OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Minnesota State Retirement System

Fiscal Year Ended June 30, 1999

FEBRUARY 10, 2000 00-01

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Report Summary

Minnesota State Retirement System
Fiscal Year Ended June 30, 1999

Key Findings and Recommendations:

- The Minnesota State Retirement System (MSRS) did not promptly deposit or record some receipts. Statutes require daily deposits. MSRS held some checks for nearly a month. We recommended that MSRS comply with statutory provisions and deposit receipts promptly. (Finding 1, page 3)

- MSRS did not ensure the integrity of its financial data by reconciling its general ledger and subsystems to the state's accounting system in a timely manner. This reconciliation ensures that transactions are recorded consistently on the accounting systems. We recommended that MSRS perform periodic reconciliations of its general ledger, subsidiary ledgers, and the state's accounting system. (Finding 2, page 3)

- MSRS did not transfer funds between pension plans in a timely manner. At one point during fiscal year 1999, the Unclassified Retirement Plan owed other MSRS retirement plans nearly $8 million. We recommended that MSRS transfer funds between plans more promptly. (Finding 3, page 4)

Agency Response:

- In its response, MSRS agreed with the findings and recommendations and is taking corrective action to resolve the issues.

Background Information:

- MSRS administers retirement plans for various groups of state employees. The plans provide income upon retirement, disability, or death. MSRS also administers a deferred compensation plan available to all Minnesota public employees and officials. MSRS' assets at June 30, 1999, totaled nearly $10 billion.

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Eric Wion, CPA, CISA	Auditor-in-Charge
Ellen Sibley	Auditor

Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Minnesota State Retirement System on December 7, 1999:

David Bergstrom	Executive Director
Arvin Herman	Assistant Director, Finance and Systems
Dennis Jensen	Accounting Manager

Office of the Legislative Auditor
State of Minnesota • **James Nobles, Legislative Auditor**

Report on Compliance and Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Kenneth Yozamp, Chair
Minnesota State Retirement System Board of Trustees

Members of the Minnesota State Retirement System Board of Trustees

Mr. David Bergstrom, Executive Director
Minnesota State Retirement System

We have audited the financial statements of the Minnesota State Retirement System (MSRS) as of and for the year ended June 30, 1999, and have issued our report thereon dated December 1, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether MSRS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 that are required to be reported under *Government Auditing Standards*. We did note an immaterial instance of noncompliance, which we discuss in Finding 1.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered MSRS' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the

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internal control over financial reporting. However, we noted two internal control weaknesses that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MSRS' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Findings 2 and 3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described in Findings 2 and 3 is a material weakness.

This report is intended solely for the information and use of the Legislative Audit Commission and the Minnesota State Retirement System, and is not intended to be and should not be used by anyone other than these specified parties.

/s/James R. Nobles

James R. Nobles
Legislative Auditor

/s/Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 1, 1999

Report Signed On: February 7, 2000

Current Findings and Recommendations

1. MSRS did not promptly deposit or record some receipts.

MSRS did not promptly deposit and record some receipts. Minnesota Statute 16A.275 requires that state agencies deposit all receipts over $250 on a daily basis. We found that MSRS held some checks for nearly a month before depositing them in the bank and recording the deposit in the accounting system. The checks varied from several hundred to several thousand dollars; two of the larger checks were for $15,000 and $35,550.

The statutory prompt deposit requirement follows sound financial management policy. It is designed to safeguard receipts from possible loss or theft and maximize the ability for those deposits to earn investment income.

The checks that MSRS did not deposit promptly were usually payments from former plan participants who wanted to "buy back" their retirement benefits. MSRS held the checks pending verification of the "buy back" calculation. MSRS staff secured the checks in a locked cabinet until deposit.

Recommendation

- *MSRS should promptly deposit all receipts in compliance with statutory requirements.*

2. PRIOR AUDIT FINDING NOT RESOLVED: MSRS did not ensure the integrity of its financial data by reconciling its general ledger and subsystems to the state's accounting system in a timely manner.

MSRS did not perform periodic reconciliations to ensure that its financial activity was properly recorded on its general ledger and subsystems and on the state's accounting system, MAPS. During fiscal year 1999, MSRS had problems obtaining information needed to perform the reconciliation. On November 30, 1999, MSRS' June 30, 1999, general ledger cash balance exceeded the MAPS cash balance by $80,000. In December 1999, MSRS identified the transactions that caused the difference.

The use of multiple accounting systems heightens the risk that errors may occur and not be detected. Most transactions originate on one of MSRS' subsystems. The subsystems maintain the detail of the transactions. The subsystems post summary transactions to the general ledger and MAPS through electronic interfaces. Some transactions originate on MAPS and have to be manually entered on MSRS' general ledger. The general ledger is MSRS' main source of information for the financial statements, but MAPS reflects the agency's actual cash activity.

