

Financial-Related Audit

**Minnesota State Colleges and
Universities
Office of the Chancellor
July 1, 1998, through June 30, 2001**



Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. James H. McCormick, Chancellor
Minnesota State Colleges and Universities

Members of the Minnesota State Colleges and Universities Board of Trustees

We have audited selected areas of the Office of the Chancellor for the period July 1, 1998, through June 30, 2001, as further explained in Chapter 1. Our audit scope included: financial management, payroll and employee expenditures, consultant contracts and capital outlay expenditures, and other administrative expenditures. We emphasize this has not been a comprehensive audit of the Office of the Chancellor. The audit objectives and conclusions are highlighted in the individual chapters of this report.

We conducted our audit in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Office of the Chancellor complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. The management of the office is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of the Chancellor. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 20, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 26, 2002

Report Signed On: June 14, 2002

Office of the Chancellor

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Linda Pha	Auditor
Alan Sasse, CPA	Auditor
Marisa Zenk	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Office of the Chancellor at the exit conference held on April 5, 2002:

Laura King	Vice Chancellor/Chief Financial Officer
Rosalie Greeman	Associate Vice Chancellor, Financial Reporting
Rick Ellefson	Accounting Manager
Bonnie Myers-Hirte	Business Office Supervisor
John Asmussen	Executive Director, Internal Auditing

Report Summary

Overall Conclusions:

The Office of the Chancellor's budgetary controls provided reasonable assurance that it operated within available resources. Except as noted below, the office's internal controls provided reasonable assurance that assets were safeguarded and financial activities were properly recorded in the accounting system. In addition, the office complied with applicable legal provisions for the items tested.

Key Findings:

- The Office of the Chancellor did not timely reconcile its local bank account statement to the accounting system. We noted several instances where the office did not reconcile the bank account for three or four months between July 2000 and January 2002. In addition, the office did not resolve differences identified in the reconciliation process for the period February through May 2001 until June 2001. The office should reconcile the bank account to the MnSCU accounting system and resolve any differences on a timely basis. (Finding 1, page 7)
- The Office of the Chancellor did not adequately restrict certain computer security clearances. Six employees had access to either the purchasing or payment function, which did not relate to their duties. The Office of the Chancellor should monitor security profiles to ensure employee access is restricted to job responsibilities. (Finding 2, page 14)

Agency Background:

The Minnesota State Colleges and Universities (MnSCU) is comprised of the 34 state universities, community colleges, and technical colleges and the Office of the Chancellor. Minn. Stat. Section 136F assigns the powers necessary to govern the state colleges and universities to the MnSCU Board of Trustees. The office employs staff to provide support to all colleges and universities within the system. James H. McCormick began his term as chancellor in July 2001.

<p>The Office of the Chancellor is part of the Minnesota State Colleges and Universities (MnSCU) system. This audit report focused on financial management, payroll expenditures, consultant contract and capital outlay expenditures, and other administrative expenditures for the period July 1, 1998, through June 30, 2001. The office's response is included in the report.</p>

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Chapter 1. Introduction

The Minnesota State Colleges and Universities (MnSCU) is comprised of the 34 state universities, community colleges, and technical colleges and the Office of the Chancellor. Minn. Stat. Section 136F assigns the powers necessary to govern the state colleges and universities to the MnSCU Board of Trustees. The Office of the Chancellor employs staff to provide services to all colleges and universities within the system. James H. McCormick began his term as chancellor in July 2001.

The Office of the Chancellor (office) is responsible for reviewing and coordinating educational programs, overseeing the credit transfer process, negotiating labor contracts, and coordinating system-wide financial management operations. Organizationally, the Office of Internal Auditing is located within the Office of the Chancellor. The Office of the Chancellor coordinates presidential searches, communicates with the public and the press about MnSCU, carries out policies of the Board of Trustees, and represents the colleges and universities at the Legislature.

The office provides support to colleges and universities in the areas of budgeting, facilities management, information technology, student loan servicing, faculty professional development, and training for professional and volunteer firefighters and public safety personnel. The office allocates to the institutions costs it incurs to provide central services. The office allocated central service costs totaling \$34 million to the colleges and universities during fiscal year 2001. Our audit scope included financial management of the office, including its relationship with the Northstar State Colleges and Universities Foundation, payroll and employee expenditures, consultant and capital outlay expenditures, and other administrative expenditures. Federal grant revenue, Revenue Bond Fund activity, and Retirement Fund activity were subject to other audit coverage and were not included in our scope.

