O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Report on Internal Control Over Statewide Financial Reporting

Year Ended June 30, 2009

February 11, 2010 **Report 10-01**

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Members of the Legislative Audit Commission

Mr. Tom J. Hanson, Commissioner
Department of Management and Budget

In auditing the State of Minnesota's basic financial statements for the year ended June 30, 2009, we considered the state's internal controls over financial reporting. We also tested the state's compliance with significant legal provisions impacting the basic financial statements and did not identify any noncompliance to report.[1] This report contains our findings and recommendations on internal control over the state's financial reporting process taken as a whole. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the State of Minnesota's internal controls or compliance. In addition, our work may not have identified all significant control deficiencies or instances of noncompliance with legal requirements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The report contains five findings related to the preparation of the basic financial statements. We consider all of the deficiencies to be material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

Individual agency responses to our findings and recommendations are presented in the accompanying section of this report titled, *Agencies Responses.* We did not audit the responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the State of Minnesota's management, the Legislative Audit Commission, and federal grantor agencies; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 11, 2010.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: December 11, 2009
Report Signed On: February 8, 2010

[1] We separately report the results of our tests of compliance with federal programs.

Table of Contents

Report Summary

Conclusion

The state's financial statements were fairly stated in all material respects. However, the state continued to have weaknesses in internal control over financial reporting, as noted below.

The audit report contains five findings related to controls over the preparation of the state's financial statements. Three of the findings include prior audit findings that had not been fully resolved.[1]

Findings

- Prior Finding Partially Resolved: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements. (Finding 1, page 3)
- Prior Finding Partially Resolved: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls. (Finding 2, page 5)
- The Department of Management and Budget and other state agencies did not have adequate controls to prevent and detect errors in the financial information used to compile the financial statements. (Also includes one prior audit finding not resolved.) (Finding 3, page 7)
- The Department of Management and Budget did not always prepare accurate footnote disclosures to the financial statements. (Finding 4, page 10)
- Some agencies did not reconcile their subsystem data to the state's accounting system to ensure accurate financial information. (Finding 5, page 12)

Audit Scope

We audited the state's financial statements for the year ended June 30, 2009. Our audit encompassed work at many large state agencies that managed financial activities that were significant to these financial reports.

Background

The Department of Management and Budget is responsible for preparing the state's annual financial statements, which are included in the *State of Minnesota's Comprehensive Annual Financial Report*.

The issues contained in this report relate to internal controls in the state's financial reporting process as a whole.

[1] Office of the Legislative Auditor's Financial Audit Division Report 09-03, Report on Internal Control Over Statewide Financial Reporting, issued February 13, 2009.

Financial Statement Findings and Recommendations

Finding 1

Prior Finding Partially Resolved: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

The state did not have a comprehensive internal control structure for its financial reporting processes to ensure that it would prevent or detect and correct a material misstatement of the state's financial statements on a timely basis. A comprehensive internal control structure is critical to accurate financial reporting and safeguarding of state resources because the state prepares its financial statements in an environment that has a high risk of error. The state's primary accounting system cannot generate accurate financial statements without significant manual calculations and adjusting entries. In addition, the Department of Management and Budget relies on personnel in other state agencies to accurately account for many unique financial transactions according to a complex set of governmental accounting principles. Because the Department of Management and Budget has ultimate, statutory responsibility to prepare the state's annual financial reports, it must ensure the reliability of the internal control structures of other state agencies on which it relies for important financial information. The state's policy on internal control requires each agency head to develop and maintain an effective internal control structure.[2]

Over the past year, the Department of Management and Budget and other state agencies became more aware of the need for a comprehensive internal control structure, began identifying risks, and could generally describe their internal control policies and procedures for financial reporting. Following are some steps agencies took to improve their internal control structure:

- The Department of Management and Budget established an internal control unit as required by statutory changes made by the 2009 Legislature.[3] The unit is responsible for the internal control structures across state government. In August 2009, the department hired an internal control director to lead the unit.

- The Department of Management and Budget also made progress toward implementing the state's code of conduct policy by offering training and

[2] Department of Management and Budget Policy 0102-01.
[3] *Laws of Minnesota* 2009, Chapter 101, Article 2, Section 44 and *Minnesota Statutes* 2009, 16A.057.

establishing an implementation date of December 31, 2009, for all state agencies.[4] The code of conduct policy is an integral part of establishing an effective internal control structure.

- The Department of Employment and Economic Development established an internal audit function that assessed its risks for financial reporting and identified specific controls over its business processes for the Unemployment Insurance Fund.

- The Teachers Retirement Association developed a comprehensive risk assessment over financial reporting and also made improvements to its control structure in fiscal year 2009 by establishing an internal audit subcommittee of the Board of Trustees and establishing an internal audit function.

Despite these efforts, weaknesses in the internal control structure continued to exist. Most agencies had not taken sufficient action to remedy certain internal control deficiencies in their financial reporting processes. Some agencies delayed their independent efforts to document their internal controls, awaiting centralized guidance from the Department of Management and Budget's internal control unit. Many agencies had not documented existing internal control procedures and had not established processes to monitor the effectiveness of those controls. Following are examples of the weaknesses that existed in the state's internal control structure:

- The Department of Management and Budget did not update its fiscal year 2008 assessment of the state's risks in the basic financial reporting process for specific fiscal year 2009 changes. In addition, the department had not fully extended the fiscal year 2008 assessment to include risks that exist at other state agencies on which it relies for important financial information, such as accounts receivable and accounts payable accruals.

- The departments of Education, Human Services, Public Safety, Revenue, Transportation, the State Board of Investment, and the Minnesota State Retirement System had not fully assessed and documented their financial reporting risks.

- The Department of Employment and Economic Development had not performed steps to monitor its controls. Without monitoring, department management may not know whether its staff performed the internal control procedures as intended and whether those procedures were effective in reducing the risk of misstatement. In addition, a recent information technology audit found that the department did not have adequate security controls over the state's unemployment insurance

[4] Department of Management and Budget Policy 0103-01.

program's computer system.[5] The weaknesses identified in that report affect the integrity of unemployment system data and could potentially result in a misstatement of the Unemployment Insurance Fund financial statements.

A comprehensive control structure has the following key elements:

- Personnel are trained and knowledgeable about financial reporting goals and applicable policies and procedures.

- Management identifies risks associated with financial reporting and develops policies and procedures to effectively address the identified risks.

- Management continuously monitors the effectiveness of the controls, identifies weaknesses and breakdowns in controls, and takes corrective action.

- Management focuses on continual improvement to ensure an acceptable balance between controls and costs.

