



Agency Policies and Procedures

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Internal Auditing

Policy Objectives:

This policy is designed to:

- Define Admin’s internal audit function and criteria for successful audits,
- Describe the roles and responsibilities of *all* Admin staff relative to agency internal audits, and
- Provide guidance on sound business practices for outsourcing internal audit work.

Background Information:

Internal auditing is an independent, objective (unbiased) assurance and consulting activity designed to add value and improve an organization’s operations.

Internal auditors can be of great value to a state agency in many ways. In particular, they can help an agency accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of internal controls, to assess whether business risks are managed appropriately, and to help improve the overall control environment of an organization. In this capacity, internal auditors themselves function as an essential component of an organization’s internal control structure.

For purposes of this policy, the internal auditor is any audit professional who works directly for management and whose primary responsibility is helping management to fulfill its duties as effectively and efficiently as possible. Today the internal auditing profession covers a wide range of activities extending beyond evaluations of accounting functions. The profession is involved in activities including:

- Reviewing accounting systems,
- Reviewing information technology environments,
- Assessing compliance with policies and procedures, best practices, and pertinent laws, rules, and regulations,
- Conducting performance audits,
- Advising on the design of new systems or changes to existing ones, and
- Participating in special investigations and studies.

Authority:

- **Minnesota Statutes**

[M.S. § 3.972, subd. 3 Audit Contracts](#) – This statute requires each state agency, including Admin, to have the Office of the Legislative Auditor (OLA) review a proposed contract for a public accountant to perform an audit, prior to initiating a negotiation of contract terms for the desired services.

<https://www.revisor.leg.state.mn.us/statutes/?id=3.972>

[M.S. § 13.392 Internal Auditing Data](#) – This statute classifies internal auditing data, notes, and preliminary drafts of reports as protected, nonpublic data until the final report is published, or an audit or investigation is no longer actively pursued. This statute also classifies data on an individual as private, if the auditor provided assurances to the individual that the individual's identity would remain private, in order to obtain the data. (<https://www.revisor.leg.state.mn.us/statutes/?id=13.392>)

[M.S. § 16A.055, subd. 1\(7\) Some of the Commissioner's Duties](#) – This statute requires Admin's commissioner to coordinate efforts with the Department of Finance's commissioner to report to the legislature biennially on progress made developing and maintaining standards for internal auditing in state agencies. (<https://www.revisor.leg.state.mn.us/statutes/?id=16A.055>)

[M.S. § 16C.05, subd. 5 Contract Management; Validity and Review](#) – This statute requires that most contracts for goods or services contain an audit clause. The audit clause gives authority to the contracting agency, the legislative auditor or the state auditor to examine a vendor's books, records, documents and procedures relevant to the contract or business transaction. (<https://www.revisor.leg.state.mn.us/statutes/?id=16C.05>)

- [Government Finance Officers Association \(GFOA\) Recommended Practice](#) – In 1997, the GFOA recommended the establishment of an internal audit function for all state and local governmental units. Specifically, the GFOA recognized the internal audit function as an important role in helping management maintain a comprehensive framework of internal controls. The GFOA recommended that a formal charter or resolution establish the internal audit function. (https://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)
- **Admin's Internal Audit Charter** – Admin's internal audit charter establishes the internal audit function in the agency. The charter clarifies the internal audit unit's purpose, audit scope, responsibilities, and authority to act. It can also establish an audit committee and specify its responsibilities and authority to act. It also contains the approvals of the agency internal auditor, the financial management director and the commissioner.

Business Risks:

- An adequate internal control is diminished without an internal audit function to monitor the design and proper functioning of control activities, especially those involving a high degree of business risk.
- Without the internal audit function, management has no one to turn to for consultant support, technical expertise on financial or compliance matters, and an objective assessment of policies and procedures to meet business objectives in an efficient and effective manner.

Policies and Procedures:

PART ONE: THE INTERNAL AUDIT FUNCTION

1. [Accountability](#) - In the absence of an agency audit committee, Admin's internal auditor is accountable to the financial management director for delivery of internal audit services. To demonstrate accountability, the internal auditor must:
 - A. Submit a risk-based annual audit plan to the financial management director for approval,
 - B. Receive the financial management director's prior authorization before deviating from the approved audit plan to perform other higher-priority work, and
 - C. Communicate audit progress and accomplishments periodically.
2. [Audit Scope and the Internal Auditor's Independence and Authority to Act](#)
 - A. All Admin divisions, work units, and business activities are subject to internal audits.
 - B. Admin's internal auditor is authorized to have full, free, and unrestricted access to *all* Admin employees, activities, records, files, property and other information required for audit.
 - C. Internal audit shall not have operational authority over any organizational unit within Admin. The internal auditor must remain independent of the activities he/she audits, and carry out one's work freely and objectively.

