



AUDIT COMMITTEE
JUNE 18, 2014
9:00 A.M.

MCCORMICK ROOM
30 7TH STREET EAST
SAINT PAUL, MN

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.

- (1) Minutes of May 21, 2014 (pages 1-6)**
- (2) Internal Audit Update
- (3) Approve Annual Audit Plan for Fiscal Year 2015 (pages 7-20)**
- (4) Review Results from Capital Construction Audit Pilot (pages 21-26)

Members

Ann Anaya, Chair
Philip Krinkie, Vice Chair
David Paskach
Elise Ristau
Michael Vekich

Bolded items indicate action required.

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES
AUDIT COMMITTEE MEETING MINUTES
May 21, 2014**

Audit Committee Members Present: Trustees Ann Anaya, Chair; Phil Krinkie, Elise Ristau, Michael Vekich, and David Paskach (by phone).

Audit Committee Members Absent: none.

Others Present: Chancellor Steven Rosenstone, President Pat Johns, President Edna Szymanski, Alexander Cirillo, Duane Benson, Cheryl Dickson, Maria Peluso, Tom Renier.

The Minnesota State Colleges and Universities Audit Committee held its meeting on May 21, 2014, 4th Floor McCormick Room, 30 East 7th Street in St. Paul. Chair Anaya called the meeting to order at 8:08 a.m.

1. Minutes of April 23, 2014

The minutes of the April 23, 2014 Audit Committee were approved as published.

2. Review Results of the Internal Control and Compliance Audit of Minnesota State University Moorhead

Ms. Beth Buse, Executive Director of Internal Auditing, introduced Audit Committee presidential liaison, President Edna Szymanski. Ms. Buse also introduced Ms. Melissa Primus who is the Audit Project Manager. She stated that Mr. Craig Fautsch, Ms. Carolyn Gabel and Ms. Indra Mohabir were the audit coordinators who worked on the project.

Ms. Buse stated that the audit was part of the audit plan approved by the Audit Committee in June. She noted that Minnesota State University Moorhead's last internal control and compliance audit was 14 years ago and had been completed by the Office of the legislative Auditor. Ms. Buse reviewed the audit objectives as well the scope of the audit and the methodology that was used.

Ms. Buse stated that the overall conclusions were that with the exception of some receipts, internal controls were generally adequate. She added that, for the items tested, they generally complied with significant finance-related legal requirements and applicable policies, procedures, and guidelines. Finally she stated that the report contained seven findings.

Ms. Primus reviewed the seven findings from the report. Ms. Buse noted that the findings were similar to findings from other recent internal control and compliance audits, and that some of the findings reflected very small dollar amounts. She noted however, that this kind of coverage provided a Tone at the Top perspective and having audit presence at the colleges and university helped with a control environment.

Regarding finding number five, Trustee Krinkie asked why the university was denied a request to assign student workers their own passwords accounts. Ms. Buse stated that individual access would give student workers broad access beyond what they would need to have in order to accomplish their work. Ms. Buse stated that the system was being looked at to see if there was a way to break apart the security access to a more granularly level in order to limit access to particular functions.

Trustee Krinkie asked if this practice was going on at other institutions. Ms. Buse stated that given transitions and resource restraints, it was likely that the practice was going on in other places. She cautioned that an employee sharing their password goes against the acceptable use policy in board policy and system procedure. But she added that if employees are put into difficult situations where they are being asked to violate policy and procedures, then the system needed to look for a different solution.

Trustee Anaya thanked President Szymanski for her letter of May 9th. She stated that she shared her perspective about Tone at the Top, and she thanked the president for her kind words regarding the Office of Internal Auditing.

President Szymanski stated that the Minnesota State University Moorhead audit was an excellent experience. She stated that the tone and the approach really helped her staff to see the audit constructively and to work through the issues. President Szymanski stated that the university had either resolved the findings or, in the case of inventory practices, were in the process of resolving the findings. But she added that she wished that the universities and colleges had the opportunity to have these audits more often. She felt that it was an excellent tool for her as a president, and as she prepared to pass the torch to a new president, she felt that she would be able to pass along a much better university, with far better internal controls. She thanked the audit committee, the system office, as well as her own staff for the excellent work.

3. Review Results of Financial Aid Audits

Ms. Buse introduced Mr. Craig Popenhagen, Principal with CliftonLarsonAllen LLP, Ms. Brenda Scherer, Audit Manager with CliftonLarsonAllen LLP, and Mr. Christopher Halling, System Director for Financial Aid.

Ms. Buse presented overview material on the single audit and explained that this was an annual report that was required by federal law and focused on major federal programs. The Office of the Legislative Auditor identified student federal financial aid as the only major federal program for the system. The audit work, which was performed by CliftonLarsonAllen was compiled into a State of Minnesota Single Audit report. That report was issued to the federal government on time this year, however, Ms. Buse reminded the committee that the results of the fiscal year 2012 audit had not been submitted in a timely way last year. Everything had been completed in a timely way by MnSCU, however, because those results are incorporated into the State of Minnesota's report and their report was submitted late, MnSCU was sanctioned. As a result, the colleges and universities have been working under sanctions that were imposed by the United States Department of

Education. Ms. Buse stated that those sanctions were still in place and created an extra burden for the colleges and universities to work under in administering their federal financial aid programs.

Trustee Dickson asked why the Perkins and Nursing grants were not included in the graph that showed MnSCU's Federal Financial Assistance trending. Ms. Buse explained that those grants were part of a revolving fund, so they did not represent new dollars coming into the system. She stated that in the future there could be another graph that shows the full picture of loans going to MnSCU students. Trustee Renier added that the money from those loans came back to the system and remained dedicated to those specific purposes, so they never lost their federal identity. Ms. Buse agreed and stated that the loans were collected within a central loan collection unit, but institution funds were kept separate, so the collections determine how much would be available to loan out the following year at each institution.

