

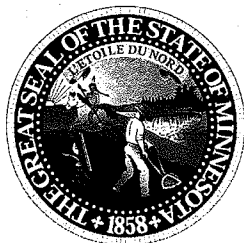
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Department of Finance

Department of Administration

Internal Audit Progress Report

State of Minnesota



Biennial Report

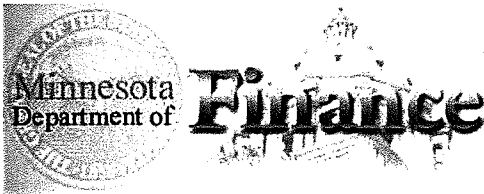
January 2005

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Report Cost: Approximately \$7,500

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January 31, 2005

The Honorable Tim Pawlenty
Governor
130 State Capitol Building

The Honorable Richard J. Cohen, Chair
Senate Finance Committee
121 State Capitol Building

The Honorable Jim Knoblach, Chair
House Ways and Means Committee
453 State Office Building

Dear Governor Pawlenty, Senator Cohen, and Representative Knoblach:

In accordance with Minnesota Statutes, Section 16A.055 Subd. 1(7), we are enclosing the *2005 Internal Auditing Progress Report*. This report highlights the progress made in the area of internal auditing during the past two years and future plans for developing and maintaining internal auditing standards in Minnesota state agencies.

This report is the collaborative effort of several Minnesota state agencies. While the departments of Finance and Administration share statutory responsibility for publishing this report biennially, this report is possible only because of the assistance, cooperation, and dedication of Minnesota State Government Internal Auditing Advisory Roundtable members representing other state agencies. We extend our appreciation to these employees for their significant contributions and the time devoted to preparation of this report.

If you have any questions concerning this report, please contact Barb Ruckheim at (651) 296-5190, Judy Hunt at (651) 296-6298, or Pete Maurer at (651) 296-5187.

Sincerely,

Peggy S. Ingison
Commissioner
Department of Finance

Dana Badgerow
Commissioner
Department of Administration

c: Senator Satveer Chaudhary
Representative Marty Seifert
Dan McElroy, Chief of Staff

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Executive Summary

The Institute of Internal Auditors, the premier professional organization for internal auditors worldwide, defines internal auditing as an independent, objective assurance and consulting activity designed to help an organization achieve its goals and improve its operations.¹

Ten state agencies have established internal audit functions that perform their duties consistently with the above definition. These agencies are the Departments of Administration, Corrections, Finance, Human Services, Natural Resources, Revenue, and Transportation; Higher Education Services Office; Minnesota State Colleges and Universities; and the Minnesota Supreme Court.

During the past two years, internal auditors in state agencies actively contributed to the overall success of their respective agencies. The disciplined, systematic approach used by internal auditors adds value to agency operations and assists the agency in meeting its mission. Examples of some of these contributions include:

- Improved the quality of financial and other information
- Analyzed and evaluated the efficiency and effectiveness of programs
- Reviewed compliance of agency staff with applicable laws, policies, and procedures
- Conducted inquiries and investigations of alleged improprieties by agency employees
- Provided assurance and consulting services to state agency management

The chief internal auditors in the state agencies with internal audit functions comprise the Minnesota State Government Internal Auditing Advisory Roundtable (Advisory Roundtable). The Advisory Roundtable is a professional resource to the commissioners of the departments of Finance and Administration in carrying out the requirements in Minnesota Statutes, Section 16A.055, subd. 1(7) regarding developing and maintaining standards for internal auditing in state agencies. Additionally, the Advisory Roundtable seeks opportunities from the internal auditing profession to add value to state government, and monitors the direction of the profession, future mandates, and best practices for state government.

Over the past two years, the Advisory Roundtable performed several activities as follows:

- Continued efforts to establish implementation options for professional auditing standards

¹From The Definition of Internal Auditing, Copyright 1999 by The Institute of Internal Auditors, Inc., 247 Maitland Avenue, Altamonte Springs, Florida 32701-4201 U.S.A. Reprinted with permission.

