



Minnesota
STATE COLLEGES
& UNIVERSITIES

Annual Report Fiscal Year 2007

Office of Internal Auditing
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Members of the Board of Trustees

I am pleased to submit the annual report on the Office of Internal Auditing for fiscal year 2007 as required by Board Policy 1D.1 part 8. The report demonstrates that the Internal Auditing has continued to help the Minnesota State Colleges and Universities build a strong foundation for integrity and reliable information. In March 2007, the office underwent its first external quality assurance review. The review showed that Internal Auditing was in full compliance with the professional practices of internal auditing.

I would also like to take this opportunity to reiterate my personal dedication to managing an office that provides you with credible, professional services. Organizationally, the Office of Internal Auditing is structured to ensure its independence by reporting directly to the Audit Committee. Personally, I take great care to avoid assignments or relationships that would compromise my independence. Accordingly, I pledge to you that I remain independent and objective pursuant to the professional practices of internal auditing.

Thank you for your confidence and support in our work.

John Asmussen, CPA, CIA, CISA, MBA
Executive Director

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Summary

The audit plan approved by the Board of Trustees in June 2006 provided the foundation for the internal auditing activities carried out in fiscal year 2007. The key areas of this report are highlighted below:

- The report shows that internal auditing services were provided consistently with the expectations of the fiscal year 2007 audit plan.
- Major assurance projects completed during fiscal year 2007 and their respective percentage of applied audit hours were: assist with audited financial statements (22%), follow-up and assist with resolution of audit findings (23%), and system-wide study of student success (19%).
- A new component to the report is a section on the status of prior audit findings. It shows that 80% of prior audit findings were resolved fully. The report highlights the most significant unresolved audit findings that need further attention.

John Asmussen, Executive Director, had lead responsibilities for this report.

I. Assurance Services Requested by Board of Trustees

The Office of Internal Auditing spent the majority of its time working on assurance services which focus on improving the quality and reliability of information. The following assurance services were conducted at the request of the Board of Trustees.

Audited Financial Statements

Fiscal year 2007 marked the seventh year that the Minnesota State Colleges and Universities contracted for an external audit of its financial statements. The external audit firm of Kern, DeWenter, Viere & Company provided an unqualified (clean) opinion on the system-wide financial statements. The Financial Reporting Unit of the Office of the Chancellor and the Office of Internal Auditing both worked very hard to deliver the audited financial statements. In fiscal year 2007, Internal Auditing spent 22% of its applied hours on assisting with the financial statement audits. This level of support provides two benefits: cost savings to make the external audit contracts affordable and strengthened external audit coverage by use of Internal Auditing’s knowledge of the Minnesota State Colleges and Universities system and its business systems.

In addition, audited financial statements were developed for twelve of the largest institutions: the seven state universities and five two-year colleges. The financial statements for all twelve institutions received unqualified audit opinions from the CPA firms that the board appointed for the audits. These audits follow the direction and scope for audited institutional financial statements set forth in the strategic external auditing plan adopted by the Board of Trustees in January 2005.

Internal Control & Fiscal Compliance Issues

The annual financial statement audit program ensures that the most significant internal control cycles are reviewed for universities and five of the largest colleges each year. In addition, the principal auditor for the system-wide financial statements reviews internal controls at about one-third of the remaining colleges each year.

Since 1996, MnSCU has had a contract with the Office of the Legislative Auditor (OLA) to obtain periodic finance-related audits of each college and university. In fiscal year 2004, the OLA audit coverage was adapted to complement the institutional financial statement audits conducted by CPA firms. Basically, the colleges not subject to an annual financial statement audit are to be audited by the OLA on a three year rotating schedule. In fiscal year 2007, the OLA audits covered seven colleges:

- Central Lakes College
- Inver Hills Community College
- Normandale Community College
- Pine Technical College
- Ridgewater College
- Riverland Community College
- St. Cloud Technical College

The OLA report on these colleges had 24 audit finding statements that mostly represent opportunities for operational improvements. One finding, though, concerning the operations of the Pine Technical College Employment & Training Center, required further consideration and was referred to the Educational Policy Committee. Four other findings concern critical issues needing immediate attention.

- Findings 5 and 6 cited several errors that colleges had made in calculating supplemental faculty pay and severance payments. Inver Hills Community College, in particular, had a large number of exceptions. The college has indicated that it has implemented several actions that will correct the past errors and avoid future ones.
- Finding 16 raised several questions about a \$1 million contract entered into by Metropolitan State University. The Vice Chancellor – CFO has requested that Internal Auditing examine this contract further.
- Finding 4 cited a fundamental deficiency in the main cashiering operation at Central Lakes College. The college has reported that it has taken prompt corrective action to remediate this situation.

