



cutting through complexity™

City of Minneapolis - Audit Committee Workshop

October 18, 2012

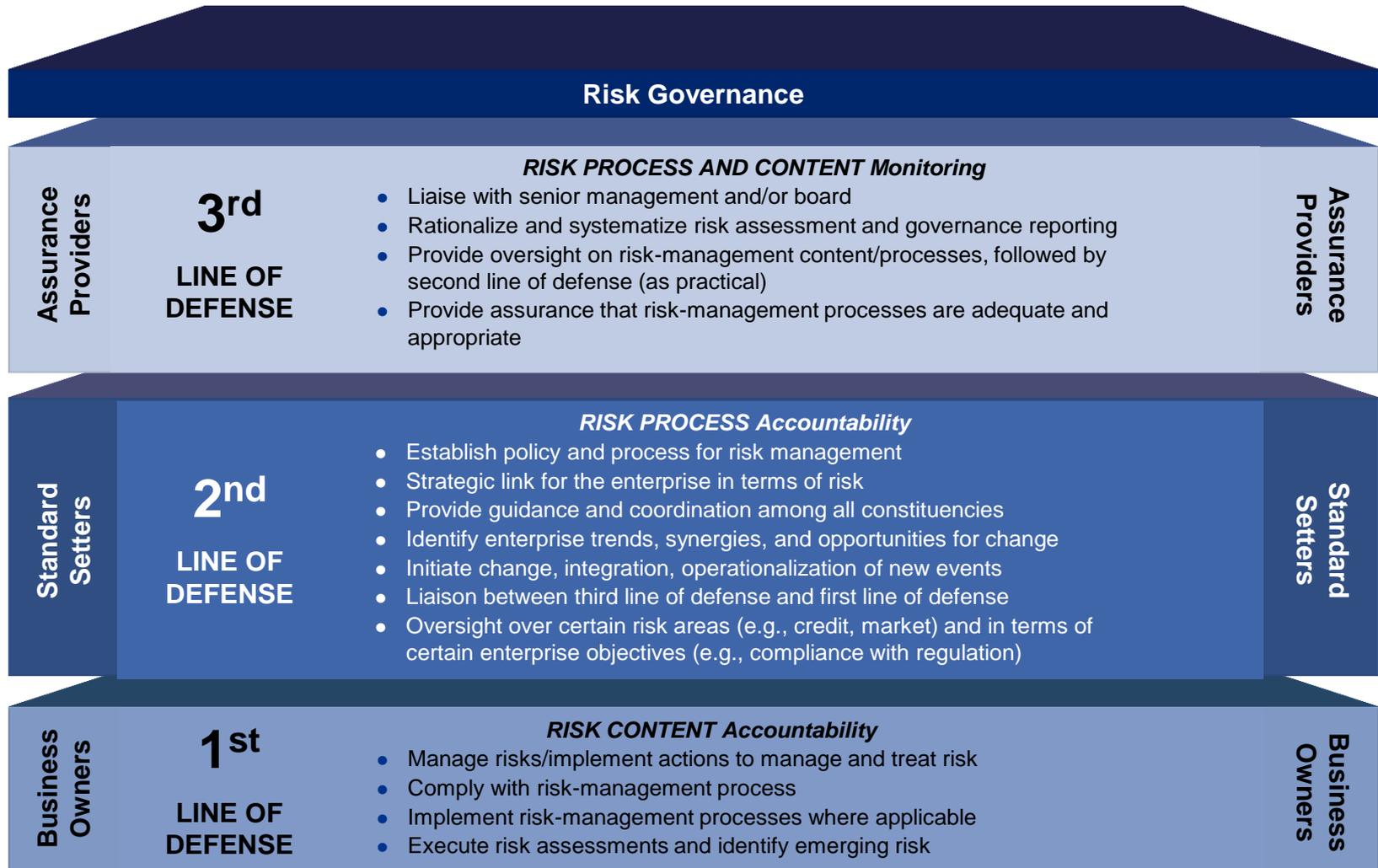
Agenda

- Confirm Agenda
- Governance
- Roles and Responsibilities of the Audit Committee
- Roles and Responsibilities of Internal Audit
- Reporting Structure
 - Administratively
 - Formally
 - Convergence

