



**OFFICE OF THE LEGISLATIVE AUDITOR**  
STATE OF MINNESOTA

Management Letter

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# Department of Finance

## Fiscal Year Ended June 30, 2002



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## 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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All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

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](mailto:auditor@state.mn.us)

# Department of Finance

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### Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
Jeanine Leifeld, CPA, CISA	Audit Manager
Chris Buse, CPA, CISA, CISSP	Audit Manager
Michael Hassing, CPA	Audit Director
Susan Kachelmeyer, CPA, CISA	Team Leader
Mark Mathison, CPA, CISA	Team Leader
Patrick Ryan	Team Leader
Ching-Huei Chen	Auditor
John Hakes, CPA	Auditor
Marisa Isenberg	Auditor
Susan Mady	Auditor
David Massaglia	Auditor
Kristen Poore	Auditor
Karen Dee	Intern

### Exit Conference

We discussed the findings and recommendations in this report with the following representatives of the Department of Finance at the exit conference held on March 4, 2003:

Dan McElroy	Commissioner
Anne Barry	Deputy Commissioner
Jean Henning	Chief Information Officer
Lori Mo	Assistant Commissioner, Accounting Services and Information Technology
Barb Ruckheim	Financial Reporting Director
Pete Mauer	Financial Reporting Supervisor
Ron Mavetz	General Ledger Division
Ron Gates	Technical Services Division

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## Report Summary

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### Key Audit Conclusions:

- We issued an unqualified audit opinion, dated December 6, 2002, on the State of Minnesota's basic financial statements for the year ended June 30, 2002. In accordance with *Government Auditing Standards*, we also issued our report, dated December 6, 2002, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. In March 2003, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with the U.S. Office of Management and Budget's *Circular A-133*.

### Key Findings:

- The Department of Finance did not properly secure access to the databases and queries used to prepare the state's financial statements. Limiting security clearances is an important control to prevent unauthorized changes to the data that underlies the state's financial statements. Without appropriate security controls, unauthorized data changes could lead to costly delays in the financial statement preparation process. Unauthorized data changes could also diminish the integrity of information that the department uses to make important financial reporting decisions. (Finding 1, page 3)
- The Budget Division and Accounting Services Division published different budget reports that require reconciliation. The department's preliminary budgetary financial statements also contained errors and omissions that resulted in audit adjustments. We recommended that the department search for ways to modify its budgetary financial reporting practices to reduce the differences and minimize confusion and perform analytical reviews to identify errors and omissions in preliminary budgetary financial statements. (Finding 2, page 4)
- The department did not ensure the accuracy and completeness of financial information received from other state agencies for inclusion in the state's financial statements. We made several audit adjustments related to this financial activity. Left uncorrected, these types of transactions have the potential to negatively impact the accuracy of the state's financial reporting process. (Finding 3, page 5)

**Management letters** address internal control weaknesses and noncompliance issues we identified during our audit of the state's financial statements and federally funded programs. The scope of our work in the Department of Finance was limited to those activities administered by the department that were material to the State of Minnesota's basic financial statements and administration of federal financial assistance programs for the fiscal year ended June 30, 2002. The audit focused primarily on preparation of the state's basic financial statements as well as certain of the department's statewide financial management responsibilities relating to cash and debt management and the state's accounting system. The department's response to our recommendations is included in the report.



Senator Ann H. Rest, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Dan McElroy, Commissioner  
Department of Finance

We have performed certain audit procedures at the Department of Finance as part of our audit of the basic financial statements of the State of Minnesota as of and for the year ended June 30, 2002. We also audited the state's compliance with applicable requirements governing the administration of federal awards for the year ended June 30, 2002, as described in the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Finance.

The Department of Finance is responsible for statewide financial planning and reporting. The department prepares the *Comprehensive Annual Financial Report* that contains the state's basic financial statements. The department also prepares the *Financial and Compliance Report of Federally Assisted Programs* (Single Audit report) each year. The department manages the state's main accounting systems, coordinates the sale of state general obligation bonds, enters into master lease purchase agreements for state agencies, processes payments of some appropriations and grants, and provides guidance to other state agencies in areas of financial management.

