

**MnSCU Office of Internal Auditing
Annual Audit Plan & Budget
Fiscal Year 2000**

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MnSCU Office of Internal Auditing Risk Assessment

“Uncertainty and randomness exists in nature. Risk is not something to be worried about, but something to be managed. Risk management includes risk analysis and the prudent steps that come from increased understanding and awareness of the consequences of managing in an uncertain world.”

David MacNamee, Assessing Risk

A first step for establishing an internal auditing plan is to conduct a risk assessment. It facilitates a structured process for setting auditing priorities and helps direct auditing resources to the most critical areas. During the last six months the Office of Internal Auditing conducted structured interviews with 36 college and university presidents and members of their executive teams. The interview questions were developed using internal control frameworks defined in *the COSO report*¹, and *the CoCo control model*². These frameworks provide broad, management-oriented concepts of control, are authoritative, and widely accepted. We developed questions that were comprehensive and intended to touch on all elements of the college and university environment.

The purpose of the interviews was to identify concerns that colleges and universities share system-wide. We also wanted to identify concerns or issues that are unique to individual institutions. The results of these risk assessment interviews were compiled and sorted into topic areas. We then discussed potential audit topics with System Office senior administrators and representatives of the Campus Services Unit Information Technology Services. We attempted to identify other internal projects that may address some of the risk areas. Also, we sought a sense of priorities for the potential audit topics. Based on those discussions and our own judgments, we organized the topics into three categories: high, medium, and lower potential. The categories were intended to capture the relevant value of devoting internal auditing resources to a project.

The categories of potential audit topics are shown on pages 2-4. Internal Auditing recommends that it develop full project proposals for the six topics in the high potential category and present them to the Audit Committee at the July meeting. These audit proposals would then become the basis for selecting topics to be studied in fiscal year 2000.

¹ Internal Control – Integrated Framework, published in 1992 by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Sponsoring organizations included the American Accounting Association, the American Institute of CPAs, Financial Executives Institute, Institute of Internal Auditors, and the Institute of Management Accountants.

² The Guidance on Control, published in 1995 by the Criteria on Control Committee (CoCo) of the Canadian Institute of chartered Accountants.

HIGH POTENTIAL TOPICS: Internal Auditing will prepare full proposals for these topics and present them to the Audit Committee at the July committee meeting. Efforts will be made to initiate studies that will address most of these topics during fiscal year 2000.

Topic	Potential Impact	Comment
Employee Recruitment & Hiring Practices	Personnel costs represent about 80% of college and university expenditures. Employing and retaining high quality people is a key to success.	Both the Vice Chancellor for Human Resources and the Associate Vice Chancellor for Equal Opportunity and Diversity are interested in this study. It was also the most cited concern expressed by college and university administrators.
Auxiliary Enterprises	Colleges and universities operate numerous auxiliary enterprises, such as bookstores and computer stores. Little is known about these activities system-wide. In tight fiscal times, it is essential that these enterprises be well managed. Furthermore, there are tax implications that must be considered for these activities.	The Chancellor and the Vice Chancellor – CFO were very interested in this study. There is limited information currently available on the extent of current auxiliary enterprises operated by the colleges and universities.
Customized Training & Continuing Education	These activities represent a high growth area for colleges and universities. It is subject to varying definitions and inconsistent methods of measuring costs and setting prices.	A 1999 state law requires that any “excess revenues” from customized training programs be retained for customized training programs. MnSCU Academic Affairs has proposed that Internal Auditing study this area to help achieve a common definition of “excess revenue”.
System Security	An August 1997 Legislative Auditor report focused on security over central systems and found a number of vulnerabilities. Colleges and universities maintain local area networks and computing operations beyond the central systems. The degree of vulnerability associated with local operations is not known.	Technology topics were the second highest area of concern cited by college and university administrators. The Chancellor was also interested in this topic. System security continues to be an area that the Board of Trustees has concerns about.
Business Continuity Planning + System Backup & Recovery	There was interest in combining these topics. System backup & recovery is a subset of business continuity planning. Business continuity planning is a natural extension of Y2K planning.	The Chancellor and technical leaders in both the Campus Services Unit ITS Division and Academic Affairs were interested in this topic.
Web-based services & electronic business – Best Practices	The use of technology has grown rapidly beyond basic administrative functions. It has become increasingly applied as an academic delivery tool. The future competitiveness of the organization may be greatly affected by the organization’s ability to adapt to changing market demands.	The Senior Vice Chancellor for Academic and Student Affairs and the Chief Information Officer were very interested in this topic.

