

State Capitol – 600 E Boulevard Ave – Dept. 215  
 Bismarck ND 58505-0230  
 Phone: 701.328.2960 Fax: 701.328.2961  
 E-mail: ndus.office@ndus.edu Web: ndus.edu

TO: Members, SBHE Budget, Audit, and Finance Committee  
 FROM: Bill Eggert  
 DATE: March 12, 2012 Memo # M-12-3  
 SUBJECT: Proposed Internal Audit Reporting structure and Budget Recommendation

**A. Purpose**

This report is in response to a request from the Chairman of the Budget, Audit, and Finance Committee (BAFC) at the November 9, 2011, meeting and the State Auditor's Office (SAO) FY2010 & FY2011 NDUS financial statement audit recommendations.

**B. History**

A brief history of the SAO audit recommendations related to internal audit roles, responsibilities and staffing, including the NDUS original response following in italics, along with current status and proposed changes are outlined below:

**Internal Audit Staffing Levels**

SAO Recommendation: Review internal audit staffing levels at UND and NDSU

NDUS Response: Agree. UND and NDSU administration will be asked to perform an internal review of their staffing levels and submit a report and recommendation to the SBHE Budget, Audit and Finance Committee (BAFC) prior to September 2011.

Status: UND and NDSU individually submitted the following responses at the November 9, 2011, SBHE BAFC:

- ✓ "NDSU agrees with the SAO report that we need more staffing in addition to the 1.0 FTE (NDSU Internal Auditor) and the amount of your time (Bill Eggert) that is allocated to NDSU. At this time, funding does not allow us to expand the current staffing level."
- ✓ "The NDUS Internal Auditor has suggested the need for 3.5 to 4 internal auditors for an institution of our size and complexity. Current staffing in the UND Internal Audit Office includes a Director of Internal Audit, an internal auditor plus a part time administrative assistant. Keeping in mind the benchmark staffing level, attention has been given to prevention, communication, policies and education (how do we do things right at the front end) balanced with a reasonable level of monitoring/oversight (i.e. the internal audit function)."

UND also benefits from the fact that the individuals that are our internal auditors have over 43 combined years of UND audit experience.

Taking all this information into consideration, we are not recommending adding another internal audit FTE at this time."

**SAO Recommendation:** Provide for an Internal auditor at each of the schools lacking an internal auditor or provide an internal audit position at the Board level that would perform the function of an internal auditor at these schools.

**NDUS Response:** Agree. The SBHE approved the addition of one NDUS internal audit position. Following a second search, finalists for the position were interviewed in January of 2011. An individual has been hired and will start employment in February of 2011. The SAO has been kept informed of the status of the search throughout the process.

**Status:** The recommendation was, in part, implemented. As part of the 2011-13 biennial budget request process the SBHE considered requesting additional audit positions; however, this was not included in the final request. Thereafter, one System internal audit position was added, but was funded through campus assessment, with all campuses participating in the assessment.

**Proposed Change:** On a bi-yearly basis, Global Audit Information Network (GAIN) surveys, benchmarks and reports on Internal Audit staffing levels for several industries, including higher education. The GAIN benchmark is based solely on revenue; however, it does outline several factors which must be taken into account when determining proper staffing levels (e.g. Medical School, Agricultural Extension and Research, decentralized nature of campuses, NCAA athletics, amount of grants and contracts, ethics and compliance reviews, IT audits/auditors).

Applying the GAIN benchmark to the NDUS's \$1 billion plus total annual revenue suggests the NDUS should have at least ten audit positions. This compares to the current 4.8 FTE positions, or a difference of over 5 FTE positions as noted below.

#### **Audit Staffing Levels - GAIN Benchmark Applied to NDUS**

	<b>2010 Operating and Non-operating Revenues + state appropriations for capital assets</b>	<b># of Auditors based on GAIN <sup>1/</sup></b>	<b>Current # NDUS Auditors</b>	<b>Difference</b>
NDSU	\$360 million	3.5-4.0	1.0	(2.5-3.0)
UND	\$378 million	3.5-4.0	2.8 <sup>2/</sup>	(0.7-1.2)
System wide	\$1 billion	10.0	4.8 <sup>3/</sup>	(5.2)

1/ GAIN benchmark=1 auditor per \$100 million in revenues

2/ Includes student help

3/ Includes 2.8 (UND), 1.0 (NDSU), & 1.0 (NDUS)

### Other Staffing Comparisons

Organization	# of Auditors	# of campuses
Texas A&M	35	18
MN System	8	31
Iowa System	17	3
Oregon System	12	7
ND State Auditor's Office	6 1/	11

1/ The SAO have 6 full-time auditors dedicated to the audit of the NDUS for three primary audits:

NDUS financial statement (annual), Single Federal Audit (biennial) and operational/performance audits (biennial). In addition to these six full-time higher education auditors, other SAO staff is used to perform special audits including IT, performance and other audits.