Findings 2 through 5 identify specific deficiencies in agencies' internal control procedures that created an unacceptable risk of error. It is likely that the state will continue to have weaknesses in its financial reporting process until it operates within a comprehensive internal control structure.

Recommendation

- *The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.*

Finding 2

Prior Finding Partially Resolved: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Many state agencies authorized employees to have inappropriate access to the state's accounting system or state agency subsystems. One agency also authorized employees to perform incompatible duties related to the processing of certain state and federal subsystem payments. Inappropriate system access is either access to incompatible business functions or access that is not necessary for the employee's job duties. Allowing employees to have inappropriate access to business systems or

[5] Office of the Legislative Auditor's Financial Audit Division Report 09-36, *Department of Employment and Economic Development, Unemployment Insurance Program, Information Technology Audit*, issued December 3, 2009.

to perform incompatible functions increased the risk that errors or fraud could occur without detection and compromised the integrity of financial transactions underlying the financial statements.

The Department of Management and Budget did not provide sufficient oversight to ensure that agencies complied with state policies, established effective mitigating controls, and monitored their effectiveness. By not ensuring that state agencies are properly monitoring employees with incompatible access to state business systems, the Department of Management and Budget increased the risk of errors and fraud.

The Department of Management and Budget's internal control policy requires separation of incompatible duties so no one employee has control over an entire transaction or process that could result in errors or fraudulent transactions going undetected.[6] If agencies are unable to adequately separate incompatible duties, state policies require them to develop and document their controls designed to mitigate the risk that error or fraud will not be detected.[7] These controls typically include some analysis and supervisory review of transactions processed by the employees with inappropriate access. Agency management needs to document these mitigating controls and monitor that these controls are performed as designed and effective in reducing the risks.

While the state, as a whole, and some agencies have reduced the total number of employees with incompatible access, weaknesses persist in many agencies. Appendix A provides more detail about specific state business system security access weaknesses at the departments of Education, Human Services, Management and Budget, Revenue, and Transportation and two of the state retirement systems.[8]

Finally, the Department of Education did not separate incompatible duties for certain state and federal subsystem payments. One employee could modify the payment source data, enter the data into the subsystems, and process the payments. The department used this payment process for numerous state and federal programs, including the state alternative facilities program of about $14 million, and the federal head start program of about $20 million. If these duties cannot be separated, mitigating controls should be established and performed. However, the department did not implement any mitigating controls related to the lack of separation of these duties.

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[6] Department of Management and Budget Policy 0102-01.
[7] Department of Management and Budget Policy 1101-07 and HR 045.
[8] Minnesota State Retirement System and Teachers Retirement Association.

Recommendations

- *The Department of Management and Budget and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes.*

- *When incompatible access or duties cannot be eliminated, the Department of Management and Budget and state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented, documented, and effective.*

Finding 3

The Department of Management and Budget and other state agencies did not have adequate controls to prevent and detect errors in the financial information used to compile the financial statements.

The Department of Management and Budget and the departments of Employment and Economic Development, Transportation, and Revenue did not have adequate controls to prevent and detect errors as they compiled the state's financial statements. Weaknesses in the departments' controls resulted in the following errors:

Department of Management and Budget

- Department of Management and Budget misclassified $32 million of revenue on the governmentwide statement of activities. The department correctly classified the expenses for the Minnesota veteran homes as a health and human services program; however, it erroneously classified the related $32 million of revenue as general government program revenue, which resulted in a mismatch of revenues with expenses on this statement.

- Department of Management and Budget omitted $55.5 million of securities lending collateral and the offsetting liabilities for the supplemental retirement investment trust financial statements. The department omitted the amounts when entering the financial statement balances into its financial reporting software.

- Department of Management and Budget did not independently review spreadsheets its staff prepared for the general obligation debt amortization schedules and, consequently, did not detect that the schedules overstated the amount Minnesota State Colleges and Universities owed the debt service fund for its share of general obligation bonds by $1.4 million.

- Prior Finding Not Resolved: Department of Management and Budget did not accurately incorporate audited financial information from a component unit into the state's financial statements. The department recorded $1.5 million of the Office of Higher Education's accrued bond interest payable as accounts payable and recorded $7.8 million of its due to primary government liability as deferred revenue liability. During our last audit, the department made a similar error when it incorporated the Metropolitan Council's audited financial statements into the state's financial statements. Both the Office of Higher Education and Metropolitan Council are component units of the state.

- Department of Management and Budget used an incorrect formula to determine which enterprise funds it needed to present as major funds in the financial statements.[9] The department did not include nonoperating revenues, expenses, and capital contributions from the amounts it used to calculate the percentages of each enterprise fund's activity to the total of all enterprise funds. Although the error did not result in a misidentification of major enterprise funds, the state needs to accurately calculate its major fund determinations to ensure compliance with generally accepted accounting principles.[10]

Department of Management and Budget's internal reviews of the financial data were not effective to detect the above errors. Examples of effective internal review processes include analytical procedures to determine whether there are variances between fiscal years and related accounts that might indicate errors, reviews of the applicable generally accepted accounting principles, recalculations of the financial data, and a final supervisory verification of audited component unit financial statements.

<u>Employment and Economic Development</u>

- The departments of Employment and Economic Development and Management and Budget omitted $9.3 million of cash and deferred revenue from the preliminary financial statements for the Federal Fund. Although the Department of Employment and Economic Development did not prepare the Federal Fund financial statements, it provided information about the cash balance and federal requirements to the Department of Management and Budget, which initially led to the conclusion that the cash did not need to be included in the Federal Fund financial statements. The state received the funds in February 2009 through the federal

[9] Enterprise funds are used to report any activity for which a fee is charged to external users for goods or services. The state colleges and universities, unemployment insurance, and lottery funds are examples of the enterprise funds for the state.

[10] Guide to Implementation of GABS Statement 34 on Basic Financial Statement – and Management's Discussion and Analysis – for State and Local Governments, Question and Answer, #184, states that both operating and nonoperating revenues and expenses should be considered in the major fund determination for enterprise funds.

government's economic stimulus plan as an increase to the unemployment insurance program's administrative funding.

Transportation

- Prior Finding Not Resolved: The Department of Transportation reported incorrect infrastructure and right of way capital asset balances to the Department of Management and Budget for inclusion in the state's financial statements. The department made some similar errors in five of the past six years. The department had insufficient controls over the entry of the capital asset reporting codes in the accounting system. The codes denote whether the project is capitalized or expensed on the state's financial statements. The department also made other coding errors related to classifying infrastructure or right of way assets and identifying the correct fiscal year to recognize the liability for capital asset expenditures. Most significantly, in fiscal year 2008, the department used an incorrect capital asset job code related to expenditures for the Northstar Commuter Rail. The error resulted in a $94.6 million previously unidentified understatement of the state's fiscal year 2008 capital asset balance that required a prior period adjustment to correct the state's capital asset balances in the fiscal year 2009 financial statements.

