MINNESOTA STATE SENATE

MANAGEMENT LETTER
(Including Communication to Rules
and Administration Committee)

JUNE 30, 2007

Minnesota State Senate
State of Minnesota
St. Paul, Minnesota

In planning and performing our audit of the financial statements of the Minnesota State Senate, State of Minnesota (Senate) as of and for the years ended June 30, 2007 and 2006, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of its internal control. Accordingly, we do not express an opinion on the effectiveness of its internal control.

Our consideration of the Minnesota State Senate's internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute material weaknesses.

- Currently the financial statements are prepared by the auditor. See the discussion in the attached memorandum under Material Weaknesses – Internal Control Documentation and Financial Reporting.

- During the current year audit, several material journal entries were identified and recorded. See the discussion in the attached memorandum under Material Weaknesses – Internal Control Documentation and Financial Reporting.

Minnesota State Senate
St. Paul, Minnesota

- Currently documentation of internal control over major financial processes is not adequate. See the discussion in the attached memorandum under Material Weaknesses – Internal Control Documentation and Financial Reporting.

This communication is intended solely for the information and use of management and the Senate and is not intended to be, and should not be, used by anyone other than the specified parties.

Virchow Krause & Company, LLP

Minneapolis, Minnesota
April 7, 2008

MATERIAL WEAKNESSES – INTERNAL CONTROL DOCUMENTATION AND FINANCIAL REPORTING

Recently a new auditing standard was issued that focuses on internal control, and what we communicate to you regarding your controls. Those requirements are set out in Statement in Auditing Standards No. 112, "*Communicating Internal Control Matters Identified in an Audit.*"

The new standard clarifies some definitions and will promote more consistency in how weak areas in internal control are communicated by auditors to their clients.

Internal control is a process – affected by an entity's governing body, management, and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

Internal control consists of five interrelated components:

a. *Control environment* sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
b. *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
c. *Control activities* are the policies and procedures that help ensure that management directives are carried out.
d. *Information and communication* systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
e. *Monitoring* is a process that assesses the quality of internal control performance over time.

How does this affect your organization? The new standard required us to review many factors to determine if a material weakness exists within your organization. There are three factors in particular which will require us to report a material weakness that affects many governments.

- *Internal Control Documentation* - there is a lack of complete documentation of your system of internal control,
- *Financial Reporting* - the auditor finds material journal entries not detected by the client,
- *Financial Reporting* - the auditor prepares the annual financial statements and footnotes for the client.

Internal Control Documentation

Many of our clients do not have adequate written documentation of the various internal control processes that take place within their organization. We, as auditors, have done some amount of high level documentation of your processes for our files. You, on the other hand, should theoretically have all of your major processes contained in written documents in enough detail that another person could come in and fulfill the requirements of a particular process by following the explanations.

MATERIAL WEAKNESSES – INTERNAL CONTROL DOCUMENTATION AND FINANCIAL REPORTING (cont)

Internal Control Documentation (cont.)

The major areas that should be documented are:

Cash Receipts	Payroll
Cash Disbursements	Financial Reporting
Purchasing	Information Technology
Receiving	

Other than the computer software instruction manual, most of our clients have little written documentation covering these areas. As a result, this is considered to be a material weakness in your internal control.

At this point in time, we have been able to complete your audit without asking for such documentation. **However, beginning with your 2007-2008 audit, we will be required to ask you for complete documentation of your internal control systems, due to the new auditing standards**. Therefore, you should plan now to complete that documentation, so that we can evaluate your compliance with the new rules during our audit of your 2008 financial statements. We will be able to provide you with forms and other resources to assist you with meeting the new requirements.

Financial Reporting

In theory, a properly designed system of internal control staffed with enough people with sufficient training would provide your organization with the ability to not only process and record monthly transactions, but also to prepare a complete set of annual financial statements. Most of our clients do a good job of processing and recording monthly transactions. However, very few are capable of preparing annual financial statements.

The new standard makes it clear that the definition of a material weakness in internal control should now include consideration of the year end financial reporting process. To avoid the auditor reporting a material weakness in internal control, your system of controls would need to be able to accomplish the following:

1. Present the books and records to the auditor in such a condition that the auditor is not able to identify any material journal entries as a result of our audit procedures. This is very rare for most of our clients.