MEDIUM POTENTIAL TOPICS: Although these topics present good potential for study, the timing may not be optimal for Internal Auditing to study them in fiscal year 2000.

Topic	Potential Impact	Comment
Information Technology Survey	The organization depends on information technology for basic operations and continues to extend its use into the delivery of academic programs.	In 1997, MnSCU hired a firm to inventory information technology hardware. The inventory was updated in fiscal year 1999. This information, has not, however, been analyzed to determine how technology is used and supported by the colleges and universities.
Budget Reserves	The Legislature has continued to question the need for MnSCU to retain its reserve balances. Measurement of reserves allows substantial discretion and may have significant inconsistencies.	The MnSCU Budget Division monitors reserve calculations.
Academic Program Review Process	Academic offerings are at the heart of the organization's mission. It is an ongoing challenge to eliminate outdated or unpopular programs and introduce new high demand programs.	The Metro Plan is leading an effort to reconsider the process for academic program review. The results will be evaluated for statewide implications.
Foundations & Fundraising	A wide range of practices and successes exist in raising private donations. Much remains unknown about whether colleges and universities are realizing their full fundraising capacity.	The Associate Vice Chancellor for Public Affairs is seeking to hire a Director for Development and expects to initiate changes in this area in the future.
Recruiting & Retaining Students	Nothing is more important to colleges and universities success than their ability to recruit and retain students.	The Associate Vice Chancellor for Public Affairs has commissioned a \$250,000 study focused on enrollment management. The consultant will interview approximately 5,000 current, past, and prospective students. Results are expected to be released in July 1999.
Construction Contract Management	MnSCU spends hundreds of millions of dollars on construction contracts. It owns over 22 million square feet of building space.	The Associate Vice Chancellor for Facilities has created six advisory groups to review current construction management projects. New project management policies and procedures are expected to be implemented by the end of fiscal year 2000.

LOWER PRIORITY PROJECTS: Although these topics attracted good interest, there are other actions in progress that should address any concerns.

Topic	Potential Impact	Comment
Labor Contract Negotiations	Labor contract negotiations continue to have a dramatic impact on college and university finances and management practices.	MnSCU has recently acquired the authority to negotiate faculty contracts without reliance on the Department of Employee Relations. As a result, the process may change significantly and any study would be premature.
Data Analysis tools & Ad-hoc Reporting	As MnSCU systems are implemented, data becomes increasingly available to meet management's information needs.	The Campus Services Unit ITS Division plans to initiate an extensive review of the organization's data warehousing needs.
System Office: Communications & Role	The 1999 Legislature mandated that a report be submitted on the system office role.	The chancellor will be initiating actions to address these concerns.
Corporate Governance	Colleges and universities continue to seek greater contact with the Board of Trustees.	The Board of Trustees is in the process of hiring an Executive Director.
Academic Degree Granting Authority	Degree granting authority continues to be a potentially contentious issue, particularly between community colleges and technical colleges.	In June 1999, the Board of Trustees will give final consideration to four new academic policies that will have a significant impact on current practices.

**MnSCU Office of Internal Auditing
Products & Services – Fiscal Year 2000**

For technical products and services, MnSCU Internal Auditing plans to allocate its resources among the following four areas:

1. System-wide Audits -- Topics Selected by the Audit Committee (35% of total resources, an estimated 5,600 hours)

System-wide audits are intended to be those high impact projects that focus on centralized systems, policy matters, or common challenges faced by colleges and universities. The potential projects shown in the prior section will serve as the starting point for selecting system-wide audits for fiscal year 2000. Internal Auditing will prepare full project proposals for the six high potential projects.

The office continues to work on the Code of Conduct Best Practices study that was selected by the Audit Committee in January 1999. The Audit Committee will be asked to select additional audit topics, as resources become available throughout the year. Depending on the scope of the projects, Internal Auditing should have resources to conduct 3-6 projects from the list. Ideally projects will be chosen throughout the year, as resources become available.