- Promoted high quality internal auditing by developing information resource packets for management considering establishing an internal audit function and for newly-hired internal audit directors
- Offered advice on statewide policies
- Collaborated on training efforts for internal auditors

During the past two years, the Advisory Roundtable has seen the prominence of the internal auditing profession continue to emerge in the aftermath of the corporate governance reforms enacted by the United States Congress. Increasingly, the internal auditing function is considered an essential element for effective corporate governance. The New York Stock Exchange has taken the unprecedented action of requiring that each listed company have an internal audit function. Governmental units, although not subject to the rules of the stock exchange, are now considering voluntarily adopting such provisions. With this in mind, the Advisory Roundtable drafted a code of conduct that establishes behavior standards and practices for executive branch employees whose duties include accounting, auditing, financial reporting, or tax filing. The Advisory Roundtable also promoted best practices similar to other key provisions of the 2002 Sarbanes-Oxley Act.

Consistent with its charter, the Advisory Roundtable is responsible for advising the commissioners of the departments of Finance and Administration on developing and maintaining internal auditing standards in state agencies; supporting the education of state employees about controls, risk assessment, and ethical conduct; highlighting concerns related to the control environment within state agencies; promoting the value of internal auditing services to key state decision-makers; and providing mutual support to and sharing expertise and training opportunities with colleagues in state agency internal auditing functions. While considering these responsibilities, the Advisory Roundtable has established important goals to accomplish in the next two years. These goals include:

- Continue efforts to promote best practices for employees with accounting, auditing, financial reporting, or tax filing duties
- Encourage the implementation of additional financial controls similar to the key provisions of the Sarbanes-Oxley Act of 2002
- Determine the applicability of professional standards for Minnesota internal auditors
- Continue to promote improvement of internal auditing within Minnesota state government
- Provide advice on statewide policies
- Collaborate on training and sharing knowledge

Introduction

*"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."*²

Ten state agencies have voluntarily established internal audit functions that perform their duties consistently with this definition. These agencies are:

- Department of Administration
- Department of Corrections
- Department of Finance
- Higher Education Services Office
- Department of Human Services
- Minnesota State Colleges and Universities
- Minnesota Supreme Court
- Department of Natural Resources
- Department of Revenue
- Department of Transportation

The newest internal audit function, within the Minnesota Supreme Court, was established in calendar year 2004.

During the past two years, the internal audit function for the Veterans Home Board was eliminated due to resource constraints. In addition, the internal audit function of the Department of Military Affairs is no longer state funded and is not included in the above information. Military Affairs continues to have an internal audit function performed by members of the Minnesota National Guard and staff with the United States Property and Fiscal Office located at Camp Ripley.

Although state agency internal audit functions vary in size and structure, each enhances accountability and improves quality of state government operations. Examples include assisting management in setting the tone for ethical behavior; providing assurances to management on the effectiveness of controls to mitigate key strategic, operational, and financial risks; and following-up and reporting progress to management on agency efforts to resolve audit issues, including those identified by external auditors such as the Office of the Legislative Auditor (OLA).

Controls within the purview of the internal audit function include ethical values, performance measures, risk identification and assessment mechanisms, communication of pertinent information, monitoring actions, and other various control activities designed to

²From The Definition of Internal Auditing, Copyright 1999 by The Institute of Internal Auditors, Inc., 247 Maitland Avenue, Altamonte Springs, Florida 32701-4201 U.S.A. Reprinted with permission.

ensure reliable financial information for decision-making purposes, compliance with laws and ethical standards, operational efficiency, safeguarding of assets, and achievement of strategic goals.