Ms. Laura King, Chief Financial Officer, stated that the trending toward increasing student financial aid grants and loan activity is a national phenomenon. She added that those increases are unrelated to the increases in tuition. Ms. King stated that what has been found is an increasing financial need in the student population coming out of their households. Financial capacity seems to be a change in household income and support for higher education, more than the rising cost of attendance, at least for MnSCU institutions.

Mr. Popenhagen reviewed the fiscal year 2013 Federal Student Financial Aid findings. He stated that the three prior year findings had been resolved. He stated that the results of the audit were good. Ms. Scherer went on to explain the process used to conduct the audit. Mr. Popenhagen stated that conducting the Student Financial Aid Audit takes a high degree of coordination both with system office staff as well as with staff at the campuses. He stated that they had good coordination and communication with everyone, and he thanked the staff for their good work and assistance.

Ms. Buse continued with a brief background on the financial aid work that was done by the Minnesota Office of Higher Education. The work of the Minnesota Office of Higher Education was done at an individual college or university level. She stated that the Office of Internal Auditing does follow-up work on all findings.

Trustee Dickson noted that MnSCU students receive 31% of the state grants, she asked of the students that were eligible, what percentage were MnSCU students. Mr. Halling stated that more than half of the students receiving state grants were MnSCU students, but they received only 31% of the funds.

4. Review Results of Audit Risk Assessment

Ms. Buse started by stating that internal audit standards and board policy required that an audit plan be developed based on a documented risk assessment and be brought to the audit committee annually for approval.

Trustee Benson asked if there were differences between higher education auditing and other types of auditing. Ms. Buse noted that there were significant differences, primarily in

resources, but she added that while the financial services area is highly regulated and may have very large audit teams, they follow the same internal auditing standards as the MnSCU Office of Internal Auditing.

Ms. Buse highlighted some thought leader themes related to risk, and reviewed the framework used for completing the audit risk assessment.

Ms. Buse introduced a model for looking at operational risk management endorsed by the Institute of Internal Auditors called the Three Lines of Defense. The first line of defense are functions that own and manage risks, the second line of defense are functions that oversee risks, and the third line of defense are functions that provide independent assurance. Trustee Anaya stated that she would like to come back to the first line of defense in a later conversation as it relates to the use of passwords with students.

Ms. Buse moved on to discuss the overall themes. The challenges of constrained resources was a theme that was imbedded in all the conversations. The impact and support of leadership transitions going on within the organization is an issue. She noted that almost half of the presidents will have less than two years of experience, and that is true of system office cabinet as well. Ms. Buse stated that the Campus Service Cooperative is working toward common business practices but currently the number of decentralized processes creates a risk to the organization. Ms. Buse stated that there is an increasing complexity of operations and regulations, using the same limited resources. She added that one of the conundrums is encouraging innovation vs. implementing solutions on a systemwide basis. We are challenged as an organization to learn how to encourage innovation by individuals who see a need, balanced with the need to streamline to common business practices, given constrained resources. In determining the three lines of defense framework, she stated the system has a limited second line of defense.

Ms. Buse reviewed some areas where an audit might add value to the organization. Those areas included international studies programs and undergraduate student transfer. In the area of regulatory compliance she suggested an audit of Clery Act compliance. She noted that there's a reputational risk if the system is not in compliance, because this relates to reporting of crime statistics. She noted other areas such as of ADA and PCI compliance, pension administration, and workers compensation management. Other options included audits in the area of facilities, the Campus Service Cooperative and the emerging area of the Affordable Care Act.

Ms. Buse stated that that Board had approved a revised financial audit plan for the system in January 2014. As part of that plan we reduced the number of individual college and university financial statement audits, and the goal was to increase number of financial internal control and compliance audits. Earlier in the meeting the committee heard the results of an institution financial internal control and compliance audit of Minnesota State University Moorhead. Functional internal control and compliance audits, such as the Purchasing Card audit, are expensive audits to conduct because of the lack of common business practices across the system. The audit team has to get an understanding about the processes at each college or university, which takes time.

Ms. Buse reviewed the methodology for the institution financial risk model that has been used for the last four years. She noted that the metrics have been tweaked every year. Ms. Buse stated that although the tool is a starting point, the results of running the model showed an increase in financial risk. She stated that one of the things that was looked at was the number of years since the last internal control and compliance audit. As fewer audits are performed that risk rises. There has been an increase in the number of institutions with a negative net operating income. Also twenty-three institutions had a decrease in their CFI from FY12 to FY13. And finally Ms. Buse noted that a change in key personnel and leadership transitions adds risk to the organization.

Ms. King stated that she was troubled by what the tool is doing because it has so much weight in the audit category. She stated that she would like to think about how to factor in materiality before the audit committee is given advice from a risk assessment stand point. She noted that she and Ms. Buse were committed to keep working on the model, but she invited committee discussion about their thoughts about the metrics used for the tool.

Trustee Vekich stated that he had discussed the collaboration between the Office of Internal Auditing and the Finance group with Ms. Buse. He noted that finance is a risk area, but as you look at overall risks, he felt that it was probably more in the moderate area of risk than the level that the model was suggesting. Trustee Anaya agreed.

Mr. Eric Wion, Deputy Director of Internal Auditing, stated that the protection and stewardship of data and data systems is an important issue to everyone in the organization. He reviewed the three broad areas of Information Technology Risk, confidentiality, integrity of data, and availability of systems. Mr. Wion talked about the cost of breach to the organization from both a financial and a reputational risk perspective.

Mr. Wion discussed the process used to assess and determine IT audit risk in the system. He stated that the MnSCU computing environment was a complex environment and each of the systems have many levels of controls, technologies, and complexities.