2. Quality Management Self-Assessments (18% of total resources, an estimated 2,800 hours)

Quality management initiatives are known by many names: Total Quality Management (TQM), reengineering, continuous process improvement, and the COSO internal control framework. Internal Auditing has experimented with various forms of quality management techniques, such as facilitated workshops and employee questionnaires. These techniques have had positive impact. It became apparent, however, that the terminology of traditional accounting models was confusing and foreign to many managers. Therefore, Internal Auditing is committed to developing a generic quality management model that can be used as criteria for evaluating the effectiveness of college and university management.

While the model remains under development, it currently contains five, interactive components:

- X *Culture & Organization Structure* X The core of any organization is its people X their individual attributes, including integrity, ethical values, and competence X and the environment in which they operate. They are the engine that drives the entity and the foundation on which everything rests.

- X *Goals & Change Management* X Successful organizations set meaningful goals and manage toward their attainment. Accomplishing goals requires selling them to stakeholders and applying the necessary budget resources.
- X *Policies & Procedures* X Policies and procedures must be established and executed to help ensure that the actions identified by management as necessary to achieve an entity=s objectives are carried out effectively.
- X *Evaluation & Feedback* X The entire process must be monitored and modifications made as necessary. In this way, the system can react dynamically, changing as conditions warrant.
- X *Information and Communication* X Surrounding the other components are information and communication systems. These enable the entity=s people to capture and exchange the information needed to conduct, manage and control its operations.

The new Quality Management Program Coordinator will be responsible for completing the design and promotion of this generic model. The coordinator will then refine techniques for applying the model in the MnSCU environment. These techniques will be offered to colleges and universities through the regional audit coordinators.

3. Consultative & Advisory Projects (11% of total resources, an estimated 1,800 hours)

Successful internal auditing functions are positioned to address indications of immediate needs. These projects cannot be predicted with any specificity. Examples include projects such as investigations, special requests, and alerting colleges and universities to potential problem areas. Board of Trustees policy 7.2 requires colleges and universities to notify the MnSCU Office of Internal Auditing of suspected illegal acts or misconduct that involves finances. Internal Auditing will assure that any of these cases are thoroughly investigated and resolved.

Other types of ad-hoc projects may be to respond to requests from presidents or the chancellor. Internal Auditing will attempt to be responsive to the needs and interests of MnSCU executives. Finally, Internal Auditing has developed a mechanism, “Alert Communications”, that is used to forewarn colleges and universities about potential problems or common concerns.

4. Follow-up on Prior Findings (15% of total resources, an estimated 2,400 hours)

Internal Auditing is committed to an aggressive program for following up on prior audit findings and encouraging corrective actions for known problems. Audit follow-up includes findings from both Internal Audit reports and Office of the Legislative Auditor reports. Internal Auditing provides quarterly reports on the progress toward implementing Legislative Audit findings. The Audit Committee is kept apprised of progress toward implementing critical Internal Auditing findings on an ongoing basis.

MnSCU Office of Internal Auditing Internal Audit Staffing

Internal Auditing proposes maintaining its current staffing structure for fiscal year 2000. Three of the audit coordinator positions were not filled until the fall of 1998 and the Quality Management Program Coordinator position has just been filled. The office has the following positions:

- 1 Executive Director responsible for overall management of the Office of Internal Auditing. Primary liaison to the Board of Trustees, the Chancellor, and MnSCU Executive Staff.
- 1 Deputy Director responsible for information technology audits and providing leadership for using technology as an audit tool. Primary liaison to the Chief Information Officer and information technology specialists.
- 6 Regional Audit Coordinators responsible for overseeing or conducting all audit related activities on assigned campuses. Each region contains about six colleges or universities. Locations include the Minneapolis area, St. Paul area, Central Minnesota, Southeast Minnesota, Northwestern Minnesota, and Northeastern Minnesota. Most regional audit coordinators have offices on MnSCU college or university campuses.
- 1 Quality Management Program Coordinator responsible for designing and facilitating self-assessments and continuous improvement programs. This position will develop a generic quality model suitable for the MnSCU environment, develop training programs, and coordinate the use of techniques such as facilitated workshops and employee questionnaires. This coordinator will collaborate with the regional audit coordinators to provide consultative services directly to the colleges and universities.
- 1 Principal Auditor responsible for analyzing system-wide data, compiling project data, supporting the Deputy Director on technology audits, and available for special projects.
- 1 Administrative Support position responsible for coordinating communications, report production, and other administrative and office services duties.