This report discusses the progress in internal auditing during the past two years. This report has four sections:

- *Section 1* indicates the developments in the internal auditing profession since December 2002
- *Section 2* identifies contributions of Minnesota state agency internal auditors that added value to their organizations during the past two years
- *Section 3* discusses the accomplishments of the Advisory Roundtable
- *Section 4* conveys the future goals of the Advisory Roundtable

Section 1: Update on the Internal Auditing Profession

The prominence of the internal auditing profession has continued to emerge in the aftermath of the corporate governance reforms enacted by the United States Congress. Increasingly, the internal auditing function is considered an essential element for effective corporate governance. On November 3, 2003, the New York Stock Exchange took the unprecedented action of requiring that each listed company have an internal audit function:

Listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and the system of internal control.³

Governmental units, although not subject to the rules of the stock exchange, often voluntarily adopt such provisions. For example, on November 18, 2004, the President of the Treasury Board of Canada announced plans to strengthen the internal audit function across the Canadian government. Some state governments currently have legislative requirements for the internal auditing function. Eventually, bond rating agencies and investors are likely to look more favorably on governmental issuers that maintain internal auditing functions.

▪ *Internal auditing areas of responsibility*

The Institute of Internal Auditors (IIA) is the premier professional organization for internal auditors. The IIA definition of internal auditing cites three areas where internal auditors may help an organization accomplish its objectives: (1) risk management, (2) control, and (3) governance processes. Changes in each of those areas of study have required internal auditors to adapt. Some of the more significant changes in these areas include:

- The Sarbanes-Oxley Act of 2002 has raised the expectations for companies to maintain effective internal controls. Section 404 of the Act requires companies to undertake a vigorous process to document and test internal controls and remediate any significant deficiencies identified. Internal auditors have the background and training to play a vital role in this process. The Act also requires that Audit Committees have a reliable communication channel for receiving and processing evidence of possible fraud. In many organizations, internal auditors serve as a vital link for carrying out this important function.

The Act also created the Public Company Accounting Oversight Board (PCAOB). The PCAOB collaborates with the Auditing Standards Board (ASB) and the U.S. Government Accountability Office (GAO), formerly the General Accounting Office, to achieve consistent auditing standards for financial audits for all organizations including governmental, not-for-profit, and private sector corporations.

³ New York Stock Exchange Listed Company Manual, Rule 303A.07(d).

- In September 2004, the Committee on Sponsoring Organizations of the Treadway Commission (COSO)⁴ released *Enterprise Risk Management – Integrated Framework*. This framework was developed following several years of research and public comment. It provides a uniform framework for assessing the sufficiency of risk management efforts. The framework defines its role as follows:

The underlying premise of enterprise risk management is that every entity exists to provide value for its stakeholders. All entities face uncertainty, and the challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value. Uncertainty presents both risk and opportunity, with the potential to erode or enhance value. Enterprise risk management enables management to effectively deal with uncertainty and associated risk and opportunity, enhancing the capacity to build value.⁵

- Developments in corporate governance practices continue to evolve. The IIA has a major effort underway to develop guidance in a Practice Advisory on the *Role of Internal Auditors in the Governance Process*. This new guidance is expected to be available in 2005.

To preserve the vitality and credibility of internal auditing, internal auditors must be vigilant in protecting their independence while assisting in these areas.

- ***The profession of internal auditing***

Internal Auditing has evolved to be recognized as a profession. Like any profession, internal auditing recognizes a common body of knowledge and its members are expected to conduct their work in a systematic, disciplined approach. The IIA released a major revamping of its professional standards in 2002, and continues to refine expectations for internal auditors. In January 2004, it issued an extensive series of practice advisories and definitions to aid with implementation of the standards.

One of the newest internal auditing standards pertains to assuring the quality of the internal auditing function. Effective December 31, 2006, the standards require internal audit functions to undergo an external quality assessment review at least once every five years. External quality assessment reviews have been required for governmental audit organizations, like the Office of the Legislative Auditor, and public accounting firms for several years. The external quality assessment will reassure management, the Audit Committee, and external auditors that the internal audit function has adhered to the professional standards.

⁴ Five professional organizations comprise COSO: American Accounting Association, American Institute of Certified Public Accountants, Financial Executives International, Institute of Management Accountants, and the Institute of Internal Auditors.

⁵ Committee on Sponsoring Organizations of the Treadway Commission, Enterprise Risk Management – Integrated Framework, September 2004, p. 3.