3. Internal Audit Services Offered - Internal audit services include, but are not limited to, the following as defined in the internal audit charter:
 - A. Financial audits – reviewing the reliability and integrity of financial information, and determining if assets are properly safeguarded,
 - B. Compliance audits – reviewing business processes to ensure compliance with pertinent laws, rules, regulations, and internal policies and procedures,
 - C. Performance audits – reviewing operations to determine whether results are consistent with established goals and objectives,
 - D. Special investigations – gathering evidence to support or to refute allegations of financial mismanagement or employee misconduct,
 - E. Consultant support – providing technical expertise on complex financial transactions and other matters, and
 - F. Follow-up audits – determining whether staff fully and satisfactorily implemented prior audit recommendations. Typically, the internal auditor will assess the extent of corrective action taken and report the results to management within six months after issuance of the final internal audit report.

4. Planning
 - A. Internal audits are performed according to a risk-based annual audit plan consistent with professional standards of internal auditing.
 - B. Internal audits may also be initiated at management’s request, subject to the availability of internal audit resources and priority within a risk-based annual audit plan.
 - C. The internal auditor will monitor compliance with audit plans on an ongoing basis.
 1. The internal auditor will track budgeted versus actual hours worked on each audit engagement and report audit status periodically to the financial management director and/or audit committee.
 2. The internal auditor will track completed versus planned audit engagements and report progress periodically to the financial management director and/or audit committee.

5. Internal Audit Process
 - A. Most internal financial, compliance, or performance audits performed will consist of three phases: planning and survey phase, fieldwork, and the reporting phase.
 - B. Internal audits will be conducted according to the *Standards for the Professional Practice of Internal Auditing* (commonly referred to as the red book) promulgated by the Institute of Internal Auditors.
 - C. Admin’s internal audit will incorporate the concept of internal controls embodied in the Treadway Commission’s Committee of Sponsoring Organizations (COSO) report, *Internal Control – Integrated Framework*.
 - D. The audit process should be structured to keep management informed of the audit progress and any potential findings and recommendations. The internal auditor must recognize that ongoing communications are essential to a successful engagement.
 1. An entrance conference will be held to discuss the internal audit objectives, scope, procedures, time frame and management’s concerns.
 2. As a professional courtesy, the internal auditor will inform management when planning to meet with his/her staff to discuss an audit matter or to obtain audit evidence.
 3. The internal auditor will inform a division manager of any significant findings that require immediate corrective action.
 4. Findings and recommendations will be reviewed at an exit conference with the division manager after completion of the fieldwork. The internal auditor will exercise professional judgment when deciding what issues to bring to the division manager’s attention. Materiality and other factors will be considered in this process.
 5. A draft written report will be issued to the division manager. The draft report should present the purpose, scope, and results of the audit, including any findings and recommendations for improvement.

- the internal audit report should contain an expression of the internal auditor's opinion, where appropriate. Only significant matters should be reported.
6. Draft reports will be issued within 30 days of fieldwork completion.
 7. The division manager must respond within 14 days of issuing the draft report.
 8. Final reports, containing the division manager's response to the findings and recommendations, will be issued within 10 days following the receipt of the division manager's written response.
 9. At a minimum, the internal auditor will distribute the final internal audit report to the division manager involved in the audit, executive management to whom the division manager reports, and the audit committee.

PART TWO: RESPONSIBILITIES OF ALL ADMIN EMPLOYEES RELATIVE TO AGENCY INTERNAL AUDITS

1. Responsibilities of Admin's Internal Auditor

- A. Develop an annual audit plan using risk assessment techniques,
- B. Inform division management of significant results of an internal audit,
- C. Perform audits in a competent and timely manner, in accordance with professional standards,
- D. Report findings and recommendations fully, objectively, and in a timely manner,
- E. Where possible, coordinate audit efforts with external auditors to prevent duplication of audit efforts and to promote efficient use of audit resources (refer to Admin policy and procedure FMR-1C-01, *External Auditing*, for specific responsibilities of the internal auditor when sharing relevant audit evidence with external auditors and helping external auditors perform portions of a financial audit or gather evidence in an investigation.),
- F. Educate Admin employees on internal control concepts, and
- G. Network with other state agency internal auditors on an ongoing basis and biennially, coordinate efforts with the Department of Minnesota Management and Budget's Internal Control unit staff to report on progress made towards developing and maintaining standards for internal auditing.

2. Responsibilities of All Admin Employees Relative to Agency Internal Audits

- A. Ensure full cooperation with the internal auditor during internal audits, and
- B. Take an active role in implementing corrective actions.

3. Commissioner Responsibilities

- A. Approve the audit charter establishing the internal audit function and authorizing the internal auditor's scope, responsibilities, organization status, and authority to act, and
- B. Ensure that division management takes corrective actions in a timely manner.