  The Department of Transportation also overstated by $30 million accounts payable amounts reported in its preliminary financial statements for the municipal state-aid and county state-aid funds. The department included some payments in its liability amounts that should have been recognized in the following fiscal year. In applying generally accepted accounting principles, the department should have determined the liability based on the date the county or municipality approved the request for payment;[11] however, the department's state-aid subsystem and the state's accounting system did not contain this information.

  Although errors this year were generally not significant enough to materially misstate the financial statements, the department's repeated errors increase the risk that more significant errors could occur without detection. In addition, the department's control process did not always include a supervisory approval or a secondary verification of the capital asset and accounts payable amounts submitted to the Department of Management and Budget, which may have detected these errors.

[11] Governmental Accounting Standards Board, St. No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.*

<u>Revenue</u>

- The Department of Revenue did not accurately calculate and report various accounts payable and receivable information to the Department of Management and Budget. The department also did not reconcile and verify that it accurately recorded various property tax remittances from counties on its internal tracking system, which resulted in other financial statement errors. The Department of Management and Budget also had several errors related to its recording of information from the Department of Revenue that required reclassification adjustments to both the General Fund and other funds to ensure it properly presented the activity in the financial statements.

  Although errors this year were not significant enough to materially misstate the financial statements, the number of errors indicates that the department's processes and procedures for determining financial statement amounts may allow more significant errors to occur without detection.

Recommendation

- *The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.*

Finding 4

The Department of Management and Budget did not always prepare accurate footnote disclosures to the financial statements.

Footnote disclosures are an integral part of the financial statements. As shown below, 8 out of 21 draft footnote disclosures prepared and reviewed by the Department of Management and Budget contained errors which required adjustments.

- *Note 2 - Cash and Investments*: The department misclassified balances in its draft disclosure of investments and cash equivalent investment balances by type, as follows:

  -- Government, proprietary, and agency funds' corporate bonds were overstated by $15.9 million.

  -- Pension trust and investment trust funds' corporate bonds were understated by $17.2 million, commercial paper was overstated by $11.7 million, and corporate stock was overstated by $5.1 million.

- *Note 4 - Loans and Notes Receivable*: The department misclassified $13 million of loans and notes receivable for some nonmajor special revenue funds by overstating the economic development receivable by $13 million and understating the agricultural, environmental, and energy resources receivable by $11 million and the other loans and notes receivable by $2 million.

- *Note 6 - Capital Assets*: The department could not support its $1.7 million increase to the prior year's $8.6 million balance for accumulated equipment purchased through capital leases. It later adjusted the footnote to show the prior year balance because it could not determine the amount of fiscal year 2009 purchases. In addition, the department overstated the acres for the Permanent School Fund land by 470 acres. The draft footnote disclosure showed 2,521,310 acres rather than 2,520,840.

- *Note 10 - Long-Term Commitments*: The department did not include $213 million of long-term commitments that the Housing Finance Agency, a component unit of the state, had disclosed in its financial statements. The commitments related to the purchase and origination of future loans or other housing assistance.

- *Note 11 - Operating Lease Agreements*: The department understated the Minnesota State Colleges and Universities' operating lease agreements by $14 million. The department did not adjust its preliminary lease information to agree with information from the colleges and universities' final audited financial statements.

- *Note 12 - Long-Term Liabilities – Primary Government*: The department understated the general obligation bonds authorized but not yet issued by $2 billion.

- *Note 15 - Segment Information*: The department incorrectly disclosed a positive net assets balance at year end of $37 million for the 911 Services Fund although the fund actually had a negative net assets balance at year end of $37 million.

- *Note 18 - Risk Management*: In disclosing the coverage limits for the Risk Management Fund, the department overstated the liability coverage for the bodily injury and property damage by $100,000 per person and $300,000 per occurrence. It also understated the casualty reinsurance program's retention amount to protect the state from auto and general liability claims by $200,000.

The department's analytical procedures and review processes did not detect these errors. The financial statements may be misleading if footnote disclosures are inaccurate, inconsistent with financial statement amounts, or missing required information.

Recommendation

- *The Department of Management and Budget should ensure that footnote disclosures to the financial statements are accurate and complete.*

Finding 5

Some agencies did not reconcile their subsystem data to the state's accounting system to ensure accurate financial information.

The departments of Education, Human Services, and Revenue did not consistently perform key reconciliations of their subsystem data to the state's accounting system, as required by state policy.[12] Because the state's accounting system is the primary source of financial information for the state's financial statements, it is essential that the state's accounting system agrees with the underlying detail of financial transactions initiated and recorded in agency subsystems.

Agencies had the following weaknesses in their subsystem reconciliation processes:

<u>Education</u>

- During fiscal year 2009, the Department of Education did not perform reconciliations between its federal education subsystems and the state's accounting system for the period July 2008 through January 2009. In addition, for eight months, the department did not have documentation to show that it completed a monthly reconciliation between its state education aid subsystem and the state's accounting system; the department's documentation did not show how it resolved reconciliation discrepancies. The department used the two subsystems to pay nearly $570 million of federal aid and over $6.8 billion of state aid to school districts and charter schools. The department did not implement any mitigating or monitoring controls, such as an independent review of these subsystem reconciliations to ensure that the department completed the reconciliations accurately and resolved any discrepancies.

  When the department completed the federal subsystem reconciliations in March 2009, the individual that completed the federal subsystem reconciliations had also processed federal payments, resulting in an inadequate separation of duties.

[12] Department of Management and Budget Policy Number 0102-01.

Human Services

- The Department of Human Services' reconciliation process did not ensure that staff identified and resolved differences between the detailed transaction data for the child care assistance subsystem and transactions recorded on the state's accounting system. The department used the subsystem to provide approximately $116 million of child care assistance aid in fiscal year 2009.

Revenue

- The Department of Revenue did not reconcile actual intergovernmental aid payments recorded on the state's accounting system to amounts it certified to be paid. Consequently, the department did not identify that it needed to reprocess a payment to a township because a bank rejected the initial $33,699 payment and returned the funds to the state.

Sufficient controls over the reconciliation process would include ensuring that an independent person performs the reconciliations, monitoring that the reconciliations are promptly completed, and that outstanding items are resolved.