▪ *Emerging issues in state government internal audit functions*

Two research studies were recently conducted on state internal auditing functions. The results of the first nationwide survey of state internal auditors released by the National Association of State Auditors, Comptrollers and Treasurers concluded the following:

Overall, state internal auditing functions follow professional auditing standards, report to a high level within the organization, issue reports to management, and follow up on the implementation of recommendations. Improvements to more closely follow professional standards could be made in the area of conducting more frequent external quality control reviews.⁶

In February 2004, the IIA Research Foundation conducted a survey of state, local, and federal auditors. This survey concluded four major findings.

- Government auditors face numerous significant challenges. Half of the respondents rated “Adequate audit staffing” and “Adequate compensation for auditors” as being either severe or high challenges.⁷
- The most important step that government agencies can take to reduce the number of severe challenges facing auditors is to ensure that an independent audit committee is in place. At nonfederal organizations, auditors reported severe challenges 71 percent more often when they did not report to or have a relationship with an audit committee.⁷
- Accounting education is important, but a blend of skills is necessary to assure that the audit function can perform its duties efficiently and effectively. Auditors for organizations employing only degreed accountants reported a higher level of severe challenges with “adequate audit staffing” than any other group. They also reported a higher number of severe problems with their ability to contract for functional expertise in audits.⁷
- Government auditors face many common challenges, but individuals engaged in different types of government auditing report somewhat different challenges. While all groups indicated that adequate audit staffing was one of their most significant challenges, auditors from very small auditing functions were the most likely to report severe challenges with staffing.⁷

⁶ National Association of State Auditors, Comptrollers and Treasurers, The State of State Internal Auditing, February 2004, p. 10.

⁷ Copyright 2004, Challenges in Government Auditing by The Institute of Internal Auditors Research Foundation, 247 Maitland Avenue, Altamonte Springs, Florida 32701-4201 U.S.A. Reprinted with permission.

Section 2: Accomplishments of State Agency Internal Audit Functions

During the past two years, internal auditors in Minnesota state agencies contributed to the overall success of their respective agencies by adding value to agency operations.

Internal auditors contributed actively to state agency operations that assisted agency management in fulfilling each agency's mission. Highlights and examples of some of these contributions include:

- ***Sought to improve the quality of financial and other information***

Internal audit functions assisted with compiling financial information needed for the state's Comprehensive Annual Financial Report (CAFR) and verifying that receivables, revenues, liabilities, and expenditures reported by agencies for inclusion in the CAFR were accurate.

The Minnesota Colleges and Universities (MnSCU) internal audit function assisted in preparing audited financial statements for the agency, including seven state universities and five two-year colleges. The financial statements for all twelve institutions received unqualified audit opinions from the Certified Public Accountant (CPA) firms that the MnSCU Board appointed for the audits. In fiscal year 2004, the MnSCU internal audit function participated in adapting finance-related audits conducted by the Office of the Legislative Auditor (OLA) to complement the institutional financial statement audits conducted by CPA firms. This resulted in additional audit coverage at the institutions.

The Department of Administration (Admin) internal audit function developed technical documentation for computer software acquired for departmental use that assisted Admin employees in assuring that this software will be properly reported in financial statements. The documentation was also used by Department of Finance employees in developing the statewide policy on accounting for internally developed software.

- ***Analyzed and evaluated the efficiency and effectiveness of programs***

Higher Education Services Office internal auditors conducted numerous audits of institutions participating in state financial aid programs. These audits resulted in repayments exceeding \$350,000 to various state student financial aid programs mainly because grant funds were disbursed at the wrong enrollment level.

The Department of Revenue internal auditors reviewed the department's transition from a paper-based to an electronic-based business environment. The internal auditors provided consulting services to ensure that the new systems included adequate controls to help prevent, detect, and correct errors or fraud.

The Department of Corrections internal audit unit reviewed cellular telephone use and costs that resulted in changes to service plans purchased by the department and improved justification for cell phone acquisition.

