

MnSCU Office of Internal Auditing Annual Report Fiscal Year 2001

Submitted to the MnSCU Board of Trustees on October 18, 2001, as required by Board Policy 1.D. Part 8.

The end of fiscal year 2001 marked the sixth anniversary for the MnSCU system. Internal Auditing has existed for roughly two-thirds of that time. Much has been accomplished. A solid financial and operational foundation is being formed for the system. Information systems have become more stable and are able to produce data that is more reliable and uniform across campuses. The organization is beginning to pursue new opportunities in training incumbent workers and its e-Learning capacity. Many people throughout the system have made this progress possible. Internal Auditing has attempted to stay in tune with system-wide priorities and to contribute to these successes when possible.

In July 2000, the MnSCU Board of Trustees formally adopted a revised internal auditing charter into board policy. Prior to that time, Internal Auditing had under operated under a charter that had been established by the board in 1997, but had not been codified into board policy. The new charter, codified as board policy 1D, incorporated elements of a new definition of the professional practice of internal auditing. It also drew upon the experience of two and a half years of internal auditing experience in MnSCU. The policy identified four types of services provided by internal auditing: assurance services, consulting services, fraud inquiry and investigation support, and professional advice. This annual report includes a summary of activities within each of those lines of service.

Assurance Services - System-wide Studies

Network Security - In February 2001, Internal auditing issued a major system-wide study of network security. This study examined practices for securing access and use of information technology resources at each of the 35 MnSCU colleges and universities. Major findings and conclusions contained in the report included:

- The study confirmed that the threat of network security problems exists and is growing. Major corporations such as Microsoft and Amazon.Com have been targeted by security attacks in the past year. Also, MnSCU colleges and universities have experienced about one security incident each week. To date, MnSCU has avoided catastrophic results from a network security attack. It, however, has endured damages to websites, destroyed data files, and expensive damage from viruses. MnSCU data on students, research, and curricula are among the organization's most valuable assets. Inadequate network security exposes the organization to potential

financial losses, denial of service, lost or corrupted data, unauthorized disclosure of confidential data, unauthorized use of resources, loss of public image or reputation, and the possibility of legal actions against MnSCU officials. Thus, it is essential that this information be protected from loss or damages.

- The report offered recommendations for improvements to the Board of Trustees, System Office, and individual colleges and universities. It notes that increasingly organizations, including other higher education institutions are developing centralized information security policies.
- The report then recommended that the System Office translate board policy into procedures, standards, and guidelines to assist colleges and universities with network security matters.
- Finally, the report offered a series of recommendations to colleges and universities. It suggests that presidents review their organizational structures and staffing levels to ensure effective information technology services. Other recommendations address matters such as network infrastructure documentation, physical security, logical security, backup of data and program files, virus protection, and software licensing.

The issuance of this report sparked much interest. Of particular concern to the Board of Trustees was the lack of firewalls or similar technology in place at the colleges and universities. Mr. Ken Niemi, Associate Vice Chancellor for Information Systems - Chief Information Officer, developed an action plan in response to the board's concerns. The Office of Internal Auditing is tracking the progress of this action plan closely.

Post-Secondary Enrollment Options Program - In July 2001, Internal Auditing issued another major system-wide study of the Post-Secondary Enrollment Options (PSEO) program. This program allows high school juniors and seniors to earn college credits. We estimated in the report that approximately 20% of Minnesota high school seniors earn college credits before graduating from high school.

As part of this study, Internal Auditing received expert assistance from Academic Affairs representatives from the Office of the Chancellor and MnSCU colleges and universities. Major findings and conclusions contained in the report included:

- MnSCU is the dominant provider of college credits to Minnesota high school juniors and seniors. High school students from nearly every public high school in the state accessed MnSCU campuses to earn college credits. MnSCU colleges and universities have further expanded the reach of the program by offering college courses in 163 Minnesota high schools.
- The MnSCU Board of Trustees has educational policies that govern the PSEO program. Policy 3.5 establishes an admissions threshold for high school juniors and seniors and creates some quality assurance standards for College in the High School

programs. Policy 3.3 requires assessing the college readiness of incoming students (including PSEO students). These policies have not been uniformly accepted, interpreted, nor implemented. In particular two state universities have chosen to disregard a clear directive contained in Policy 3.5. This experience suggests that the methodology for developing, interpreting, implementing and enforcing PSEO educational policies needs to be reconsidered.