Recommendation

- *The departments of Education, Human Services, and Revenue should establish sufficient controls to ensure that staff complete timely reconciliations between departmental subsystem data and the state's accounting system, in compliance with state policy, to ensure accurate financial information.*

Appendix A – Additional Details Supporting Finding 2 - Inadequate Security Access Controls Over State Business Systems

Education

The Minnesota Department of Education lacked a formal process to grant employees access to its internal business systems or to periodically recertify that ongoing access was appropriate. The department did not have authorized request forms on file for any of the 29 employees we tested. Rather, the department granted access to its various business systems through an informal request process, which did not always include specific accesses needed. Without a formal process, the department cannot ensure that employees have only the required access needed to perform their job duties.

Six of the 29 employees we tested had incompatible access to the department's business systems and data. These employees had the ability to add a vendor, establish source data, and create and/or manipulate financial information. The department did not have formalized mitigating controls to monitor the accuracy or appropriateness of these changes, which increased the risk of undetected employee errors or fraud.

Human Services

Prior Finding Not Resolved: As of September 2009, the Department of Human Services had 14 employees who had incompatible security access to the state's accounting system. The incompatible profiles allowed these employees to encumber funds, process purchase orders, and pay invoices through the state's accounting system. The department should have designed and documented controls to mitigate the risk of fraud or error. (The 14 employees cited in this audit are not the same 14 employees cited in our 2008 report.)

In addition, the department granted six employees unnecessary access to the state's accounting system. During the department's relocation to its new building in 2005, these employees needed to access another agency's records. However, the department did not rescind the access once it was no longer necessary.

The department granted 36 employees incompatible access to the Medicaid Management Information System without requiring written mitigating controls. The department designed reports that allowed for identification of employees with incompatible access; however, there were no documented reviews of the report or follow up to eliminate incompatible access. The incompatible access allowed employees to modify medical provider and/or client data and to process payments. There was an increased risk that employees could have processed fraudulent payments without detection.

The department granted 11 county workers incompatible access to its child care assistance subsystem without having documented mitigating controls. The department was aware of the incompatibilities but did not take action to follow up on the issue. The incompatible access allowed county workers to enter family data, determine eligibility, approve child care, and process child care payments. As a result of our audit, the department removed the incompatible access of seven county workers and documented mitigating controls for the other four employees.

Department of Management and Budget

As of June 2009, the Department of Management and Budget gave four of its employees incompatible access to the encumbering, receiving, and disbursing functions in the state's accounting system. Three of these four employees had clearance to all state agencies. Three additional staff had access to the encumbering and receiving function, and one of these employees also had incompatible access to the accounting system's contract module. Staff at the department asserted they had processes in place to monitor the transactions processed by these seven users; however, the department could not provide adequate evidence of this monitoring and did not have written procedures outlining its monitoring practices.

Revenue

The Department of Revenue did not minimize its risk associated with granting employees access to edit bank account and bank routing numbers for approved tax refunds in its Electronic Payment System. According to agency records, during fiscal year 2009, only two bank accounts were changed by department employees. However, the department granted system access to 21 employees that allowed them to edit bank information for outgoing tax refunds. Of the 21 employees with this access, eight worked in the financial reporting unit, which had no business purpose for this level of access. Access to this critical process should be limited to only those employees that need it to perform their job duties.

In addition, the department did not develop any monitoring procedures to verify that changes made to taxpayers' bank accounts were proper. Without effective monitoring controls, employees could redirect refunds to their own bank accounts and not be detected.

Transportation

Prior Finding Partially Resolved:[13] As of October 2009, the Department of Transportation had eight employees with incompatible access to the state's accounting system, compared with 59 employees in the prior year. Each of these employees had incompatible access to create a purchase order, encumber funds, and process payments. The department had not established mitigating controls to address the increased risk associated with the level of access granted to four of these employees. Although the department had developed mitigating controls for the other four employees, it had not documented the mitigating controls as required by the Department of Management and Budget's policy.[14]

Minnesota State Retirement System

Prior Finding Partially Resolved:[15] In response to our prior audit report, the Minnesota State Retirement System formalized its processes to request, review, and authorize access for computer users and to notify security staff when personnel terminate employment. The Minnesota State Retirement System developed access authorization forms for new hires or changes to current employees' access. In addition, it eliminated employees' incompatible access to the state's accounting system. However, the following security access weaknesses continue to exist:

-- The Minnesota State Retirement System lacked a formal process to periodically review and recertify computer users' access.

-- The Minnesota State Retirement System did not have adequate documentation, including the identification of incompatible security access profiles, to help managers make informed decisions about the level of security access to grant their staff.

-- Sixty-five Minnesota State Retirement System employees had incompatible access to the department's business system. These employees had the ability to change an annuitant's name, address, and bank routing information without proper controls in place to monitor these changes. In addition, 2 of the 65 employees also had physical access to refund checks, which increased the risk of misappropriation in the refund process.

[13] Office of the Legislative Auditor's Financial Audit Division Report 09-03, Report on Internal Control Over Statewide Financial Reporting, issued February 13, 2009.
[14] Department of Management and Budget Policy 1101-07
[15] Office of the Legislative Auditor's Financial Audit Division Reports 09-03, Report on Internal Control Over Statewide Financial Reporting, issued February 13, 2009; and 9-17, Minnesota State Retirement System Financial Statement Report, issued April 23, 2009.

Teachers Retirement Association

The Teachers Retirement Association had not identified incompatible access profiles within its subsystem. The Teachers Retirement Association made improvements in limiting access to system functions and data; however, the criteria used for limiting access did not take into account whether existing profiles resulted in incompatible access.

Prior Finding Partially Resolved:[16] In fiscal year 2009, the Teachers Retirement Association had 13 employees with the ability to make changes to sensitive member account information without mitigating controls to monitor the accuracy or appropriateness of changes to this information, which increased the chances of employee errors or fraud. (In fiscal year 2008, the Teachers Retirement Association had 38 employees with this level of incompatible access.) In addition, the association had one employee in fiscal year 2009 (compared with five employees in fiscal year 2008) that had incompatible access to the state's accounting system without adequate mitigating controls in place.

[16] Office of the Legislative Auditor's Financial Audit Division Reports 09-03, Report on Internal Control Over Statewide Financial Reporting, issued February 13, 2009; and 9-05, Teachers Retirement Association Financial Statement Report, issued February 26, 2009.