Governance

Risk Management Structure and Governance

Three Lines of Defense



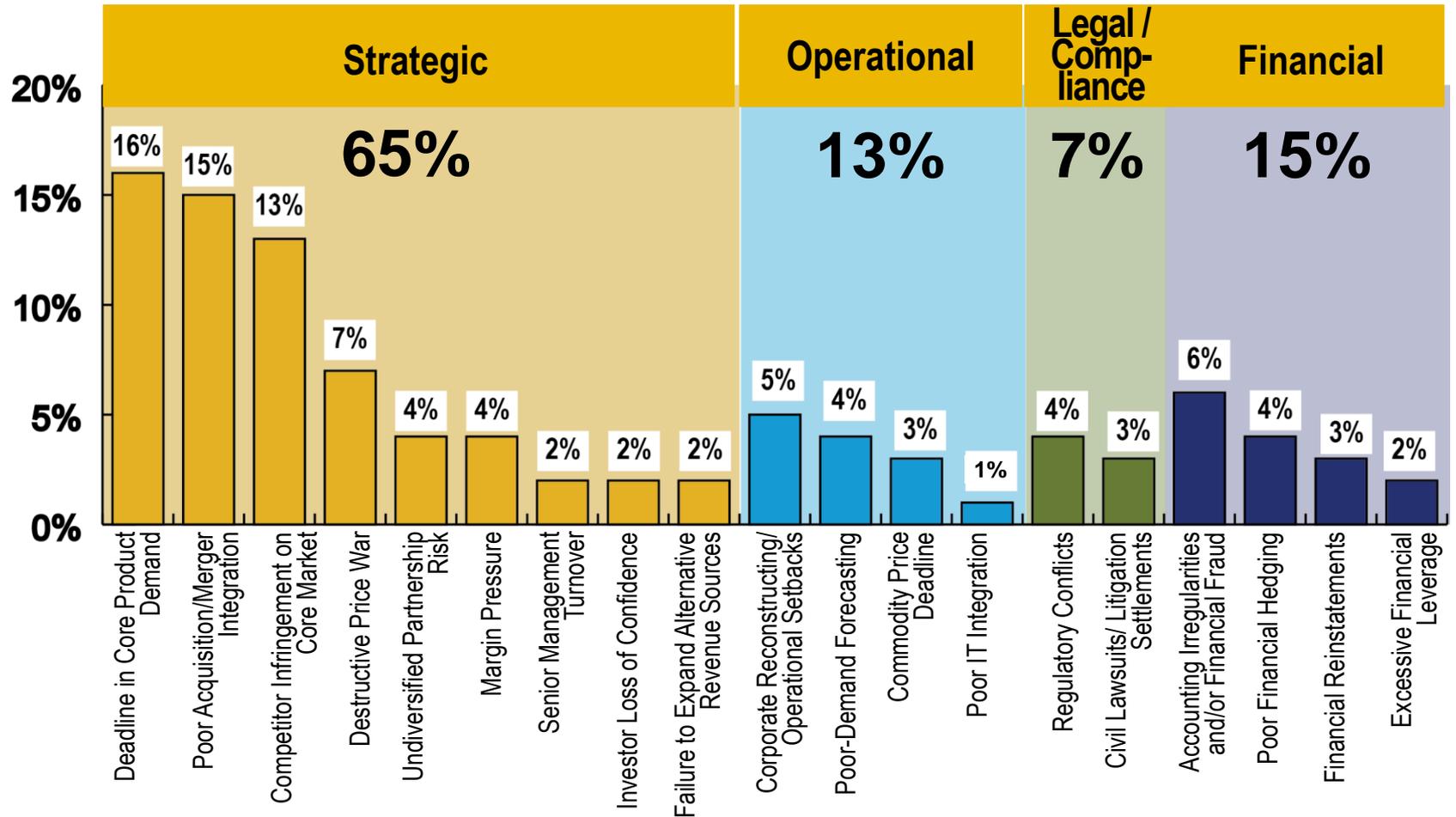
Sustainable Risk Management Framework



There is no single tool, committee, or process that can be applied to ensure effective governance

