**MANAGEMENT
AND BUDGET**

Biennial Report:
System of Internal Controls
And Internal Auditing
In Executive Agencies

January 2017

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Introduction

The Minnesota Management and Budget (MMB) Internal Control and Accountability Unit (the unit) is pleased to present this report on the State of Minnesota's system of internal controls and internal auditing for 2015 and 2016. M.S. Section 16A.057 created the unit in 2009. Since that time, agencies have shifted from haphazard control systems to full ownership of internal controls by agency leadership, management and employees at all levels. Under MMB's leadership, the state's internal auditors, internal control professionals, and agency management have significantly improved the state's internal control systems. In summary:

- The number of internal auditors and internal control professionals continues to increase among cabinet-level agencies (increased from 37 in 2009 to 51 in 2016)
- 100% of executive agencies completed their annual internal control certifications
- The number of audit findings per report has decreased from 2010 to 2016
- A majority of audit findings were fully resolved within the last two years
- The unit continues to provide leadership, training, and assistance to agencies on internal controls

Internal Control and Accountability Unit Mission

By law, the MMB commissioner is responsible for designing, implementing, and maintaining effective internal controls and internal auditing in the state executive branch. The mission of the MMB Internal Control and Accountability Unit is to improve internal controls in executive branch agencies. Our enabling legislation gives us the following statutory responsibilities:
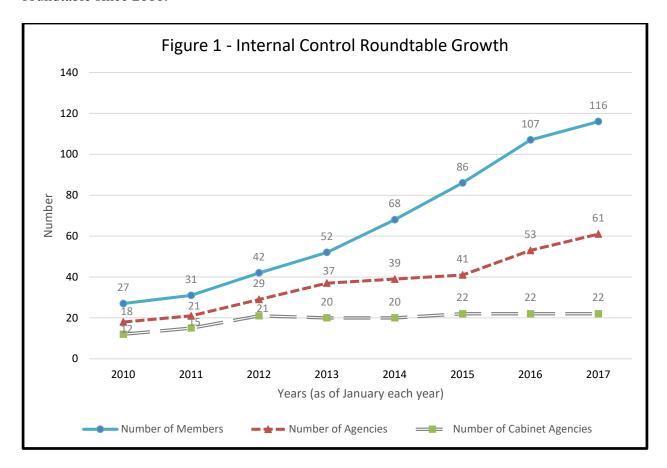
- Adopt statewide internal control standards and policies
- Coordinate executive branch agency internal control training and assistance
- Promote and coordinate the sharing of internal audit resources
- Monitor Office of the Legislative Auditor (OLA) reports and corrective action plans
- Report biennially on the system of internal controls and internal auditing in executive branch agencies
- Prescribe and coordinate the annual executive agency head internal control certification process

Strategy 1: Skilled and Engaged Internal Control Professionals

The state's internal auditors and internal control professionals promote strong internal controls throughout the state. Some agencies have internal audit departments that focus on assurance and compliance testing. Other agencies have "internal control specialists" who do not perform traditional audit work, but work on behalf of management to facilitate risk assessments, train staff, draft policies and provide management consulting.

The executive branch's internal audit and internal control professionals work within individual state agencies. This decentralized structure is appropriate. It allows audit and internal control professionals to focus attention and expertise solely on one state agency. These professionals are familiar with their organization's unique businesses, objectives, operating culture, and personnel.

To coordinate and support state agency internal control and internal audit efforts, the unit facilitates a statewide Internal Control Roundtable. The roundtable has members from cabinet and non-cabinet executive agencies, Minnesota State Colleges and Universities, three retirement systems, the State Board of Investment, the Attorney General's Office, and the state courts system. The roundtable is made up of internal auditors, internal control specialists, chief financial officers, executive directors and agency managers, and others dedicated to improving internal controls within their agencies. The group meets every six weeks to discuss internal control and internal audit issues, network, receive and provide training, and share ideas and promote best practices. The roundtable is a vibrant group of dedicated employees committed to continually improving their respective state agencies. Figure 1 charts the growth of the roundtable since 2010.

