2011 ANNUAL REPORT

OFFICE OF THE INTERNAL AUDITOR
City of Minneapolis

April 25, 2012

Minneapolis
City of Lakes

TABLE OF CONTENTS

2011 Audit Plan and Results

Client Satisfaction Survey Results

Office of Internal Audit Update

Other Updates

2011 AUDIT PLAN AND RESULTS

Project Status Update

The chart below details the status of each project included in the 2011 Audit Plan approved by the Audit Committee on Nov. 16, 2010. Out of 17 projects planned for 2011, 10 were completed, 4 are in progress and 3 were postponed. See project added to page 5.

No.	Review Name	Current Status	Comments
1	City of Minneapolis Computer Network Penetration	In-progress	Review will be reported April 25th.
2	Database Access	In-progress	Review will be reported April 25th .
3	School-Based Clinics Electronic Medical Record System Pre-Implementation*	In-progress	System implementation expected in August 2012; report expected shortly after implementation.
4	UNISYS Contract Review	In-progress	Review in progress and carried forward to 2012. Report is expected in May 2012.
5	AMPCO Contract Review	Complete	Report No. 2011-05
6	• Bank Account Reconciliations • Bank Account Access • Automated Clearinghouse Transactions	Complete	Report No. 2011-07
7	Cash Collection and Handling	Complete	Report No. 2011-08
8	Training Finance Department on Testing of Internal Controls	Complete	Report No. 2011-01
9	Quarterly Control Testing – Financial Reporting	Postponed	Review will be combined with Internal Controls over Financial Reporting slated for 2013 Audit Plan.
10	Internal Controls over Financial Reporting	Postponed	Review slated for 2013 Audit Plan.
11	Police Scheduling and Time Reporting	Complete	Report No. 2011-02
12	Timekeeping System Pre-Implementation	Complete	Report No. 2011-03
13	Procurement Processes	Complete	Report No. 2011-04

No.	Review Name	Current Status	Comments
14	Accounts Payable • Vendor Setup • Invoice/Purchase Order/Receiving Matching • Invoice Processing Segregation of Duties	Postponed	Review slated for 2012 Audit Plan.
15	Impound Lot - Contract Management, Cash Collections, and Physical Security	Complete	Report No. 2011-09
16	Water Revenue Capture	Complete	Report No. 2011-06
17	Grant Management Proccess	Complete	Report published March 28th.

*Review name, scope and objectives were changed and approved by the Audit Committee on the May 25, 2011 meeting.

Overview and Summary of Findings

The Office of Internal Audit issued nine internal audit reports in 2011. These reports can be found at on the Audit Committee website at
http://www.minneapolismn.gov/meetings/audit/index.htm?timeRange=2011&sResults=10.

In these audit reports, 72 recommendations were made to City departments to address risks that can be more effectively controlled. Of the 72 findings identified, 70 were not considered to be significant. While these 70 findings individually may not significantly impair City operations, they do present risks that can be more effectively controlled.

Based on the professional judgment developed by the Office of Internal Audit, two of the 72 findings identified in 2011 were categorized as "significant". Note that there was no criteria used to distinguish the level of significance of audit findings for any of the 2011 audit reports, so findings are not categorized as such in any of the reports published in 2011. However, the Internal Auditor developed criteria for findings that may be categorized as "significant" for use in the 2011 Annual Report based on one or more of the following criteria:

> "A key control was nonexistent or not effective, which may lead to significant operational, reputational, compliance, or legal exposure; fraud; significant negative impact on accomplishing one or more of the City's strategic goals; and a detrimental impact on operations or public perceptions."

The two findings ranked as significant by the Internal Auditor were:

• **Timekeeping System Pre-Implementation Review** (Report No. 2011-03)
   Accountability for Exempt Employees' Time
   Finding:
      There was no process in place to require exempt employees to enter time into their online timesheets and either self-approve it or require their supervisor to approve it. This process is necessary to ensure appropriate accountability for time reporting throughout the City.