System-wide Report: Student Success Measures and Systems

At the request of the Audit Committee, Internal Auditing conducted a system-wide study of Student Success Measures and Systems. The report, issued in October 2007, had two major objective areas and the following overall conclusions.

Student Success Measure

- The data supporting the system-wide student success measure is reliable, compiled consistently across colleges and universities, and conforms to a uniform definition. Users must be cautious, however, because there are some limitations in consistency of certain data elements over time and interpretative problems with overall success rates.
- More credibility for this measure must be built with presidents and other constituents. Users need guidance on how to link the system-wide measure to college and university operations. College and university reports to the Board of Trustees should use the official system-wide measure whenever possible, rather than college and university specific operational measures.
- Certain underlying measurement limitations and national trends merit continued study to further enhance the validity of the measure. Possibilities include a methodology to establish student intent based on course-taking behavior, make transfer success contingent on academic standing, and include data on Spring entrants.

DARS and CAS Implementation

- System-wide implementation has not been achieved for two information systems designed to facilitate monitoring and managing student progress toward completing academic programs. Full implementation of the Degree Audit Reporting System (DARS) was expected by December 31, 2002, and the Course Applicability System (CAS) by December 31, 2004.

- Full implementation of these systems will facilitate course transfer, improve graduation planning, produce efficiencies in student advising, and help enable innovations such as predicting demand for course offerings and reducing time for students to earn degrees.

Requested Assurance & Consulting Services

The Board of Trustees, as demonstrated in policy 1.D., intends to share internal auditing services with the Office of the Chancellor and college and university presidents. Accordingly, Internal Auditing has made its services available to the Chancellor or a college or university president upon request. In fiscal year 2007, Internal Auditing spent about 13% of its applied hours on assurance and consulting projects requested by the Chancellor or presidents.

Although some requested services are for traditional assurance audits, many requests are for consulting services. Internal Auditing will accept consulting engagements as long as no conflict is created with its auditing role. The office supplements its traditional audit skills with the services of an organizational improvement professional for consulting projects.

During fiscal year 2007, Internal Auditing provided consulting or assurance services for the following types of requests:

- Facilitated a series of workshops to help improve the business practices for a college's customized training operations.
- Administered an employee climate survey for a college.
- Administered an employee diversity survey for the Office of the Chancellor.
- Tested the compliance of expenses incurred by the Chancellor and Board of Trustees.
- Facilitated the work of a cross-functional work team from the Office of the Chancellor on conducting presidential transition reviews at Normandale Community College and St. Cloud State University which were hiring new presidents.
- Compiled the results of the Chancellor's annual performance evaluation for the Board of Trustees.

II. Follow-up on Prior Audit Findings

The Chancellor and the Board of Trustees expect timely resolution of audit findings. Accordingly, Internal Auditing maintains a database to follow-up on audit findings and tracks their resolution. In about January of each year, Internal Auditing assesses the status of prior audit findings and submits a mid-year follow-up report to each president. In June, Internal Auditing prepares year-end follow-up reports and also submits copies to Chancellor McCormick for consideration during his annual performance evaluations of presidents and vice chancellors. In fiscal year 2007, Internal Auditing spent about 23% of its applied hours on following up on prior audit findings.

As a result, the timely resolution of audit findings is taken seriously. In fiscal year 2007, 80% of college and university audit findings were resolved. As of June 30, 2007, Internal Auditing was continuing to monitor 72 unresolved audit findings at the colleges and universities. Internal Auditing had classified 15 of these unresolved findings as critical issues that warranted immediate attention. Critical unresolved audit findings at the colleges and universities included:

- Seven institutions needed to improve the completeness of data on the race/ethnicity of their students. Internal Auditing originally cited this finding in its July 2004 report on Services to Traditionally Under-represented Students. When the report was released 23 colleges and universities had an unknown race/ethnicity rate for their students of greater than 10%, and the system-wide unknown rate was 20%. By June 2007, the system-wide unknown rate had declined to 7%, and only seven institutions had unknown rates greater than 10%. All seven institutions, though, were approaching unknown rates of 10%. This data is essential for assessing progress toward narrowing the achievement gaps in higher education.
- Two institutions had federal financial aid findings that were awaiting closure from the U.S. Department of Education. St. Cloud State University and Minneapolis Community and Technical College had been cited for not complying with some aspect of federal financial aid regulations. Although the institutions had taken corrective actions to come into compliance with the regulations, the final resolutions must be approved by the federal agency.
- Fond du Lac Tribal & Community College had eight unresolved audit findings. Three of these findings have remained unresolved for over five years, including one critical finding pertaining to the need to improve purchasing controls. Some college employees were initiating purchases without verifying that sufficient funds were available. Internal Auditing met recently with college officials and is working with them to develop solutions to these problems.
- Lake Superior College had a comprehensive Legislative Audit report released in June 2006. The audit followed the dismissal of a former Vice President of Administration for fiscal misconduct. It cited 28 findings. The college has made substantial progress on resolving these audit findings; nine findings remain open, however, until evidence shows that corrective action are working as intended and being sustained.
- Bemidji State University was cited for not recording faculty workload assignments consistently. This issue arose in an internal audit of faculty supplemental pay that was requested by Vice Chancellor Bill Tschida. The university was in the process of hiring a new Personnel Officer who would be responsible for resolving the finding.
- Northland Community & Technical College needed to tighten its computer access controls. This finding was cited in an October 2006 Legislative Audit report. The college had drafted a new procedure, but had not put it into operation yet.

