MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES

Agenda Item Summary Sheet

Committee: Audit Committee          Date of Meeting: September 18, 2007

Agenda Item: Review Office of Legislative Auditor Report

☐ Proposed Policy Change ☐ Approvals Required by Policy ☒ Other Approvals ☐ Monitoring

☐ Information

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

This audit was conducted consistent with the schedule of external audits approved by the Board of Trustees in January 2005, and with the fiscal year 2007 internal auditing plan.

Scheduled Presenter(s):

John Asmussen, Executive Director, Office of Internal Auditing
Brad White, Legislative Audit Manager
Mike Hassing, Legislative Audit Manager

Outline of Key Points/Policy Issues:

➢ The public release of this audit report will occur at the September 18, 2007 audit committee meeting. Therefore, the contents may not be disclosed publicly prior to that time.

Background Information:

➢ The audit scope covered seven colleges that are not subject to annual financial statement audits by Certified Public Accounting firms.
➢ The Office of the Chancellor has a contract with the Office of the Legislative Auditor that provides for periodic audits of colleges.
➢ The audit cycle for the colleges not subject to annual financial statement audits (generally the smaller colleges) is approximately one audit every three years.
➢ The audit also tested contract compliance at a few additional colleges and universities.
BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES

BOARD ACTION

REVIEW OFFICE OF LEGISLATIVE AUDITOR REPORT

BACKGROUND

The public release of this audit report will occur at the September 18, 2007 audit committee meeting. Therefore, the contents may not be disclosed publicly prior to that time. Supplemental materials and copies of the final report will be available at the audit committee meeting. Additional copies of the final report may be obtained from the Office of the Legislative Auditor web site: www.auditor.leg.state.mn.us starting on September 18, 2007.

Date Presented to the Board of Trustee: September 18, 2007
OVERVIEW

On September 18, 2007, the Office of the Legislative Auditor released its most recent audit report on the Minnesota State Colleges and Universities. The report has 24 audit finding statements that mostly represent opportunities for operational improvements. One finding, though, will require further consideration by a Board of Trustees’ policy committee and four other findings concern critical issues needing immediate attention.

AUDIT SCOPE

As part of its strategic external audit plan, the Office of the Chancellor contracts with the Legislative Auditor to conduct periodic financial audits. Each year, the Legislative Auditor audits about 7-8 colleges (the seven universities and five large colleges have annual financial statement audits conducted by CPA firms). The Legislative Auditor consults with MnSCU Internal Auditing and the Office of the Chancellor Finance Division on the audit scope, but possesses independent authority to audit other areas at its discretion. There were three major components to the 2007 audits:

- Routine audits of core\(^1\) transaction cycles such as tuition, payroll, and administrative expenditures of seven MnSCU colleges: Central Lakes College, Inver Hills Community College, Normandale Community College, Riverland Community College, Pine Technical College, St. Cloud Technical College, and Ridgewater Community and Technical College.

- Additional audit coverage of transaction types that had not been examined in previous audits of these seven colleges. These transactions lacked the materiality of core operations, but were subject to higher risk of errors. Areas added to the scope included supplemental faculty pay, employee severance pay, leave accruals, local banking and remote cash collections points, and arrangements with affiliated parties.

- A separate review of professional-technical contract services incurred during fiscal year 2006 throughout the MnSCU system. This audit was part of a larger state-wide project that the Office of the Legislative Auditor was conducting.