Figure 1 - Internal Control Roundtable Growth

Strategy 2: Continuous Improvement through Annual Certification

Our enabling legislation requires all executive branch agency heads to sign annual internal control structure certifications. The certifications remind agency heads they are responsible for their agency's internal controls. It also provides yearly opportunities to reassess and continually improve the agency's internal control system. To prepare for annual certification, members of the unit meet with representatives of each executive agency. The goal is to better understand each agency's control system maturity and offer help. In each of the past four years, 100% of executive branch agency heads submitted the required internal control certification.

The state of Minnesota follows the U.S. Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government*, also known as the *Green Book*, as the state internal control standard. The *Green Book* is an overall framework for establishing and maintaining effective internal control systems in government. The standards in the *Green Book* are organized around five interrelated components: control environment, risk assessment, control activities, information and communication, and monitoring.

Control Environment Self-Assessments

One component of the annual internal control structure certification is control environment. The *Green Book* identifies control environment as the foundation that "provides the discipline and structure to help an entity achieve its objectives."

To help executive agencies assess their own agency-wide control environment, the unit created a self-assessment tool. The control environment self-assessment tool leads agency executives to reflect on 20 organizational goals. They can comment on what the agency is doing well and highlight any action items for improvement. For each goal, the tool links related Minnesota statutes, laws, rules, and policies. This provides clear expectations from the state legislature and executive branch management. The tool shows how seemingly disparate state requirements in areas such as budget monitoring, data practices, human resources, and management style all work together to create a healthy and effective organization. For nearly all goals, both cabinet and non-cabinet level agencies reported improvement since 2014. Table 1 lists the 20 goals and the average ranking for cabinet and non-cabinet agencies for each goal for fiscal years 2016, 2015, and 2014.

Table 1 – Comparative Agency Control Environment Self-Assessment Results
 (Three-year averages based on a 3 point scale)
The ranking scale is as follows: 1.00 – Excellent, 2.00 – Adequate, 3.00 – Inadequate

Goal No.	Control Environment Goal Description	FY16 Cabinet[1]	FY15 Cabinet	FY14 Cabinet	FY 16 Non-Cabinet	FY 15 Non-Cabinet	FY 14 Non-Cabinet
1	The agency's positive culture promotes professional and ethical behavior. Employees know what kind of behavior is acceptable.	1.53	1.48	1.58	1.54	1.49	1.46
2	The agency maintains an environment free from violence, harassment, and discrimination.	1.64	NA[2]	NA[2]	1.49	NA[2]	NA[2]
3	Management has a sound basis for setting and monitoring budgets and does circumvent budget statutes, rules, and instructions.	1.40	1.52	1.61	1.21	1.34	1.30

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[1] Cabinet level agencies are those designated as *Departments of the State* in M.S. Section 15.01 and the following additional agencies: Housing Finance Agency, Iron Range Resources and Rehabilitation, Bureau of Mediation Services, MN.IT Services, Office of Higher Education, and Pollution Control Agency.

[2] Due to changes in Goal 2, prior year scores are not comparable to FY2016.