4. Financial Management Director Responsibilities

- A. Exercise administrative authority over the internal audit function (i.e. hire competent personnel for the internal auditor position),
- B. Work with Admin's internal auditor to identify all potential audit activities and to assess business risks,
- C. Approve the annual audit plan, in the absence of an agency audit committee,
- D. Approve any deviation from the annual audit plan for the internal auditor to focus audit efforts on higher-priority concerns,
- E. Provide consultation and support, as necessary, to the internal auditor during the audit process,
- F. Meet regularly with the internal auditor to discuss the status of internal audit engagements and significant results of all audits, and
- G. Review a draft internal audit report prior to its release to a division manager.

5. Manager or Division Manager Responsibilities

- A. Maintain an adequate internal control structure,
- B. Take appropriate action to ensure that all employees understand and comply with all pertinent laws, policies and procedures,
- C. Respond to an internal audit report within 14 days, and
- D. Take timely appropriate corrective action, when necessary, to address each audit finding and recommendation.

PART THREE: OUTSOURCING INTERNAL AUDIT ACTIVITIES

1. Outsourcing Internal Audit Work is Permitted - Admin's internal auditor may partner with a division manager to engage an independent public accounting firm or other outside professional to perform work traditionally done by Admin's internal auditor. Such arrangements are permissible only if the following conditions exist:

- A. Admin's internal audit resources are fully utilized or Admin's internal auditor lacks technical expertise in a specific audit area, *and*
- B. The division requesting internal audit services has sufficient financial resources to engage an outsourcing vendor, *and*
- C. It is deemed a high-risk area that requires immediate attention.

2. Contract Management - It is essential that any arrangements with an outsourcing vendor be properly structured, carefully conducted, and prudently managed.

- A. The internal auditor should partner with division management to develop a request for proposal for contracted internal audit work.
- B. The internal auditor should also be involved in evaluating proposals or bids received, and selecting a contractor.
- C. The written contract for outsourcing internal audit activities should, at a minimum:
 - 1. Specify the objectives and the scope of the internal audit work the outsourcing vendor must perform,
 - 2. Indicate the time frame (start and end dates) for performing the audit work,
 - 3. Specify the names and qualifications of the principal audit manager and staff assigned to perform the audit work, and the compensation terms for their services and reimbursable expenses,
 - 4. Identify the internal auditor as the principal contact in Admin,
 - 5. Detail the manner and frequency for the outsourcing vendor to report project status and any findings to Admin's internal auditor and division management,
 - 6. Establish the protocol for changing the terms of the service contract, especially for the expansion of audit work if significant audit issues are found,
 - 7. State that Admin is the owner of all workpapers, notes, and reports that the outsourcing vendor produces relative to the audit engagement,
 - 8. State that Admin is granted immediate and full access to the internal audit reports and related workpapers that the outsourcing vendor prepared with respect to the audit engagement,
 - 9. Prescribe the method for determining who bears the cost of consequential damages that may arise from audit errors, omissions, or negligence,
 - 10. Require that the outsourcing vendor maintain its independence throughout the engagement and prohibit the outsourcing vendor from performing management functions (i.e. make decisions) or act, or appear to act, in the capacity equivalent to an Admin employee,
 - 11. Set forth a mutually agreed-upon contingency plan in the event the outsourcing arrangement is suddenly terminated, by either party, to ensure the continuity of audit coverage, especially in high risk areas, and
 - 12. Incorporate all other necessary provisions found in a standard agency professional/technical contract document.

- D. All proposed written contracts for outsourcing internal audit services need the Office of the Legislative Auditor's review and approval prior to the initiating any contract negotiations.
 - E. Admin's internal auditor and division management, in partnership, will oversee the outsourcing vendor's work.
 - F. Before entering into any contractual agreement, Admin's internal auditor and the division manager requesting the desired services should take necessary precautions to satisfy themselves that the vendor has a sufficient number of qualified staff to perform the engagement. Admin's internal auditor should ensure that the outsourcing vendor maintains sufficient expertise to perform its contractual obligations effectively.
3. Communication of Audit Findings - All work that the outsourcing vendor performs should be well documented and all findings should be promptly reported to Admin's internal auditor and division management.

See Also:

FMR-1A-01, [Internal Control](#)
FMR-1C-01, [External Auditing](#)

Refer to the [Glossary](#) for definitions of the key terms listed below:

annual audit plan
assurance activity
audit charter
audit committee
audit findings
consulting activity

COSO Internal Control -
Integrated Framework
external auditing
external auditor
Government Finance Officers
Association (GFOA)
internal auditing

internal auditor
internal control structure
outsourcing
outsourcing vendor
performance audits
red book