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AGENDA

AUDIT COMMITTEE

Wednesday, August 28, 2019 • 10:15 a.m.

Claiborne Building, 1st Floor
Louisiana Purchase Room 1-100
1201 North Third Street
Baton Rouge, LA 70802

- I. Call to Order
- II. Roll Call
- III. Internal Audit Presentation
 - A. Funding Formula Internal Audit
 - B. Review of Internal Audit Charter
 - C. Year 2 Internal Audit Plan Contract
- IV. Other Business
- V. Adjournment

Committee Members: T. Jay Seale III, Chair, Jacqueline Wyatt, Vice Chair, Claudia Adley, Robert Levy, Charles McDonald, Darren Mire, and Felix Weill



Board of Regents – Internal Audit of Outcomes-Based Funding Formula Processes
June 4, 2019

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Postlethwaite & Netterville, A Professional Accounting Corporation

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Objective & Scope

An internal audit was conducted to assess the Board of Regents' processes and applicable internal controls related to the outcomes-based funding formula.

Overview

- Obtained documented policies and procedures
- Interviewed key personnel to gain an understanding of the applicable processes
- Performed walkthroughs to gain an understanding of key processes
- Assessed the audit process related to certain funding formula components

Observations Summary

- ❖ During the walkthroughs performed and interviews conducted, P&N identified the following controls that were designed to mitigate certain risks associated with the outcomes-based funding formula processes*:
 - The funding formula includes several independent inputs obtained from external entities such as Southern Regional Education Board, Public Retirement Systems' Actuarial Committee, College and University Professional Association, Integrated Postsecondary Education Data System, and National Science Foundation.
 - Institutions submit the necessary self-reported data to be utilized in the formula via online systems such as the Statewide Student Profile System (SSPS), the Statewide Completers System and the Financial Aid Data System (FADS). Data validation checks are built into each application to help mitigate the risk of erroneous data being provided by institutions (i.e., validation that a letter is not included in a numeric field). In addition, system specification documentation for each application is published at the Board of Regents' website and provides a detailed guide on how to make uploads of self-reported information by the institutions.
 - A portion of the calculations utilized in the formula is completed using queries that are run in a database which helps to mitigate the risk of human manipulation and error in those calculations.
 - The funding formula and associated results undergo several levels of review. Significant changes in funding amounts, past feedback from institutions, and past trends are evaluated to identify areas that may require additional attention and determine if any corrections may be necessary. In addition to undergoing three levels of review within the Board of Regents performed by the Associate Commissioner for Finance and Administration, the Deputy Commissioner for Finance and Administration, and the Commissioner of Higher Education, the institutions are also provided the Excel spreadsheet formula calculations for their review.
 - Audits are performed on several of the self-reported inputs of the calculation, such as Student Credit Hours, Out of State Online Credit hours, Pell students enrollment/completers, enrollment/completers of students over the age of 25, cross enrolled students, transfer students from 2 to 4 year institutions, and certificate and diploma completers. Per discussion with Audit and Compliance, over the past 18 months, the audit process has been enhanced to include a more robust planning process and stronger documentation related to audit planning, results, and reporting of identified audit findings.

**Tests of operating effectiveness were not performed for each of the controls described.*

Observations Summary - Continued

❖ Identified controls - continued:

- The Board of Regents conducts an annual Summit, which provides training and an updated overview of the funding formula calculation. Members of each institution are invited to attend. In addition, the Board of Regents prepares institution-specific guidance which identifies and communicates each school's strengths and weaknesses, along with suggestions on how to utilize data to best leverage the funding formula.
- The funding formula model was included in an analysis performed by an independent third party, HCM Strategists (HCM), for the prior two fiscal years (FY 2018 and FY 2019). HCM produces a report establishing a comprehensive typology of outcomes-based funding formula models and a state-by-state classification of funding systems. The classification is used to assign each state's funding formula a category/"type" according to its level of sophistication and its adherence to promising practices. For the prior two fiscal years, the Board of Regents' formula was assigned the highest category. Additionally, following the FY 2019 HCM review, the Board of Regents requested an independent review of their funding formula model, focusing on the model's alignment to best practices. The review was conducted by Lumina Strategy Labs, utilizing the data and analysis from the HCM report. The analysis found the funding formula model to be aligned or partially aligned with all elements included in the assessment.

❖ Based on our procedures, no high risk observations were identified. Two observations were identified and assessed to be moderate risk to the Board of Regents, related to the following areas:

- Lack of formally documented processes detailing inputs and sources of information, specific calculations, and assigned roles and responsibilities related to the preparation, review and oversight of the outcome based finding formula processes.
- Lack of a formal risk-based audit plan specific to overall processes and funding formula inputs.

❖ P&N also identified an additional best practice recommendation for management's consideration, related to the following area:

- Opportunity to further automate manual calculations that are currently performed in Excel to mitigate the risk of unintended errors that can lead to issues with data integrity.

Please refer to the Results section of this report for additional details.