2. Be capable of preparing a complete set of year end financial statements for the auditor to test. Currently, almost all of our clients have us prepare the financial statement document. This includes drafting the individual fund statements, making conversion entries, drafting the government-wide statements, and preparing footnote disclosures. Your staff would need to be capable of presenting the auditor with a set of complete financial statements in such a condition that the auditor is not able to identify any material changes as a result of the audit.

MATERIAL WEAKNESSES – INTERNAL CONTROL DOCUMENTATION AND FINANCIAL REPORTING (cont)

Financial Reporting (cont)

To accomplish such a high level of internal control over financial reporting is a difficult task for most governments. Many large organizations, such as SEC companies, have been required by law to prepare their own statements for years, and are staffed appropriately to do so. Most governments operate with only enough staff to process monthly transactions and reports, and so rely on us to prepare certain year end audit entries and handle the year end financial reporting. Under the new auditing standards, we must, therefore, inform you that these are material weaknesses in your internal control.

If you have any questions on these new disclosures, please contact your audit team.

NEW AUDITING STANDARDS EFFECTIVE FOR NEXT YEAR

In March of 2006, the American Institute of Certified Public Accountants issued eight new auditing standards (SAS No.'s 104-111) that will change the way auditors approach the audit process. The new standards are intended to improve the auditors' understanding of you, the client, the environment in which you operate, your internal controls, and the risks involved in the audit.

The new standards will result in some relatively significant changes to the way our audit is conducted. The major changes can be broken down into three main areas:

1. **Understanding Your Business and the Environment in Which You Operate** – The new standards require us to perform a more rigorous assessment of your business and the current environment in which you operate, such that we are better able to identify the key risks inherent in the engagement. This increased emphasis will lead to an audit approach that will focus testing on the key risk areas that we identify. Gaining and documenting this understanding will take place primarily "behind the scenes", and will involve, among other things, brainstorming sessions amongst our engagement team, research and review of relevant industry news and publications, and inquiries of various members of your organization, including personnel outside of the accounting department.

2. **Understanding Key Risks Associated With Your Information Technology (IT) Infrastructure** – We will also be required to perform a more thorough review of your IT environment, including an assessment of the information system and application controls that exist. We will be utilizing IT specialists to perform these reviews in many cases, and those professionals will be spending time with your IT department to evaluate those controls.

3. **Understanding and Evaluating Your Internal Controls** - The new audit standards require that the auditor *"evaluate the design of the controls relevant to an audit of financial statements and to determine whether they have been implemented."* In the past we were only required to *"gain an understanding"* of the controls so that we could plan the audit. This distinction may seem small; however, it will result in a significant increase in procedures that we will need to perform. Auditor inquiry alone will not be sufficient for the evaluation process. We will need to perform "walkthroughs" and other procedures to verify the controls are designed correctly and that they have been implemented. This could also lead to additional communications to your governing body pertaining to the ability of your accounting department to perform such duties.

   The evaluation and documentation of internal controls will most likely have the most significant impact on your organization. The key accounting processes, and the related controls that exist within those processes, will need to be documented in order for us to perform a proper evaluation, this responsibility for documenting internal controls ultimately lies with you. As a result, you will need to first become familiar with how to properly complete this documentation, and then actually complete the documentation process. You may choose to utilize us to perform this function in conjunction with our evaluation of the design and implementation of your controls; however, this would fall out of the scope of the audit, and we would need to reach an appropriate arrangement for our services.

   Virchow Krause is in the process of developing tools and templates to assist our professionals and our clients in the internal control documentation process.

In summary, the new Risk Assessment Audit Standards require auditors to develop the audit strategy with an emphasis on understanding the client and its internal controls, including controls over information technology, and to use that understanding to identify key risks associated with the engagement in order to tailor audit procedures to address those key risks. We can no longer choose to place no reliance on internal controls as a matter of efficiency. Instead we must now evaluate the design and implementation of internal controls, and then determine whether or not to rely on those controls in developing our audit strategy.

This approach will in most cases result in additional engagement hours, especially in the initial year of adoption of the new standards (next year). In addition, many of these hours will need to be spent during the planning phase of the engagement, which means that we will need to spend additional time with you prior to our traditional fieldwork.

Finally, we anticipate that you will receive some tangible benefits from the new audit process. The documentation of your key accounting processes and the related controls will help you understand where key weaknesses may lie in your system. Our increased understanding of your organization and your controls will in many cases lead to additional opportunities to provide you with value-added and meaningful management letter comments. Please feel free to contact your audit team if you would like clarification or additional information on the new risk assessment audit standards.