In addition, some audit findings are directed at the Office of the Chancellor for resolution. Unresolved findings remain in three areas: student financial aid administration, information technology security and data warehouse controls, and capital construction contract administration.

System-wide Student Financial Aid Administration

For the past few years, MnSCU's student financial aid practices have been under close scrutiny from the U.S. Department of Education. Significant problems had been detected in complying with two particular aspects of federal financial aid regulations: (1) Monitoring student academic progress and (2) Returning funds for students who have withdrawn from all classes during an academic term. Much progress has been made on resolving these issues, but some additional corrective actions remain underway.

Monitoring Student Academic Progress

In 2003, it was discovered that methods for monitoring the academic progress of students had serious breakdowns at Metropolitan State University and Minnesota State University Mankato. Based on a system-wide review requested by Chancellor McCormick, MnSCU also self-reported the potential for similar, but less significant problems, at four colleges. The U.S. Department of Education has settled these issues with the two universities and three of the colleges. In 2006, it required the other college, Minneapolis Community and Technical College, to conduct an intensive file review of its academic progress monitoring practices. The college reported the results of that review to the department in November 2006, but the department has not yet reported its initial determination of those results.

As a result of these problems, the Office of the Chancellor convened a system-wide work group to study more systemic solutions. The work group developed a new board policy (MnSCU Policy 2.9) and Chancellor's Procedure (MnSCU Procedure 2.9.1) that were adopted in March 2004. In May 2006, Policy 2.9 and Procedure 2.9.1 were modified again. In the most recent revision, colleges and universities were required to align the academic standing policy for both financial aid recipients and non-recipients. The Office of the Chancellor also began conducting an annual review of institutional compliance with these provisions. Its latest review has revealed that most institutions have implemented the changes necessary to comply with the policy and procedure. The Office of the Chancellor is working with some institutions to clarify language used in their policies. It also is working with MSU, Mankato to amend a provision in its institutional policy that is contrary to the MnSCU policy and procedure. MSU, Mankato officials have offered assurances that the necessary policy changes shall be made expeditiously. Finally, it is working with the U.S. Department of Education to receive assurance that the policy and procedure comply fully with federal regulations.

Returning Federal Funds for Students Who Withdraw

Federal regulations require financial aid funds to be returned to the U.S. Department of Education if students withdrew either officially or unofficially from all courses during a semester. This regulation is referred to as "Return to Title IV" or R2T4. Official withdrawals occur when, after the drop/add period has ended, students drop all courses and accept a grade of "W" for each course. Unofficial withdrawals are more difficult to identify. They result when students simply stop attending all of their courses before a semester is 60% completed (the attendance threshold for students to earn federal financial aid). An indication of an unofficial withdrawal is when a student receives any combination of all "W" or failing grades for a term. For unofficial withdrawals, institutions are required to investigate whether there is evidence that a student had attended any

course beyond the 60% point of the term. If no evidence exists, then a calculation must be made to determine the amount of federal funds to be refunded to the federal government.

In fall 2003, it was discovered that St. Cloud State University had not complied with the R2T4 regulation. It had not completed calculations for either official or unofficial withdrawals for 2001 to 2003 due to a breakdown in communications between the business office and the financial aid office. The university took action to calculate the refund amounts and returned funds to the U.S. Department of Education and lenders as required. The corrective action taken by the university, however, was not effective for unofficial withdrawals and the problem recurred in part during 2005. In 2006, the university continued to struggle to complete its R2T4 calculations timely. Additional follow-up is needed to determine if the problem was resolved in 2007.

Other problems with R2T4 compliance were subsequently discovered. Metropolitan State University, Minnesota West Community and Technical College, and Anoka Technical College had to take action to comply with the R2T4 provisions. The U.S. Department of Education has since approved the corrective actions taken by these institutions to correct this problem.