To control and ensure the integrity of data recorded on all the systems, MSRS needs, at a minimum, to reconcile the cash balance recorded on each system. Timely, periodic reconciliations will allow MSRS to detect transactions posted in error, interfaces that did not function properly, or transactions entered directly on MAPS that need to be posted to the general ledger. Without this reconciliation, errors and irregularities may not be detected in a timely manner

Recommendation

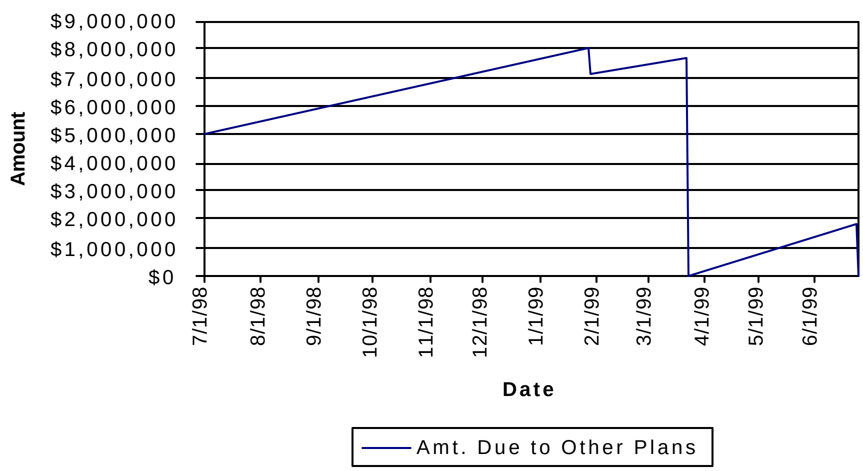
- *MSRS should perform periodic reconciliations of its subsystems, general ledger, and MAPS.*

3. MSRS did not transfer funds between pension plans in a timely manner.

MSRS did not transfer funds between pension plans in a timely manner. Although MSRS accounted for the liability between the plans, it did not actually transfer the assets timely. MSRS needs to transfer funds between plans when members move from one plan to another because of changes in employment or the plans' eligibility requirements. When a member changes plans, MSRS must transfer the member's cumulative retirement contributions and investment earnings.

Figure 1-1 shows that the Unclassified Retirement Plan held funds due to other retirement plans for most of fiscal year 1999. The $5 million owed by the Unclassified Retirement Plan in July 1998 increased to nearly $8 million by March 1999 before MSRS made the transfer.

Figure 1-1
Minnesota State Retirement System
Amounts Due from the Unclassified Retirement Plan
to Other MSRS Retirement Plans
Fiscal Year 1999



From the time that MSRS calculated the amount to be transferred and the time that the transfer was made, the fund holding the assets earned investment income. This income did not transfer with the plan assets. For example, by March 1999 the Unclassified Plan would have earned $375,000 on the $5,000,000 owed to other plans at June 30, 1998, if investment earnings were ten percent. Had MSRS transferred the assets more timely, the income that accrued to the Unclassified Plan would have accrued to another plan.

Recommendation

- *MSRS should perform its interfund transfers in a timely manner.*

Status of Prior Audit Issues
As of December 31, 1999

Most Recent Audit

The Office of the Legislative Auditor performs an annual audit of the Minnesota State Retirement System (MSRS). **Legislative Audit Report 99-10,** dated February 18, 1999, covered fiscal year ended June 30, 1998. The audit scope included those areas material to the MSRS financial statements. The report discussed two findings:

- MSRS had not met the Department of Finance's reporting deadline and had submitted draft financial statements that required significant adjustment. MSRS implemented our recommendations and met the deadlines and reporting requirements for the fiscal year 1999 financial statements.

- MSRS had not performed timely reconciliations of its general ledgers and subsystems to the state's accounting system to ensure the integrity of its data. MSRS did not implement this recommendation and it is repeated in our report as Finding 2.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as the Metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

MSRS

Minnesota State Retirement System

February 1, 2000

Ms. Cecile Ferkul, Audit Manager
Office of the Legislative Auditor
1st Floor, Centennial Office Building
St. Paul, MN 55155

Dear Ms. Ferkul:

I am writing in response to the current findings and recommendations.

Your first recommendation states,

> "MSRS should promptly deposit all receipts in compliance with statutory requirements."

MSRS will daily deposit all receipts in excess of $250.00. Buybacks that vary more than $25 from the computation or do not comply with the provisions of Minnesota Statutes, Chapter 356, will be refunded to the payer.

Your second recommendation states,

> "MSRS should perform periodic reconciliations of its subsystems, general ledger, and MAPS."

MSRS prepares monthly reconciliations for its general ledger. Previous lapses were caused by our reliance on routine MAPS reports that were periodically not available. We have upgraded our hardware and software to facilitate file transfers and customized reports which make monthly reconciliation possible.

Your third recommendation states,

> "MSRS did not transfer funds between pension plans in a timely manner."

MSRS will transfer cash between funds on a quarterly basis or whenever the interfund balances reach a specific amount. Please note, MSRS invests all unexpended daily cash balances in the short-term trust fund; at no time were any interest earnings lost because of transfer delays.

Thank you for this opportunity to respond to your findings and recommendations. We look forward to working with you in the future so that we can maintain the "clean" audit opinion on our financial statements.

Sincerely,

/s/David Bergstrom

David Bergstrom
Executive Director

DKB:jb

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