February 5, 2010

James R. Nobles, Legislative Auditor
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140 Centennial Office Building
658 Cedar Street
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to discuss with your staff the audit findings in the Report on Internal Control over Statewide Financial Reporting. Since this report includes all findings statewide, our response will specifically address only those findings related to Department of Management and Budget. The remainder of the findings will be addressed by the specific agency involved. However, we will continue to work with agencies to ensure all findings in this report are implemented.

We place a high priority on continuing our long history of issuing high quality, accurate financial statements in compliance with Generally Accepted Accounting Principles. Our 24-year history of receiving unqualified audit opinions and the "Certificate of Achievement for Excellence in Financial Reporting" from the Government Finance Officers Association is important to us. We value suggestions which will make our existing process even stronger.

Recommendation

Finding 1. The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.

Response

We agree that adequate internal control structures over financial reporting to mitigate the risk of potential misstatements in the financial statements are essential. Strong financial management is very important and we are committed to the highest levels of financial integrity.

In addition to establishing an internal control unit and implementing the code of conduct policy statewide as you mention, we also continue to enhance our overall risk assessment and documentation of internal controls over financial reporting. We have been and will continue to work with agencies throughout the year to identify and address financial statement risks and issues. This effort includes annual discussions on changes in processes for agencies with material impacts to the financial statements, such as the departments of Revenue, Human Services, and Education. These discussions

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also include issues identified in the past, program changes, and impacts of new Generally Accepted Accounting Principles (GAAP). It is an ongoing process to assess risks and improve internal controls to mitigate material risks of misstatement.

Effective internal control structures are very complex and require detailed risk assessments and extensive documentation of controls. We will continue to revise and enhance our overall risk assessment and document it more formally. During this process, we will continue to prioritize risks and weigh the costs and benefits of controls.

In the coming year, we will conduct an extensive training program to be rolled out to agencies. This training will cover a broad spectrum of topics on GAAP ranging from an introduction of governmental GAAP to detailed discussions on recognizing potential issues in recording revenues and expenditures. This training will also cover topics on implementing new GAAP pronouncements as well as discussion on internal controls over financial reporting. In addition, the internal control unit will also provide training and tools to help agencies assess their risks and document their internal control structure.

We take our financial oversight responsibilities very seriously. We will continue to assess risks over financial reporting and work with agencies to help improve the accuracy of the financial statement information provided to us.

Person Responsible: Lori Mo, Accounting Services Assistant Commissioner

Implementation Date: December 31, 2010

Recommendation

Finding 2. The Department of Management and Budget and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes. When incompatible access or duties cannot be eliminated, the Department of Management and Budget and state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented, documented, and effective.

Response

Over the last two years, we have expanded our efforts to reduce incompatible access in the state's accounting system. While we are pleased the level of incompatible duties has been reduced by more than 50%, we recognize that additional progress is necessary for optimal internal controls.

Early actions focused on the highest risk access and more recently have expanded to the combinations of access that present lower risk. We have provided agencies with new tools to identify users with incompatible access and added requirements to certify mitigating controls in those situations where the incompatible access has not been eliminated.

As we have discussed, it is not always possible to eliminate incompatible access, but we do expect the numbers to decline further. Where incompatible functions are necessary, we expect to improve the strength of compensating controls and related monitoring.

As we complete our annual user certification, we will continue our campaign to educate agencies and mandate compliance. Through our recently created Internal Control and Accountability Unit, we will provide agencies with additional information on appropriate design, documentation, and monitoring of mitigating controls.

Persons Responsible: Lori Mo, Accounting Services Assistant Commissioner
Jeanine Kuwik, Internal Control and Accountability Director

Implementation Date: October 31, 2010

Recommendation

Finding 3. The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.

Response

We continue to place a high emphasis on our review process. Extensive analysis and supervisory reviews are conducted of work performed by our financial reporting team. These reviews are designed to prevent material misstatements to the financial statements.

The state is a very complex reporting entity. Significant changes occur each year that require extensive analysis to ensure financial information is properly classified and reported in compliance with Generally Accepted Accounting Principles (GAAP). We have numerous processes in place to identify these changes and ensure this activity is properly reflected in the financial statements. This is an on-going challenge. One of the changes we identified was the combining of the Veteran Homes Board into Veteran Affairs that resulted in an inaccurate classification of the combined agency activity in the financial reporting system. We reclassified and correctly reported approximately $90 million in expenses in both the fund and government-wide financial statements. However, this analysis did not extend to the revenue on the government-wide financial statement. We will continue to strengthen our analysis and documentation of these unique adjustments to ensure amounts are properly reflected in the financial statements by extending the analysis to all areas affected.

We place a high priority on issuing high quality, accurate financial statements in compliance with GAAP. Over the past ten years, new GAAP pronouncements have been issued annually. The financial reporting team monitors and interprets each of these pronouncements to determine the impacts on the financial statements. We document applicable GAAP in the financial reporting processes. We understand the need to change the formula for calculating major enterprise funds to include non-operating revenues, expenses, and capital contributions and we will review our documentation. As you noted, the change did not result in any misclassification of major enterprise funds.

We will continue to review our process and strengthen our documentation to ensure the accuracy of the information included in our financial statements. These reviews are designed to prevent material misstatements to the financial statements. We continually make judgments on how to utilize our resources based on identified risks and materiality in relation to the financial statements.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: December 31, 2010

Finding 4. The Department of Management and Budget should ensure that footnote disclosures to the financial statements are accurate and complete.

Response

We go through a very extensive review process to ensure all footnote disclosures agree with the financial statements. Unfortunately, in order to complete the state's financial statements timely, we must release preliminary drafts of the footnote disclosures to the auditors before our entire review process is complete. All footnote disclosures agreed to the financial statements with two exceptions. The general obligation bonds authorized, but not yet issued, included a number transposition that occurred during a late adjustment in the review process, and the net assets in the segment note were entered as a positive number instead of a negative number. We strongly believe our final review process would have caught these adjustments as all numbers in the footnote disclosures are tied back to the supporting documentation and to the financial statements. Our final review process identified several similar adjustments.

We will continue to review our process and documentation for preparing footnote disclosures to further strengthen our process. When it is necessary to release drafts of the footnote disclosures using preliminary financial statements from agencies or component units, we will strive to review and update the footnote disclosures more timely upon receipt of the final financial statements.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: December 31, 2010

Again, thank you for the opportunity to discuss and respond to the audit findings of the department. We value your work to improve Minnesota's internal control structure.