▪ ***Reviewed compliance of agency staff with applicable laws, policies, and procedures***

The Department of Finance internal audit function performed audits of agencies without internal audit functions, boards, and councils to determine compliance with applicable laws, policies, and procedures. Additionally, the internal auditors performed ongoing compliance tests of various transactions processed through the state's accounting system by all agencies. The internal auditors worked with agency staff to resolve any issues, including ensuring that adequate controls and procedures are in place to safeguard the state's assets and mitigate risks.

Several internal audit functions performed selected scope audits of expenditure types such as employee business expense reimbursement and employee payroll to determine compliance with applicable laws, policies, and procedures and to ensure that sufficient documentation exists to support expenditures of state funds.

Internal audit functions at various agencies conducted audits of purchasing card use and contracts to determine compliance with applicable laws, policies, and procedures and to ensure that adequate controls are in place to safeguard the state's assets.

The Admin internal audit function was involved in the department's quality assurance efforts to improve compliance with fiscal policies and procedures related to non-payroll transactions processed in the state's accounting system. These efforts are aimed at improving agency staff compliance with guidelines while promoting efficient and cost savings measures.

▪ ***Conducted inquiries and investigations of alleged improprieties by agency employees***

The Department of Human Services internal audit function conducted over fifty investigations within the department covering a variety of issues and provided computer forensic assistance to sixteen state agencies. The investigations covered areas such as misuse of state resources, falsifying documents including timesheets, unauthorized installation of software, and data practices violations. The forensic assistance included many of the same areas as well as data recovery from seized computers, violation of state policies on use of electronic communications, and downloading of pirated files.

The Admin internal audit function conducted investigations related to allegations of conflict of interest and irregularities regarding adoption of codes for building codes and standards.

Additionally, as requested by agency management, other internal audit functions conducted inquiries and investigations regarding alleged employee misconduct.

▪ ***Provided assurance and consulting services to state agency management***

The MnSCU internal audit function provided assurance and consulting services that management had requested. These included a study of *Services to Traditionally Underrepresented Students* and projects focused on academic leadership development, customized training, and cost sharing for a multi-institutional facility.

The Department of Revenue internal audit function was involved in the department's efforts related to business recovery planning, including the review of disaster recovery plans. The internal audit function also assisted on behalf of the department on the national Streamlined Sales Tax Project regarding audit standards for certifying computer systems for out-of-state sales transactions.

The Department of Finance internal audit function provided consulting and assurance services when requested by state agency staff. The types of services included advice on how to implement audit recommendations, mitigate risks, and apply state policies, as well as answers to specific inquiries covering a variety of topics related to accounting operations and financial reporting.

The Minnesota Department of Transportation (Mn/DOT) internal audit function conducted audits to determine that the proper rates had been applied to projects. These rates included laboratory test cost recovery, maintenance overhead, shop overhead, sampling, testing, inspecting, and equipment usage.

Under provisions covering federal expenditures and the single audit act, the Mn/DOT internal audit function conducted audits of specific single audit requirements for two major federal programs, Highway Planning and Construction, and Airport Improvement.

The Department of Natural Resources internal audit unit, as follow-up to an OLA special report, reviewed grantee records to resolve reimbursement claims for items not paid by the grantee. The internal auditors completed audits of over 100 grants to local governments and of all state park system concession grant agreements.

The above examples show that the systematic approach used by internal auditors adds value to a state agency and assists the agency in meeting its mission.

While not specifically mentioned previously, state agencies that have an internal audit function typically experience a reduction in the number of audit findings from OLA, which is at least partially attributable to the interaction between state agency internal auditors and OLA auditors. Internal auditors have the knowledge and expertise to assist agency staff in addressing and resolving problems prior to an audit by the OLA. When an OLA audit report is issued, internal auditors work with agency staff to implement recommendations that resolve audit report findings.

Internal auditors understand agency activities and dynamics because the auditors are an integral part of the agency. Thus, internal auditors' professional background is further enhanced by their knowledge of the agency, which allows internal auditors to better monitor agency conditions and assist in ensuring excellence in state government.