Trustee Anaya asked if it would be possible to table the fiscal year audit planning until the June meeting. Ms. Buse stated that she would like to come back to the committee in June with a suggested audit plan for FY2015. The committee could take time at that meeting for discussion about the plan and about the audit topics for the upcoming year. She stated that she would plan to take the information and the feedback she received from discussions with trustees, and come back to the committee with a draft for them to talk about. She added that it might be possible to build some flexibility into the plan so that the committee could have further discussions in the fall when they meet again. Trustee Anaya agreed with that plan.

Trustee Vekich stated that collaboration with the finance committee would need to be worked into the plan as well. He noted that the presentation didn't mention culture and he asked the chancellor for his vision as it relates to culture and tone at the top, and if he was satisfied with the audit risk assessment that was presented.

Chancellor Rosenstone stated that the discussion about the Minnesota State University Moorhead audit and the tone that the president had set throughout the organization was an example of tone at the top. He stated that we live in a complicated world and we will never have all the resources to mitigate all the risks that exist. He shared two thoughts. The first thought was that the results of the process has to get everyone focusing on the risks which have the highest probability of actualizing and the highest impact if they do actualize. His second thought was the question of how do we create the culture, not just from the top, but the culture throughout the entire organization of zero tolerance for violation of board policy, and zero tolerance of not speaking out when something inappropriate occurs. The chancellor stated that a culture of vigilance and attention to risks would be the most effective and efficient way to mitigate a whole range of risks. He added that it was an extremely important point, because if the culture and climate of the organization did not encourage and reward compliance with policy, attention to risk, and daily management of risks, then the system would not accomplish what it needed to as an organization. Trustee Vekich agreed with the chancellor.

The meeting was adjourned at 9:43 a.m.

Respectfully submitted,
Darla Senn, Recorder

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

Name: Audit Committee

Date: June 18, 2014

Title: Approve Annual Audit Plan for Fiscal Year 2015

Purpose (check one):

Proposed
New Policy or
Amendment to
Existing Policy

Approvals
Required by
Policy

Other
Approvals

Monitoring /
Compliance

Information

Brief Description:

Board Policy 1D.1, part 6, requires the Executive Director of Internal Auditing to present an audit plan for each fiscal year. Internal auditing standards require that the Board approve the annual plan.

The audit plan presents an overview of how the Office of Internal Auditing plans to use its resources in fiscal year 2015.

Internal audit plans to maintain flexibility in the audit plan. Plan updates will be brought to the Audit Committee throughout fiscal year 2015.

Scheduled Presenter(s):

Beth Buse, Executive Director, Office of Internal Auditing

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

BOARD INFORMATION

APPROVE ANNUAL AUDIT PLAN FOR FISCAL YEAR 2015

BACKGROUND

According to Board Policy 1.D., Part 6, the Office Internal Auditing must submit an annual audit plan to the Audit Committee. Internal auditing standards require that the Board approve the annual plan. The fiscal year 2015 audit plan is attached.

RECOMMENDED COMMITTEE ACTION

On June 18, 2014, the Audit Committee reviewed the Fiscal Year 2015 Internal audit plan and approved the following motion:

RECOMMENDED BOARD OF TRUSTEES MOTION

The Board of Trustees approves the Office of Internal Auditing annual audit plan for fiscal year 2015.

Date Presented to the Board of Trustees: June 18, 2014

**Minnesota State Colleges and Universities
Office of Internal Auditing
Fiscal Year 2015 Annual Audit Plan**

This document outlines the Office of Internal Auditing’s annual audit plan for fiscal year 2015. It includes all internal and external audit activities planned for the year, as required by Board Policy 1D.1, Part 6. This document contains five sections and one appendix:

Section I – Audit Risk Assessment Results

Section II – Use of Internal Auditing Resources

Section III – Other Audit Activities

Section IV – External Audits, Evaluations, and Reviews

Section V – Administrative Activities

Section I: Audit Risk Assessment Results

The International Standards for the Professional Practice of Internal Auditing state the chief audit executive (CAE) is responsible for developing a risk-based plan to determine the priorities of the internal audit activity, consistent with the organizations goals. The standards state the plan must be based on a documented risk assessment, undertaken at least annually. The risk assessment should take into account the organization’s risk management framework and input from senior management and the board.

The methodology for completing the audit risk assessment included; discussions with many system leaders at the system office and colleges and universities, discussions with several board members, involvement in task forces and other systemwide meetings, review of thought leadership on risks, and internal audit staff observations. In addition, an evolving tool used to assess college and university financial risk was updated.

In addition, the methodology included reviewing information from the enterprise risk management program that was introduced to the Board of Trustees in 2013. The program framework categorized risks into two overall classes, strategic and operational. In determining the internal audit risk assessment results, the same framework was utilized. However, concentrated work was completed in two operational risk categories, financial and technology.

Results were presented and discussed at the May 2014 Audit Committee meeting.

Strategic Risks

In November 2013, the board adopted the Charting the Future report and recommendations. The recommendations work to increase access, affordability, excellence, and service by forging deeper collaborations among our colleges and universities to maximize our collective strengths, resources, and the talents of our faculty and staff.

The three commitments of the framework are: to ensure access to an extraordinary education for all Minnesotans; be the partner of choice to meet Minnesota’s workforce and community needs; and deliver to students, employers, communities and taxpayers the highest value/most affordable higher education option.

Eight implementation teams will be working on implementing the recommendations from the Charting the Future report in fiscal year 2015. Internal Auditing will stay abreast in these efforts to determine if changes need to be made to the audit plan.