Sincerely,

Tom J Hanson

Tom J. Hanson
Commissioner

February 1, 2010

James Nobles
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1063

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings for the Minnesota Department of Education ("Department") which were included in the audit of the State of Minnesota's consolidated financial statements for the year ended June 30, 2009. Specific issues for the Department are included in findings 1, 2, 5 and Appendix A. The response to each finding, person responsible for implementation and timeframe is included with each finding.

The Department is in agreement with the findings and plans to begin corrective action and/or implementation immediately.

Finding 1: "Prior Finding Partially Resolved: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in financial statements."

OLA Recommendation: "The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process."

The Department agrees with this recommendation and will continue to work on the risk assessment and internal control structure. The Department has and will be working with and through the guidance being provided by the Internal Controls group at Minnesota Management and Budget. With their direction, it is expected the Department will be on track to complete the assessment and analysis by the end of state fiscal year 2011.

The manager responsibility for implementation of this finding will be Tammy McGlone, Director of Administrative Services.

Finding 2: "Prior Finding Partially Resolved: Many state agencies continue to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls."

OLA Recommendation: "The Department of Management and Budget and state agencies need ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes."

The Department will implement the recommendations of the auditor and remove incompatible access or formalize mitigating controls if the access cannot be avoided. The Department will also assure separation of duties for state and federal subsystem payments.

The manager responsibility for implementation of access control will be Cathy Wagner, Director of Information Technology. The manager responsible for the separation of duties for subsystem payments will be Thomas Melcher, Director of Program Finance.

Finding 7: "Some agencies did not reconcile their subsystem data to the state's accounting system to ensure accurate financial information."

OLA Recommendation: "the Department's of Education, Human Services, and Revenue should establish sufficient controls to ensure that staff complete timely reconciliations between departmental subsystem data and the state's accounting system, in compliance with state policy, to ensure accurate financial information."

The Department will implement the recommendations of the auditor and ensure subsystem reconciliations occur timely and are recognizable to the auditor upon review.

Tom Melcher, Director of Program Finance, will be responsible for resolving this finding and the Department.

I appreciate the opportunity to respond to the findings for the Department. Please contact Tammy McGlone at 651-582-8835 if you have any questions or comments.

Sincerely,

Alice Seagren

Alice Seagren
Commissioner

C: Chas Anderson
Tom Melcher
Tammy McGlone
Cathy Wagner

February 1, 2010

Mr. James R. Nobles
Legislative Auditor
First Floor, Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations as a result of the audit of the State of Minnesota's financial statements for the year ended June 30, 2009. The Department of Employment and Economic Development (DEED) was referenced in two of the five findings.

Audit Finding 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Recommendation:

- *The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.*

Response: The department agrees with the finding and recommendation. We appreciate the auditor's acknowledgement of the achievements that DEED has made over the past year to improve its internal controls over financial reporting. These achievements include the establishment and staffing of an internal audit function and the documentation of our risks and controls related to the financial statements for the unemployment insurance program. These are significant steps in our ongoing efforts to improve internal controls throughout the department. Our next step will be to develop and begin to execute a monitoring plan designed to obtain reasonable assurance that the controls are working as intended. Cindy Farrell, Chief Financial Officer, will oversee the establishment of this plan by June 30, 2010.

Audit Finding 3: The Department of Management and Budget and other state agencies did not have adequate controls to prevent and detect errors in the financial information used to compile the financial statements.

Recommendation:

- *The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.*

Response: The department understands the finding resulting from this complex situation. The auditor notes an omission of $9.3 million of cash on the preliminary financial statements for the Federal Fund. These were funds awarded by the U.S. Department of Labor through the American Recovery and Reinvestment Act for the purposes of administering the unemployment insurance program. Although these funds were for administrative purposes, the federal government placed them in the Unemployment Insurance Trust Fund maintained at the federal Bureau of Public Debt and allocated for DEED's use. DEED had not made any expenditure of these funds during fiscal year 2009 and, therefore, the funds were not drawn down into the state treasury. There were numerous discussions held between DEED and Minnesota

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Management and Budget staff regarding the appropriate accounting treatment of these funds. These discussions led to the conclusion that since DEED did not have actual custody of the funds nor had it expended and earned these funds that the funds should not be recorded on the state's financial statements. The auditor disagreed with this conclusion and after additional discussion an audit adjustment was made to the financial statements. No additional action will be taken regarding this finding.

If you have any questions or need additional information please contact Cindy Farrell at Cindy.Farrell@state.mn.us or 651-259-7085.

Sincerely,

Dan McElroy

Dan McElroy
Commissioner

Minnesota Department of **Human Services**

February 3, 2010

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The enclosed material is the Department of Human Services response to the findings and recommendations included in the draft audit report titled, "Report on Internal Control Over Statewide Financial Reporting" for the fiscal year ended June 30, 2009. It is our understanding that our response will be published in the Office of the Legislative Auditor's final audit report.

The Department of Human Services policy is to follow up on all audit findings to evaluate the progress being made to resolve them. Progress is monitored until full resolution has occurred. If you have any further questions, please contact David Ehrhardt, Internal Audit Director, at (651) 431-3619.

Yours sincerely,

/s/ Cal R. Ludeman

Cal R. Ludeman
Commissioner

Enclosure

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Department of Human Services'
Response to the Report Titled, "Report on Internal Control Over Statewide Financial Reporting"
For the Year Ended June 30, 2009

Audit Finding #1

Prior Finding Partially Resolved: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Audit Recommendation #1

- *The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.*

Department Response #1

The department agrees with the recommendation. During the June – December 2009 period, Financial Operations Division management, supervisors and staff committed in excess of 600 hours to a risk assessment process that was based on the Minnesota Management and Budget Internal Control Self-Assessment Tool. The resulting document will be reviewed and updated annually, or more frequently if necessary, and appropriate actions will be taken that respond to risks.

Person Responsible: Martin Cammack, Financial Operations Director

Audit Finding #2

Prior Finding Partially Resolved: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Audit Recommendation #2

- *The Department of Management and Budget and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes. When incompatible access or duties cannot be eliminated, the Department of Management and Budget and the state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented, documented, and effective.*

Department Response #2

The department agrees with the recommendations.

Accounting System: The Department is currently reviewing and updating its procedures for both initial approval to access MAPS accounting system and the annual review of staff with access to MAPS accounting system. Staff identified as having incompatible access will be reviewed and incompatible access will be eliminated whenever possible. In cases where it is not possible to eliminate incompatible access compensating controls will be put in place to address employees with incompatible access.

Person Responsible: Martin Cammack, .Financial Operations Director

Estimated Completion Date: February 28, 2009

MMIS System: The employee access reviewed only allows the ability to modify, not create new (i.e. add) providers. Current authorized providers also review their expected payments from the Department of Human Services (DHS) and report any discrepancies.