Based on the above data, expectations and work demands, the Chancellor recommends that the SBHE consider adding three additional positions. More specifically:

- 1.0 System internal auditor effective July 1<sup>st</sup>, 2012, to be paid through campus assessment, at a yearly cost of \$127,550; (Salary \$85,000, benefits \$26,300 & other costs \$16,250)
- 1.0 System compliance officer effective January 1<sup>st</sup>, 2013, to be paid through campus assessment, at a cost of \$50,000 for 6 months. (Yearly salary up to \$65,000, Benefits \$22,000 and other \$16,250)
- 1.0 System internal auditor be requested from state funding in the 13-15 SBHE budget request, at a cost of \$100,000; (Salary up to \$65,000, benefits \$21,700 and other costs \$16,250)

### Reporting Relationships

**SAO Recommendation:** Require that internal audit staff at all schools report to the Budget, Audit, and Finance Committee

**NDUS Response:** Disagree. The SBHE BAFC considered this option and chose instead to retain staff reporting relationships to the President (for campus internal audit staff) or Chancellor (for system internal audit staff); and, furthermore those agency heads have a corresponding responsibility to assure timely conveyance of substantial findings, including suspected fraud and other illegal activities, through established administrative chain of command, and ultimately to the BAFC.

**Status:** A direct reporting relationship of all internal audit positions was proposed to the BAFC in the initial policy draft, but was changed based on the recommendation of the Chancellor and UND and NDSU Presidents. Current SBHE Policy 802.8 and provides the following reporting relationship:

*"Internal audit functions and staff for the NDUS and the institutions with internal audit functions (NDSU and UND) report directly and solely to their recognized agency heads (Chancellor and institution presidents respectively). Those agency heads have a corresponding responsibility to assure timely conveyance of substantial findings, including suspected fraud and other illegal activities, through established administrative chain of command, and ultimately to the BAFC. On an annual basis, an overview of anticipated future internal audit activities will be presented directly to the BAFC by involved agency heads or their representatives."*

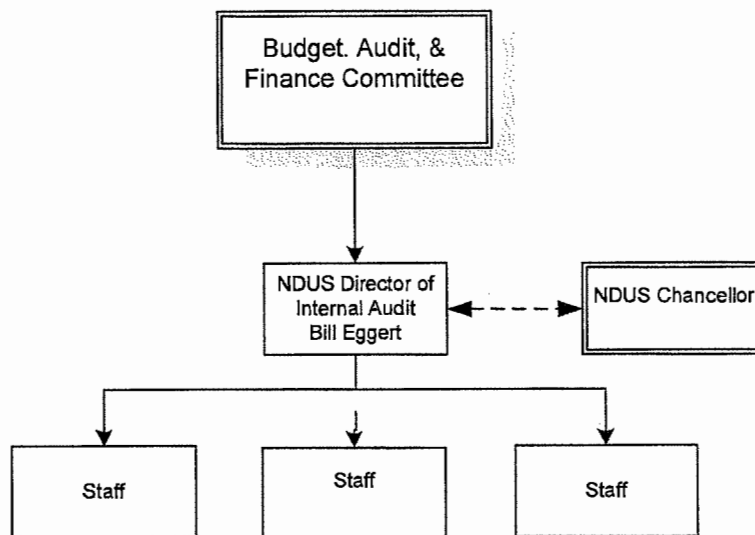
**Proposed Change:** According to the Institute of Internal Auditors standards and professional practices framework, the internal audit function should report directly to the audit committee, or a subset of the board with a dotted line to the CEO or in this case, Chancellor, for day-to-day administration. This allows for more independence while having an increased ability to enforce policy and/or change.

According to the Institute of Internal Auditors, independence is further strengthened when internal auditors directly report to the audit committee. This reporting relationship helps ensure the internal auditors have adequate recourse in cases of non-compliance, lack of cooperation from auditee's or a lack of action on recommendations, misconduct or fraud involving senior management.