Results: Outcomes-Based Funding Formula

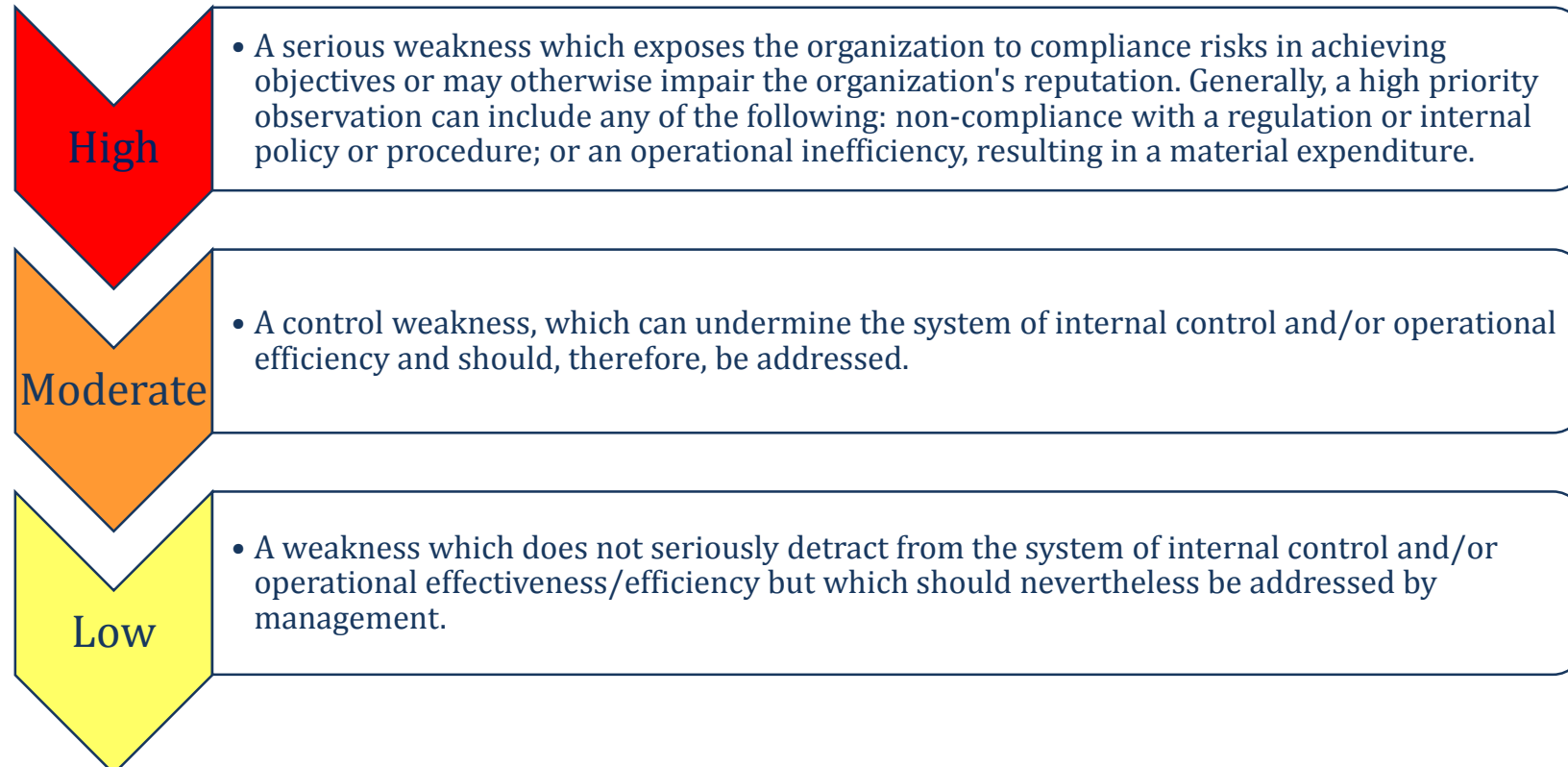
Observation	Risk	Root Cause	Recommendation	Responsible Party	Management Response
Risk Rating: Moderate					
While there was a process for performing the outcomes-based funding formula calculation, monitoring and oversight, this process had not been formally documented. As a result, there was no clear description related to formula inputs, sources of information, specific database queries and Excel calculations, and assigned roles and responsibilities. In addition, the process related to formula changes and required approvals was not documented.	- Lack of a formal documented process increases the risk of potential errors or unauthorized changes to the outcomes-based funding formula. Additionally, there is an increased risk of loss of institutional knowledge, if current process owners are absent or no longer in their current positions.	- Lack of formally assigned responsibility for documenting outcomes-based funding formula processes.	- Management, with the help of process owners, should consider creating a formal process document of the internal procedures performed related to the funding formula calculation, to include, but not be limited to the following: <ul style="list-style-type: none"> • Identification of each process owner • Inputs, sources of data/rates used in the calculation • Specific formula and queries used in the calculation • Individuals responsible for monitoring and oversight • Defined process for documentation and approval of any changes to inputs and/or calculations. 	Finance and Administration Management	The Board of Regents currently provides an overview of the annual formula development process on its website. Additionally, the calculation spreadsheets are sent to the system Chief Financial Officers and Legislative analysts. In order provide greater transparency and reduce possible risk, the Board of Regents is creating an outcomes-based funding formula procedure manual. This manual will provide Regents staff with a step-by-step process regarding the annual formula development to ensure continuity of operations. These processes will include how data submitted by the institutions is utilized in the cost and outcomes formula, how peer data is obtained and utilized in the cost formula, and how the cost matrix and outcomes weights are applied to determine cost and outcomes allocations for each formula institution. The procedure manual will be complete by the September board meeting and will be used for the cost formula development for the FY21 higher education budget request in October.
While Audit and Compliance was in the process of implementing a risk-based audit approach, at the time of our procedures, there was no formal risk assessment performed to determine the audit plan specific to the funding formula inputs and the overall processes.	- Increased potential for errors in the funding formula inputs, calculation and resulting allocations to go undetected.	When the outcomes-based funding formula model was implemented in fiscal year 2017, associated audit procedures were not immediately adjusted to account for changes. However, at the time of our audit, implementation of a risk-based audit approach was planned for fiscal year 2020.	- Management should continue development of a risk based audit plan specific to the funding formula processes, which includes identifying high risk metrics and inputs that have the greatest impact on the formula in order to develop the audit plan and procedures. - Management should consider performing an annual risk assessment relative to the formula to identify high risk institutions to include in the audit plan. Based on the results of the risk assessment, management should determine if additional resources are needed to carry out the audit plan.	Finance and Administration Management	Last year the Board of Regents Audit and Compliance reassessed the approach to auditing the formula as a part of an internal improvement process. Through this process it was determined that Audit and Compliance could improve by focusing on higher risk areas rather than the broad approach previously utilized. Since the reassessment, Audit and Compliance has been planning to transition to a risk-based approach since a risk-driven audit plan is best for the data accuracy, fairness of the formula funding allocation and for all of the Board of Regents' departments that rely on this data. The risk methodology that will be used has been under development for six months and the prospective timeline for completion will be the August board meeting.