Management Response:
>   The Time and Labor project management team incorporated controls into the Time and Labor application requiring each exempt employee below the Charter Department Head level to consistently enter time into their online timesheets. The time must then be self-approved and approved by a supervisor. This corrective action was taken before the system went live and the audit report issuance on May 25, 2011.

- **Bank Account Reconciliation, Bank Account Access and ACH Transaction Review** (Report No. 2011-07)

   Commercial Electronic Office (CEO) Transaction Limits and Authorization

   Finding:
   >   All authorized users of CEO (the portal used by Treasury management to monitor and manage Wells Fargo banking activities) have a high dollar wire transfer transaction limit, which represents unnecessary risks to the City.

   Management Response:
   >   Though management understands that certain wire transfer transaction limits may appear marginally high, the internal controls (described below) that are in place and used for these types of transactions significantly reduce the risk associated with these types of transactions. As a result, management does not concur that the City is subjecting itself to a level of unnecessary risk that is "significant." In addition, the CFO has worked with Treasury Division management, the City Coordinator and policy-makers to assess the transactional limits and staff authorizations for wire transfers, with a perspective of balancing transactional risk management and operational risk. The wire transfer transaction limits must be high enough to address the business needs of the City. As a result of this assessment, certain limits were reduced and some limits were raised.

   >   The risks associated with setting transaction limits at any level are mitigated by the other controls Treasury has established for these transactions. The controls in use are considered to be best practice or above best practice by the banking industry, the GFOA, and other private sector financial organizations like the AFP. These compensating controls include such things as: dual controls (the person approving the transaction in the CEO system is different from the person creating the transaction); multi-layer identification controls that prevent unauthorized use or hacking of the CEO system and system data; system generated notification of the wire transaction to persons outside of those who processed the transaction; segregation of duties; and daily reconciliation and review of wire transfer and ACH payment transactions by a person outside of Treasury. Management believes that controls such as these are the most important safeguards against fraud and inappropriate transfers, and serve as the key controls to mitigate risk no matter where transactional limits are set.

Internal Audit is required, according to Standard No. 2500.A1 of the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing, to monitor and follow-up on the status of any open items until properly addressed. The chart below details the status of management action plans for reviews issued in 2011 as of December 31, 2011.

Report Name	Total Recommendations	Complete	On Track
2011-01: Training Finance Department on Testing of Internal Controls Memo	0	0	0
2011-02: Police Scheduling and Time Reporting Review	9	7	2
2011-03: Timekeeping System Pre-Implementation Review [1]	8	8	-
2011-04: Procurement Process Review	6	3	3
2011-05: Ampco Contract Review [2]	14	11	3
2011-06: Water Revenue Capture Review [3]	13	3	10
2011-07: Bank Account Reconciliation, Bank Account Access and Automated Clearing House (ACH) Transactions Review	8	5*	3
2011-08: Cash Collection and Handling Review [4]	7	5	2
2011-09: Impound Lot Review [4]	7	3	4
Total (Percentage of Total)	72 (100%)	45 (63%)	27 (37%)

* Note that two of the five recommendations listed in the "Complete" column on this chart indicates that Management has responded that the controls in place are adequate to manage the associated risks and do not intend to take any further action.

---

[1] All action plans were completed on or before the expected completion dates.
[2] Four (4) of the 14 findings were discovered through audit work performed by Ampco's Internal Audit team.
[3] Nine (9) of the 13 recommendations were proposed by CDM, an outside consultant hired by Public Works.
[4] This review included security data that the Minnesota Data Practices Act legally classifies as not public. To protect City resources and comply with the Act, information related to these recommendations have been withheld from this chart.

2011 Budgeted Hours vs. Actual Hours

2011 Budgeted Hours	
Total Budgeted Hours	7,524
Total Budgeted Project Hours	5,041
% of Total Project Budget Hours	67%

2011 Actual Hours	
Total Actual Hours	7,603
Total Actual Project Hours	4,821
% Total Actual Project Hours	63%

Note: The 4% variance is due to time spent on additional administrative activities getting the Internal Audit Office operational in its first year.