CURRENT YEAR COMMENT

Entering of Payroll Data

The entering of data from the "Personnel Action Notice" form into the Senate's payroll accounting system is currently being performed by staff within the Senate Fiscal Services Office.

To enhance control in this area, we recommend a change in procedure. The Senate should consider changing payroll accounting system access so that only the Human Resource Director or Human Resource Assistant has the ability to enter certain data now included on the "Personnel Action Notice" form, specifically hiring and salary information. Another option would be to have Senate Fiscal Services Office personnel continue to enter this data, but have the Human Resource Director or Human Resource Assistant periodically generate a report of employees and pay rates, or view this data on-line, and compare to the actual "Personnel Action Notice" forms.

PRIOR YEAR COMMENTS

Cross-Training and Transition Planning

We would like to take this opportunity to stress the importance of cross-training within the fiscal services office. Optimizing staff resource dollars is a crucial component of effective management in any organization. As salary and benefits costs continue to increase, protecting the fiscal investment in staff resource allocations is vital.

We believe that the use of effective cross-training would provide additional internal control within the fiscal services office. We understand that each fiscal services staffer performs various parts of the payroll or account payable processes. It is extremely important to know that, if needed, the payroll assistant could perform all the duties of the payroll supervisor and the accounts payable assistant could perform all the duties of the accounts payable supervisor. Then, if something unforeseen should happen, fiscal related services of the Senate would continue without interruption.

Transition planning is also an important area to consider when evaluating your staffing situation. If there are key positions in which you anticipate turnover, it is important to have a proactive plan of action. Often, this is an excellent opportunity to redesign the current organizational structure or to realign key tasks and core process workflow. Any change in staff responsibilities should consider the need for additional employee training.

By taking a proactive approach to optimizing staff resources and properly planning for transition periods, you can maximize your investment in your employees, which will protect your fiscal investment in overall staff resources. Should you have questions or need more information, we are available to assist you.

Status: We encourage you to make effective cross-training for the payroll assistant a priority.

PRIOR YEAR COMMENTS (cont.)

Senator Phone Bills

We noted during our testing for the years ended June 30, 2005 and 2006 that there were several Senator long distance telephone bills that were not signed by them as required by law as evidence of approval.

Status: During our current year testing of Senators' phone bills, we noted that seventeen Senators had at least one month of long distance phone bills that had not been approved.

Reconciliations

During the audit for the years ended June 30, 2005 and 2006, we noted differences between the Senate's control accounts and Department of Finance (DOF) records as well as differences between the Senate's control accounts and its subsidiary records. During the course of our audit fieldwork, these differences were resolved.

These two types of reconciliations (control accounts to DOF and control accounts to subsidiary records) should be done each month to insure that the accounting records maintained by the Senate and used to prepare reports for management are accurate. If there are differences noted in either of these reconciliations, the reasons should be found immediately, with appropriate corrections made.

We are available to provide assistance with reconciling the control accounts to subsidiary records. Please let us know if you would like some specific guidance for this process.

Status: It appears that timely reconciliations between the Senate's control account and the DOF are being completed. We recommend also reconciling total expenditures on the Senate's control sheet to its subsidiary records on a monthly basis.

COMMUNICATION TO THE RULES AND ADMINISTRATION COMMITTEE

Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Minnesota State Senate. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Our Responsibility Under U.S. Generally Accepted Auditing Standards and Government Auditing Standards (cont.)

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Minnesota State Senate's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Minnesota State Senate are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the Minnesota State Senate during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Minnesota State Senate's financial reporting process. Matters underlying adjustments proposed by the auditor could potentially cause future financial statements to be materially misstated. In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Minnesota State Senate, either individually or in the aggregate, indicate matters that could have a significant effect on the Minnesota Senate's financial reporting process.

Certain audit and bookkeeping adjustments we prepared were included in your financial statements. The following summarizes audit adjustments, we prepared:

	Amount
Adjustments for accrued payroll	$ 17,786
Adjustments for accounts payable	237,183

In addition, uncorrected misstatements for invoices expensed in the current fiscal year when $34,322 of the invoices relate to future fiscal years were noted. Management has determined that the effect of these uncorrected misstatements is immaterial to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Minnesota State Senate's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.