The employee access reviewed only allows modification to recipients receiving services paid for by the Department of Human Services. Monthly Explanation of Benefit (EOB) statements are sent to the recipient receiving those services, excluding services suppressed for privacy reasons. The EOB has language asking clients to notify DHS if services they did not receive appear on the statement. This process further supports our efforts of fraud deterrence because our clients question any services paid for on their behalf that they don't remember receiving.

Additional steps have been taken to further reduce the risk by decreasing the number of required staff with this limited access (i.e. reduced from 36 to 4 staff).

In response to the need to document the review of potential unnecessary or incompatible access, we will begin initialing and dating the monthly reports, noting actions taken and explanations for when actions are not required. These copies will be retained for one year.

Person Responsible: Adriann Alexander, Health Care Operations Director

Estimated Completion Date: March 1, 2010

Department of Human Services'
Response to the Report Titled, "Report on Internal Control Over Statewide Financial Reporting"
For the Year Ended June 30, 2009

Audit Finding #5

Some agencies did not reconcile their subsystem data to the state's accounting system to ensure accurate financial information.

The Department of Human Services' reconciliation process did not ensure that staff identified and resolved differences between the detailed transaction data for the child care assistance subsystem and the transactions recorded on the state's accounting system. The department used the subsystem to provide approximately $116 million of child care assistance aid in fiscal year 2009.

Audit Recommendation #5

- *The Departments of Education, Human Services and Revenue should establish sufficient controls to ensure that staff complete timely reconciliations between subsystem data and the state's accounting system, in compliance with state policy, to ensure accurate financial information.*

Department Response #5

The department agrees with the recommendation. The child care assistance subsystem is new and the fiscal reports are still currently under development. The department does identify differences between the subsystem and MAPS on a monthly basis at a summary level and does balance the total daily subsystem expenditures to the total expenditures posted to MAPS via entries posted to the "Expenditures" table in MAPS. Once all subsystem fiscal reports are complete, a robust daily reconciliation process to balance subsystem transaction data to MAPS will be implemented and documented.

Person Responsible: Martin Cammack, Financial Operations Director

Estimated Completion Date: June 30, 2010

MINNESOTA STATE BOARD OF INVESTMENT

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Howard J. Bicker

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January 27, 2010

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the finding contained in the Report on Internal Control Over Statewide Financial Reporting for the year ended June 30, 2009.

Finding 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Audit Recommendation: The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.

Audit Response: While the State Board of Investment believes that overall the current internal controls are adequate, we do recognize that additional assessment and documentation of financial reporting risks needs to be performed. The State Board of Investment will continue to work to develop and maintain an effective internal control structure in accordance with Department of Management and Budget policy.

Person Responsible: Steve Schugel, Administrative Director

Implementation Date: June 30, 2010

Sincerely,

Howard Bicker

Howard Bicker
Executive Director

MSRS Minnesota State Retirement System
MNDCP Minnesota Deferred Compensation Plan
HCSP Health Care Savings Plan

February 1, 2010

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the findings and recommendations your report on internal controls over statewide financial reporting for the fiscal year ended June 30, 2009. As always, we take any audit finding very seriously and have already initiated corrective actions to address your findings and recommendations.

Finding 1 - Prior Finding Partially Resolved: The Minnesota State Retirement System did not identify, analyze, and document its internal controls related to business operations and financial reporting.

We concur with your report comments that we have not have fully assessed and documented our financial reporting risks. While we continue to believe that we have strong, effective financial controls in place, we recognize that we need to do more to improve documentation of our internal controls over financial reporting processes and to perform formal risk assessments periodically. It is our goal to resolve this audit issue by the end of December, 2010. Accounting Director Dennis E. Jensen and Assistant Executive Director Judy Hunt are the persons responsible for resolution of this finding.

Finding 2. Prior Finding Partially Resolved: The Minnesota State Retirement System did not have adequate controls to ensure computer users' access was appropriate on an ongoing basis, and it did not adequately restrict access to some computer systems to eliminate incompatible duties.

We appreciate your acknowledgement of our recent progress to resolve this audit issue. We are still developing a formal process to periodically review and recertify computer users' access to our systems. This involves the development of a manual that will guide managers and supervisors to select the appropriate user profile for each of their employees who need access to our systems to perform their assigned job duties. Persons responsible for finalizing the review and recertification process and completing the user profile guide for management and supervisors use are Information Systems Manager Al Cooley and Assistant Database Administrator Lloyd Johnson.

We will continue to explore options to eliminate incompatible access among our employees who have the ability to update member account information or to mitigate the risks of error or fraud associated with their access profiles. Resolution of this audit issue may require computer programming changes, implementation of a quality control function, or other mitigating controls. Persons responsible for resolution of this audit issue include Information Systems Manager Al Cooley and Assistant Executive Directors Judy Hunt and Erin Leonard.

We hope to resolve all aspects of this finding by the end of December, 2010.

Thank you, again, for the opportunity to respond to your report comments. We value the work of your agency to identify areas within MSRS that need improvement. We are committed to taking appropriate actions to further strengthen our internal control structure.

Sincerely,

David Bergstrom

Dave Bergstrom
Executive Director

cc: Judy Hunt
Dennis E. Jensen
Lloyd Johnson
Erin Leonard
Al Cooley

MINNESOTA · REVENUE

February 2, 2010

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
Suite 140 Centennial Office Building
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for providing us the results of your audit of the State's financial reporting for the year ended June 30, 2009. Below is our response to your findings and recommendations relating to the Department of Revenue.

RESPONSES:

(Finding 1) *The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.*

Recommendation:

The Department of Management and Budget and state agencies need to continue to develop a comprehensive internal control structure for the state's financial reporting process.

Response:

Department employees have completed code of conduct training. We have reviewed and updated procedures in the areas of receipts, refunds and financial report preparation in anticipation of completing a financial reporting risk assessment. In addition, identifying areas of risk has been a priority as our new Integrated Tax System is configured. We are fully committed to working with the Department of Management and Budget to implement statewide internal control policies and procedures for financial reporting.

Jean Jochim will be responsible for making sure this audit recommendation is resolved on an ongoing basis.

(Finding 2) *Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.*

Recommendation:

The Department of Management and Budget and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in business processes.

Response:

Department employee access has been changed to minimize risk, and monitoring procedures are in place. Our internal audit staff conducts on-going audits of employee access to department systems.

(Finding 3) *The Department of Management and Budget and other state agencies did not have adequate controls to prevent and detect errors in the financial information used to compile the financial statements.*

Recommendation:

The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.