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Chapter 2. Financial Management

Chapter Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that it operated within available resources and in compliance with applicable legal provisions and management's authorization. The Office of the Chancellor's internal controls provided reasonable assurance that state treasury and local bank account financial activities were adequately safeguarded, accurately recorded in the accounting records, and in compliance with applicable legal provisions and management's authorization. We found, however, that the office did not reconcile its bank statement to the accounting system in a timely manner. For the items tested, the office complied with applicable legal provisions.

The office properly accounted for central service expenditures and accurately allocated those costs to individual colleges and universities. In addition, we found that the office established an appropriate operating relationship with its foundation.

The Office of the Chancellor receives most of its funding from General Fund appropriations, federal and private grants, and investment income. The fiscal year 2001 General Fund appropriation totaled \$20.7 million. Staff within the individual cost centers develop their budgets based upon prior year revenues and expenditures, considering any changes in the budget guidelines. The office management team reviews the individual budgets and makes necessary adjustments. The Chancellor reviews and approves the office budget and submits it to the Board of Trustees for final approval.

The office also has a process for monitoring the status of the budget and the corresponding revenues and expenditures throughout the year. The office produces monthly reports for review by the cost center supervisors. Budgetary staff also meet periodically with the cost center supervisors to review their financial activity. The monitoring process includes controls over the transfer of funds between cost centers and divisions and procedures for increases to individual cost center budgets.

The statewide accounting system (MAPS) is the primary accounting system for funds held in the state treasury. The office uses the MnSCU accounting system to initiate transactions that interface into MAPS to generate warrants from the state treasury. A delegation of authority and an approval system is used to control financial transactions.

The office retains a portion of the MnSCU appropriation to pay for certain system-wide activities performed for colleges and universities. These system-wide activities include computer systems,

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debt service principal and interest payments, and other administrative activities. At the end of the fiscal year, the office determines the amount of expenditures for each of the activities and allocates the costs to the colleges and universities. There is a specific allocation formula used for each type of activity. The expenditures are transferred from the office cost centers to the colleges and universities. The office allocated campus services costs totaling \$34 million to the colleges and universities during fiscal year 2001. Appropriation amounts equal to the costs are also transferred to the colleges and universities.

The Office of the Chancellor is affiliated with the Northstar State Colleges and Universities Foundation. The foundation exists primarily to provide student scholarships and financial aid to students of the Minnesota State Colleges and Universities. The foundation has its own board of directors, articles of incorporation, and by-laws. The office provided administrative support to the foundation. The foundation prepares annual financial statements that are subjected to an external audit by a CPA firm.

Audit Objectives and Methodology

The primary objectives of our review of the Office of the Chancellor's financial management were to answer the following questions:

- Did the office's internal controls provide reasonable assurance that it operated within available resources and in compliance with applicable legal provisions and management's authorization?
- Did the office's internal controls provide reasonable assurance that state treasury and local bank account financial activities were adequately safeguarded, accurately recorded in the accounting records, and in compliance with applicable legal provisions and management's authorization?
- Did the office properly account for central service expenditures and accurately allocate the costs to the individual colleges and universities?
- Did the office establish an appropriate operating relationship with its foundation?

To answer these questions, we interviewed office staff to gain an understanding of the MnSCU accounting system as it pertained to each program area discussed in the following chapters. We gained an understanding of internal controls in place over the local bank accounts and the programs included in our audit scope. We reviewed MnSCU transactions posted to the accounting records to determine if the office properly recorded revenue and expenditure transactions in MnSCU accounting. In addition, we gained an understanding of management controls, such as budget development and monitoring, in place over financial activities. We also reviewed the administration of security privileges to determine whether the office adequately restricted access to its computerized business systems. Finally, we reviewed the office's agreement with its foundation.

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Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that it operated within available resources and in compliance with applicable legal provisions and management's authorization. The office's internal controls generally provided reasonable assurance that state treasury and local bank account financial activities were adequately safeguarded, accurately recorded in the accounting records, and in compliance with applicable legal provisions and management's authorization. However, we found that the office did not timely reconcile the state depository bank statement to the MnSCU accounting system. This issue is discussed in Finding 1. The office accounted for central service costs and accurately allocated those costs to the individual colleges and universities. In addition, we found that the office established an appropriate operating relationship with its foundation.