Operational Risks

The primary theme through most conversations with system leaders are the challenges that resource constraints have on the system. Specific discussion points included:

- Impact and Support of Leadership Transitions – leaders discussed the number of leadership transitions at both the system office and at colleges and universities. Half of all presidents and system office cabinet positions have had turnover in the past two years, with additional turnover expected in fiscal year 2016. In addition, colleges and universities are seeing significant turnover within their operations.
- Decentralized Processes - the system primarily relies on decentralized processes at colleges and universities. With personnel turnover and budget challenges, institutions are finding it challenging to sustain adequate internal controls over operations.
- Increasing Complexity of Operations and Regulations – state, federal, and industry requirements continue to place additional responsibilities on colleges and universities with limited ability add personnel.
- Energy and Resources Needed to Implement Change – the work of the implementation teams in Charting the Future and the Campus Services Cooperative will be bringing significant change to the system. System leaders are concerned about the effort needed to drive this needed change in the system.
- Cyber Security – security is a risk area on the minds of most individuals, within MnSCU but also across all industry sectors. The risk of disclosing private or not public data collected, processed, and stored by MnSCU’s enterprise computer systems as well as college or university-specific computer systems were the most frequent topic of discussions.
- Risk Management – the enterprise risk management program within the system is still evolving.

Topics that arose out of conversations for consideration as audits included: international and study abroad programs, defined contribution pension administration, workers compensation management, the Campus Services Cooperative, and regulatory compliance areas (Clery Act, Environmental and Occupational Health and Safety, Payment Card Industry Data Security Standards, Title IX, and the Affordable Care Act).

Financial Risks

Internal audit, in collaboration with the Finance Division, developed a model for assessing financial risks at colleges and universities. The model has been used for the past three years and contains several risk metrics outlined below:

Metric Category	Factors Measured
Audit (points = 350)	<ul style="list-style-type: none"> • Time since last internal control and compliance audit and the volume of findings • Whether the institution has an annual financial statement audit and the volume of findings from the last audit • Number of outstanding unsatisfactory audit findings
Financial Condition (points = 300)	<ul style="list-style-type: none"> • Operating gains or the size of losses • Composite Financial Index (CFI) • Overall materiality of financial transactions
Business Operations (points = 275)	<ul style="list-style-type: none"> • Change or loss in key personnel, knowledge, or skills • Diversity or complexity of operations • Number of incompatible security access rights
Other (points = 100)	Use of professional judgment to adjust for significant financial risks that were not part of the model.

The overall results of the financial risk modeling for this year showed increased financial risk. The increased risk is attributable to a number of factors including; increase in number of years since last internal control and compliance audit, increase in number of institutions with a negative net operating income (FY12 = 10 to FY13 = 20), decrease in CFI by 23 institutions from FY12 to FY13, and change in key personnel at institutions.

Questions about the adequacy of this tool have been raised by senior management. Internal auditing plans to work closely with the Finance Division and the board over the next year to determine the desired factors for driving financial risk and make modifications to the tool as needed.

We also assessed financial risk by looking at functional areas. Internal audit and Finance Division staff considered materiality, transaction volume, complexity, susceptibility to fraud, compliance requirements, and past audit history. We determined the following functional areas to have high risk:

- Grant Management
- Employee business expenses
- Tuition and fees
- Financial aid
- Bookstore operations
- Equipment inventory
- Student activity funds
- Academic resale activities
- Capital project administration
- Banking and cash controls
- Purchasing cards

A future consideration for looking at financial risk will be the overall change to business processes and utilization of the Campus Services Cooperative (CSC).

Information Technology Risks

Internal audit gathered information from a variety of sources to help identify and assess information technology risks. We held discussions with IT professionals, attended the annual MnSCU ITS Conference, and attended CIO and IT Risk Management Committees and the IT Guidelines Working Group meetings. We also participated in a recent Educause Security Professionals Conference that brought together IT security professionals from higher education to discuss and learn about a variety of relevant topics. Finally, we reviewed documents including the IT Service Delivery Strategy and MnSCU System policies, procedures, and guidelines.

When considering risks associated with specific technologies, we generally considered the following:

- Confidentiality – Does the technology collect, process, or store large volumes of private or not public data that must be protected from unauthorized disclosure or use?
- Integrity – Does the technology, collect, process, or store large volumes of data that must be complete and accurate because it is used to help make significant business decisions?
- Availability – Does the technology support mission critical functions and need to be accessible (“up-and-running”) or have little to no down time?
- Accessibility – Is the technology accessible from the Internet or very broad audiences?

Although all four of the above risks are important the topic of most discussions were the risk of disclosing private or not public data, including data on current and past students, faculty, and staff.

The system office manages MnSCU’s wide area network and several mission critical enterprise technologies used by each college and institution. The need for data confidentiality, integrity, and availability is generally high in each of them:

- The Learning Management System (LMS) for online learning
- The Enterprise Resource Planning (ERP) system that supports business functions including accounting, human resources, payroll, student registration, grades, transcripts and financial aid
- The Data Warehouse used for ad-hoc data analysis and reporting
- The Vulnerability Management System (VMS) for identifying software security vulnerabilities
- The Identity and Access Management (IAM) System for authenticating user access to key systems

In addition, each college and university manages its own data centers, local area networks, and unique applications and databases, including systems and databases that house private or not public data on students, faculty, and staff.

Section II: Use of Internal Auditing Resources

A summary of projected technical staff time allocation is shown below.

Summary of Projected Technical Staff Time Allocation for Fiscal Year 2015

Audit Area	Percentage of Time
Employee Benefits	18%
Administrative	8%
Investigations	11%
Planning and Development	3%
Advisory Services	3%
Follow-up	4%
Assurance Services	53%
Total	100%

For fiscal year 2015, the Office of Internal Auditing has identified the following priorities based on the results of the audit risk assessment and available resources.