Benchmark data for higher education internal auditing functions suggests that MnSCU Internal Auditing should have a staff complement of 16 to 20 professional positions. Because we have hired experienced staff, located coordinators in regions throughout the state, and made extensive use of technology tools, we believe that 10 professional auditors will serve the organization effectively.

**MnSCU Office of Internal Auditing
Fiscal Year 2000 Audit Plan**

Resource Allocation – Overview

Activities	Estimated Hours	% of Total
<u>Technical Products & Services</u>		
• System-wide Audits	5,600	35%
• Quality Management Self-Assessments	2,800	18%
• Consultative & Advisory Services	1,800	11%
✓ Investigations		
✓ Alert Communications		
✓ Special Requests		
• Follow-up on Prior Findings	2,400	15%
✓ Internal Audits		
✓ OLA Audits		
✓ CPA Audits		
<u>Planning & Development</u>		
✓ Conduct Risk Assessments	1,600	10%
✓ Promote Internal Auditing		
✓ Educate about Controls		
<u>Administration</u>		
✓ Hiring	1,800	11%
✓ Training		
✓ Design Audit Tools		
✓ Develop Audit Policies		
✓ Staff Meetings		
<u>Estimated Hours Available</u>		16,000 100%

Notes:

1. Schedule shows estimated hours for following 10 positions (hours for 1 administrative support position are not included in schedule):
 - 1 Executive Director
 - 1 Deputy Director
 - 6 Regional Audit Coordinators
 - 1 Quality Management Program Coordinator
 - 1 Auditor Principal
2. Hours are shown net of estimated amounts for leaves of absence, sick leave, vacations, holidays, and possible turnover.
3. If necessary, additional resources, temporary help or specialty expertise, could be acquired through contracting.

**MuSCU Office of Internal Auditing
Fiscal Year 2000 Proposed Budget**

For budgetary purposes, Internal Auditing is considered part of the system office. The Internal Auditing budget, shown within the system office budget, includes salaries, contractual services, and unique administrative costs for travel, training, and purchased services. In addition, the Internal Auditing budget must pay for the costs associated with maintaining campus-based offices for the regional coordinators, such as office rental, use of campus facilities, and remote equipment needs. This budget does not, however, include common costs incurred by the system office. Costs for office space, phones, photocopies, supplies, computer hardware, software, and telecommunications are provided for from shared system office cost centers.

Based on the system office budget methodology, the Internal Auditing budget as established for fiscal year 1999 and proposed for fiscal year 2000 is as follows:

**MnSCU Office of Internal Auditing
Budgeted Expenditures
Fiscal Years 1999 and 2000**

Budgeted Expenditures (1)	FY 1999 (2)	FY 2000
Salaries	\$677,300	\$726,400
Contractual Services	125,000	60,000
Other Administrative Expenditures	83,800	87,000
Total Internal Auditing Budget	\$886,100	\$873,400

- (1) Office space costs in St. Paul and computer related costs for the entire system office are provided for in a separate budget.
- (2) Due to vacant positions and limited use of consultants in fiscal year 1999, substantially less than the amount budgeted will be expended.

Now that the Internal Auditing office is fully staffed, the possible need for contractual services should be lessened and, accordingly, this budget line item has been reduced significantly. The office may use some of those funds to employ student workers to assist the regional audit coordinators in carrying out their duties.

**MnSCU Office of Internal Auditing
External Audits**

MnSCU acquires external audit services from the Office of the Legislative Auditor (OLA) and Certified Public Accounting firms. The following schedule shows a summary of external audit costs for fiscal year 1999 and estimated for fiscal year 2000.