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 the *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

## **Conclusions**

We issued an unqualified audit opinion, dated December 6, 2002, on the State of Minnesota's basic financial statements for the year ended June 30, 2002. In accordance with *Government Auditing Standards*, we also issued our report, dated December 6, 2002, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. In March 2003, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with the U.S. Office of Management and Budget's *Circular A-133*.

As a result of our financial statement audit, we identified some internal control weaknesses over financial reporting that we discuss in the following findings.

## **1. The financial reporting unit did not properly secure the financial statement preparation databases and queries.**

Some financial reporting employees had unnecessary clearance to the data and computer programs that are used to prepare the *Comprehensive Annual Financial Report*. Limiting security clearances is an important control to prevent unauthorized changes to the data that underlies the state's financial statements. Without appropriate security controls, unauthorized data changes could lead to costly delays in the financial statement preparation process. Unauthorized data changes could also diminish the integrity of information that the department uses to make important financial reporting decisions.

The department used a financial reporting software package along with several different databases and queries to prepare the state's financial statements. We assessed security controls over these financial reporting components and found some employees with inappropriate clearances and others that shared accounts and passwords. We also found the department did not secure one powerful database administration account. The following is a synopsis of the security concerns that came to our attention:

- Twenty-two employees could make changes to the databases that were used to gather and reformat statewide accounting system financial information. Some of these employees may have needed read-only access to the databases to fulfill their job duties. However, very few employees needed clearance to modify the financial reporting data or the underlying extraction queries.
- Thirteen employees could modify the worksheet that the department used to generate the camera-ready financial statements. The department designated specific employees to make all changes to this worksheet because it contains complex formulas that interact with the financial reporting software. However, other employees could easily circumvent these change control procedures.
- Two employees shared a powerful account that was used to administer the financial reporting software. This administrative account had complete and unfettered access to all financial reporting data, including the chart of accounts.
- All employees in the financial reporting unit shared an account to access a financial reporting information warehouse (referred to as "Idata"). This shared account gave the employees the ability to update or delete the Idata information, even though such clearance was not necessary.
- The department did not assign a password to one extremely powerful database administration account. This account had complete access to all data underlying the financial reporting software. When questioned, the department took immediate action to remedy this security weakness.

Assigning unique accounts and passwords to all employees is important because it provides organizations with a mechanism to identify the person who initiated each transaction. Sharing

## Department of Finance

passwords is always unacceptable because it destroys individual accountability. Once a password has been shared, it is virtually impossible to identify who initiated a specific computerized transaction.

### *Recommendations*

- *When granting access to the financial reporting databases and queries, the department should give employees the minimum clearance necessary to perform their job duties.*
- *The department should prohibit employees from sharing passwords.*

## **2. The department published different budgetary financial reports that require reconciliation and had errors and omissions in its preliminary budgetary financial statements.**

The Budget Division and the Accounting Services Division each publish separate budgetary financial reports for funds with legally adopted budgets. Each division's reports outlines the projected revenues, expenditures, and undesignated balance of each fund. By design, the two divisions do not always use the same criteria to account for financial events. As a result, the same fund often had a different undesignated balance in each division's budgetary report.

For the most part, each division produces its budgetary reports independently. The Budget Division publishes a Biennial Operating Budget several times throughout the fiscal year. At the end of the fiscal year, the Budget Division then adjusts its estimates to reflect the actual financial activities that occurred. The Accounting Services Division publishes projected and actual budgetary data in the state's *Comprehensive Annual Financial Report (CAFR)* and its *Legal Level of Budgetary Control (LLBC)* report. When questioned, Accounting Services Division employees told us that they produce their own budgetary financial reports because those produced by the Budget Division do not contain the necessary level of detail for financial reporting purposes.

Our audit identified significant differences between the two divisions' budgetary reports. For example, in its final fiscal year 2002 Biennial Operating Budget, the department reported a budgetary fund balance of \$205 million for the Trunk Highway Fund. This balance was 26 percent lower than the actual ending fund balance reported in the state's CAFR. Other funds had significant differences as well. We asked the department to investigate selected variances and learned that each division uses different criteria to account for certain financial activities. For example, long-term government projects are typically encumbered in the state's accounting system when contracts are executed. The Budget Division counts all of the anticipated contract payments as expenditures in the year when the contract is encumbered. However, the Accounting Services Division recognizes the expenditures over the life of the project, as contractors are paid. We also learned that each division records fund balance reservations differently. Adopting consistent budgetary financial reporting practices throughout the department could help alleviate the confusion between the two types of budgetary reports.