CLIENT SATISFACTION SURVEY RESULTS

After each review, Internal Audit sends a client satisfaction survey to each key member of management involved in the audit process. In addition to asking for general feedback, the survey contains 10 statements regarding their experience with Internal Audit and asks the respondent to rank their agreement with the statement using a scale of zero to four with four being "strongly agree."

In total, 30 surveys were sent to key management staff who participated in one (or several) of the Internal Audits conducted in 2011. Of those, 14 responses were received, representing 7 of the 9 Internal Audits conducted in 2011.

Cumulatively, the survey respondents gave an average score of 3.48 out of four.

OFFICE OF INTERNAL AUDIT UPDATE

Staffing

The Office of Internal Audit currently has two full-time employees and two part-time interns. The internship program will continue throughout 2012, with two new interns to replace the current two interns who will depart in May 2012. These interns will work full-time during the summer months and part-time during the school year.

Below is a list of the full time Internal Audit employees, along with their professional certifications, number of years of experience in both business and internal auditing, and the number of hours of training attended.

- **Jacob L. Claeys, Senior Internal Auditor**
  - o Certified Government Auditing Professional (CGAP)
  - o Certified Internal Controls Auditor (CICA)

  Mr. Claeys has eight years of business experience, with more than seven of those years devoted to internal audit work in local government. He has attended 57.5 hours of continuing professional education training during 2011.

- **Magdy S. Mossaad, Director of Internal Audit**
  - o Master of Business Administration (MBA)
  - o Certified Internal Auditor (CIA)
  - o Certified Management Accountant (CMA)
  - o Certified Fraud Examiner (CFE)
  - o Certified Public Accountant (CPA)
  - o Certification in Control Self-Assessment (CCSA)

  Mr. Mossaad has 30 years of business experience, with 20 of those years working specifically in internal auditing. He has attended 50.5 hours of continuing professional education training during 2011.

The Office of Internal Audit's two current interns attend or have graduated from the University of Minnesota's Carlson School of Management.

- **Kelcie Brady, Undergraduate Student Intern**
  Ms. Brady graduated from the University of Minnesota Carlson School of Management in December 2011, with a dual degree in Accounting and International Business.

- **Lauren Heir, Undergraduate Student Intern**
  Ms. Heir will graduate from the University of Minnesota Carlson School of Management in May 2012, with a degree in Accounting.

2011 Internal Audit Office Highlights

- Introduced the Internal Audit function to City leaders and management.
- Completed 9 projects.
- Leveraged technology for enhanced efficiencies: AutoAudit – Audit management software system, ACL – Data mining software.
- Implemented an Internal Audit Department internship program and recruited two interns.
- Developed the Internal Audit Department Policies and Procedures manual (i.e. policies, procedures, templates, etc.), based upon professional guidance and government regulations.
- Continue to build business relationships with other audit functions and other local government entities.
- Performed a second annual City-wide risk assessment and developed a two-year audit plan – conducting more than 45 interviews with City leaders and management.

2011 Annual Budget

2011 Budget vs. Actual Expenses	
Total Internal Audit Budget	490,338
Total Actual Expenses	470,554
Variance	**(19,784)**

Note: The variance of approx. $20,000 is due to not fully utilizing the additional 700 hours budgeted for in the 2011 Audit Plan.

OTHER UPDATES

2011 Audit Committee Highlights

- Held 10 Regular and Special Audit Committee Meetings throughout 2011.
- Published nine audit reports in alignment with the 2011 audit plan.
- Promoted and participated in an Audit Committee Workshop to discuss and fine-tune the Audit Process within the City of Minneapolis.