External Audit Costs
Fiscal Years 1999 and 2000

External Audit Services	Fiscal Year 1999 Actual Costs	Fiscal Year 2000 Estimated Costs
Office of the Legislative Auditor:		
Contract	\$440,000	\$460,000
Federal Financial Aid Audit (1)	\$258,000	\$230,000
CPA Firms		
Revenue Fund Audit	\$36,100	\$34,100
Foundations (2)	N/A	N/A
Minnesota Job Skills Partnership Act Grants (2)	N/A	N/A
Totals	\$734,100	\$724,100

- (1) There is a two-year lag between when these services are provided and when the Department of Finance submits "indirect cost" bills to state agencies. The estimated fiscal year 2000 audit costs are for audits of federal financial aid conducted in fiscal year 1998.
- (2) Costs are not available for these audit services. Foundation audit costs are born by the foundations and not the colleges and universities. Audit costs are an allowable expense from the Minnesota Job Skills Partnership Act (JTPA) grants distributed by the Minnesota Department of Trade & Economic Development to participating colleges and universities.
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Legislative Auditor Services

Since fiscal year 1997, MnSCU has contracted for supplemental audit services from the Office of the Legislative Auditor. The audit contract has allowed the Legislative Auditor to conduct comprehensive financial audits of all MnSCU colleges and universities over a three-year period. By the end of fiscal year 1999, the Legislative Auditor will have audited each college and university and the system office once since the merger. The Legislative Auditor has also conducted other special audits, such as an audit of system security in August 1997. The following schedule shows a summary of the costs associated with the audit contract.

Office of the Legislative Auditor
 Summary of MnSCU Contract
 Fiscal Years 1997 – 1999

Fiscal Year	Number of Audits	MnSCU Payments	OLA Share Not Billed	Total Contract Value
1997	14	\$400,000	\$306,926	\$706,926
1998	13	\$420,000	\$325,011	\$745,011
1999 (1)	13	\$440,000	\$293,400	\$733,400

(1) Value for FY 1999 is estimated.

As the schedule indicates, MnSCU is responsible for paying only a portion of the full value of the contract audit services. The MnSCU share is based on 60% of the estimated contract value, capped at a maximum dollar amount each year. The Legislative Auditor absorbs the remainder of the contract costs from its state appropriation.

State law also requires MnSCU to reimburse the Minnesota Department of Finance for indirect costs associated with audits of its federal financial assistance (commonly known as the Single Audit). There is a two-year lag, however, between when the Legislative Auditor conducts the Single Audit and when the Department of Finance bills MnSCU for the indirect costs. Also, there is a relationship between the MnSCU audit contract and the indirect cost billings. The contract allows the Legislative Auditor to satisfy certain Single Audit requirements, thus reducing indirect cost billings (two years later due to the lag). Indirect cost billings are shown in the following summary:

MnSCU Indirect Cost Billings
 For Audits of Federal Financial Assistance
 Payments made from Fiscal Years 1997- 1999

Year of Service	Year of Payment	Amount
1995	1997	\$285,000
1996	1998	\$333,000
1997	1999	\$258,000

If MnSCU did not contract with the Legislative Auditor for comprehensive audits, then the indirect cost billings would increase. For example, the fiscal year 1999 indirect cost payment would have been approximately \$65,000 higher without the contract.

Finally, the Legislative Auditor conducts other work related to MnSCU that is not billed out under either the contract or through indirect costs. For example, the auditor examines some MnSCU financial activity each year as part of the annual audit of the state's financial statements. The estimated value of the MnSCU share of this audit work in fiscal year 1998 was about \$90,000, which was absorbed by the Legislative Auditor's general fund appropriation. Another example, of Legislative Auditor projects for which

MnSCU would not be billed is program evaluations. The Legislative Auditor has not conducted a program evaluation of MnSCU since the merger, but it has tentative plans to begin a limited evaluation of MnSCU in late calendar year 1999.

The contract relationship with the Legislative Auditor has been viewed as highly successful. It has proven to be a very cost efficient solution for MnSCU to obtain external audit coverage. Also, it has helped focus attention on areas that need improvement. MnSCU presidents have indicated that they find the Legislative Audits to be a valuable tool. In fact, many presidents have expressed a desire to receive annual audits.