\(^1\) Core transaction cycles encompass the material revenue and expenditure activities of the colleges. These core cycles are of such fundamental importance that they are examined for every audit.
RESULTS

The auditor’s overall conclusion was that MnSCU “generally safeguarded assets and correctly recorded financial activities for the areas we examined. With certain exceptions, these colleges and universities complied with MnSCU policies and management’s authorizations for tested transactions.” The size of the audit report (70 pages and 24 audit finding statements\(^2\)), though, seems to contradict this positive conclusion. To interpret the results of this audit, it is necessary to consider the audit findings in the context of the audit scope and the relative severity of the findings. In fact, further analysis reveals that the audit results in this report are comparable to prior years. Figure 1 shows the recent historical trend of the number and severity of Legislative Audit findings for the core audit areas of seven colleges each year.

\[\text{Figure 1: Trend of Audit Findings based on Core Audit Scope} \]

\[\text{2004 to 2007}\]

- Number of Core Findings
- Report Year
- Critical: [ ]
- Important: [ ]
- Limited: [ ]

Source: MnSCU Internal Auditing analysis of Legislative Audit reports.
Notes:
(1) 2004 audits actually represent the prior audit reports for the 7 colleges audited in 2007. Reports on two colleges (Pine Technical and Ridgewater) were from 2003 and the other five colleges were audited in 2004.
(2) The Office of the Chancellor was also audited in 2005, but its audit findings are not included to achieve comparability (7 colleges each year).
(3) The Legislative Auditor conducted a special audit of Lake Superior College in 2006; again, for comparability purposes, its results are not included.
(4) See discussion in text for definition of core audit scope areas.
(5) MnSCU Internal Auditing assigned the values of “critical”, “important” or “limited impact” to each audit finding. These values indicate the relative severity of each finding:
  - “Critical” findings merit immediate attention and remedy,
  - “Important” findings may develop into serious problems, but do not show evidence that immediate adverse consequences exist, and
  - “Limited Impact” findings indicate problems that have limited consequences and low risk.

\(^2\) Note that an audit finding statement may cite more than one college. The 2007 report has 65 findings contained in 24 finding statements.
Figure 1, however, aggregates findings for the seven colleges and does not reveal the trends at individual colleges. To overcome this averaging effect, Figure 2 provides a breakdown of the core audit findings by college. It shows that Pine Technical College was an outlier in the prior audit with 14 audit findings. The college has shown substantial improvement in its most recent audit with only three findings from core audit areas. Five of the other colleges, though, were cited for more core audit findings in 2007 than their prior audit. These increases may be due, in part, to a new approach taken by the auditors in 2007 or could signal some deterioration in internal controls. In any event, the audit findings serve as a reminder that periodic assessments of controls provide an opportunity for continuous improvement.

As previously indicated, the audit scope for the 2007 Legislative Audit report was expanded beyond the core areas. The auditors were able to expand the scope into several areas that had not been audited previously. MnSCU Internal Auditing and Finance worked with the auditors to identify the highest priority areas to add to the scope. In addition, the Legislative Auditor had conducted a separate audit of professional technical –contracts of major state agencies, including MnSCU. Findings related to MnSCU were included in the 2007 report. Regardless of the origin of these audit findings, it is necessary to view them as continuous improvement opportunities and take corrective action as warranted. Figure 3 shows the breakdown of the 2007 audit findings by audit scope. Findings from the new areas were classified mostly as “limited impact”, but a couple “critical” findings were identified (discussed later). The contract audit area identified relatively few findings. The Office of the Chancellor has devoted significant attention to improving contract procedures
Critical Audit Findings

Internal Auditing classified five audit findings as “critical”, meaning that immediate remedial action should be taken.

- Findings 23 and 24 pertained to the Employment and Training Center at Pine Technical College. The college has entered into joint powers agreements with area counties to sponsor this center for many years. The 2007 audit was the first time that certain aspects of this relationship had been examined by the auditors. In finding 23, the auditors raised questions about the authority for creating this center; a policy committee of the board will need to consider this issue further (see recommended board motion). Finding 24 centers on compliance with MnSCU Procedure 7.3.4 on cost allocation; the Office of the Chancellor Finance Division will work with the college on its resolution.

- Findings 5 and 6 cited several errors that colleges had made in calculating supplemental faculty pay and severance payments. Inver Hills Community College, in particular, had a large number of exceptions. The college has indicated that it has implemented several actions that will correct the past errors and avoid future ones.