- The rapid growth of PSEO programs at MnSCU colleges and universities have created new challenges to preserving the quality of academic programs and ensuring the academic achievement of high school students. The academic performance of most high school students attending college and university campuses has been impressive; although too many high school students fail or withdraw from courses taken at college and university campuses. Also, several College in the High School programs should reevaluate the rigor of their programs and their standards for assessing student performance. There are additional improvement opportunities with student data, program information, secondary school relationships, and obtaining feedback from program participants.
- Despite its very impressive reach across the State of Minnesota, there are additional opportunities to expand the availability of earning college credits to high school students. In particular, the program has had difficulty extending college-level technical education opportunities to high school students. There are further expansion opportunities by reaching out to student that cannot succeed in the high school environment and through the use of technology.
- In fiscal year 2000, the State of Minnesota and local school districts invested about \$27 million in supporting high school students that earn college credits at MnSCU colleges and universities. We estimate that this investment returned savings of over \$45 million to Minnesota taxpayers, parents, students, and the federal government. The State of Minnesota alone is saving at least \$7 million on these students. Despite these state-level savings, MnSCU is required to absorb an estimated loss of about \$6.3 million for sponsoring PSEO programs. MnSCU shields individual colleges and universities from recognizing this loss, however, the current MnSCU allocation model rewards individual colleges and universities for participation in PSEO.

Progress on Prior System-wide Studies

Internal Auditing continued to track progress on issues identified in three other system-wide studies on topics that had significant implications.

- **The Student Information System (ISRS)** was the topic of a major internal auditing study issued in January 1999. The study revealed significant problems with the MnSCU system development methodology, resulting in major risks for the new student system. The Audit Committee requested periodic reports from Internal Auditing as the new student system was implemented throughout calendar year 1999.

The system implementation proved to be rocky at times, but ultimately all MnSCU colleges and universities converted to the new system for the Fall 1999 semester. Also, during fiscal year 2000, the Board of Trustees approved a new information technology (IT) strategic plan and governance structure. While some IT matters remain to be resolved, the environment has experienced significant stability in the past year. Internal Auditing will continue to monitor areas that still need improvement, such as system security, quality assurance and project management.

- **Reliability of MnSCU Financial Data** was addressed in an internal auditing study issued in May 1999. The study found that while the organization had successfully consolidated financial systems, the current systems were complicated and not well understood by users. As a result, the reliability of financial data was questionable. Many of the issues discussed in the report have been substantially resolved. However, internal auditing continued to work with campuses in identifying areas that needed improvement, such as occurrence date coding, in the past year. The work completed will hopefully result in an unqualified opinion for the fiscal year 2001 MnSCU financial statement audit currently being conducted.
- **Incumbent Workforce Training Programs** was the topic of a major system-wide study issued in June 2000. This report was the first topic where Internal Auditing had the opportunity to work closely with MnSCU Academic Affairs on a system-wide study. Since the issuance of the report, Mr. Richard Tvedten, System Director of Customized Training and Continuing Education has made steady progress on developing and implementing issues and recommendations identified in the report. Mr. Tvedten has been issuing a quarterly follow-up report on recommendations in the report.