Ongoing Assurance Services:

- Monitor progress toward implementing audit finding recommendations: It is important that the Board of Trustees, chancellor, and presidents have confidence that any problems revealed by audits and investigations receive appropriate attention. Internal Auditing monitors progress toward implementing all audit finding recommendations, with particular attention to significant issues. Internal Auditing provides status reports on outstanding audit findings to presidents each year. The chancellor is informed about any unsatisfactorily resolved audit findings as part of the annual presidential performance evaluation process.
- Fraud inquiries and investigations: Board Policy 1C.2 Fraudulent or Other Dishonest Acts requires presidents and the chancellor to consult with the Executive Director of Internal Auditing to determine responsibilities for conducting fraud investigations. Internal Auditing continues to be actively engaged with colleges and universities in conducting needed investigations. Due to the continuous demand for these services, Internal Auditing is in the process of creating a position to focus on investigations.

Financial Internal Control and Compliance Audits

In January 2014, the Audit Committee approved a revised financial audit plan for the system. The main focus of the plan was to reduce the number of individual college and university financial statement audits and increase internal control and compliance audit coverage. A specific recommendation for fiscal year 2015 was to expand internal audit resources to enable 3-4 additional college and university reviews. Feedback from presidents and other stakeholders was that this type of audit coverage provides a ‘tone at the top’, which is needed on a more regular basis.

Proposed college and university financial internal control and compliance audits for fiscal year 2015 include:

- Minnesota State University, Mankato
 - Last internal control and compliance audit was in 1999.
 - Total assets as of June 30, 2013 were \$353 million (11% of system total assets)
- Minneapolis Community and Technical College
 - Last internal control and compliance audit was in 2002
 - Total assets as of June 30, 2013 were \$144 million (5% of system total assets)
- Dakota County Technical College
 - Last internal control and compliance audit was in 2009
 - Total assets as of June 30, 2013 were \$49 million (2% of system total assets)
- Itasca Community College
 - Last internal control and compliance audit was in 2008
 - Total assets as of June 30, 2013 were \$17 million (.5% of system total assets). The Northeast Higher Education District total assets as of June 30, 2013 were \$84 million (3% of system total)

The fiscal year 2014 audit plan included an approved functional financial internal control and compliance audit of grant management. Planning work will be completed in fiscal year 2014 but audit fieldwork and reporting will be completed in fiscal year 2015.

Operational Audits (non-financial)

In past years, Internal Auditing has completed systemwide operational audits of non-financial areas. The last study completed in May 2010 focused on undergraduate student credit transfer. Other studies have included reviews of auxiliary and supplemental revenues, affiliated foundations and implementation of student success systems. Two audits are proposed for fiscal year 2015:

- Academic Topic: International and Study Abroad Programs – many institutions offer short-term and long-term study abroad programs. In addition, some system institutions have relationships with partner institutions around the world. This audit would determine the breadth of programs offered and assess college and universities processes for mitigating risks association with these programs.
- Regulatory Compliance Topic: Clery Act - the federal act requires timely crime reporting. Colleges and universities must maintain a publically accessible crime log that is up-to-date within 48 hours, warns campus communities if there is an immediate threat, and release an annual report (by Oct 1st) detailing crime statistics for the prior three years. Institutions that provide on-campus housing are also required to have written procedures on emergency

response, evacuation, and missing student notification. The audit would review requirements under the act and assess how colleges and universities are complying with the requirements.

Information Technology Audits

The following information technology audits are planned:

- College and university controls over computers and networks allowed access to the enterprise data warehouse: To help limit security risks, the system office ITS Division restricts data warehouse access to only designated computers on designated networks at each campus. These computers and networks are required to meet specific security guidelines. Approved in the 2014 Audit Plan, planning for this audit began in June 2014 and fieldwork will be completed during FY 2015. The audit will focus on information security controls that protect these computers and networks. The audit will also consider college and university policies and procedures that address the handling and protection of any data it exports from the enterprise data warehouse and may or may not allow to be further transferred to other internal or external computers and networks. In addition, the audit may incorporate a review of business continuity and disaster recovery controls.
- High-level security assessments of key controls at four institutions: To help provide additional assurances at the institution level, internal audit plans to incorporate an IT security component in the financial internal control and compliance audits planned at individual colleges and universities. Planning will include developing an approach that produces a high-level assessment of select key controls by spending a minimal amount of time on the campuses.
- Networking security controls for enterprise computer systems: This audit will study the network architecture and controls that help to protect MnSCU's key enterprise computer system' managed by the system office ITS Division.

The Office of Internal Auditing has one dedicated position for IT audits. The plan above cannot be completed without additional resources. We propose using the IT audit designated one-time resources of up to \$100,000 to hire a consultant(s) to primarily augment staffing. The one time resource was from salary savings over the past several years. Use of the funds has been delayed due to transitions in both internal auditing and the ITS Division.

Advisory Services

The Institute of Internal Auditing allows internal auditors to provide advice and guidance to management through consulting or advisory services. These services can be invaluable to management when transforming an area to help ensure that appropriate risks and controls are built in up front rather than waiting until an assurance service engagement. In providing these services, it is important that management is responsible for decisions or actions that are taken as a result of the advice or guidance provided.

Two specific areas that the Office of Internal Auditing plans to continue to be actively engaged from an advisory services standpoint include; the Campus Services Cooperative and the IT guidelines working group.

In addition, the Office of Internal Auditing provides ongoing professional advice to colleges and universities and the system office.

Section III: Other Internal Auditing Activities

Evaluate Results of Capital Construction Audit Pilot: In fiscal year 2013, the Office of Internal Auditing contracted with an external audit firm with expertise in construction auditing to complete a contract compliance audit on two capital construction projects in coordination with the Finance Division facilities unit. We received \$50,000 in system office initiative funds for the pilot project.

The results of this work were presented to the Audit Committee in June 2014 by the external audit firm. Internal audit and the facilities unit plan to evaluate the results and propose recommendations for future audit efforts in this area.

Fulfill Recommendations from January 2014 Revised Financial Audit Plan: As discussed earlier, in January 2014, the Audit Committee approved a revised financial audit plan for the system. Recommendations related to increasing college and university internal control and compliance audits were to explore alternative resources and/or methods to gain audit coverage and provide update to the committee by January, 2015 and to continue refinement of the risk assessment tool used for audit planning.