Section 3: Progress of the Minnesota State Government Internal Auditing Advisory Roundtable

The chief internal auditors in the ten state agencies with internal audit functions comprise the Minnesota State Government Internal Auditing Advisory Roundtable (Advisory Roundtable). The Advisory Roundtable has been in operation since March 2001. As its newly revised charter indicates, the Advisory Roundtable serves as a professional resource to the commissioners of the departments of Finance and Administration in carrying out the requirements in Minnesota Statutes, Section 16A.055, subd. 1(7) regarding developing and maintaining standards for internal auditing in state agencies. Additionally, the Advisory Roundtable seeks opportunities from the internal auditing profession to add value to state government, and monitors the direction of the profession, future mandates, and best practices for state government.

Over the past two years, the Advisory Roundtable performed several activities. Highlights of some of these activities include:

- ***Continued efforts on the standards review project to establish implementation options for satisfying professional auditing standards***

In late calendar year 2001, the Advisory Roundtable launched a project to review the newly approved Institute of Internal Auditors (IIA) *Standards for the Professional Practice of Internal Auditing*. This project had two objectives as follows:

- To determine what advice, if any, the Advisory Roundtable should provide to the commissioner of the Department of Finance addressing the internal auditing standards and providing expectations about their applicability in state agency internal auditing functions; and
- To share best practices for ensuring compliance with professional auditing standards as effectively and efficiently as possible.

This project involved extensive review and discussion of eleven key topics addressed in the professional auditing standards. These topics included auditor independence and objectivity, executing an effective quality assurance and improvement program, managing the internal auditing activity, performing engagements, communicating results, and monitoring management's acceptance of risk.

The Advisory Roundtable planned to devote a portion of its monthly meetings to this project to complete it during calendar year 2004. Because of significant events in the accounting and auditing profession, the Advisory Roundtable focused its attention on how the Sarbanes-Oxley Act of 2002 affects the state of Minnesota; thus, placed the professional standards project on hold.

In July 2004, the Advisory Roundtable returned to the professional standards project. The Advisory Roundtable felt that achieving the project objectives would be beneficial. Adopting existing professional internal auditing standards and customizing auditing practices for state government would promote consistency in internal auditing practices among state agency internal auditors and enhance the credibility of their work to external stakeholders and peer reviewers. Accomplishing this goal would also protect internal auditor independence and promote professionalism within the state agency internal audit functions.

To ensure continuation of the project, the Advisory Roundtable addressed ways to overcome the barriers to successful project completion. For example, to ensure the group meets continuously, the Advisory Roundtable modified its charter to include co-leadership from representatives of the departments of Finance and Administration. Each co-leader facilitates the Advisory Roundtable meetings in the other's absence.

The Advisory Roundtable also developed an action plan that included member assignments and stated project deliverables. Although timelines for completion are yet to be determined, the Advisory Roundtable defined the final deliverable for this project as a series of recommended internal auditing policy statements based on group consensus. Each statement will contain a requirement, guidance to achieve compliance, and consequences for noncompliance.

In August 2004, the Advisory Roundtable reached consensus on the definition of internal auditing. Specifically, the Advisory Roundtable expressed its support for the IIA definition of internal auditing. This definition sets the foundation for participation as a member of the Advisory Roundtable and distinguishes state agency internal auditors from others who do similar tasks including compliance officers, consultants, fiscal analysts, and individuals assigned to special projects.

In August 2004, the Advisory Roundtable also affirmed its earlier decision to revisit the applicability of the IIA Code of Ethics after finishing the review and discussion of the 11 key topics addressed in professional auditing standards. At that time, the Advisory Roundtable will obtain consensus on what the ethical expectations are for members of the roundtable.

▪ ***Promoted best practices similar to key provisions of the 2002 Sarbanes-Oxley Act***

In a reactionary response to unprecedented corporate and accounting scandals (e.g., Enron, Tyco, WorldCom), the federal government enacted the Sarbanes-Oxley Act (the Act) in July 2002. The purpose of the Act was to protect investors and to restore public confidence in financial markets and audited financial information. The law was enacted to increase accountability, strengthen corporate governance, and improve the accuracy and reliability of audited financial disclosures required pursuant to the securities laws. As such, the Act applies officially only to Securities and Exchange Commission registrants.