Additional Best Practice Recommendations for Management Consideration

- ❖ In addition to the specific observations and recommendations included in this report, P&N also identified the following additional best practice recommendation for management's consideration:
 - Observation:
 - While certain data elements and inputs to the funding formula calculation were automated and queries were performed in a database, the overall outcomes-based funding formula calculations were performed in Excel.
 - Risk:
 - While we did not identify any errors or data integrity issues during the performance of our procedures, performing manual calculations in Excel increases the risk of unintended errors and issues with data integrity.
 - Recommendation:
 - To further enable data integrity, management should consider automating the manual calculations that are currently performed in Excel. In considering an automated solution, management should ensure that reports on key metrics are available, to allow for proper and efficient monitoring and oversight.

Appendix A: Risk Rating Definitions

Risk ratings were assigned as follows:



Appendix B:

Assumptions and Limiting Conditions

Our procedures were not designed to detect fraud, to constitute a financial statement audit, review, compilation, or to provide assurance on the internal controls or information provided. Accordingly, we will not express an opinion or conclusion, nor provide any other form of assurance on the completeness and accuracy of the information. Additionally, the projection of any conclusions, based on our findings, to past or future periods is subject to the risk that changes may have occurred during the passage of time that may alter the validity of such conclusions. Furthermore, the projection of any conclusions, based on our findings, to the whole population is subject to the risk that the samples selected may not accurately reflect the population as a whole.

This engagement was conducted in accordance with the *American Institute of Certified Public Accountants' Statement on Standards for Consulting Services (SSCS)* and the *International Standards for the Professional Practice of Internal Auditing (Standards)*.

Appendix C: Transmittal Letter

June 4, 2019

Regent Jay Seale
Audit Committee Chair
Louisiana Board of Regents
1201 N. Third Street, Suite 6-200
Baton Rouge, LA 70802

Dear Regent Seale:

As presented in this enclosed report, Postlethwaite & Netterville, APAC (P&N) has completed our internal audit of the Louisiana Board of Regents' outcomes-based formula process. On the pages above, this report provides: 1) the procedures performed, 2) a summary of the observations noted during our engagement, 3) recommended actions to consider related to the outcomes based formula processes.

These recommendations are only for your consideration, and are not intended to be implemented without management's thorough understanding and acceptance.

P&N appreciates the cooperation and assistance provided by the Board of Regents of the State of Louisiana personnel during this engagement. We sincerely appreciate this opportunity to be of service to you. Please do not hesitate to contact us if you have any questions related to this report or any other matters.

Sincerely,

Postlethwaite & Netterville, APAC

POSTLETHWAITE & NETTERVILLE, APAC