Discussions have been held with the Office of the Legislative Auditor about extending the audit contract into the next biennium. The office is interested in extending the contract and has been very open to ideas about how the audit schedule and approach could be made more effective. There is a commitment to incorporate the following features into the contract:

- Explore ways of reducing the cost of audits by having MnSCU document and assess internal procedures and business processes and prepare data in advance of the audits. Possible solutions include MnSCU Internal Auditing helping colleges and universities with quality management self-assessments.
- Changing the timing of some audits from a scheduled approach to a need basis. For example, schedule audits to occur when a president resigns or retires. Also, focus audit resources toward colleges or universities that are having the most difficulty with their financial management processes.
- Establishing the foundation for annual audited MnSCU financial statements. The Governmental Accounting Standards Board is scheduled to propose new financial reporting principles for colleges and universities in June 1999. The new standards would set the stage for MnSCU being presented as a separate entity in the state's financial report and, in essence, require an annual MnSCU financial statement audit. The new standard is expected to have an effective date of fiscal year 2002. This plan proposes beginning work to acquire audited financial statements for fiscal year 2001. It sets aside 1,000 hours of the Legislative Auditor's hours to assess the reliability of selected balance sheet accounts at the end of fiscal year 2000. Particular emphasis would be given to accounts that historically have not been measured in accordance with generally accepted accounting principles, such as plant and equipment accounts.

The following schedule shows the potential audit coverage from the Legislative Auditor for fiscal year 2000.

Office of the Legislative Auditor
Proposed Contracted Audit Services
Fiscal Year 2000

Explanation	Estimated Audit Hours
<u>Colleges/Universities Last Audited in 1997 (1):</u>	11,250
Alexandria Technical College	
Dakota County Technical College	
Fergus Falls Community College	
Lake Superior College	
Metropolitan State University	
Minneapolis Community & Technical College	
Moorhead State University	
Normandale Community College	
Northland Community and Technical College	
Pine Technical College	
St. Paul Technical College	
Winona State University	
<u>Colleges/Universities with new presidents (2):</u>	1,250
Laurentian District (3)	
South Central Technical College	
Audit Selected FY2000 balance sheet accounts (3)	1,000
Additional Savings Possible (5)	(1,150)
Estimated Hours Available (6)	2,150
Total Estimated Hours	14,500

- (1) In fiscal year 1997, these audits required over 14,000 hours to complete. The Legislative Auditor estimates that the audits can be conducted more efficiently now because of the experience that the auditors gained with the first audits.
- (2) St. Cloud State University is expected to have a new president named in 2000; another audit of the university is tentatively planned to coincide with that appointment (probably in the summer of 2000). Interim presidents are managing Anoka Hennepin Technical College, Rochester Community & Technical College, and Ridgewater College. When permanent presidents are named, the need for another audit will be assessed.
- (3) This work would help lay the foundation for obtaining an audit of FY2001 MnSCU financial statements.
- (4) Audit fieldwork for the Laurentian District audit, currently underway, will be extended through fiscal year 1999.
- (5) Internal Auditing will use quality management self-assessment techniques and other mechanisms in an attempt to further reduce the audit hours.
- (6) These hours are available in the event of presidential turnover, for special audits, and to assist with developing audited financial statements.

CPA Firm Audits

The Revenue Fund financial statements must have an annual audit, as required by the bond covenants. Beginning with fiscal year 1998, MnSCU entered into a three-year contract with the firm of Larson, Allen, Weishar & Company to conduct this audit. The annual audit costs under the contract are \$36,100, \$34,100, and \$35,100, payable from the Revenue Fund in fiscal years 1999, 2000, and 2001, respectively.

Some colleges and universities also receive grants under the Minnesota Job Skills Partnership Act administered by the state Department of Trade & Economic Development. These grants require a closeout audit to verify compliance with the grant terms. Colleges and universities have contracted with CPA firms to satisfy this grant requirement. The audit costs are an allowable cost under the grant program and generally cost only a few thousand dollars.

Most colleges and universities also are associated with private not-for-profit foundations. Board policy requires that any foundation with annual revenues greater than \$350,000 be audited annually and smaller foundations must receive audits at least once every three years. Foundations are responsible for paying these audit cost from their resources.