1. The Office of the Chancellor did not timely reconcile its local bank statement to the accounting system.

The office did not timely reconcile cash balances in its local bank account to amounts recorded on the MnSCU accounting system. During our review of bank reconciliations from July 2000 to January 2001, we found six reconciliations that were not performed in a timely manner. Several reconciliations were not performed for up to three or four months. For example, the office reconciled the March and April 2001 bank statements on July 24, 2001. In addition, the office did not resolve differences identified in the reconciliation process for the period February through May 2001 until June 2001. Reconciling differences ranged from -\$15,104 to \$8,556. Reconciliations should be performed in a timely manner to ensure that the accounting records accurately reflect all financial activity and to protect against errors and irregularities going undetected.

Account activity included credit card service deposits, deposits from the schools for payroll taxes, and Perkins loan repayments. Deductions and withdrawals included those for state treasury sweeps, credit card fees, and electronic payment of payroll taxes. The average daily balance for this account was as high as \$2.7 million.

Recommendation

- *The office should reconcile the monthly bank statement to the MnSCU accounting system and resolve any differences on a timely basis.*

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Chapter 3. Payroll and Employee Expenditures

Chapter Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that payroll expenditures were accurately reported in the accounting records and complied with applicable legal provisions and management's authorization. For the items tested, the Office of the Chancellor complied with the significant finance-related legal provisions concerning payroll, including employee bargaining unit agreements.

The Office of the Chancellor paid travel and reimbursed employee and members of the MnSCU Board of Trustees expenditures and per diem amounts in compliance with applicable laws and regulations, for the transactions tested.

The Office of the Chancellor employed about 300 staff during fiscal year 2001. Payroll expenditures, including salary and fringe benefits, totaled approximately \$22.5 million for the fiscal year ending June 30, 2001. Travel, employee expense reimbursements, and board member per diems totaled about \$1.2 million in fiscal year 2001.

The Office of the Chancellor used the State Colleges and Universities Personnel/Payroll System (SCUPPS) to process salary and personnel transactions and the State Employee Management System (SEMA4) for payroll processing.

The Office of the Chancellor had separate human resource and payroll divisions. The human resource division updated SCUPPS for personnel appointments and salaries. The payroll division input payroll into SEMA4 during mass time entry and was responsible for ensuring proper recording of payroll expenditures in MnSCU accounting.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did the Office of the Chancellor's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the Office of the Chancellor comply with the significant finance-related legal provisions concerning payroll and board members' per diems, travel, and employees and board members' expense reimbursements?

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To meet these objectives, we interviewed the Office of the Chancellor's employees to gain an understanding of the internal control structure over the payroll and personnel process. We analyzed payroll expenditures to determine proper recording of payroll transactions, reviewed source documents to determine proper authorization, and tested a sample of payroll expenditures to ensure proper payment pursuant to contract provisions. We also audited the security clearances for payroll and personnel transactions.

Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that payroll expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization. For the items tested, the Office of the Chancellor complied with the material finance-related legal provisions for employee contracts. The office also paid travel and expense reimbursements and per diem amounts to employees and members of the MnSCU Board of Trustees in compliance with applicable laws and regulations.

Chapter 4. Consultant Contracts and Capital Outlay

Chapter Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that consultant contract expenditures and capital outlay were accurately reported in the accounting records and that expenditures were made in accordance with management's authorization.

For the items tested, the Office of the Chancellor complied with the significant finance-related legal provisions concerning contracts and capital outlay.

The Office of the Chancellor negotiates contracts for consultant, professional, and technical services. These service contracts are intellectual in character and do not involve the purchase of equipment or materials. The contracts result in the production of a report or the completion of a task. Consultant contract expenditures totaled approximately \$10 million for fiscal year 2001 for architectural services, legal services, network services, and other professional services. The office also administers certain construction contracts for individual college and university building projects. Those capital outlay expenditures totaled about \$10.3 million in fiscal year 2001.

