

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

Agenda Item Summary Sheet

Committee: Audit Committee

Date of Meeting: October 18, 2011

Agenda Item: Approval of FY 2012 Internal Auditing Annual Audit Plan

- Proposed Policy Change Approvals Required by Policy Other Approvals Monitoring
- Information

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

Board Policy 1D.1, part 6, requires the Executive Director of Internal Auditing to present an Audit Plan for each fiscal year.

Presenter at the Audit Committee meeting:

Beth Buse, Executive Director, Office of Internal Auditing

Outline of Key Points/Policy Issues:

- Based on discussions at the May and June Audit Committee meetings, the audit plan presents an overview of how the Office of Internal Auditing plans to use its resources for fiscal year 2012.

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

BOARD ACTION
APPROVAL OF FY 2012 INTERNAL AUDITING ANNUAL AUDIT PLAN

BACKGROUND

According to Board Policy 1.D., Part 6, the Office Internal Auditing must submit an annual Audit Plan to the Audit Committee. The fiscal year 2012 audit plan is attached.

COMMITTEE ACTION:

On October 18, 2011, the Audit Committee reviewed the draft Fiscal Year 2012 Internal audit plan and approved the following motion:

RECOMMENDED MOTION:

The Board of Trustees approves the Office of Internal Auditing annual audit plan for fiscal year 2012.

Date Presented to the Board of Trustees: October 18, 2011

Minnesota State Colleges and Universities
Office of Internal Auditing
Fiscal Year 2012 Annual Audit Plan

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

Section I – provides results of audit risk assessment activities.

Section II - provides an overview of how the Office of Internal Auditing plans to use its technical resources.

Section III - describes other monitoring activities.

Section IV – provides an overview of administrative activities that need to occur during the fiscal year.

Section I: Audit Risk Assessment Results

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

When a formal enterprise risk management program exists, internal audit is able to leverage the results to limit additional risk assessment. However, a mature process does not exist within the Minnesota State College and University system.

We conducted an audit risk assessment approach that took into consideration enterprise strategic risks, financial risks, and information technology risks.

Enterprise Strategic Risks

Representatives of the Finance Division, Office of Internal Audit, and Office of General Counsel held meetings with various groups of system, college, and university leaders to discuss risk factors affecting the system. Specifically, the team met with:

- 25 colleges that do not have an annual financial statement audit. These meetings were with college leadership and were held in conjunction with Vice Chancellor King's regional Trends and Highlights meetings.
- Three institutions that have an annual financial statement audit. Meetings were held with leadership from Bemidji State University, Minnesota State University, Mankato, and Rochester Community and Technical College.
- Focused groups from various institutions representing college and university registrars and finance officers.

In addition, the Office of Internal Auditing had focused discussions with the Chancellor, Compliance Oversight Committee, Leadership Council, Interim Vice Chancellor for Academic and Student Affairs, Vice Chancellor of Finance, Vice Chancellor of Human Resources, the three external audit firms and the Legislative Auditor. Finally, the Office of Internal Auditing had two discussions with the Audit Committee to gain their input. In total over 200 system leaders were part of these discussions.

Common themes that came to light in nearly all of the conversations included:

- Difficult economic times the State of Minnesota and the nation are facing and the resulting decline in state support of higher education.
- Loss of knowledge due to turnover of key staff.
- Insufficient personnel in fundamental areas.

Over 40 areas were identified as potential risk areas during discussions with leadership. Possible areas where internal audit could provide audit coverage include: financial aid administration, student & employee safety, online education, employee professional development, and tuition & fee costs – use of differential tuition.

Financial Risks

For the first time, internal audit assessed fiscal risk factors at each college and university, using 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 = 200)	<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 make adjust for significant financial risks that were not part of the model.

The above metrics were assigned a point value for determining an overall ranking for each college and university. The table below shows the overall results of the financial risk modeling of the colleges and universities. Note that the results varied significantly between each institution with the highest total points being 525 and the lowest being 35.

Risk	Results	Number of Colleges and Universities
High	≥ 350	10
Medium	< 350 and > 200	17
Low	< 200	11

This work helped us identify ten potential audit targets with the greatest financial risk, as discussed below:

- 5 universities were included in the top 10. Their scores generally ranked high as a result of material financial activity, large numbers of people with incompatible access, and the length of time since the last internal control and compliance audit. These universities have not had an internal control and compliance audit since 1999 or 2000.
- 5 colleges were included in the top 10. Their scores were generally ranked high due to the volume of past internal control and compliance findings and the number of outstanding audit findings. Four of these colleges had operating losses in 2010 and one has not had an internal control and compliance audit since 2001.

We also assessed financial risk by looking at functional areas. Internal audit and finance division staff considered materiality, past audit issues and transaction volume and complexity when assessing risk over functional areas. We determined the following functional areas to have high risk: banking and cash controls, ISRS user level security, capital assets, financial aid, employee payroll, tuition and fee billing, and grants.

Information Technology Risks

Certain information technology risks were identified during the work done assessing enterprise strategic and financial risks. We supplemented this lists with other information technology risks to identify key areas where audit coverage could provide system leaders with independent assurance:

- Vulnerability and threat management
- Continuity of operations
- Security and integrity of sensitive data
 - Student
 - Employee
 - Credit card
- Banking and vendor controls
- Quality assurance and change management
- Financial aid ISRS module

The Office of Internal Auditing is planning to develop a more comprehensive information technology risk assessment in fiscal year 2012.