Additionally, an audit committee is normally granted the authority to conduct investigations within the scope of its responsibilities and to retain legal, accounting and other advisors. This status and authority plays an important role in resolving disagreements between management and the external auditors in regard to financial reporting and other issues.

Through the chart below, the yearly audit plan would involve input from the updated risk assessment, the BAFC, campus presidents and other personnel, and the current events happening on other campuses. The audit process would continue at the campus level with input from the presidents or a designated person on the audit plan and scope. This same group of individuals would be given updates as to the progress of the audit and any issues that are discovered. If issues are uncovered the campus will develop a plan to correct and monitor the control. Internal audit will then verify the new controls at a later time.

**Thus, it is recommended that the SBHE revise SBHE policy 802.8 to change the reporting relationship for all current and future NDUS audit staff to report directly to the BAFC, through the NDUS Director of Internal Audit as outlined in the organizational chart below.** Campus internal audit staff will report only to the campus presidents and not to the SBHE. Additionally, the policy should be amended to require system internal audit personnel changes, including hiring, firing and pay decisions, be reviewed by the SBHE BAFC prior to any change.



## Risk Assessment

**SAO Recommendation:** Contracted with a company to perform an entity wide control risk assessment and we received final reports in October 2011, therefore we consider this part of the finding implemented. However, a comprehensive fraud and control risk assessment was not performed by each institution so that part remains not implemented.

**NDUS Response:** Agree. The LarsonAllen risk assessment was meant to be high level and a starting point for development of the NDUS annual internal audit plan. As such, a fraud and control risk assessment is a part of the NDUS internal audit methodology and will be a part of all future individual audits based on a Risk and Control Matrix. Fraud and process level controls, as well as control gaps, will be identified and documented. This will be done through individual program audits, and will take several years to fully complete due to limited audit staff resources and complexity of the organization.

## Internal Controls

**SAO Recommendation:** Appropriate internal controls have not been established therefore there has been no formal training on proper internal controls.

**NDUS Response:** Disagree. The NDUS has extensive internal controls in place in all functions of the NDUS. Certainly, more can always be done, but, at times, are limited by staff resource availability. Appropriate internal controls and formal training is an integral part of the NDUS internal audit methodology. The NDUS Director of Internal Audit will explore various platforms (video, presentations, etc.) to conduct training on internal controls and will implement a plan by June 30, 2012. Campus accounting staff participates in annual training, which in part, addresses internal control issues.

SAO Recommendation: Internal audit staff has not to the best of our knowledge been involved in establishing or testing internal control policies and procedures.

NDUS Response: Disagree: The NDUS methodology is based on the identification, development, implementation and testing of internal controls. The audits performed to date at NDUS, NDSU and most recently UND, have centered on the internal control framework and the testing of those controls.)

## **Role of Comprehensive and Consolidated NDUS Audit Function**

The vision for the department would be two-fold.

1. Building an overarching Enterprise-wide Risk Management (ERM) framework, implementing federal or state requirements for compliance, large internal audits, and special requests.
2. Leverage existing departmental/process level audit programs and practices across all institutions.

### **A. Deliverables/Audit plan**

This approach will allow the team to focus on large, system-wide risks while building a solid internal control foundation at the process level. A more detailed audit plan will be developed from the list below.

System Level:

- ERM projects
  - Inventory/Build Campus Profile
  - Business Continuity
  - Disaster Recovery
  - System Wide Culture Surveys
  - Governance, Risk, and Compliance Matrix
  - Risk Assessment Responsibilities
- Audits of system-wide significant processes and risks:
  - PCI Compliance
  - Program Fees
  - Distance Education Fees/Overload Pay
  - Payroll
  - Vendor Management
  - I/T specific audits (Access, SOD)
  - Adherence to Board Policy
- Consulting and Advisory:
  - Efficiency Studies
  - New Process Development (considering risk and control during program development)
  - Other Special Requests
  - Best Practices and Internal Control Guides
- Oversight of Fraud Risk Management Program
  - Annual Fraud Awareness Training
  - Fraud Hotline Monitoring

- Coordinated Fraud Risk Assessment
- Exit survey Monitoring

**Campus Specific:**

- Audits of process and academic risks
  - Department Level Audits
  - Enrollment, collaborative students
  - Surprise Cash Counts
  - Follow-up on Internal audit and SAO Audit Issues
  - Campus Control Environment Surveys
- Consulting and Advisory:
  - Presidential and Executive Leadership Requests
  - Training on Specific Topics