While the Act does not apply to state government (with one exception that makes it a federal criminal offense for any entity to destroy certain records), the Sarbanes-Oxley Act addresses universal concerns. Many of the Act's key provisions are emerging as new standards for organizational behavior and expected practices for ensuring honest financial reporting. Implementation of these practices has become the "gold standard" by which all entities, including governmental entities offering securities to the investment community, will ultimately be measured.

In November 2003, the Advisory Roundtable communicated its views to the commissioner of Finance in a position paper. The Advisory Roundtable recommended enacting a code of conduct for executive branch employees with accounting, auditing, financial reporting, or tax filing duties as the first step to creating an environment conducive to successful implementation of other key practices similar to the Sarbanes-Oxley provisions. Designed to supplement the ethics requirements contained in Minnesota Statutes, Sections 43A.38 and 16C.04, the proposed code addresses the principles of honesty, full disclosure, and compliance with laws. The code obligates employees to report evidence of fraudulent financial reporting or significant internal control deficiencies to appropriate authorities. It requires appropriate communication and training mechanisms to build a foundation of honesty and integrity.

The Advisory Roundtable also advocates future discussions with the commissioner of Finance about implementing other best practices similar to the key provisions of the Sarbanes-Oxley Act. Specifically, it supports increasing management responsibility for certifying financial information, assessing internal controls, and performing pre-employment background checks.

- ***Promoted high quality internal auditing by developing information packets for management considering establishing an internal audit function and for newly-hired internal audit directors***

The Advisory Roundtable completed a draft of an information resource packet designed to assist management who are considering establishing an internal audit function in their individual state agencies. This packet is a compilation of ideas and documents containing answers to frequently asked questions about the professional practice of internal auditing. It also highlights the financial requirements for maintaining an internal audit function, as well as qualifications a chief internal auditor should possess. The packet also includes sample position descriptions and helpful questions for interviewing prospective internal audit candidates.

The Advisory Roundtable is also developing an information resource packet for a newly-hired internal audit director. This start-up packet will include tools and techniques for managing and budgeting the internal audit function, risk assessments and audit planning, audit follow-up, internal quality assurance, and other internal auditing activities, including a list of resources.

The Advisory Roundtable expects to finalize both information resource packets in early calendar year 2005. It plans to distribute the packets as part of training on the code of conduct and at the request of agencies.

▪ ***Offered advice on statewide policies***

Members of the Advisory Roundtable provided comments on draft statewide policies. Advisory Roundtable members offered constructive criticism and suggested changes that clarified the policies and addressed unidentified business risks and essential controls that were absent. Many of the Advisory Roundtable's suggestions were incorporated into the existing statewide policies.

During 2004, members of the Advisory Roundtable responded to managers' requests for information on other topics to help the managers better fulfill their job responsibilities. Examples of these topics included access controls to safeguard desktop and laptop computers, the applicability of the 2002 Sarbanes-Oxley Act to Minnesota State Government, and professional assurance services available to protect the integrity of Internet data and security.

Periodically at monthly Advisory Roundtable meetings, the members inform each other of new statewide policies and their impact on agencies. This enables each member of the group to ensure that the policies are effectively communicated to pertinent employees for implementation within their respective agencies.

▪ ***Collaborated training efforts***

Members of the Advisory Roundtable recently participated in training sponsored by the National Association of State Auditors, Comptrollers and Treasurers (NASACT), in conjunction with the Association of Government Accountants, the National Association of Local Government Auditors, and the Institute of Internal Auditors. This training is a part of a series of audio conferences addressing timely issues in government financial management.

The first NASACT audio conference held in July 2004 was "The Value Proposition for Internal Auditing in Government". This audio conference presented the global, federal, state, and local views on value-added approaches that internal auditors use to help their organizations.

