The Executive Director of Internal Auditing designated Carolyn Gabel, an employee of the MnSCU Office of Internal Auditing, as the project manager to lead the self-assessment.

The IIA has developed a set of tools which includes checklists, guides and structured review programs to facilitate performance of external quality assessments and self-assessments that are subsequently submitted to an external validator. The tools incorporate the requirements of the *Standards* and relevant guidance from the *Practice Advisories*. The tools have been referenced to the *Standards* to assist in evaluating whether the internal audit activity is conforming to the *Standards*. The Executive Director and the self-assessment project leader reviewed and determined which of the tools should be completed as part of the self-study.

The internal assessment team was selected from Office of Internal Auditing staff, as they are familiar with the internal audit charter, the organization, the policies and procedures of the organization and the internal audit activities. Under the direction of the self-assessment project manager, employees of the MnSCU Office of Internal Auditing were assigned a variety of tasks in preparation for the quality self-assessment.

The primary activities in the planning and preparation phase were to complete relevant portions of the Self-Study (Tool 2) and the Chief Audit Executive (CAE) Questionnaire (Tool 3). Completion of Tools 2 and 3 are intended to assess the efficiency and effectiveness of the internal auditing activities, identify opportunities for improvement and provide an opinion as to the degree of conformity to the *IIA Standards*.

Surveys were not sent to audit or consulting customers, or others served by Internal Auditing. However, a survey of the Office of Internal Auditing employees was performed. One of the Internal Auditing staff members, the Director of Consulting Services, managed the staff survey as part of the overall self-assessment. The Executive Director asked the Director of Consulting Services to maintain confidentiality of all responses, prepare and provide a summary of the responses to the external validators, and then only subsequently make it available to others within Internal Auditing.

As part of the planning and preparation process, a qualified, independent evaluation team was engaged and performed the validation phase of the self-assessment.

Self-Assessment Fieldwork

Fieldwork activities included completion of relevant portions of additional IIA Tools to assess Internal Auditing's structure and organization, risk assessment and engagement planning processes, and engagement and staff management processes.

Review of individual engagement work papers was a core element of the assessment. The Office of Internal Auditing offers assurance, consulting, investigative and professional advice services to assist the Board of Trustees, Chancellor and presidents in accomplishing their objectives and in improving operations. A representative and well-balanced sample of engagements was randomly selected for review from all services performed by the Office of Internal Auditing in calendar year 2005. All audit coordinators participated in the work paper review. For each sample engagement selected for review, the audit coordinator completed the Individual Work Paper File Review Program (Tool 17) developed by the IIA to evaluate the effectiveness of guidance provided to staff and the coordination with management for planning, conducting, reporting and following-up on individual engagements. The tool is designed to determine whether staff and supervisors are adhering to the *Standards* and provide information on which to base recommendations for enhancing the Internal Auditing's effectiveness.

Self-Assessment Results, Recommendations and Implementation Plans

The aforementioned activities contribute to the preparation of the overall report. The report contains the results/findings, with emphasis on opportunities for process improvement and action plans for implementation of the improvements. A draft self assessment report was provided to the independent validation team for its review. This final self-assessment report was amended based on the work conducted by the independent validation team; it represents the conclusions agreed upon between the Executive Director of Internal Auditing and the independent validation team.

OPINION AS TO CONFORMITY TO THE STANDARDS

It is our opinion that the activity of the Office of Internal Auditing generally conforms to the following *Standards*:

- 1000 – Purpose, Authority, and Responsibility (Charter),
- 1100 – Independence and Objectivity,
- 1200 – Proficiency and Due Professional Care,
- 1300 – Quality Assurance/Improvement Program,
- 2000 – Managing the Internal Audit Activity,
- 2100 – Nature of Work,
- 2200 – Engagement Planning,
- 2300 – Performing the Engagement,
- 2400 – Communicating Results,
- 2500 – Monitoring Progress
- 2600 – Management’s Acceptance of Risks, and
- The IIA’s Code of Ethics.

However, we found opportunities for further improvement in the following areas: enhancing its quality assurance and improvement program covering all aspects of the internal audit activity, including periodic internal and external quality assessments and ongoing internal monitoring; improving work paper documentation linking fieldwork to final audit reports; and planning for information technology audits.

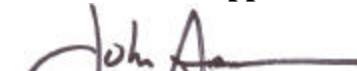
In our lexicon, “generally conforms” means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards*, with some opportunities for improvement, as discussed in our recommendations. “Partially conforms” means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner. “Does not conform” means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

Prepared by:



Carolyn Gabel, CPA
Regional Audit Coordinator
Self-Assessment Project Manager
Office of Internal Auditing

Reviewed and Approved by:



John Asmussen, CPA, CIA, CISA, MBA
Executive Director
Office of Internal Auditing

Team Members :

- Carolyn Gabel, CPA (Project Manager)
- John Asmussen, CPA, CIA, CISA, MBA
- Beth Buse, CPA, CIA, CISA
- Craig Fautsch
- Beth Fondell, CPA
- Marita Hickman, CPA, MBA
- Kim McLaughlin, CPA, CFE
- Eric Okpala, CPA, CISA, MBA
- Melissa Primus, CPA, CIA
- Darla Senn
- Julie Smendzuik-O'Brien, MPA, CQM

OBSERVATIONS AND RECOMMENDATIONS

1. The Office of Internal Auditing should enhance its quality assurance and improvement program.

The Office of Internal Auditing has an internal process for developing guidelines to provide assistance on how it will comply with certain IIA *Standards*. In an effort to comply with IIA *Standard 1300 – Quality Assurance and Improvement Program* and related standards, Internal Auditing has developed a set of guidelines for its operations, many of which have been adopted and are periodically reviewed and modified. Internal Auditing recently adopted a final guideline for IIA Standard 1300 and its implementation is scheduled to be phased in over the next few years.