**B. Benefits:**

- Common methodologies, reporting and work product across the system
- Stronger, more detailed reporting on risks to the SBHE and BAFC
- I/T specific risk identification and audits
- Leveraging audit plans and staff across campuses to proactively address control issues
- Sharing of ideas, process, and control improvements
- Improved staff development for long term effectiveness and staffing of the internal audit function
- Flexibility to work with individual campuses on specific issues

**C. Challenges:**

- Large, diverse, and complex organizations with varying goals and objectives
- Known reportable issues identified through events and state audit reports
- Limited internal audit resources and exposure
- Viewpoint of internal audit focusing on accounting controls and procedures
- Entrepreneurial and empowered organization not accustomed to stringent internal oversight
- Engaging campuses to utilize internal audit as a change agent for process improvement
- Lack of funding to provide for enabling technology supporting audit work papers, tracking of issues and communication across the system

**D. Cost**

In November 2011, the BAFC requested a proposed budget reflecting a proposed change in audit structure and staffing levels. Attached is a schedule that outlines this request. Addition of 2.0 new FTE audit positions, with the cost of all new and current positions shared by all institutions, based on revenue.

**North Dakota University System  
Budget Proposal Related to Internal Audit Staff - July 2012**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Institution	2011 Total assets, Operating and Non-Operating Revenues	Percent of Total Revenue	2011 NDUS Internal audit Costs per Campus (Annually)	7/1/12 to 6/30/13 NDUS Internal audit staffing plan (1 current, 1 new)	Incr (Decr) over current	Additional auditor 1/1/13 to 6/30/13	Total Increase 2013	2014 NDUS staffing budget for 4 auditors (3 campus funded, 1 state funded)	
UND	\$914,320,646	40.2%	\$9,480	110,040	50,560	20,095	70,655	150,229	100,000
NDSU	\$795,219,151	35.0%	\$1,024	95,706	44,682	17,477	62,159	130,660	
MISU	\$149,155,602	6.6%	10,071	17,951	7,880	3,278	11,158	24,507	
NDSCS	\$74,275,771	3.3%	4,985	8,939	3,953	1,632	5,886	12,204	
BSC	\$89,273,714	3.9%	5,602	10,744	5,142	1,962	7,104	14,668	
DSU	\$82,265,100	3.6%	5,449	9,901	4,452	1,808	6,260	13,517	
MASU	\$47,568,119	2.1%	2,784	5,725	2,941	1,045	3,986	7,816	
VCSU	\$40,163,747	1.8%	2,311	4,834	2,523	883	3,405	6,599	
WSC	\$43,758,494	1.9%	2,053	5,266	3,213	962	4,175	7,190	
LRSC	\$23,266,287	1.0%	1,511	2,800	1,289	511	1,600	3,823	
DCB	\$15,775,078	0.7%	984	1,899	915	347	1,261	2,592	
<b>TOTAL</b>	<b>\$2,275,041,709</b>	<b>100.0%</b>	<b>146,255</b>	<b>273,805</b>	<b>127,550</b>	<b>50,000</b>	<b>177,550</b>	<b>373,805</b>	<b>100,000</b>

Annual Cost Detail:					
FTE					
NDUS Director		146,255	146,255		146,255
NDUS staff (1) July 1st 2012			127,550		127,550
NDUS staff (1) Jan 1st 2013	6 months			50,000	100,000
NDUS staff July 1st 2014	12 Months				100,000
<b>TOTAL</b>		<b>146,255</b>	<b>273,805</b>	<b>50,000</b>	<b>373,805</b>



Internal Audit Benchmarking Survey			
University System Respondents			
System - Total Number of Internal Auditors			
Sorted by number of campuses			
As of: FYE 2010			
State	Organization	System Total Number of Auditors	Total campuses in system
MN	Minnesota State University system	8	31
WI	University of Wisconsin System	26	26
CA	Ca State Univ System	24	23
NY	SUNY	38	24
GA	University System of Georgia	55	20
TX	Texas A&M University System	31	18
MD	University System of Maryland	18	17
TX	University of Texas System	118	16
TX	Texas State University System	15	13
NH	University System of New Hampshire	5	13
Puerto Rico	Ana G. Mendez University System	10	11
ND	North Dakota University System	1	11
IL	Southern IL University	9	12
AZ	Maricopa Community Colleges	6	10
TX	Univ. of Houston Sys.	11	9
OR	Oregon University System	11	9
NV	Nevada System of Higher Education	10	9
PA	Pennsylvania State System of Higher Education	7	7
Illinois	University of Illinois	18	6
Texas	University of North Texas System	15	7
Utah	State Board of Regents	27	5
MN	University of Minnesota	16	5
TN	University of TN System	17	4
CO	University of Colorado	12	4
AL	University of Alabama System	18	3
Texas	Texas Tech University System	14	3
AZ	Arizona University System	14	3
CO	Colorado State University System	6	3
Average:		20	12