Strategic Risk Causes Greatest Decline in Market Capitalization

Market Capitalization Decline Drivers - Top 20% of Fortune 1,000 (1988 – 2005)



Source: Audit Director Roundtable research; Finance Leadership Academy research; CFO Executive Board research

Roles and Responsibilities of the Audit Committee

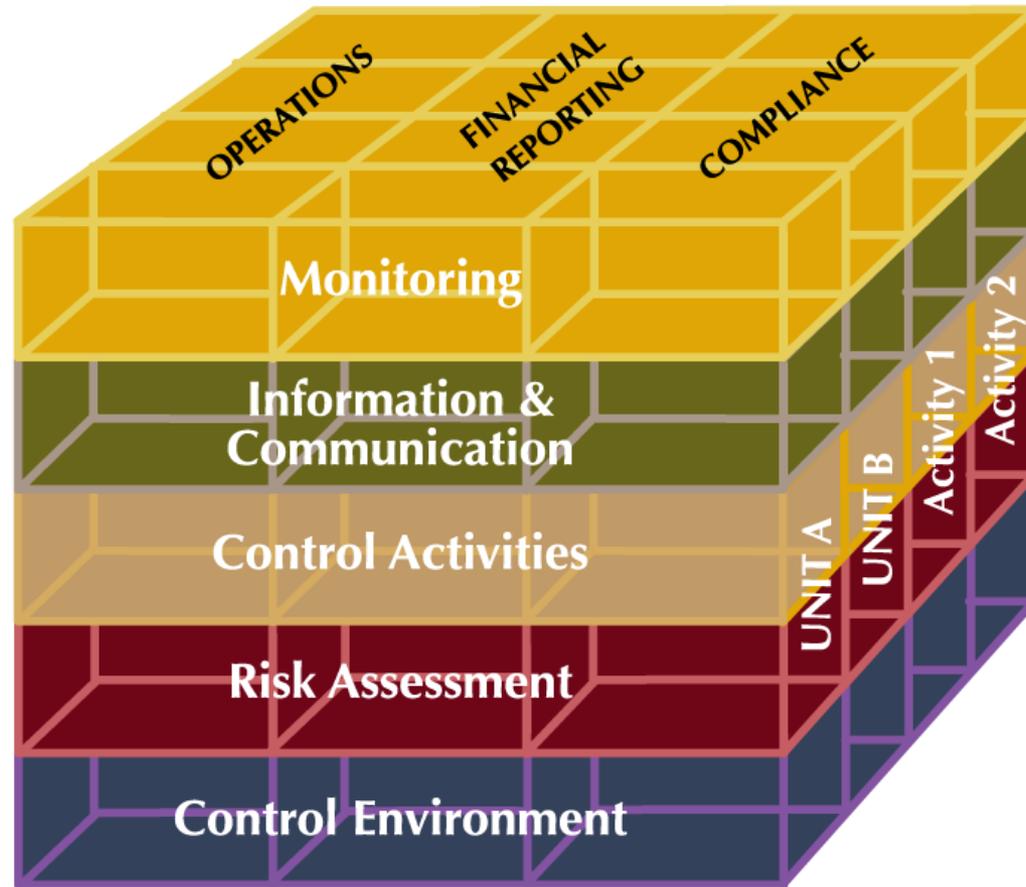
Roles / Responsibilities

- Who's responsible for the following risks?
 - Strategic
 - Operational
 - Compliance
 - Finance

- What are the roles and responsibilities of?
 - City Council
 - Audit Committee
 - Internal Audit
 - City Departments