MnSCU Internal Auditing Guideline 1300 identifies how the office will conduct periodic assessments and ensure its quality assessment program remains up-to-date. External assessments are required to be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization. This report constitutes a “self-assessment with independent validation” that satisfies the external quality assessment requirements of the *IIA Standards*. In addition, the *Standards* require periodic internal quality assessments to be conducted more frequently than the external quality assessment. The newly adopted MnSCU Internal Auditing Guideline 1300 requires an internal self-assessment at least every two years. Internal Auditing plans to implement that provision prospectively.

Once implemented, it is important that Internal Auditing continue its efforts to monitor the quality of its programs. Annually, Internal Auditing presents a report to the Board of Trustees about the past year’s activities which includes an analysis of actual hours against planned hours. It uses other metrics for internal management purposes, such as evaluating staff performance. Examples include a distribution of time spent at individual colleges and universities and frequency of responses to professional advice questions or engagements with reported fraud incidents. Internal Auditing should explore using some of these metrics as measures of organizational quality and report them in its annual report to the board. Furthermore, Internal Auditing should consider using some qualitative measures, such as client satisfaction surveys.

Finally, MnSCU Internal Auditing Guideline 1300 establishes a 3-year schedule for Internal Auditing to review its guidelines. The intent of this process is to ensure that practice remains aligned with professional standards. Because of the importance of the Internal Auditing charter as a foundational document, it should be reviewed annually for sufficiency and any proposed changes discussed with the Audit Committee as part of the annual reporting process.

Recommendations:

- *The Office of Internal Auditing should ensure that the internal quality assessment provisions of Guideline 1300 are implemented in future years.*
- *The Office of Internal Auditing should explore the use of additional qualitative and quantitative measures that can be used to assess the efficiency and effectiveness of the internal audit activity.*
- *The Executive Director of Internal Auditing should review the internal audit charter annually and discuss any proposed changes with the Audit Committee.*

MANAGEMENT RESPONSE: *We concur with these recommendations.*

RESPONSIBLE PARTY: *Executive Director of Internal Auditing*

EXPECTED COMPLETION DATE: *September 2007 for reviewing quality metrics and Audit Charter. The next scheduled periodic internal quality assessment review will occur in with the results reported to the Audit Committee in September 2009. The next scheduled external quality assessment will occur in 2011 with result presented to the Audit Committee in September 2011.*

2. Improvement is needed in retaining evidence that demonstrates that final audit reports have been subject to internal review and offered for management response.

Review and testing of engagement work papers was performed to determine whether work papers adequately document the procedures performed, information obtained, conclusions reached and support for engagement communications. In general, work papers and other documentation prepared by Internal Auditing adequately met those objectives, but improvement could be made with evidence that documents internal reviews and dissemination of draft reports to management for responses.

Documentation was not retained related to discussions of certain draft reports, proposed management letter comments or findings with college or university management or personnel. Discussions with Internal Auditing management and staff indicated that the reviews had been conducted and that MnSCU management had been offered opportunities to review and comment on draft reports. To provide physical evidence of compliance with *IIA Standard 2330*, Internal Auditing should develop internal tools for gathering evidence of its report review process.

Recommendations:

- *Appropriate evidence of supervision and review should be documented and retained. For example, evidence may consist of completing a checklist or preparing a memorandum specifying the nature, extent and results of the review.*
- *The engagement work papers should include support for communications. As previously suggested, this could include preparation of notes or memoranda documenting the discussions, or completion of a work paper checklist for providing evidence of communications with engagement clients.*

MANAGEMENT RESPONSE: *We concur with these recommendations and will create templates or checklists to accumulate evidence of report reviews. Also, we will modify Internal Auditing Guideline 2300 as appropriate.*

RESPONSIBLE PARTY: *Executive Director of Internal Auditing*

EXPECTED COMPLETION DATE: *June 30, 2007*

3. Periodic assessments of information technology risks should be communicated to the Audit Committee as part of the audit planning process.

The Office of Internal Auditing conducts an annual risk assessment process and reports the results to the Audit Committee. The risk assessment is the basis for the annual internal auditing plan and the strategic external auditing plan. For the past several years, MnSCU has contracted with the Office of the Legislative Auditor (OLA) to conduct information technology (IT) audits of selected areas. The IT audit topics have been selected based on a collaborative assessment conducted by MnSCU Information Technology, MnSCU Finance, and MnSCU Internal Auditing. The results of the OLA IT audits have been reported to the Audit Committee.

The Office of the Legislative Auditor has encountered some staffing challenges that have not allowed it to provide IT audit coverage for MnSCU in the past year. As a result, the January 2007 Request for Proposal for external auditing services cited the need for the principal MnSCU external auditor to conduct IT audit work necessary to render an opinion on the MnSCU financial statements. This IT audit coverage will not, however, address broader IT risks related to operations.

Because of the importance of information technology to MnSCU operations, Internal Auditing should consider devoting a discrete component of its annual risk assessment process to IT. An audit plan for IT areas could either be incorporated into the annual internal auditing plan or created as a more strategic long-term plan, similar to the approach taken for external auditors.

Recommendation:

- *Internal Auditing should consider a more rigorous process for assessing information technology risks and planning IT audits.*

MANAGEMENT RESPONSE: *We concur. The Executive Director of Internal Auditing will work with the MnSCU Information Technology Services and Finance Divisions to create a risk assessment and audit plan for information technology areas.*

RESPONSIBLE PARTY: *Executive Director of Internal Auditing*

EXPECTED COMPLETION DATE: *May 2007*