

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED
ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Members of the Minnesota State Legislature

The Honorable Tim Walz, Governor

Mr. Jim Schowalter, Commissioner, Minnesota Management and Budget

We have audited, 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 financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Minnesota as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the State of Minnesota's basic financial statements, and have issued our report thereon dated December 16, 2022. Our report includes a reference to other auditors who audited the financial statements of the Minnesota State Colleges and Universities, Minnesota State Lottery, Minnesota Housing Finance Agency, Metropolitan Council, University of Minnesota, Minnesota Sports Facilities Authority, Office of Higher Education, Public Facilities Authority, and Workers' Compensation Assigned Risk Plan, as described in our report on the State of Minnesota's financial statements. The financial statements of the Minnesota Housing Finance Agency and Workers' Compensation Assigned Risk Plan were not audited in accordance with *Government Auditing Standards*. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Minnesota's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Minnesota's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Minnesota's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified a certain deficiency in internal control, described in the accompanying *Finding and Recommendation* section as Finding 1, that we consider to be a significant deficiency.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Minnesota's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

State of Minnesota's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the State of Minnesota's response to the findings identified in our audit and described in the accompanying *Finding and Recommendation* section. The State of Minnesota's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Lori Leysen, CPA
Deputy Legislative Auditor



Scott Tjomslund, CPA
Audit Director

December 16, 2022

Finding and Recommendation

FINDING 1

The Minnesota Department of Health did not have adequate internal controls to ensure it properly identified and accurately reported certain liabilities.

The Minnesota Department of Health (MDH) overstated liabilities related to its open Federal Fund encumbrance balances by \$99.237 million. Open encumbrance balances represent future payments to vendors for ordered goods or services, or future grant disbursements under existing grant agreements. Under accounting principles generally accepted in the United States of America, open encumbrance balances as of the end of the fiscal year are not payables for that fiscal year unless a liability was incurred by June 30.¹ For open encumbrance balances for the purchase of goods or services, a liability is incurred when goods or services are received. For open encumbrance balances for grants, a liability is incurred when the grantee meets all eligibility requirements for a disbursement. For example, some grant agreements include a requirement that disbursements must be for eligible costs incurred by the grantee. In that situation, a liability is incurred at the point when the grantee incurs eligible costs.

To include liabilities related to open encumbrance balances in the state's financial statements, Minnesota Management and Budget (MMB) identified all open encumbrance balances of \$500,000 or more in the state's accounting system as of August 19, 2022, and sent each to the appropriate state agency for review. MMB requested each state agency to identify and report any liabilities incurred by June 30, 2022, for those encumbrance balances. MDH initially identified and reported liabilities totaling \$127.541 million for 42 of its open Federal Fund encumbrance balances. Our initial sample testing included \$7.828 million in liabilities reported by MDH for two of those encumbrances, and we found that no liability was incurred by June 30, 2022, for either encumbrance. After discussing those errors with both MDH and MMB, all parties agreed that MDH would review and reassess all the reported liabilities for those 42 encumbrances. Based on that subsequent review, MDH reduced the reported liabilities to \$49.313 million for 19 encumbrances. We tested the revised liabilities reported for all of those encumbrances, and found incorrect amounts for four of them totaling \$21.009 million.

MDH delegated the responsibility for identifying any liabilities for open encumbrance balances to various staff outside of its financial management division, and it appears that not all of those staff sufficiently understood the criteria for identifying the liabilities. MDH's financial management division staff reported the liabilities identified by staff outside the division to MMB without sufficiently reviewing and validating those liabilities. As a result, accounts payable, health and human services function expenditures, federal aid receivable, and federal revenues were all overstated by \$21.009 million on the Federal Fund financial statements.²

RECOMMENDATION

The Minnesota Department of Health should strengthen internal controls over identifying liabilities for open encumbrance balances to ensure the accuracy of the liabilities reported to Minnesota Management and Budget.

¹ Governmental Accounting Standards Board, *Codification of Governmental Accounting and Financial Reporting Standards*, part 1, secs. 1600.119 and 1600.128.

² The Federal Fund reports activity related to grants from the federal government. State agencies generally receive federal grant money on a reimbursement basis. Thus, when accounts payable and expenditures are recognized for state liabilities related to federal grant money, corresponding federal aid receivables and federal revenues are also recognized.

February 9, 2023

Ms. Judy Randall
Legislative Auditor
Office of the Legislative Auditor
658 Cedar St. Room 140
Centennial Office Building
St. Paul, MN 55155-1603

Dear Ms. Randall,

Thank you for the opportunity to respond to the finding and recommendation of the State of Minnesota's financial statements for the Minnesota Department of Health.

FINDING 1

The Minnesota Department of Health did not have adequate internal controls to ensure it properly identified and accurately reported certain liabilities.

Recommendation:

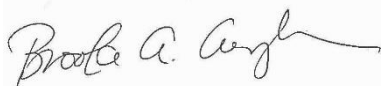
- The Minnesota Department of Health should strengthen internal controls over identifying liabilities for open encumbrance balances to ensure the accuracy of the liabilities reported to Minnesota Management and Budget.

Response:

MDH will review internal processes related to determining liabilities for open encumbrance balances to ensure sufficient controls exist for accurate reporting to MMB. Joshua Bunker, Chief Financial Officer, will be responsible for resolving the finding by August 30, 2023.

We value the work of your office and the professionalism of your staff. If you have any questions or need additional information, please contact Joshua Bunker, our Chief Financial Officer.

Sincerely,



Brooke Cunningham, MD, PhD
Commissioner
Minnesota Department of Health
P.O. Box 64975
St. Paul, MN 55164-0975