Assurance Services - External Audits

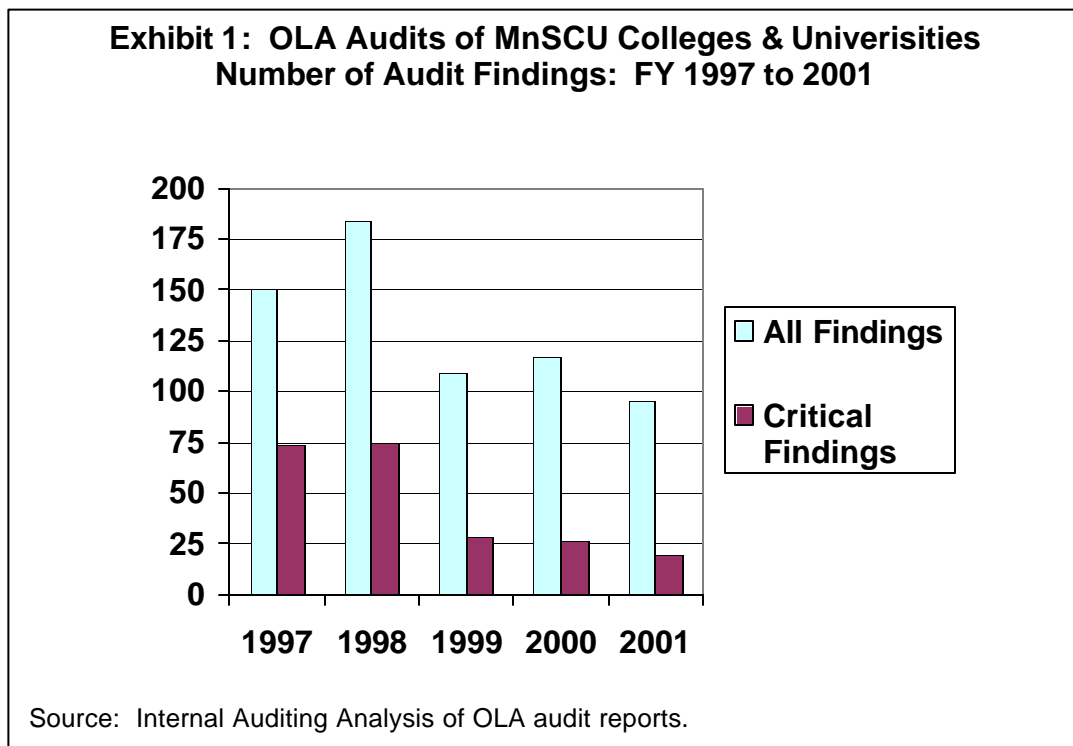
MnSCU contracts with the Office of the Legislative Auditor (OLA) and public accounting firms for external audits. These audits have focused on the internal controls and fiscal compliance of individual colleges and universities. Also, a major initiative was launched to acquire audited financial statements for the MnSCU system and each of its colleges and universities. An external audit is also needed to satisfy federal grant requirements. Finally, the OLA has statutory authority to conduct additional audits of MnSCU. It used its authority to conduct a program evaluation of the “MnSCU merger” and an information technology audit of system security. Internal Auditing coordinates its work with external auditors and leads efforts to contract with them.

Internal Control & Fiscal Compliance Audits

Since 1996, MnSCU has had a contract with the Office of the Legislative Auditor (OLA) to obtain periodic financial audits of each college and university. This contract results in about one-third of the colleges and universities being audited each year. By the end of fiscal year 1999, the OLA had audited all 36 colleges and universities. The audits

showed numerous and significant problems with financial management and business practices. Internal Auditing created a database and guidelines to monitor external audit findings. Quarterly follow-up reports are presented to the Audit Committee to show progress toward implementing corrective action. Generally, colleges and universities have been responsive and implemented timely corrective actions. Some issues have proven more difficult to resolve and have required changes to MnSCU financial policies.

In fiscal years 2000 and 2001, the OLA completed its second round of financial audits of 13 MnSCU colleges and universities each year. This second round of audits has shown dramatic improvements. For example, the first round of audits in fiscal year 1998 produced 188 audit findings. In fiscal year 2001, the second round audits of these same 13 colleges and universities produced 95 findings (a decline of 49%). Perhaps more importantly, the number of critical findings (those presenting an immediate risk to an institution) dropped from 75 to 19 (a decline of 71%). Exhibit 1 shows the history of audit findings for MnSCU colleges and universities.



An analysis that compares critical audit findings cited in the first round of OLA audits with critical findings cited in the second round produces further insights into how the organization has progressed in the past three years. Exhibit 2 compares these critical findings by areas cited. There are some noteworthy trends shown in the table.

- Separation of duties issues were a very serious problem in the first round of audits and have virtually disappeared in the second round. Improvements in this area may be attributed to a greater understanding of the importance of assigning financial duties properly.
- Serious problems with revenue and cash controls and reconciliations have also diminished greatly. Many of these problems have been resolved due to the implementation and increased understanding of new financial systems.

Implementation of the MnSCU integrated computer system, Integrated Statewide Records System, has automated many of the duties that previously were performed manually. In essence, the challenge of separating the physical duties of employees has now moved inside the computer. Increased computerization has accentuated the need for colleges and universities to exercise greater care in assigning security clearances to employees. System security is an area that accounts for the majority of unresolved audit findings. It is clearly an area that needs additional education and awareness in order to improve.