2009 Quality Assessment Review Status Update

In 2009, an evaluation of the Minneapolis Internal Audit Department, as requested by the Minneapolis Board of Estimate and Taxation (The Board), was conducted. The Board requested that the Internal Audit Review Committee, a group of volunteers[5] knowledgeable in the audit profession, assess Minneapolis' Internal Audit function, determine what it does well, what it is lacking and where it meets or does not meet accepted industry standards for internal auditing. Based on that, the Committee was to make recommendations for the future of Internal Audit that would maximize its potential to provide a thorough, objective perspective to evaluating and improving the effectiveness of City Government in Minneapolis. The review concluded that Minneapolis Internal Audit does not comply with the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing. Below is a status update, as of Dec. 31, 2011, of the seven recommendations (three Matters for the Consideration of the Board and City Leadership and four Matters Specific to Internal Audit) made by the review team.

Matters for the Consideration of the Board and City Leadership

Recommendations:	Status/Interal Audit Action Plans:
1. Organizational Independence. The City should ensure that there is an audit committee with purview over internal audit to ensure its ongoing organizational independence.	Completed. An Audit Committee was created and has purview over the Internal Audit activity.
2. Organizational Independence. The Internal Auditor should have a dual reporting relationship to the Board or its successor (Audit Committee) for audits and to the City Coordinator for administrative matters.	Completed. The current organizational structure for the Internal Audit activity is at the ideal organizational reporting level to ensure independence. The Internal Audit Department reports functionally to the Audit Committee.

---

[5] The goup of volunteers consisted of: Katie Shea, Metropolitan Council; Al Willie, University of Minnesota; Cliff Hoffman, Deloitte and Touche; Matt Marsh, Deloitte and Touche; and James McQuillan, Deloitte and Touche

3. Reporting to Senior Management and the Board. The City should work to increase the staff of Internal Audit by at least two FTEs and possibly as many as four as soon as possible. This will ensure better audit coverage and allow City management to better identify and manage critical risks.	Partially Completed. As a result of 2012 budget constraints, the Internal Audit Department reduced its staff from two Senior Auditors and a Director (three FTEs) to one Senior Auditor and a Director (two FTEs) by eliminating a vacant Senior Auditor position.

Matters Specific to Internal Audit

Recommendations:	**Status/Interal Audit Action Plans:**
4. The Institute of Internal Auditors (The IIA) Code of Ethics. Minneapolis Internal Audit should adopt the IIA Code of Ethics and incorporate a reference to it in its Audit Charter.	Completed. The Internal Audit Department is committed to a world class quality internal audit function. Each of the Audit team members including the students interns have signed the IIA Code of Ethics; it will be signed on an annual basis. The Internal Audit Policies and Procedures Manual incorporates a reference to the IIA code of Ethics.
5. Audit Charter. The Internal Audit Charter should be revised to conform to IIA Standards and clearly define the desired role for the internal audit function in the future of the City.	Completed. A decision has been made to rely on the City Ordinance, as the Charter of the Internal Audit Department. The City Ordinance requires the office of internal audit to adhere to the International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors.
6. Audit Planning. Minneapolis Internal Audit should develop an annual risk assessment process that includes input from the Mayor, the City Coordinator, Senior Managers of City Departments and the City Council.	Completed. For 2011, Internal Audit jointly with KPMG developed a risk based three year audit plan that included input from the Mayor, the City Coordinator, Senior Managers of City Departments and the City Council. For 2012, Internal Audit developed a risk based two year audit plan. The process will be done annually and on an ongoing basis to update and maintain the audit plan.
7. Quality Assurance and Improvement Program. Minneapolis Internal Audit should develop a Quality Assurance Improvement Program that includes regular internal quality check elements, as well an external review within the next 2 or 3 years if the activity can be brought into conformance, and then every 5 years as required by the Standards.	Partially Completed. Internal Audit has developed regular internal quality control checklists within the audit process as a Quality Assurance Improvement Program. Internal Audit is planning to request the Audit Committee approve an external Quality Assessment to be performed within the fourth quarter of 2012, and every 5 years as required by the IIA Standards.