Sorted by number of auditors			
State	Organization	System Total Number of Auditors	Total campuses in system
TX	University of Texas System	118	16
GA	University System of Georgia	55	20
NY	SUNY	38	21
TX	Texas A&M University System	31	18
Utah	State Board of Regents	27	5
WI	University of Wisconsin System	26	26
CA	Ca State Univ System	24	23
MD	University System of Maryland	18	17
Illinois	University of Illinois	18	6
AL	University of Alabama System	18	3
TN	University of TN System	17	4
MN	University of Minnesota	16	5
TX	Texas State University System	15	13
Texas	University of North Texas System	15	14
Texas	Texas Tech University System	14	3
AZ	Arizona University System	14	3
CO	University of Colorado	12	4
TX	Univ. of Houston Sys.	11	9
OR	Oregon University System	11	9
Puerto Rico	Ana G. Mendez University System	10	11
NV	Nevada System of Higher Education	10	9
IL	Southern IL University	9	10
MN	Minnesota State University system	8	31
PA	Pennsylvania State System of Higher Education	7	7
AZ	Maricopa Community Colleges	6	10
CO	Colorado State University System	6	3
NH	University System of New Hampshire	5	13
ND	North Dakota University System	1	11
Average:		16	12

\*W/O \*MBS

Internal Audit Benchmarking Survey										
University System Respondents			Sorted accord to Assets							
As of:	FYE 2010									
State	Organization	Number of campuses	System Total Number of Auditors?	Total Systemwide \$ amount of expenses?	Total Systemwide \$ amount of assets?	Total Systemwide Number of students?	Total Systemwide Number of employees?	Is your System Audited by state or legislative auditors? (yes/no)	If yes, how often are system institutions audited?	Does your System include hospital(s) in your internal audit universe? (Yes/no)
TX	University of Texas System	16	118	\$ 12,248,248,864	\$ 40,418,706,338	211,213	87,487	Yes	regularly	Yes
CA	Ca State Univ System	23	24	\$ 6,752,747,000	\$ 14,944,448,000	440,819	42,884	No		No
NY	SUNY	64	38	\$ 8,800,000,000	\$ 11,800,000,000	221,686	61,455	Yes	10 - 20 Audits Annually by State Auditors	Yes
GA	University System of Georgia	20	55	\$ 6,033,000,000	\$ 9,124,000,000	301,000	53,000	Yes	Annually	No
TX	Texas A&M University System	18	31	\$ 3,300,000,000	\$ 7,500,000,000	120,900	28,200	Yes	varies	No
WI	University of Wisconsin System	26	26	\$ 4,136,827,678	\$ 6,220,000,000	182,090	30,552	Yes	Annually for financial audit and single audit	No
AL	University of Alabama System	3	18	\$ 3,166,598,657	\$ 6,158,444,403	53,254	24,998	Yes, Compliance Audits Only	Annual Compliance Audits by State; Annual Financial Audits by PwC	Yes
MD	University System of Maryland	17	18	\$ 3,864,000,000	\$ 5,900,000,000	152,000	36,000	Yes	every 3 yrs	yes
Illinois	University of Illinois	6	18	\$ 4,760,000,000	\$ 5,500,000,000	77,000	33,000	Yes	Annually	Yes
AZ	Board of Regents	3	14	\$ 3,240,454,000	\$ 5,433,105,000	132,035	30,175	Yes (Auditor General)	Annual Financial Audit	No
MN	University of Minnesota	5	16	\$ 2,931,265,000	\$ 4,579,879,000	67,932	19,000	State: no; Legislative Auditor: yes, they have audit rights, but rarely use them		No
CO	University of Colorado	3	12	\$ 2,285,433,000	\$ 4,103,528,000	48,511	13,310	Yes, state auditor hires external firm to conduct the audit	The state auditor's office conducts periodic performance audits that may touch HE institutions.	No
OR	Oregon University System	9	11	\$ 2,100,000,000	\$ 3,861,000,000	92,000	12,000	Yes- F/S A133	Annually	No