Revise Board Policies: Two board policies need to be reviewed and revised as appropriate:

- Board Policy 1D.1 Office of Internal Auditing – this policy contains the audit charter for the Office of Internal Auditing, certain changes are required to comply with internal auditing standards.
- Board Policy 1C.2 Fraudulent or Other Dishonest Acts – this policy was adopted by the board in June 2002 and has not been review since that time.

Review of Board of Trustee’s expenditures: Internal Auditing conducts periodic reviews of expenses incurred by the Board of Trustees, and submits an audit report to the Executive Committee of the board through the Board Treasurer.

Section IV: External Audits, Evaluations, and Reviews

In addition to the audit activities discussed in the previous sections, a variety of other external audits, evaluations, and reviews occur. Accordingly, Internal Auditing will monitor the results from the following activities and recommend corrective actions to the chancellor, presidents, or the Board of Trustees, as warranted.

Coordinate financial statement and federal financial assistance audits:

In January 2014, the board of trustees approved a revised Financial Audit Plan for the system. It included significant changes to financial statement audits within the system. Specifically, the revised plan recommended:

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

In April 2014, the board approved a recommendation to appoint the external audit firm of CliftonLarsonAllen as the system's external auditor. CliftonLarsonAllen is under contract for fiscal year 2015 to provide audit services for the system, including; systemwide financial statements, Revenue Fund financial statements, four state university financial statements, and federal student financial aid.

Other Required Audits – Some special grants and other funding sources have certain audit requirements that must be satisfied. State law requires that the Legislative Auditor review any audit contracts prior to their execution. Known required audits include:

- Minnesota Job Skills Partnership (MJSP) grants: colleges and universities who receive these grants are required to have an external audit at the close of each grant.
- Radio Stations: Grants from the Corporation for Public Broadcasting requires St. Cloud State University to obtain a financial statement audit of its radio station each year.
- Itasca Community College Student Housing Funds: an annual independent audit is required by trust agreements between US Bank, Itasca County Housing and Redevelopment Authority, and Itasca Community College Revenue Bonds Series 2013.

Reviews Conducted by State and Federal Student Financial Aid Authorities – The Minnesota Office of Higher Education conducts periodic reviews of state financial aid programs administered by colleges and universities. Most colleges and universities are examined once every three years as part of that process. Internal Auditing reviews these reports to determine whether findings indicate more systemic issues needing attention. Internal Auditing will summarize and report on the results of these audits in April 2015.

Also, the U.S. Department of Education conducts ad-hoc program reviews and investigations of federal financial aid programs. The department schedules its reviews based on a risk assessment process and does not schedule routine reviews of each college and university. Two program evaluations were conducted in fiscal year 2014, it is unknown how many will occur in fiscal year 2015.

Audits of Affiliated and Associated Organizations – Board Policy 8.3 requires periodic financial audits of affiliated foundations. Also, other related organizations, such as the statewide student associations submit annual audited financial statements to the system office. Internal Auditing will review these audit reports and determine the need to recommend any action by the chancellor, presidents, or board of trustees.

Section IV: Administrative Items

In addition to conducting and monitoring audits, there are a several administrative activities the Office of Internal Auditing needs to complete during fiscal year 2015. These include:

Fill Vacant Audit Position - Internal audit resources were expanded by one position to increase the number of college and university financial internal control and compliance audits. The office is currently working with human resource staff on a classification for the new position, recruiting and filling the position.

Replacement of Office of Internal Auditing Administrative Systems – As time permits over the past couple of years, we have been determining needs for outdated administrative applications used for recording and managing staff time, audit findings, and fraud inquires and investigations. We have made some modifications but still remain on one outdated application. In addition, the office needs to assess whether other tools may increase efficiency and productivity.

Office Budget - The Office of Internal Auditing is included in the same budget process as other divisions in the system office. The table below provides information on planned audit expenditures for the Office of Internal Auditing and financial statement audits for fiscal year 2015. The budget differs from fiscal year 2014 due to the revised financial audit plan approved by the board in January 2014. The number of college and university financial statement audits was reduced and internal audit resources were increased in order to complete additional internal control and compliance audits.

Audit Budget Summary for Fiscal Year 2014 and 2015

	Approved Fiscal Year 2014	Proposed Fiscal Year 2015
Salaries & Benefits (1)	1,194,025	\$ 1,326,667
Other	91,525	\$ 107,937
Total	1,285,550	\$ 1,434,604

Contract – CPA (2)	578,684	\$ 367,540
Contract – Other (3)	\$100,000	\$ 100,000
Total	678,684	\$ 467,540

Total Audit Costs **1,964,234** **\$ 1,902,144**

- (1) The internal audit office manager provides assistance to the board office; salaries have not been adjusted for this assistance.
- (2) FY14 included financial statement audits for system-wide, revenue fund, ISEEK, 13 colleges and universities and A-133 audits. In FY15, a change was made to the number of college and university financial statement audits from 13 to 4. The cost of these audits is covered by individual colleges and universities and the Finance Division.
- (3) Budgeted amounts include contracting for IT as discussed earlier in the document.

Appendix A: Proposed FY2015 Audit Committee Schedule

Note: Internal Auditing plans to work with the Vice Chancellor of Information Technology and in consultation with General Counsel to have one or two sessions of the Audit Committee each year to discuss results of information technology security related audits and for the Vice Chancellor of IT to discuss IT security strategies. This is considered a best practice for boards. Meetings may be closed as provided under the Minnesota Government Data Practices Act.