Goal No.	Control Environment Goal Description	FY16 Cabinet[1]	FY15 Cabinet	FY14 Cabinet	FY 16 Non-Cabinet	FY 15 Non-Cabinet	FY 14 Non-Cabinet
4	The agency provides the legislature and other oversight bodies with timely and accurate information to allow monitoring of agency activities.	1.35	1.55	1.57	1.29	1.35	1.30
5	Existing agency employees have a clear understanding of the organization's mission, goals, and objectives.	1.44	1.46	1.47	1.25	1.33	1.26
6	Employees understand how their job duties and responsibilities help to promote a strong internal control environment.	1.86	1.89	1.84	1.65	1.67	1.59
7	Management looks externally for opportunities to improve the internal control process.	1.66	1.61	1.57	1.48	1.59	1.62
8	The agency's organizational structure facilitates coordination and flow of information throughout the agency.	1.71	1.72	1.79	1.40	1.47	1.43
9	The agency is able to maintain its priority services during an event that might threaten to disrupt those services.	1.81	2.07	2.07	1.91	1.79	1.83
10	The agency delegates authority and assigns responsibility to the proper personnel to achieve the agency goals and objectives.	1.69	1.75	1.77	1.52	1.68	1.55
11	Management ensures that agency data is appropriately protected against loss, corruption, and misuse.	1.86	1.83	1.88	1.50	1.54	1.57
12	Valuable assets are appropriately safeguarded.	1.76	1.72	1.78	1.47	1.50	1.48
13	Agency facilities are protected against unauthorized physical access.	1.62	1.66	1.73	1.45	1.53	1.42
14	Agency management strives to recruit and retain a qualified and diverse workforce to carry out agency mission, goals, and objectives.	1.55	1.55	1.65	1.45	1.57	1.52
15	New hires have the appropriate level of knowledge and skills needed to satisfactorily perform their jobs.	1.40	1.47	1.54	1.35	1.42	1.36
16	The agency maintains diverse and inclusive programs and working environment.	1.50	NA[3]	NA[3]	1.23	NA[3]	NA[3]
17	The agency continually seeks to improve, maintain, and support new and existing employee knowledge and skills.	1.81	1.84	1.86	1.61	1.66	1.66
18	Management values opportunities to improve internal controls and correct deficiencies.	1.66	1.70	1.80	1.61	1.65	1.61
19	Management performs top-level reviews of actual performance.	1.74	1.73	1.76	1.62	1.70	1.61
20	The agency actively engages with the legislature, oversight committees and/or oversight boards.	1.33	1.46	1.54	1.27	1.37	1.34

[3] Due to changes in Goal 16, prior year scores are not comparable to FY2016.

Risk Assessment Plans

Having established an effective control environment, management must also assess the risks facing the entity. As a result, agencies meeting specific size and risk level criteria must submit annual risk assessment plans. The *Green Book* defines risk assessment as assessing "the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses."
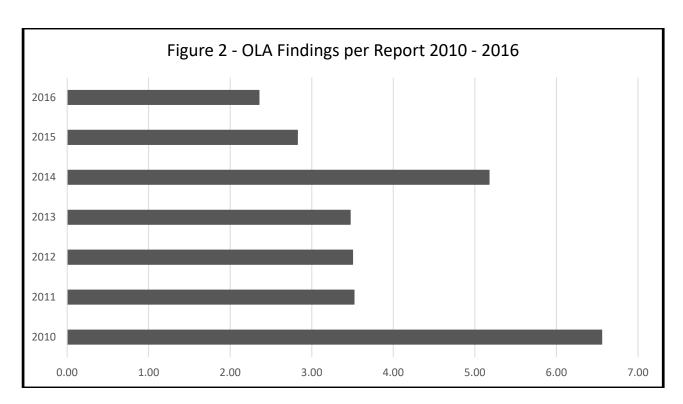
Agencies must perform and document formal risk assessments on all high profile, key risk business processes and mitigate identified control weaknesses and gaps. Agency risk assessment plans identify the specific business process risk assessments the agency plans to do in the next year. Agencies may document their risk assessment plans in a format of their own choosing. The number and type of business processes identified in the individual agency risk assessment plans are based on the agency's own qualitative and quantitative analysis of the highest risk processes within the agency. Due to the varied agency size and diversity of business processes, agency risk assessment plans differ greatly in format and function, and can include both programmatic and functional areas.
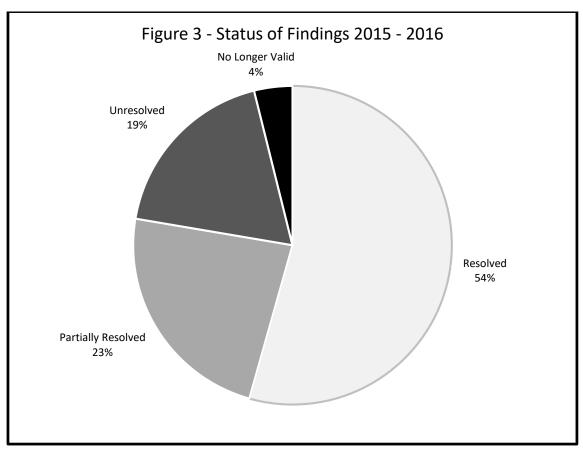
The risk assessment process is powerful because it allows individual employees and work units to become more accountable for their own risks and controls. In a typical risk assessment, staff from all levels and applicable functions analyze the process and decide how much control is enough. Risk assessment allows for continuous improvement of agency processes and procedures. Internal Control and Accountability Unit staff facilitates agency risk assessments when requested.