Because of the recurring nature of problems in complying with the federal R2T4 provision, the Office of the Chancellor created a work group to study systemic solutions. The work group met twice in mid-2006. A new method for faculty to report the last attendance dates for students was developed and tested at two institutions. The test results indicate that further efforts are needed to ensure compliance. Thus, the Office of the Chancellor has begun a monitoring process to verify that colleges and universities are in compliance. It also is developing a new system-wide procedure to institute more consistent practices, clarify responsibilities and strengthen communication at the institutions.

Finally, many colleges and universities continue to have excessive security access granted to individuals for high level rights within the financial aid module. This access allows users complete access to set-up functionality for their institution within the module and should be limited. This issue remains unresolved and more work needs to be done.

System-wide Information Technology Security Issues

The ITS Division has made progress in the past year in resolving several outstanding audit findings; however, a number of audit findings, including several findings classified as critical have remained outstanding for several years. Resolution of these findings is in process, but most problems will not be resolved easily. Many of the issues deal with broader system issues that will only be corrected by full implementation of a comprehensive security program and establishment of a robust data warehouse.

During fiscal year 2007, the ITS division was able to obtain some additional financial resources. Although it took time to fill key positions, considerable progress has been made on implementing a security foundation, including:

- Implementing web-based security awareness training that is required to be completed by all employees.

- Developing and rolling out a campus security assessment program
- Implementation of CAP servers at the majority of the colleges and universities
- A plan to implement a disaster recovery site for ISRS.

Nevertheless, much work remains, including implementing an incident handling system which had been a priority in fiscal year 2006 until encountering barriers to completion, most prominently insufficient funding to acquire skilled staff. MnSCU has struggled for years with a chronic under-investment in its IT infrastructure. Thus, a tremendous effort was exerted in fiscal year 2007 to secure additional funds from the legislature. This funding was needed to ensure adequate IT support for students, faculty and staff in the future.

System-wide Finance Issues

In May 2006, Internal Auditing released a system-wide study on capital construction administration. Vice Chancellor Laura King had requested the study in order to assess capital construction project administration. Overall, the study found that the process for administering capital construction projects effectively prevented cost overruns. It cited eleven recommendations for improving contract administration and oversight; Internal Auditing did not classify any of the issues as critical. Much progress has been made on implementing the recommendations, but elements of many recommendations remain unresolved. An important issue that still needs attention is developing a procedure for escalating reports about potential problems to the Office of General Counsel or the Board of Trustees, as warranted. Another important issue that remains unresolved concerns the structure of the management fee charged by the Office of the Chancellor.

III. Fraud Inquiry and Investigation Support

Internal Auditing assists with conducting fraud inquiries and investigations. 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. The Executive Director of Internal Auditing advised the Chair of the Audit Committee about fraud investigations and reported potential fraud incidents to the Legislative Auditor, as required by state law.

Internal Auditing received reports on 84 incidents of potential fraud or dishonest acts during fiscal year 2007. The vast majority of these incidents related to theft of public property. These matters were reported to local law enforcement officials for investigation. Internal Auditing assisted with investigations for a few remaining incidents, primarily centering on allegations of employee misconduct or misuse of property. In fiscal year 2007, Internal Auditing spent about 9% of its applied hours on fraud inquiries and investigations.

IV. Professional Advice

Internal Auditing also makes itself available to offer professional advice on topics within its expertise. During fiscal year 2007, Internal Auditing fielded 174 questions dealing with various topics. Common questions pertained to compliance with board policies and best practices. Internal Auditing representatives also sit on various MnSCU task forces and committees, including: Security Steering Committee, Finance User Group, Staff and Leadership Development Committee, Financial Aid Directors, and the Accountability Framework Drafting Team. In 2007, Internal Auditing spent about 10% of its applied hours on professional advice services.

V. 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 multiple colleges or universities located in their regions.

The office has had the same size and structure since shortly after it was created in 1997. Its centralized structure and auditing approach allows the office to retain a modest complement of audit staff, compared to other internal audit offices in large, public higher education systems.

Each year the Board of Trustees approves an audit plan for the ensuing fiscal year. In June 2006, the board approved a plan that estimated use of staff time. Table 1 shows how actual use of staff time compares to the audit plan for technical services.

**Table 1: Percentage of Internal Auditing Technical Service Staff Hours
July 1, 2006 to June 30, 2007**

Activity	Percentage of Staff Hours	
	Audit Plan	Actual
Technical Services		
Assurance Services	64%	68%
Inquiry/Investigations Support	8%	9%
Consulting Services	12%	8%
Professional Advice	11%	10%
Planning & Development	5%	5%
Percentage of Total Applied Hours	100%	100%

The Future

In June 2007, the Board of Trustees approved the Audit Plan for Fiscal Year 2008. That plan and other information on Internal Auditing’s projects are available at the Office website, www.internalauditing.mnscu.edu.