Roles and Responsibilities – Minneapolis City Ordinance 17.90

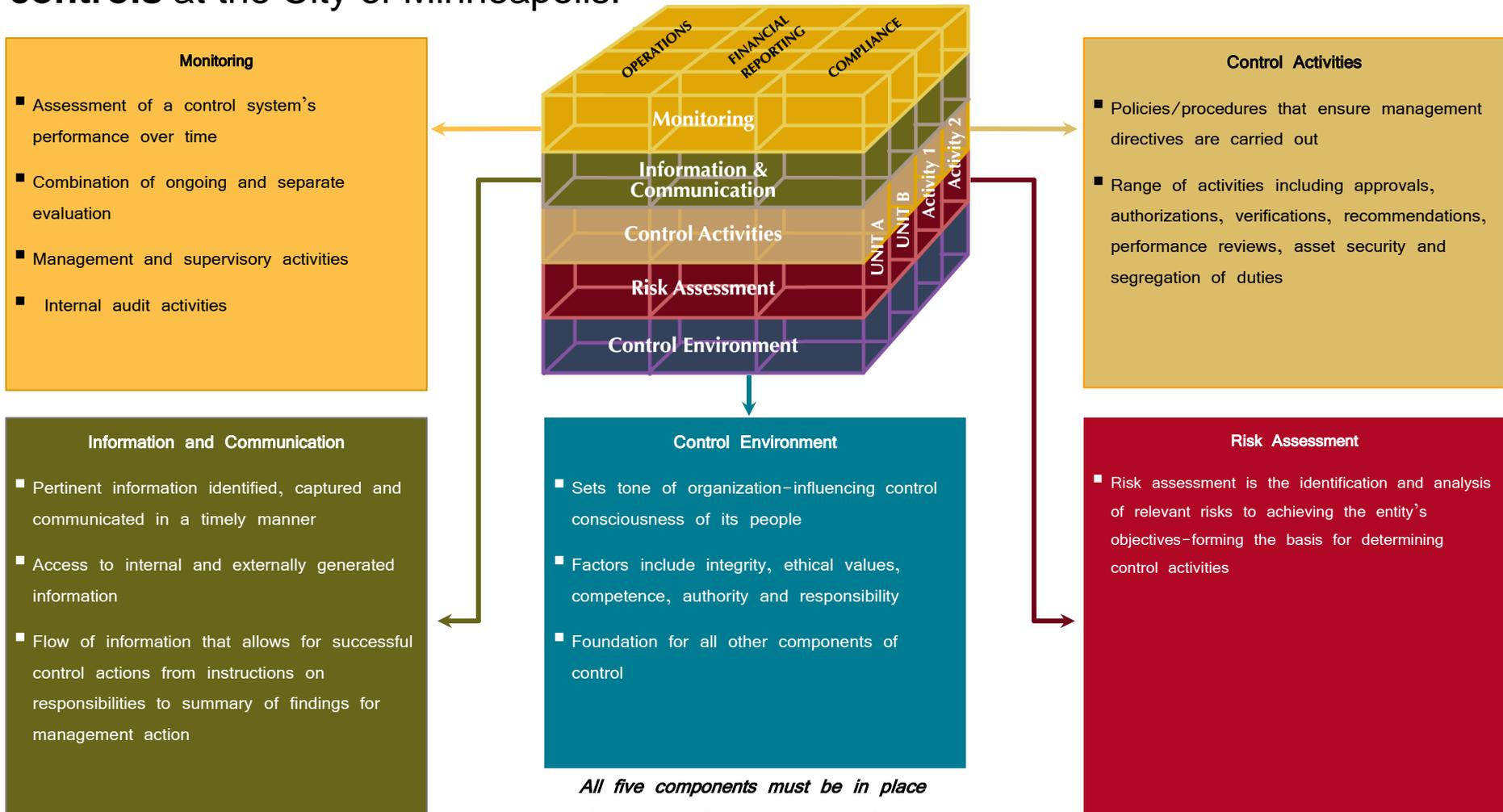
Audit Committee members have a scope of responsibility that includes **internal controls** at the City of Minneapolis:



Source: The Committee of Sponsoring Organizations of the Treadway Commission

Roles and Responsibilities – Minneapolis City Ordinance 17.90

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Source: The Committee of Sponsoring Organizations of the Treadway Commission

Roles and Responsibilities – Minneapolis City Ordinance 17.90

Minneapolis City Ordinance 17.90 defines the scope / fiduciary responsibility of the of the Audit Committee as:

“The audit committee shall be responsible for the **oversight** of the city’s internal audit function, financial reporting practices, internal controls, compliance with applicable law and regulation relating to financial controls and other related matters.”