The Office of the Chancellor is required to execute contracts in accordance with Minn. Stat. Section 471.345, Uniform Municipal Contracting Law, and Minn. Stat. Section 136F.581, Purchases and Contracts. MnSCU is exempt from the Department of Administration contracting laws included in Minn. Stat. Section 16C. MnSCU policy and procedure 5.14.2, provides the guidelines used in approving and processing contracts. Contracts over \$100,000 must be reviewed and approved by the vice chancellor/chief financial officer. This responsibility may be delegated to appropriate personnel.

Audit Objectives and Methodology

The primary objectives of our review of consulting contract expenditures were to answer the following questions:

- Did the Office of the Chancellor's internal controls provide reasonable assurance that consultant contracts and capital outlay were accurately reported in the accounting records, and that expenditures were made in accordance with management's authorization?

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- Did the Office of the Chancellor comply with significant finance-related legal provisions governing consultant contracts and capital outlay?

To answer these questions, we interviewed office staff to gain an understanding of the internal control structure and procedures over the contracting process. We analyzed contract expenditures to determine proper recording of contract amounts in the accounting system, reviewed source documents for a sample of transactions to determine proper authorization and receipt of contracted services, and ensured that the contract process complied with applicable legal provisions.

Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that consultant contracts and capital outlay were accurately reported in the accounting records and in compliance with management's authorization.

For the items tested, the Office of the Chancellor complied with significant finance-related legal provisions governing consultant contracts and capital outlay.

Chapter 5. Other Administrative Expenditures

Chapter Conclusions

The Office of the Chancellor's internal controls provided reasonable assurance that other administrative expenditures were accurately reported in the accounting records and were in compliance with applicable legal provisions and management's authorization. However, the office did not adequately monitor employee access to purchasing and payment functions within its computerized business systems.

For the items tested, the Office of the Chancellor complied with the significant finance-related legal provisions concerning other administrative expenditures.

We audited selected administrative expenditures, including purchased services, supplies, resale supplies, equipment, and other expenditures. The office spent approximately \$12 million for these activities during fiscal year 2001 as noted in Table 5-1.

Table 5-1
Selected Administrative Expenditures
Fiscal Year Ended June 30, 2001

Purchased Services	\$6,445,827
Supplies	748,744
Resale Supplies	141,937
Claims	2,242,146
Other	1,230,430
Equipment	2,793,631

Note: The above table does not include utilities, financial aid, interest and debt service, or principal payment expenditures. Expenditure amounts include costs subsequently allocated to the colleges and universities.

Source: MnSCU accounting system.

The purchasing process begins when office employees submit an authorized purchase requisition to the finance department either at the World Trade Center or the Energy Technology Center. The finance department verifies that funds are available in the appropriate cost center for the purchase, encumbers the funds, and creates a purchase order. The finance department sends the invoice to the department receiving the goods or services where appropriate staff authorize the payment.

The office follows a similar process when purchasing capital equipment. In addition, the finance department records all fixed asset purchases exceeding \$2,000, as well as sensitive items, such as

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computers, palm pilots, cameras, and other items under \$2,000, in the MnSCU equipment module. The finance department updates the equipment module, recording changes, transfers, retirements, and other disposition of assets. In addition, the office takes an annual inventory of all fixed assets over \$10,000. The office performs a complete physical inventory every three years.

Audit Objectives and Methodology

We focused our review of operating expenditures on the following questions:

- Did the Office of the Chancellor's internal controls provide reasonable assurance that administrative expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the Office of the Chancellor comply with the significant finance-related legal provisions concerning administrative expenditures?

To address these questions, we interviewed staff and obtained an understanding of the internal control structure over the procurement and disbursement processes for administrative expenditures. We examined security access to determine who can initiate payments in the MnSCU accounting system. We reviewed controls and tested transactions to determine whether the office properly procured supplies and equipment, paid the correct amount, and recorded transactions accurately in the accounting system. Finally, we reviewed the office's process to record and track its fixed assets.

Conclusions

The Office of the Chancellor designed and implemented internal controls to provide reasonable assurance that administrative expenditures were accurately reported in the accounting records and were in compliance with applicable legal provisions and management's authorization. However, as noted in Finding 2, the office did not adequately monitor employee access to purchasing and payment duties within its computerized business systems.

For the items tested, the Office of the Chancellor complied with the significant finance-related legal provisions concerning administrative expenditures.

2. PRIOR FINDING PARTIALLY RESOLVED: The Office of the Chancellor did not adequately monitor employees' access to purchasing and payment functions in its computerized business systems.