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Finally, our audit identified many errors and omissions that required adjustments to the department's preliminary budgetary financial statements contained in the CAFR and the LLBC report. For example, we identified \$152 million that was omitted from the General Fund's original budget. We detected the error by comparing the preliminary budgetary financial statements to the Biennial Operating Budget. In addition, we made adjustments to remedy inaccurate reservations of fund balance in several funds, and to remove reservations that had no legal basis. We also made adjustments to the Natural Resources Fund budgetary statements because the department did not include financial information for certain aspects of the fund's financial activities. A more effective use of analytical review procedures, including a comparison of last year's financial statements to the current year's preliminary financial statements and other sources of information, could help the department identify these types of errors and omissions.

### *Recommendations*

- *The department should search for ways to modify its budgetary financial reporting practices to reduce the differences and minimize confusion.*
- *The department should perform analytical review procedures to identify potential errors and omissions in its budgetary financial statements.*

### **3. The financial reporting unit did not ensure the accuracy and completeness of some financial information provided by other state agencies for inclusion in the state's financial statements.**

The Department of Finance did not adequately monitor some financial information provided by other state agencies for external financial reporting. We adjusted the financial statements for several types of financial reporting inaccuracies involving accounts payable, revenues and associated accounts receivable, and errors with financial statements prepared by other state agencies.

In the past two years, new accounting principles have significantly impacted external financial reporting for governments. The new accounting principles significantly changed the way governments account for grant activity and how governments present external financial statements. The Department of Finance oversees and coordinates the reporting of financial activity by informing state agencies of applicable accounting requirements, providing checklists and memorandums documenting the requirements, and by analyzing various financial transactions recorded on the state's accounting systems. We found, however, the following errors and omissions in the information provided by certain state agencies. Left uncorrected, these types of transactions have the potential to impact the accuracy of the state's financial reporting process.

- We noted several concerns with the financial information submitted by the Minnesota Department of Transportation (MnDOT):



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--MnDOT understated accounts payable in the county highway and municipal street state aid funds by \$23.7 million. MnDOT records the payments in a subsystem so that relevant information is not available in the state's primary accounting system for financial reporting. The department needs to adjust the financial statements to accurately record these payments.

--MnDOT incorrectly reported \$13.6 million in revenues in its fund financial statements. This error resulted in these revenues erroneously being reported on the Government-wide Statement of Activities as other general revenue rather than program revenues of the Transportation or Public Safety and Corrections Functions.

--MnDOT incorrectly included state funded projects in its calculation of federal aid receivables.

- The Department of Human Services (DHS) did not recognize accounts receivable in accordance with applicable accounting principles, and did not categorize its receivables in a way to facilitate financial reporting. For example, DHS erroneously recognized accounts receivable when it sent out invoices for surcharges to hospitals and health maintenance organizations rather than when the underlying economic event (when the organization earned the revenue) occurred. The department also did not consistently recognize accounts receivable for benefit recoveries, even after a legal claim had been established. In addition, the department's accounts receivable reports had several inaccuracies and did not provide enough detail to allow for proper presentation in the state's financial statements.
- Children, Families & Learning continued to incorrectly report some expenditure transactions on the state's accounting system. The errors resulted in audit adjustments totaling over \$8 million to prevent an understatement of liabilities on the state's financial statements. Since the additional liabilities would have been offset by recognizing federal aid receivables associated with those transactions, the fund balance would not have been affected.
- The preliminary financial statements prepared by the Iron Range Resources and Rehabilitation Agency (IRRRA) for the Giants Ridge Golf and Ski Resort had certain fundamental problems. The cash balance on the financial statements did not reconcile to the state's accounting system and included other IRRRA activity. Although the IRRRA had compiled financial information for Giants Ridge in the past, the financial reporting requirements for the fund changed with the implementation of the new governmental accounting principles this year. The Department of Finance could have averted these problems if it had determined earlier that the financial activity recorded on the state's accounting system did not support the agency prepared statements.