Roles and Responsibilities – Minneapolis City Ordinance 17.90

Audit Committee members have a fiduciary responsibility to **exercise watchful and reasonable care** in supervising the city's:

- Internal audit function
- Financial reporting practices
- Internal controls
- Compliance with applicable law and regulation relating to financial controls, and
- Other related matters.

What stakeholders are relying on your oversight?

Roles and Responsibilities – Minneapolis City Ordinance 17.90

Audit Committee members have a scope of responsibility that includes **internal controls** at the City of Minneapolis:

COSO defines internal control as a process, effected by an entity's board of directors, management and other personnel. This process is designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

1. Internal control is a process. It is a means to an end, not an end in itself.
2. Internal control is not merely documented by policy manuals and forms. Rather, it is put in by people at every level of an organization.
3. Internal control can provide only reasonable assurance, not absolute assurance, to an entity's management and board.
4. Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.

Source: The Committee of Sponsoring Organizations of the Treadway Commission

Roles and Responsibilities – Minneapolis City Ordinance 17.90

Ordinance 17.90 further provides the duties of the Audit Committee as follows:

1. Appoint and remove the internal auditor;
2. Review and approve the internal auditor's annual audit plan;
3. Review the audit reports directed to it and make recommendations to the city council on the appropriate course of action on any such audit reports;
4. Monitor the internal auditor's results and follow-up activity; and
5. Review reports of the state auditor prepared for any of the city's departments, boards and commissions.

The Audit Committee relies on Internal Audit to independently validate that their oversight responsibilities are being met by management.

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Define Success for the Audit Committee

"A committee of the Board of Directors whose role typically focuses on aspects of financial reporting and on the entity's processes to manage business and financial risk, and for compliance with significant applicable legal, ethical, and regulatory requirements. The Audit Committee typically assists the Board with the oversight of (a) the integrity of the entity's financial statements, (b) the entity's compliance with legal and regulatory requirements, (c) the independent auditors' qualifications and independence, (d) the performance of the entity's internal audit function and that of the independent auditors and (e) compensation of company executives (in absence of a remuneration committee)."(Standard INTOSAI GOV #9100, "Internal Control Standards for the Public Sector", annex 2)

Source: ["INTOSAI definition"](#). INTOSAI definition.

Define Success for the Audit Committee

KPMG's Audit Committee Institute "Ten To-Do's for Audit Committees in 2012":

1. Stay focused on the audit committee's top priority: financial reporting and related internal control risk.
2. Continue to monitor accounting judgments and estimates, and prepare for accounting changes.
3. Consider whether financial statements and disclosures tell the company's story.
4. Focus on the company's plans to grow and innovate.
5. Reassess the company's vulnerability to business interruption, and its crisis readiness.
6. Understand how technology changes and innovation are transforming the business landscape – and impacting the company.
7. Focus on asymmetric information risk and seek out dissenting views.
8. Consider the impact of the regulatory environment on compliance programs and business plans.
9. Understand the company's significant tax risks and how they are being managed and modeled.
10. Monitor the PCAOB's initiatives on auditor independence and transparency, and consider the implications for the audit committee.

Source: KPMG Audit Committee Institute Spring 2012.

Roles and Responsibilities of Internal Audit

Roles and Responsibilities – Minneapolis City Ordinance 17.80, 17.110 & 17.120

Minneapolis City Ordinances 17.80, 17.110 and 17.120 details the office and duties of Internal Audit. The office of Internal Auditor was established to:

- Conduct financial, fiscal compliance, and financial procedure audits of all city departments, boards and commissions;
- Conduct audits of individual audit transactions, contracts and franchises of the city; and
- Audit the financial and accounting systems and procedures administered by the finance department and other city departments, boards and commissions.