- Finding 16 raised several questions about a $1 million contract entered into by Metropolitan State University. The Vice Chancellor – CFO has requested that Internal Auditing examine this contract further.
Finding 4 cited a fundamental deficiency in the main cashiering operation at Central Lakes College. The college has reported that it has taken prompt corrective action to remediate this situation.

**Important Audit Findings**

Internal Auditing classified 22 findings as “important”, meaning the findings should be resolved to prevent serious problems developing in the future. Most of these findings were in two core audit areas:

- Tuition and fee collection is the major source of revenue for colleges and universities. Four colleges needed to exercise more caution when retaining sensitive credit card information. One college had overpaid students when executing backdated drop transactions.

- Administrative expenditures consist of purchasing goods and services from vendors. Most colleges were cited for some weaknesses in documenting, processing, and recording expense transactions. Three colleges experienced problems with equipment inventory records. Three colleges were cited for inappropriate use of vendor issued credit cards.

**Other Audit Findings**

Internal Auditing classified the remaining findings as either “limited impact” (27 findings) or “other matters needing consideration” (11 findings). These findings are either isolated in nature or require a cost benefit analysis prior to determining whether corrective action is warranted. The Office of the Chancellor has coordinated the development of a corrective action plan that is attached to the final audit report.

**Resolution of Prior Audit Findings**

On pages 51-52 of the report, the Legislative Auditor includes a schedule on the status of prior audit findings. Of the prior findings assessed by the auditor, 15 of 19 findings were deemed fully implemented, two findings were partially resolved, one finding was now considered immaterial, and one finding was considered unresolved.

Internal Auditing has examined the material, unresolved findings further. Two findings concern security access controls. Internal Auditing believes that these two colleges were responsive to the prior conditions and took necessary remedial actions. For the 2007 findings, the Legislative Auditor has applied different criteria and is in essence citing a somewhat different problem, than the previous audit findings. The fundamental issue cited

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3 Backdated drop transactions received close scrutiny by the Audit Committee after the 2006 Legislative Audit report cited several problems with the transactions. Internal Auditing and MnSCU Finance took steps to build awareness about the risk of these transactions in early calendar year 2007. The problems cited in the 2007 audit report occurred in 2006 and prior years.
in Finding 1 merits further exploration by the Office of the Chancellor so that common
expectations are developed for colleges and universities that opt to implement detective
controls.

The other finding cited as partially implemented concerns backdated drop transactions
processed by Riverland Community College. The college has indicated that it has
implemented a rigorous practice in early calendar year 2007 to control these transactions.
Those changes would have occurred after the period tested by the auditors. Internal
Auditing will follow-up to ensure that the new practices are in place and operating
effectively.

Corrective Action Plan and Audit Follow-up

The Vice Chancellor – CFO has provided a written response that is attached to the audit
report. It concurs with the audit findings and provides a detailed corrective action plan.
Chancellor McCormick has communicated to presidents that he expects them to implement
these corrective actions promptly. Internal Auditing will follow-up on these findings and
provide periodic status reports to presidents, the Chancellor, and the Audit Committee as
necessary. Finally, the Vice Chancellor – CFO plans to distribute copies of the report to all
presidents and chief financial officers as a learning opportunity.

RECOMMENDED COMMITTEE ACTION

Based on its review, the Audit Committee recommends that the Board of Trustees adopt the
following motion:

RECOMMENDED MOTION

The Board Chair shall refer the audit finding pertaining to the authority for Pine Technical
College to enter into a joint powers agreement for the operation of its Employment &
Training Center to another policy committee of the board for further consideration.

The Board of Trustees expects that the Office of the Chancellor will work with college and
university presidents to ensure prompt implementation of the corrective actions provided in
response to Legislative Audit Report 2007-25. The Office of Internal Auditing shall
provide periodic reports to the presidents, Chancellor, and Audit Committee on the status
of these audit findings.

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