October 2014	November 2014	January 2015	April 2015	May 2015	June 2015
<ul style="list-style-type: none"> • Review Annual Internal Auditing Report for fiscal year 2014 • Train Audit Committee members on responsibilities • Review results of Grant Management internal control and compliance audit • Proposed Amendment to Board Policy 1D.1, First Reading 	<ul style="list-style-type: none"> • Review and approve release of audited financial statements • Proposed Amendment to Board Policy 1D.1, Second Reading 	<ul style="list-style-type: none"> • Present recommendations on resources or methods for increasing internal control and audit coverage at colleges and universities • Review results of two internal control and compliance audits 	<ul style="list-style-type: none"> • Review results of financial aid audits • Review results of Clery Act audit. • Proposed Amendment to Board Policy 1C.2, First Reading 	<ul style="list-style-type: none"> • Review results of audit risk assessment • Review results of two internal control and compliance audits • Proposed Amendment to Board Policy 1C.2, Second Reading 	<ul style="list-style-type: none"> • Approve Annual Audit Plan for fiscal year 2016 • Review results of International and Study Abroad Programs audit

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

Agenda Item Summary Sheet

Name: Audit Committee

Date: June 18, 2014

Title: Review Results from Capital Construction Audit Pilot

Purpose (check one):

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

Brief Description:

Review results from an independent auditor of capital construction projects at Minneapolis Community and Technical College and Hennepin Technical College.

Scheduled Presenter(s):

Beth Buse, Executive Director, Office of Internal Auditing
Matt Gardner, Risk Advisory Services Manager, Honkamp Krueger & Co.

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

BOARD INFORMATION

REVIEW RESULTS FROM CAPITAL CONSTRUCTION AUDIT PILOT

1 In fiscal year 2013, as part of a pilot program, the Office of Internal Auditing contracted with an
2 external audit firm with expertise in construction auditing to complete a contract compliance
3 audit of two capital construction projects in coordination with the Finance Division facilities
4 unit.

5
6 The firm of Honkamp Krueger & Co. P.C. completed audit work on projects at Hennepin
7 Technical College (Learning Resource Center and Student Service Center Renovation project)
8 and Minneapolis Community and Technical College (Workforce Program and Infrastructure
9 Renovation project).

10
11 Over the next few months, Internal Auditing and the facilities unit plan to evaluate the results of
12 the pilot and come back to the board with recommended future steps for construction audits
13 within the system.

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15 See the attached executive summary reports from Honkamp Krueger & Co.
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36 *Date Presented to the Board of Trustees: June 18, 2014*
37

Executive Summary for Hennepin Technical College Renovation Project

Project Description

At the request of the Minnesota State Colleges and Universities' (MNSCU) Internal Audit department, Honkamp Krueger & Co. P.C. (HK) completed an audit of the construction cost incurred by MNSCU for the work on the Hennepin Technical College (HTC) Learning Resource Center and Student Service Center Renovation project. The project consists of small additions for main entrances and construction renovations for the Library/Learning Resource Centers (LRC), Student Services and Bookstore areas at both the Eden Prairie and Brooklyn Park Campuses. The project will provide new, updated main entrances to both campuses as well as significant remodeling for improved student facilities. A stipulated sum contract was used to secure the services of LS Black Constructors (LS Black), who worked with the other members of the MNSCU and HTC Project Management Team (PMT) to organize and construct the project plan and timelines, execute the required subcontracts, and coordinate all aspects of the project. Pre-construction began on the project in January 2012 with a final completion date of September 2013. As of the time of completed fieldwork, March 18, 2014 (Pay request #19), total construction cost incurred for the project was \$8,693,908 with approximately \$240,473 still retained by MNSCU. No additional costs are expected to be incurred by LS Black. Fieldwork was performed at the LS Black office located in North St. Paul, MN.

Objective & Scope

The objective of the audit was to review documentation of costs incurred by LS Black and paid for by HTC in completion of the project to determine if the requests for reimbursement were in alignment with the applicable contracts. The scope of the audit included all costs invoiced by LS Black including subcontractor costs. Additionally, HK verified MNSCU's Stipulated Sum and Prevailing Wage requirements were met for LS Black and all subcontractors secured on the project.

Audit Approach

The following approach was taken in order to successfully achieve the objectives of the audit:

- Conducted interviews with LS Black and HTC Project Managers.
- Summarized posted transaction details for the project provided by LS Black.
- Reviewed payroll registers, time sheets, and labor contracts for LS Black and major subcontractors.
- Reviewed the accuracy of labor burden rates for LS Black and major subcontractors.
- Tested material, equipment, and insurance transactions on a sample basis for LS Black and major subcontractors.
- Reviewed LS Black major subcontractor contracts and change orders and agreed to LS Black payment applications.
- Recalculated contractor's fee, markups, bonds, and general insurance add-ons.

Summary of Audit Results

Overall, it appears the confusion of contract verbiage and LS Black project manager turnover resulted in a lack of cost containment normally associated with a project of this size as well as the volume of change orders and costs for completion of the project. We noted a number of compliance issues with the contract that appear to be in part due to misinterpretation of the contract, specifically key clauses concerning change order requirements, lack of supporting documentation, labor and labor burden costs, and costs to be included in markup percentages. The cost recovery amount identified and the final amount recovered by HTC/MNSCU through negotiation with the contractor(s) is summarized below along with best practice suggestions for improvement of HTC/MNSCU processes and contract controls. Detailed descriptions of each cost recovery opportunity along with suggestions for improvement are provided in the Cost Recovery Detail and Best Practice Suggestions Detail sections below.

As of the time of completed fieldwork, March 18th, LS Black has not responded or indicated whether a credit will be issued for some or all of the cost recovery opportunities identified. HK will continue to initiate conversations with LS Black to reach an agreement on these cost recovery opportunities. HK recommends HTC/MNSCU to continue to withhold payment until negotiations continue and agreement is reached for the costs in question.