Is the scope of internal audit's responsibilities consistent with your responsibility to oversee internal controls?

Roles and Responsibilities – Minneapolis City Ordinance 17.110

Minneapolis City Ordinance 17.110 details that the internal auditor is required to:

- “[i]mplement a comprehensive audit plan to review and evaluate the adequacy and effectiveness of the city’s internal system of financial controls. 17.110(a) (4) & (7)
- Such an audit plan is to be submitted annually for review and approval of the audit committee. 17.110(a) (5)

Minneapolis City Ordinance 17.120 (b) (a) states that:

- Programmatic audits may be requested by the major, city council, finance officer, city departments or boards and commissions but are subject to the approval of the Audit Committee.

Roles and Responsibilities – Minneapolis City Ordinance 17.80

Minneapolis City Ordinance 17.80 (c) details that the internal auditor is required to:

- The office of internal audit shall adhere to the International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors and such other standards as set by other bodies that apply to internal audit practices of local governments to conduct the auditor's work and be independent as defined by the standards.

Define Success for Internal Audit

The definition of internal audit as defined by the Institute of Internal Auditors is:

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.

Source: The Institute of Internal Auditors <http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing/>

Define Success for Internal Audit

Attributes of a successful internal audit department:

- **Independence** – no implementations, management decisions or ownership of the business. Independent validator of risk management policies and procedures.
- **Full Access / Support** – to business, attend meetings, request data and audit according to the Audit Committee approved audit plan.
- **Advisor** – partner with the business to help them address risks and control weaknesses. Allowed to make recommendations for implementation.
- **Business Acumen** – understanding the organization and its employees, processes and culture.
- **Communication** – good listeners, information translators, persuading presenters and accurate reporters.
- **Integrity / Courage** – non-negotiable professionalism to do the right thing.
- **Skills / Talent Development** – combination of seasoned and developing professionals benchmarking processes, procedures and capabilities.

Define Success for Internal Audit

The definition of independent as characterized by the Institute of Internal Auditors as having the following attributes:

- ❑ **Attitude.** The individual to whom the CAE reports administratively takes the independence of internal auditing very seriously, and never interposes his or her judgment in terms of internal audit coverage or results. The strongest message I would typically hear from such an individual is “internal auditing does not really work for me — it works for the audit committee.”
- ❑ **Stature.** The individual to whom the CAE reports administratively possesses sufficient authority to promote independence and appropriate action on engagement recommendations.
- ❑ **Perception.** The CEO and other executives within the company genuinely believe that internal auditing works for the audit committee.
- ❑ **The Charter.** The internal audit charter is very clear on the significance of the functional reporting relationship to the audit committee and includes specific audit committee responsibilities for internal auditing such as hiring, evaluating, and determining the compensation of the CAE.
- ❑ **Actions.** The actions of the audit committee reflect that it views internal auditing as reporting directly to it.

Source: The Institute of Internal Auditors

<http://www.theiia.org/blogs/chambers/index.cfm/post/Independence:%20What%20Does%20It%20Really%20Mean>

Reporting Structure

Reporting Structure

- Leading practices recommend the Internal Auditor report directly to the Audit Committee Chair with an administrative dotted line reporting relationship to the CEO. In practice, most Internal Auditors report directly to the CFO (trending downward) with other administrative reporting relationships considered, including to the Chief Risk Officer, Chief Legal Counsel, or Chief Operating Officer. The administrative reporting relationship is often dictated by the type of organization and its culture. Based on the City's structure, possible administrative reporting structures for Internal Audit might include:
 - City Coordinator
 - Mayor
 - City Clerk
- The structure should be based on effectively managing potential conflict of interest situations as well as a supporting sponsorship relationship to help the Internal Auditor get access to the information and people necessary to fulfill the responsibilities of the role. In essence, the Internal Auditor needs an administrative champion for the function.
- Another important aspect to consider is who coordinates other audit or “third line of defense” assurance processes? Leveraging the convergence of other assurance processes helps an organization avoid gaps in internal control coverage and leverage scope of work to promote efficiency.

Q&A / Next Steps

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation

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