The most recent audit conference held in November 2004 was "The Causes of Ethical Collapse in Individuals and Organizations". This audio conference referenced the collapses of Enron and WorldCom and pointed out how easy it might be for those in government to assume that they are immune from the pressures of the markets felt by the employees in these companies. The training stressed that all organizations are equally vulnerable to experience unethical behavior, and that the causes, behaviors, and pressures cross the lines of for-profit, not-for-profit, and government organizations. This session offered a look at what causes ethical collapse in individuals and organizations, as well as insights into how organizations can avoid disaster due to such unethical behaviors.

Consistent with its charter, the Advisory Roundtable is responsible for advising the commissioners of the departments of Finance and Administration on developing and maintaining internal auditing standards in state agencies, supporting the education of state employees about controls, risk assessment and ethical conduct, promoting the value of internal auditing services to key state decision-makers, and providing mutual support to and sharing expertise and training opportunities with colleagues in state agency internal auditing functions. With these responsibilities in mind, the Advisory Roundtable has established important goals to accomplish in the next two years. The Advisory Roundtable's future goals are addressed in the next section of this report.

Section 4: Future Goals of the Advisory Roundtable

Goals that the Advisory Roundtable seeks to accomplish during the next two years include:

- *Continue efforts to promote best practices for employees with accounting, auditing, financial reporting, or tax filing duties and encourage the implementation of additional financial controls similar to the key provisions of the Sarbanes-Oxley Act of 2002*

The Advisory Roundtable plans to finalize the Code of Conduct policy for employees with accounting, auditing, financial reporting, or tax filing duties. Training materials will be developed and training will be provided to educate the state of Minnesota leadership and agency staff on the requirements and implementation of the Code of Conduct. This will aid state government leadership and agency staff in fulfilling their responsibilities as listed in the Code.

The Advisory Roundtable plans to continue monitoring the direction and potential future mandates of internal auditing as they relate to state government. Recommendations for best practices in state government will be developed, which includes the possibility of implementing other provisions of the Sarbanes-Oxley Act of 2002. The provisions include certifying financial statement information, assessing internal controls, conducting pre-employment background checks, and establishing whistle-blower procedures.

- *Establish professional standards for Minnesota internal auditors*

The Advisory Roundtable will continue its in-depth review of the IIA Professional Practices Framework and other auditing standards including nature of internal auditing work, communicating results, and implementing quality assurance and improvement programs. The Advisory Roundtable intends to determine the applicability of existing internal auditing standards to services that state agency internal auditing functions provide and to make recommendations to the commissioner of Finance.

Members of the Advisory Roundtable will continue to share best practices for ensuring compliance with the standards in the most efficient and effective manner.

- *Continue to promote improvement of the internal audit function within Minnesota state government*

The Advisory Roundtable plans to finalize and distribute the information resource packets for establishing an internal audit function to management and newly-hired internal audit directors.

The Advisory Roundtable will mentor new state of Minnesota internal auditors on following internal auditing standards and practices. In addition, guidance will be provided to help the employees fulfill their responsibilities and add value to their employing agencies.

The Advisory Roundtable will also offer support and guidance to established internal audit functions in state agencies that have selected "self-assessment with independent validation" as their preferred approach to having an external quality assurance review by January 1, 2007, to fulfill IIA standards requirements.

- ***Provide advice on statewide policies when requested***

The Advisory Roundtable welcomes any opportunity to review proposed statewide policies, new or revised, developed by the departments of Finance, Administration, or Employee Relations, that have implications for internal controls and business risks. Advisory Roundtable members are able to review policies and procedures while objectively determining whether the policies and procedures can be implemented in the daily work environment. In addition, the Advisory Roundtable will ensure that significant risks are addressed with key controls and offer constructive criticism to enhance a user's understanding of the policy.

- ***Collaborate on training and sharing knowledge***

The Advisory Roundtable will continue to look for and offer opportunities to share resources and knowledge among its members. In addition to formal training events, Advisory Roundtable members will provide professional assistance and information to each other, as well as to other professional internal auditors in state agencies.