Internal Audit Benchmarking Survey										
University System Respondents			Sorted accord to Assets							
As of:	FYE 2010									
State	Organization	Number of campuses	System Total Number of Auditors?	Total Systemwide \$ amount of expenses?	Total Systemwide \$ amount of assets?	Total Systemwide Number of students?	Total Systemwide Number of employees?	Is your System Audited by state or legislative auditors? (yes/no)	If yes, how often are system institutions audited?	Does your System include hospital(s) in your internal audit universe? (Yes/no)
TX	University of Texas System	16	118	\$ 12,248,248,864	\$ 40,418,706,338	211,213	87,487	Yes	regularly	Yes
CA	Ca State Univ System	23	24	\$ 6,752,747,000	\$ 14,944,448,000	440,819	42,884	No		No
NY	SUNY	64	38	\$ 8,800,000,000	\$ 11,800,000,000	221,686	61,455	Yes	10 - 20 Audits Annually by State Auditors	Yes
Texas	Texas Tech University System	3	14	\$ 1,360,332,922	\$ 3,121,312,081	42,203	12,255	Yes	1-2 times per year with varying scopes	No hospital—but we do have a Health Sciences Center
NV	Nevada System of Higher Education	9	10	\$ 1,428,417,000	\$ 2,847,570,000	114,809	14,300	no, external audit of consolidated system financial statements	N/A	No
PA	Pennsylvania State System of Higher Education	7	7	\$ 1,859,100,000	\$ 2,760,000,000	117,000	13,000	Yes	Each University audited by this group approx. once every 3 years	No
TN	University of TN System		17	\$ 1,683,000,000	\$ 2,265,000,000	49,600	13,300	Yes	Annually	No
TX	Univ. of Houston Sys.	9	11	\$ 951,000,000	\$ 2,178,500,000	65,000	9,050	Yes	annually as part of state	No
TX	Texas State University System	8	15	\$ 958,881,000	\$ 2,114,000,000	74,604	5,000	Yes	Annually, as part of the statewide financial and federal audit. However, not every institution will be included in such audits.	No
NH	University System of New Hampshire	13	5	\$ 730,034,000	\$ 1,585,225,000	26,843	6,053	no	N/A	No
Texas	University of North Texas System	13	15	\$ 718,388,084	\$ 1,405,000,000	37,000	5,000	Selected audit topics and A-133	A-133 Annually; others as determined by state auditor's audit plan	no, but does include large physician's practice
ND	NDUS	11	1	\$ 966,000,000	\$ 1,230,000,000	49,000	18,000	Yes	Regularly on a rotating basis (financial, operational, performance, IT) Or by special request	No, Does have a school of medicine

Internal Audit Benchmarking Survey										
University System Respondents										
As of:	FYE 2010			Sorted accord to Assets						
State	Organization	Number of campuses	System Total Number of Auditors?	Total Systemwide \$ amount of expenses?	Total Systemwide \$ amount of assets?	Total Systemwide Number of students?	Total Systemwide Number of employees?	Is your System Audited by state or legislative auditors? (yes/no)	If yes, how often are system institutions audited?	Does your System include hospital(s) in your internal audit universe? (Yes/no)
TX	University of Texas System	16	118	\$ 12,248,248,864	\$ 40,418,706,338	211,213	87,487	Yes	regularly	Yes
CA	Ca State Univ System	23	24	\$ 6,752,747,000	\$ 14,944,448,000	440,819	42,884	No		No
NY	SUNY	64	38	\$ 8,800,000,000	\$ 11,800,000,000	221,686	61,455	Yes	10 - 20 Audits Annually by State Auditors	Yes
CO	Colorado State University System	3	6	\$ 855,000,000	\$ 711,000,000	35,077	6,364	Yes	annually	no (Veterinary hospital)
AZ	Maricopa Community Colleges	10	6	\$ 773,000,000	\$ 660,000,000	78,149	10,100	Yes	annually	No
Puerto Rico	Ana G. Mendez University System	11	10	\$ 215,000,000	\$ 300,000,000	42,000	5,000	No	N/A	No
Utah	State Board of Regents	5	27	Decentralized	Decentralized	126,000	30,110	Yes. Annually by the State auditors and periodically Legislative Auditors	Yes. Annually by the State auditors and periodically by Legislative Auditors	The U of U specifically has auditors that work on audits of the hospital.