Response:

The Financial Management Division has updated internal financial reporting procedures to improve the accuracy of calculations and is in the process of reviewing the validity of some methodologies. This review will be complete by June 30, 2010. The Financial Management Division is also partnering with the Property Tax Division to improve the accuracy of the property tax remittance data. We will improve the data collection process, keeping in mind that the statewide property tax will be added to our new Integrated Tax System in December 2012. We will have a new data collection and reconciliation process outlined by May 1, 2010.

Jean Jochim and Jason Nord will be responsible for resolving this recommendation.

(Finding 4) *(This finding does not involve the Department of Revenue)*

(Finding 5) *Some agencies did not reconcile their subsystem data to the state's accounting system to ensure accurate financial information.*

Recommendation:

The Departments of Education, Human Services, and Revenue should establish sufficient controls to ensure that staff completes timely reconciliations between departmental subsystem data and the state's accounting system, in compliance with state policy, to ensure accurate financial information.

Response:

Effective immediately, the Department's Financial Management Division will reconcile intergovernmental aid payments certified by the Property Tax Division to payments recorded on the state's accounting system, identify discrepancies and initiate corrections as needed. A reconciliation of Fiscal Year 2010 payments to date will be completed by March 1, 2010. Ongoing reconciliations will be completed as payments are made.

Jean Jochim will be responsible for making sure this audit recommendation is resolved.

The Department of Revenue will continue to stress the importance of having proper internal procedures and state-of-the-art technology for ensuring that taxpayer information is protected and that employees have only the accesses and authorities they need to perform their duties.

Thanks again for the very helpful audit.

Sincerely,

Ward Einess
Commissioner

Teachers Retirement Association

60 Empire Drive • Suite 400 • St Paul MN 55103-4000
651.296.2409 • 800.657.3669 • 651.297.5999 FAX • 800.627.3529 TTY

January 29, 2010

Mr. James R. Nobles
Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your report on the internal control over the state's financial reporting process. Finding #2 involves the Teachers Retirement Association (TRA).

Finding #2- Prior Finding Partially Resolved:
Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Recommendation 1:
The Department of Management and Budget and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes.

Recommendation 2:
When incompatible access or duties cannot be eliminated, the Department of Management and Budget and state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented, documented, and effective.

TRA Response to both Recommendations:
In fiscal year 2009, TRA reviewed key system application access for each employee. Based on the review, access was more closely aligned with job function. Annually, TRA management will review and certify access to internal business systems.

TRA may not be able to completely eliminate incompatible system access due to the nature of the tasks performed and current systems restrictions. However, in order to reduce the risk of error or fraud, TRA is currently designing mitigating and/or compensating controls for those employees who have incompatible access. This process is being performed concurrently with an entity-wide risk assessment.

As part of the risk assessment, TRA will be documenting potential risks and controls to mitigate those risks for its key business processes. This documentation will include responsibilities and monitoring activities. TRA's Internal Auditor is coordinating this risk assessment process and will summarize and present the analysis to TRA management, the TRA Board of Trustees and Internal Audit Subcommittee. The results of the risk assessment process will identify areas within TRA that warrant further review of internal controls. TRA Internal Audit will then perform independent tests to determine whether mitigating controls established are effective at reducing risk to an acceptable level. Testing will also include substantive testing to determine whether unauthorized transactions have occurred.

Persons Responsible: Laurie Hacking, Executive Director
Karen Williamson, Asst. Executive Director – Operations
Leslie Nagel- TRA Internal Auditor

Resolution Date: September 30, 2010, with monitoring and testing ongoing

Sincerely,

Laurie Fiori Hacking

Laurie Fiori Hacking
Executive Director

Minnesota Department of Transportation

Transportation Building
395 John Ireland Boulevard
Saint Paul, Minnesota 55155-1899

January 28, 2010

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit of the State of Minnesota's financial statements for the year ended June 30, 2009. This letter is the Minnesota Department of Transportation (Mn/DOT) response to the draft report issued by the Office of the Legislative Auditor.

Finding 1 – Prior finding partially resolved: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Response: Mn/DOT believes strongly in financial integrity and concurs with this finding. The department began to train appropriate staff in the state's code of conduct and internal control policies. Staff will continue to work with appropriate staff from Minnesota Management and Budget (MMB) to ensure that statewide policies and guidelines are incorporated into Mn/DOT's processes and procedures.

Responsible Staff: Norman Foster, Acting Chief Financial Officer
Implementation Date: September, 2009 and ongoing.

Finding 2 – Prior finding partially resolved: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Response: As referenced in Appendix A, Mn/DOT had eight employees with incompatible access to the state's accounting system, compared with 59 employees in the prior year. Mn/DOT had developed mitigating controls for four of these employees with incompatible access, but had not documented those controls as required by the department of Minnesota Management and Budget policy. In addition, there were four other employees where the department had not established mitigating controls. As of December, 2009, mitigation controls and documentation were established for one employee with incompatible access; all other incompatible access has been resolved.

Responsible Staff: Norman Foster, Acting Chief Financial Officer
Implementation Date: Completed December 2009

Finding 3 – The Department of Management and Budget and other state agencies did not have adequate controls to prevent and detect errors in the financial information used to compile the financial statements.

Transportation Prior Finding Not Resolved: The Department of Transportation reported incorrect infrastructure and right of way capital asset balances to the Department of Management and Budget for inclusion in the state's financial statements.

Response: Mn/DOT concurs with the recommendation to conduct sufficient reviews of financial data. Mn/DOT will develop a more thorough procedure to monitor the asset code assignment to ensure the accuracy of reporting capital assets.

Responsible Staff: Norman Foster, Acting Chief Financial Officer and Gerald Wood, Accounting Director
Implementation Date: February, 2010

The Department of Transportation also overstated by $30 million accounts payable amounts reported in its preliminary financial statements for the municipal state-aid and county state-aid funds.

Response: Mn/DOT concurs with the recommendation to conduct sufficient reviews of financial data. A thorough review of all accounts payable accruals will be made by Accounting Director prior to submission to MMB. A report is being developed to capture the appropriate accrual information.

Responsible Staff: Norman Foster, Acting Chief Financial Officer and Gerald Wood, Accounting Director
Implementation Date: January, 2010

Thank you for the opportunity to respond to your findings and recommendations. Mn/DOT will monitor the implementation to the successful resolution of these findings. Please contact Gerald Wood, Accounting Director, at 651-366-4904 with any follow-up questions or information.

Sincerely,

Thomas K. Sorel
Commissioner of Transportation