**Exhibit 2: Comparison of OLA Critical Audit Findings
Audits Issued in 1998 Compared to Audits Issued in 2001**

Finding Area	Number of Critical Findings	
	1 st Audit	2 nd Audit
Separation of Duties	19	4
Revenue & Cash Controls	19	3
Reconciliations	10	4
Financial Reporting	8	0
System Security	8	5
Compliance	4	0
Inventory	1	1
Other Areas	6	2
Totals	75	19

Source: Internal Auditing analysis of OLA audit reports.

Audited Financial Statements

In July 1999, the MnSCU Audit Committee adopted a plan for phasing in audited financial statements for the MnSCU system and each of its colleges and universities. In fiscal year 2000, the Legislative Auditor conducted the first audit of the MnSCU balance sheet. The audit opinion had two exceptions: One for incomplete accounts payable

information and the other for insufficient disclosure of cash collateral balances. Despite the audit exceptions, this first audit was deemed to be a success. In earlier years, it was doubtful that the MnSCU financial statements could even be audited. The development of the MnSCU information systems and creation of a financial reporting unit were key reasons for the significant improvements in financial reporting.

Fiscal year 2001 marks the second year of the board plan for audited financial statements. It anticipates an audit of the comprehensive MnSCU financial statements. Internal Auditing led an effort to hire an external auditor for this project. Following issuance of a Request for Proposal and interview process, a search committee recommended that the board hire the firm of Deloitte & Touche, LLP to serve as the primary auditor of MnSCU financial statements. The board accepted the recommendation and approved a three year contract with Deloitte & Touche, LLP, starting with the audit of the fiscal year 2001 financial statements. The contract also includes audits of federal financial assistance programs (formerly completed by the OLA) and the MnSCU Revenue Fund (formerly audited by another public accounting firm).

Program Evaluation – The MnSCU Merger

The Legislative Audit Commission directed the OLA to conduct a study that analyzed the progress that MnSCU has made since the merger. The final report was issued in August 2000 and found that MnSCU was moving in the right direction, but needed to make additional progress. It offered five recommendations for further improvements. Two of the recommendations have been fully implemented: clarify the role of individual trustees and address the faculty bargaining agreements for two-year colleges. Projects are currently underway to address the areas addressed by the other three recommendations: performance measures, academic program reviews, and transfer of technical credits to four-year universities.

Consulting Services

Since being created, the Office of Internal Auditing has worked to develop a consulting practice to complement its work on assurance services. The internal auditing profession is redefining itself to add consulting services as a standard component of the internal audit function. Some consulting services draw upon some of the same skills that auditors use for traditional audits. Other consulting activities require adding new skills. In June 1999, Internal Auditing hired Julie Smendzuik-O'Brien to add organizational development expertise to the office.

Consulting activities are distinguished from assurance services by the extent of their audiences and who has primary control over the scope of the work. Assurance services have a much more public audience than consulting services. Auditors have the ultimate authority over designing the scope of assurance services. Conversely, consulting services generally are reported only to managers that requested the service. Requesting managers have the prerogative to proceed with or cancel a consulting engagement. Internal

Auditing or the Audit Committee controls decisions on whether assurance services should be conducted.

The Board of Trustees clearly intends to share internal auditing services with the Office of the Chancellor and college and university presidents. The system-wide studies discussed previously certainly have value for the chancellor and college and university presidents. The Audit Committee must approve these projects, however. Consulting services, on the other hand, are available to the chancellor or a college and university president upon their request.

During fiscal year 2001, consulting engagements were conducted for several colleges and universities. Services were also provided to the Office of the Chancellor and the Board of Trustees. Consulting services conducted at colleges and universities during fiscal year 2001 included:

- Conducting research with employees and developing customer service strategies in a college administrative department.
- Conducting a climate survey, including assessment of risk factors, for a college.
- Examining structural, cultural and interpersonal issues related to a college business office with multiple locations.
- Conducting process-mapping workshops for two colleges documenting administrative processes, and identifying and addressing potential risks and other areas for improvement.
- Examining structural and other issues related to administrative services used by a college customized training office.
- Assisting in the design and facilitating an operational planning meeting for a college management team preparing for fiscal year 2002 work.
- Assisting a college with examining the financial relationship with its foundation.
- Examining the financial implications and business practices for a university workers' compensation program.
- Examining and recommending improvements for the financial management practices of a university radio station.
- Reviewing the budget reporting practices of a university.
- Periodic reviews of spending by the chancellor and board of trustees.