Section II: Use of Internal Auditing Resources

For fiscal year 2012, the Office of Internal Auditing has identified the following priorities based on the results of audit risk assessments and available resources, which includes adding one auditor.

Continue core assurance services:

- Coordinate financial statement and federal financial assistance audits: Fiscal year 2011 marks the eleventh year that the Minnesota State Colleges and Universities contracted for an external audit of its financial statements. The external audit firm of LarsonAllen is under contract to provide audit services for the system-wide financial statements, Revenue Fund financial statements, and federal financial assistance. This will be the second year that LarsonAllen provides these services. In addition, audited financial statements are generated for 13 of the largest institutions in the system.

The Office of Internal Auditing is obligated by current contracts to provide staffing support to external auditors for some of these financial audits.

- Monitor progress toward implementing audit findings: It is important that the Board of Trustees, Chancellor, and presidents have confidence that any problems revealed by audits or evaluations receive appropriate attention. Internal Auditing monitors progress toward implementing all audit findings. Internal Auditing provides status reports on prior audit findings to the presidents and vice chancellors in January and June of each year. The Chancellor is informed about any unresolved audit findings as part of the annual presidential and cabinet performance evaluation process.
- Assist with fraud inquiries and investigations: Since the board approved Policy 1C.2 in June 2002, Internal Auditing has worked with the Chancellor's Cabinet and presidential executive teams to implement its provisions. On July 1, 2008, a new Code of Conduct for employees was enacted as Procedure 1C.0.1. In these times of great uncertainty and change, it is reasonable to expect an increase in the number of issues that will require inquiries and possibly investigations. Accordingly, the amount of time reserved for this activity has again been increased in this plan.

Conduct Studies that have Significant System-wide Interest, based on priorities of the Board of Trustees and Chancellor. In past years, Internal Auditing has scheduled a study of a topic of major system-wide interest. Recent studies have focused on undergraduate student credit transfer, auxiliary and supplemental revenues, affiliated foundations and implementation of student success systems. We are not selecting a topic at this time but have reserved some time for a project to be selected after Chancellor-Designate Rosenstone begins in August.

Complete a comprehensive information technology audit risk assessment.

Conduct audits in the following areas:

- Internal control and compliance audit of Southwest Minnesota State University
- Functional area focused audits of state university payroll and ISRS security

- Information technology audit of vulnerability and threat management practices

An information technology audit strategy for the system will also be developed. The Office of Internal Auditing will use consultants to help develop and implement an information technology audit strategy. This would be a onetime resource, using approximately \$100,000 in salary savings from fiscal year 2011.

The table below provides a summary in the use of technical staff resources over the next three years.

Summary of Projected Staff Technical Hour Use for Next Three Years

Audit Area	Estimate 2012	Estimate 2013	Estimate 2014
External Auditor Support (1)	1,480	1,200	-
Follow-up	700	800	1,000
Fraud Investigations	1,300	1,300	1,300
Professional Advice	500	500	500
Other	930	930	930
Information Technology	1,500	1,500	1,500
Financial Internal Control and Compliance	2,000	2,000	2,700
Systemwide Projects	1,100	1,950	2,250
Total	9,510	10,180	10,180

(1) Plan to eliminate staffing support to external auditors as contracts expire.

Section III: Monitoring Other 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.

Audits of Grants and Special Financing Arrangements – Some special grant or 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. The most common source of these requirements is the Minnesota Job Skills Partnership (MJSP) grants. Because of the volume and routine nature of the MJSP grants, the Legislative Auditor has agreed in the past to permit Internal Auditing to review those audit contracts on its behalf. Other unique audit requirements, such as an audit arranged by Itasca Community College for a housing project financed with bonds sold by a County Housing and Redevelopment Agency, must be submitted directly to the Legislative Auditor for review.

Reviews Conducted by State and Federal Student Financial Aid Authorities – The Minnesota Office of Higher Education conducts periodic reviews of the state grant and loan programs being administered by the 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. 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.

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 Office of the Chancellor. 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 Activities

In addition to conducting and monitoring audits, there are a several administrative activities the Office of Internal Auditing needs to complete during fiscal year 2012. These include:

External Assessment - In January, 2002, the Institute of Internal Auditors (IIA), the professional organization responsible for promulgating the professional standards for the practice of internal auditing, added *Standard 1312 – External Assessments*. This standard requires internal audit organizations to undergo an external quality assessment review at least once every five years.

In 2007, the Office of Internal Auditing underwent an alternative method to comply with *Standard 1312*, a self-assessment with independent validation. The results were presented to the Audit Committee in March 2007.

To meet the five year requirement, the office needs to undergo an external assessment. Since the office has undergone much transition over the past couple of years, we believe it is important to contract for an external assessment. We believe the feedback and assurance this will provide the Board and senior leadership will be invaluable.

Audit Charter – The Office of Internal Auditing Charter (Board Policy 1.D.1) is not up-to-date and does not reflect recent changes to professional internal audit standards. We plan to work with the Audit Committee in fall 2011 to revise the board policy.

Replacement of Office of Internal Auditing Administrative Systems – Applications used for recording and managing staff time, audit findings, and fraud inquires and investigations are outdated and are difficult to maintain. We plan to assess office needs for administrative systems and replace these systems.