Strategy 3: Monitor Audit Reports

Our enabling legislation requires the unit to "review audit reports from the Office of the Legislative Auditor (OLA) and take appropriate steps to address internal control problems found in executive agencies." We work extensively with agencies to promote prompt resolution of all OLA findings. We also attend exit conferences held between the OLA and agency management. This allows the unit to be informed when consulting with agency management and to assist them in understanding and resolving audit issues. Figure 2 shows the number of findings we have tracked per report since 2010.

Timely resolution of audit findings is a crucial component of a strong internal control system. Unresolved audit findings represent weaknesses that can lead to serious problems, such as unmet objectives, fraud, waste or abuse, or noncompliance, resulting in fines or loss of funding. Quarterly, the unit generates reports of outstanding audit findings and requests status updates from each applicable agency. The quarterly update process reminds agencies of their responsibilities to review and resolve outstanding audit findings promptly. Figure 3 shows the current status of all OLA audit findings from 2015 and 2016 by status.

Figure 2 - OLA Findings per Report 2010 - 2016

Year	Findings per Report
2016	2.35
2015	2.80
2014	5.15
2013	3.45
2012	3.50
2011	3.55
2010	6.55

Figure 3 - Status of Findings 2015 - 2016

- No Longer Valid 4%
- Unresolved 19%
- Partially Resolved 23%
- Resolved 54%

Strategy 4: Provide Training and Assistance

Our enabling legislation requires the Internal Control and Accountability Unit to provide training and "internal control support" to agencies needing assistance. Since its beginning, the unit has worked to increase internal control awareness in the executive branch through publications, consultation, and outreach, including monthly internal controls bulletins. Team members routinely are asked to speak at training events, meet with agency employees, and participate in statewide oversight groups.

For the past three years, the unit, along with statewide representatives from the internal controls roundtable, have coordinated Fraud Awareness and Prevention Week activities throughout the executive branch. This November event is a part of a larger international fraud awareness effort sponsored by the Association of Certified Fraud Examiners (ACFE). The week's activities are intended to raise state employee awareness of the global fraud problem, including educating and training employees about fraud prevention, detection, and reporting techniques. Increasing fraud awareness throughout the state also helps the unit to fulfill its statutory responsibility to establish internal controls that "safeguard public funds and assets and minimize instances of fraud, waste, and abuse."

Internal Controls – By the Numbers

Internal Control and Accountability Unit staff = 5 full-time employees

Internal Controls Roundtable Meetings held 2015-2016 = 16 two-hour meetings

Internal Controls Roundtable Membership = 116 members, representing 61 state agencies, compared to 27 members, representing 18 agencies in 2010

Cabinet level agency internal audit and internal control professionals = 51 as of December 2016, compared to 37 as of January 2009

Requests to the unit for information and assistance 2015-2016 = 203

Number of OLA audits tracked/exit conferences attended 2015-2016 = 70

Executive agency head certifications received FY2016 = 78 (100% compliance)

OLA findings tracked since 2009 = 1,385 as of December 31, 2016

Agency risk assessment projects facilitated by unit staff from 2012 through 2016 = 15

State employees who completed the enterprise-wide code of conduct training 2015-2016 = 2,660

2016 Fraud Awareness and Prevention Week posters distributed statewide = 650

Agencies represented at the Fraud Awareness and Prevention Week Coordinators Meeting on August 31, 2016 = 31

Number of views of the MMB created fraud awareness video = 637 as of January 1, 2017

Attendees at "Understanding the Mind of a Fraudster," training sponsored by the unit on November 3, 2016 = 61

Number page views of the unit's www.mn.gov/nofraud/ website during 2016 Fraud Awareness and Prevention Week (November 13-19, 2016) = 2,367

Number of subscribers to the monthly internal controls bulletins = 1,384 as of December 2016

For more information on any of the topics presented in this report, please visit the internal control website (http://www.mn.gov/mmb/internalcontrol/).