Internal Auditing also led efforts to design a transition review process to facilitate changes in leadership at MnSCU colleges and universities. This process was created at the suggestion of former Chancellor Anderson and in response to concerns expressed by Audit Committee members. Teams with representatives from several MnSCU divisions, including academic affairs, finance, human resources, facilities, information technology, development, and internal auditing, were formed. The review teams interviewed key stakeholders and conducted other analysis as warranted when a change in president occurred at a college or university. The reviews were designed to focus on significant issues that needed to be brought to the attention of the chancellor and incoming president. Reviews were scheduled for four colleges and universities at the end of fiscal year 2001.

Fraud Inquiry and Investigation Support

Internal Auditing has assisted with conducting fraud inquiries and investigations on a few occasions. Fortunately, these kinds of problems are not common. However, when evidence of fraud is identified it must be dealt with appropriately. The results of most fraud inquiries and investigations were reported to affected presidents or the chancellor for action. Board policy requires that only significant violations of board policy or law, be communicated to the Board of Trustees. Internal Auditing found it necessary to report only one such matter to trustees in fiscal year 2001.

Professional Advice

Internal Auditing also makes itself available to offer professional advice on topics within its expertise. During fiscal year 2001, it fielded a variety of questions dealing with topics such as compliance with finance-related policies or laws, best practices, and assignment of financial duties. Internal Auditing representatives also sit on various MnSCU task forces and committees, including: Information Technology Round Table, Security Steering Committee, Student Data Integrity Group, the Finance User Group, and System Office Quality Steering Committee. Internal Auditing also contributed expertise to a consortium of colleges committed to using an alternative method of self-assessment for accreditation. Finally, Internal Auditing also assisted the Board of Trustees Subcommittee on Trustees by researching alternative self-assessment approaches and codes of conduct for board members.

Analysis of Staff Hours

Internal Auditing has a staff complement of ten professional auditors and consultants and one administrative assistant. The majority of its professional staff, regional audit coordinators, are located on college or university campuses throughout the system. The audit coordinators serve 5-7 colleges or universities located in their region.

Fiscal year 2001 was the fourth year of existence for the MnSCU Office of Internal Auditing. The Internal Auditing budget has remained unchanged since its inception. Exhibit 3 shows the distribution of staff hours by year since the office was created 3 ½ years ago.

Exhibit 3: Internal Auditing Staff Hours – FY 1998 to 2001

Fiscal Year	Staff Hours			Total
	Technical	Planning	Admin	
1998	2,403	631	1,038	4,072
1999	9,365	2,451	3,012	14,828
2000	11,734	1,454	3,606	16,794
2001	13,778	729	3,037	17,544

Source: Internal Auditing timekeeping system.

Each year the Board of Trustees approves an audit plan for the ensuing fiscal year. In June 2000, the board approved a plan that estimated 16,000 hours of staff time. Exhibit 4 shows how actual staff hours applied compares to the audit plan.

**Exhibit 4: Internal Auditing Staff Hours
July 1, 2000 to June 30, 2001**

Activity	Staff Hours		
	Audit Plan	Actual	% of Actual
Professional Services			
Assurance Services	8,000	10,442	59%
Inquiry/Investigations Support	1,600	305	2%
Consulting Services	2,800	1,869	11%
Professional Advice	1,000	1,162	7%
Subtotal – Technical	13,400	13,778	79%
Planning & Development Activities	1,000	729	4%
Administrative Activities	1,600	3,037	17%
Hours – 7/1/2000 to 6/30/2001	16,000	17,544	100%

Source: Internal Auditing timekeeping system.

Total staff hours generated in fiscal year 2001 were about 10% higher than anticipated. Minimal staff turnover accounted for the greater number of hours. A few of the categories fluctuated from the audit plan estimates for several reasons, including:

- Assurance Services – two major system-wide studies were completed during the year. In addition, time was spent working with the financial reporting unit in preparation for the fiscal year 2001 financial statement audit.
- Investigations and Inquiry Support Services – hours worked will always fluctuate in this category based on the number of incidents reported and the level of effort needed to support inquiries and investigations.
- Administrative – a significant portion of the time spent in this category is associated with professional development activities.

The Future

In July 2001, the Board of Trustees approved the Audit Plan for Fiscal Year 2002. Continual updates on Internal Auditing projects are available at the office website, www.internalauditing.mnscu.edu.