In our prior audit report, we discussed security access weaknesses for the personnel/payroll systems and the MnSCU accounting system. Since our last audit, the Office of the Chancellor has resolved the issue relating to access to the personnel/payroll systems. During the scope of this audit, we found that the office did not adequately monitor its employees' access to the MnSCU accounting system and the purchase control system. Certain employees had access to

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either the purchasing or payment function, which did not relate to their individual duties. During our review, we found the following weaknesses:

- Three employees who are not involved with purchasing had access to the purchasing functions in either the MnSCU accounting system or the purchase control system.
- Two current employees and one former employee had access to the payment functions in the MnSCU accounting system. These individuals were once involved with making payments but no longer have that responsibility.

The Office of the Chancellor has primary authority and responsibility to ensure employee access is necessary based upon job responsibilities.

Recommendation

- *The Office of the Chancellor needs to improve its process of monitoring security profiles to ensure employee access is restricted to current job responsibilities.*

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**Status of Prior Audit Issues
As of March 26, 2002**

Most Recent Audits

Office of the Chancellor

Legislative Audit report 99-42, issued August 2, 1999, covered the office's material activities and programs, including financial management, payroll, consultant contracts, and other administrative expenditures. The report contained five findings. The office implemented recommendations for four of the findings. We have repeated a portion of one prior finding in the current report in Finding 2.

Other Audit Coverage

MnSCU is subject to an annual financial statement audit and audit of its material federal programs. The fiscal year 2001 financial statement and federal program audit was conducted by a public accounting firm. The firm reported several findings and recommendations to improve the MnSCU financial reporting process.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. However, Finance has delegated this responsibility for audits of the Minnesota State Colleges and Universities (MnSCU) to the MnSCU Office of Internal Auditing. MnSCU's Office of Internal Auditing process consists of quarterly activity reports documenting the status of audit findings. The follow-up process continues until the Office of Internal Auditing is satisfied that the issues have been resolved. The process covers all colleges and universities within the MnSCU system.

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MnSCU

Minnesota State Colleges & Universities

June 11, 2002

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The purpose of this letter is to respond to the recently completed audit of the MnSCU Office of the Chancellor for the three years ended June 30, 2001. The audit was completed as a part of the MnSCU – Office of the Legislative Auditor (OLA) FY2002 – 2003 contract for audit services including system wide and college and university audits.

Please extend our appreciation to Mr. Jim Reibe, audit manager and Ms Joan Haskins, auditor-in-charge for their effort on the Office of the Chancellor audit. The MnSCU Office of the Chancellor functions both as an activity center and on behalf of the thirty-four MnSCU colleges and universities. Consequently the financial administration is very complex and we appreciate their efforts.

We are very pleased that your review found sufficient controls in place concerning budget administration, financial reporting, payroll and general administration. The audit concludes that the Board and the public can be assured that Office of the Chancellor financial activities are properly recorded and that budgets are established and appropriately controlled. The audit also found that the system wide charge back methods used are appropriate and well administered.

Attached please find specific responses to the two audit findings.

/s/ Laura M. King

Laura M. King
Vice Chancellor – Chief Financial Officer

c: James H. McCormick, Chancellor

MnSCU Office of Chancellor Audit
July 1, 1998 – June 30, 2001
Response to findings

1. **Recommendation:** The Office of the Chancellor should reconcile the monthly bank statement to the MnSCU accounting system and resolve any differences on a timely basis.

Response: We concur with the recommendation and have modified procedures in order to complete reconciliations by the end of the following month. In addition, reconciling items are reviewed and addressed on a monthly basis, rather than quarterly. Additional staff have been trained in the process and provide back up assistance.

2. **Recommendation:** The Office of the Chancellor needs to improve its process of monitoring security profiles to ensure employee access is restricted to current job responsibilities.

Response: We agree with this recommendation. The Office of the Chancellor will improve its process to manage and review access to ISRS. This process will ensure that access is restricted to only that needed for an individual's current position and for functions where they serve as backup.

The Information Technology Services Division is developing a system-wide Information Security Plan that will include an Access Management Procedure. The process for the Office of the Chancellor will be developed in conjunction with this system-wide procedure. Responsible individual – Rosalie Greeman, Associate Vice Chancellor for Financial Reporting.