<p>Cost Recovery Opportunities Identified by HK Total cost recovery opportunities not in alignment with the contract that were identified by HK.</p>	<p>\$32,937</p>
<p>Cost Recoveries Obtained by HTC/MNSCU Total cost recoveries obtained by MCTC/MNSCU through negotiation with the contractor(s) based on the opportunities noted by HK.</p>	<p>\$0</p>

Best Practice Suggestions

The following recommendations are based on observations noted in conducting the audit and are being presented to MCTC/MNSCU for consideration to improve upon their current processes and related controls:

1. Revise contract language to ensure clarity and mutual understanding by all parties involved.
2. Review and agree upon subcontractor labor rates prior to start of project.
3. Update contract to more clearly define general conditions reimbursable expenses.
4. Define personnel allowed to charge time in the contract.

Thank you again for the opportunity to provide Minnesota State Colleges and Universities and Minneapolis Community and Technical College with our Construction Audit Services. We appreciate the assistance and cooperation of MCTC/MNSCU and LS Black staff members.

Respectfully,

Team Leader:
 Matt Gardner – Construction Audit Services Practice Leader

Executive Summary for Minneapolis Community & Technical College Renovation Project

Project Description

At the request of the Minnesota State Colleges and Universities (MNSCU) Internal Audit department, Honkamp Krueger & Co. P.C. (HK) completed an audit of the construction cost incurred by MNSCU for the work on the Minneapolis Community and Technical College (MCTC) Workforce Program and Infrastructure Renovation project. The project consists of the extensive remodel of approximately 82,000 GSF for workforce programs such as nursing, architectural technology, air traffic control, barbering, computer security, jewelry and gemology, heating, ventilation, air conditioning and refrigeration, and photography/digital imaging, student services testing center located throughout the five floors of the T-building. This project will reduce an estimated \$7.6 million in deferred maintenance, eliminates the need for 67,400 sq. feet of leased space in Eden Prairie and resolves significant long standing fire code and life safety issues. Infrastructure upgrades will include: the installation of elevators and improve stair access to all levels; increase ventilation and install cooling in the trades areas on the lower level; and resolve code related issues. A Construction Manager at Risk Guaranteed Maximum Price (GMP) contract was used to secure the services of M.A. Mortenson Company (Mortenson), who worked with the other members of the MNSCU and MCTC Project Management Team (PMT) to organize and construct the project plan and timelines, execute the required subcontracts, and coordinate all aspects of the project. Pre-construction began on the project in September 2012 with the final completion date of January 2014. As of the time of completed fieldwork, May 30, 2014 (Pay request #22), final construction cost for the project was \$12,623,768.68. Fieldwork was performed on the MCTC campus located in Minneapolis, MN.

Objective & Scope

The objective of the audit was to review documentation of costs incurred by MCTC and Mortenson and paid for by MCTC in completion of the project to determine if the requests for reimbursement were in alignment with the applicable contracts. The scope of the audit included all costs invoiced by Mortenson including sub-contractor costs. Additionally, HK verified MNSCU Construction Manager at Risk and Prevailing Wage requirements were met for Mortenson and all subcontractors secured on the project.

Audit Approach

The following approach was taken in order to successfully achieve the objectives of the audit:

- Conducted interviews with Mortenson and MCTC Project Managers.
- Summarized posted transaction details for the project through January 31, 2014 provided by Mortenson.
- Reviewed payroll registers, time sheets, and labor contracts for Mortenson and major subcontractors.
- Reviewed the accuracy of labor burden rates for Mortenson and major subcontractors.
- Tested material, equipment, and insurance transactions on a sample basis for Mortenson and major subcontractors.
- Reviewed Mortenson major subcontractor contracts and change orders and agreed to Mortenson payment applications.
- Recalculated contractor's fee, markups, bonds, and general insurance add-ons.

Summary of Audit Results

Overall, it appears different interpretations of contract verbiage resulted in a minor lack of cost containment normally associated with a project of this size. We noted a number of compliance issues with the contract that appear to be in part due to different interpretations of the contract, specifically key clauses concerning labor and labor burden costs, costs to be included in markup percentages, and overhead and profit markups. The cost recovery amount identified by the audit and the final amount recovered by MCTC/MNSCU through negotiation with the contractor(s) is summarized below along with best practice suggestions for improvement of MCTC/MNSCU processes and contract controls. Detailed descriptions of each cost recovery opportunity along with suggestions for improvement are provided in the Cost Recovery Detail and Best Practice Suggestions Detail addendums attached to this report.

Cost recoveries opportunities identified during closeout testing are currently in negotiation with Mortenson and the final credit amount owed to MCTC/MNSUC has yet to be determined. Cost recovery opportunities currently in negotiation are indicated in the Cost Recovery Detail section below (issues 6-8)

<p>Cost Recovery Opportunities Identified by HK Total cost recovery opportunities not in alignment with the contract that were identified by HK.</p>	<p>\$27,252</p>
<p>Cost Recoveries Obtained by MCTC/MNSCU Total cost recoveries obtained by MCTC/MNSCU through negotiation with the contractor(s) based on the opportunities noted by HK.</p>	<p>\$14,795</p>

Note: The amount recovered was in excess of the amount identified due to additional change orders processed after audit fieldwork was completed.

Best Practice Suggestions

The following recommendations are based on observations noted in conducting the audit and are being presented to MCTC/MNSCU for consideration to improve upon their current processes and related controls:

1. Revise contract language to ensure clarity and mutual understanding by all parties involved.
2. Review and agree upon subcontractor labor rates prior to start of project.
3. Update contract to more clearly define general conditions and change order reimbursable expenses.
4. Define personnel allowed to charge time in the contract.
5. Define bidding procedures when competitive bids are not available for all scopes of work; specifically self performed work.

Thank you again for the opportunity to provide Minnesota State Colleges and Universities and Minneapolis Community and Technical College with our Construction Audit Services. We appreciate the assistance and cooperation of MCTC/MNSCU and Mortenson staff members.

Respectfully,
 Matt Gardner – Construction Audit Services Practice Leader