The Department of Finance delegates responsibility to all state agencies for the proper reporting of financial activity in accordance with generally accepted accounting principles. Finance is,

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however, ultimately responsible for the accurate presentation of the information in the state's financial statements.

### *Recommendation*

- *The Department of Finance needs to work with certain state agencies to improve the accuracy of the financial information submitted for external financial reporting.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 13, 2003.

*/s/ James R. Nobles*

James R. Nobles  
Legislative Auditor

*/s/ Claudia J. Gudvangen*

Claudia J. Gudvangen, CPA  
Deputy Legislative Auditor

End of Fieldwork: January 31, 2003

Report Signed On: March 11, 2003

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**Status of Prior Audit Issues  
As of January 31, 2003**

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**March 21, 2002, Legislative Audit Report 02-20** examined the department's activities and programs material to the State of Minnesota's *Comprehensive Annual Financial Report* and the Single Audit for the year ended June 30, 2001. The financial statement scope included cash and debt management, capital assets, and various loan programs. The Single Audit scope covered compliance with federal requirements relating to cash management and statewide indirect costs. In addition, we reviewed internal controls over selected administrative operations of the department, including payroll, computer system services, purchases of supplies and equipment, and non-operating grants and claims. The report did not contain any findings required to be reported under *Government Auditing Standards*.

**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.



State of Minnesota  
Department of Finance

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March 10, 2003

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

Dear Mr. Nobles:

Thank you for the opportunity for my staff to discuss your audit findings with the individuals in your office responsible for the Department of Finance audit. We are committed to providing accurate financial information to state agencies, the legislature, and the public. We will continue to work toward improvements in our processes.

### **Recommendation**

When granting access to the financial reporting databases and queries, the department should give employees the minimum clearance necessary to perform their job duties. The department should prohibit employees from sharing passwords.

### **Response**

We agree with this recommendation. The financial reporting software, American Fundware (AFW), is not part of the statewide accounting system, but is a reporting tool used by financial reporting to prepare the Comprehensive Annual Financial Report (CAFR). Access is limited to employees in financial reporting. The department is committed to giving employees the minimum clearance necessary to perform their job responsibilities efficiently. Four of the five recommendations have been implemented including separate passwords for the two employees with administrative responsibilities. The only remaining issue relates to establishing individual access accounts to Idata, which will be implemented by June 30, 2003.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: June 30, 2003

### **Recommendation**

The department should search for ways to modify its budgetary financial reporting practices to reduce the differences and minimize confusion.

## **Response**

The department agrees with this recommendation. The department publishes two separate budgetary reports, the Fund Balance Analysis Report (FBA) and Legal Level of Budgetary Control Report (LLBC), which have two distinct purposes. The FBA and the LLBC do not use the same criteria to account for all financial events due to long standing practice resulting from the different purposes. The FBA is used for budget planning to develop budgets with a multiple year future perspective. The LLBC is required by Generally Accepting Accounting Principles which is used to determine whether the government limited spending within it's legally adopted budget on a historical perspective based on a single year. The differences are identified to the financial statement readers by providing detailed explanations in both the "Summary of Reporting Policies" and in the financial statement notes within the LLBC. The department divisions will work to determine whether or not the differences can be minimized to increase efficiency and reduce the potential for confusion.

For example, the audit finding identifies a significant variance in the fund balance of the Trunk Highway Fund. This variance is the result of the FBA report including pre-encumbrance and encumbrance reserve amounts as expenditures in the current year for long-term projects. Because these reserves will not be liquidated for several (up to six) years and the scope of the LLBC is one year, the LLBC report includes only the actual expenditures incurred in the current year. These are clearly identified in the "Summary of Reporting Policies" of the LLBC report.

The department has reconciliation procedures and analytical review procedures, which are typically performed prior to releasing the statements to the auditors. During the current year, the department experienced turnover of key financial reporting positions, which had a large impact on staff's workload in addition to the implementation of a new accounting pronouncement. As a result, reconciliations and analytical procedures were not completed prior to releasing the preliminary budgetary statements. The preliminary status of the statements was not properly communicated to the audit managers. These reconciliations and analytical procedures will be performed prior to releasing the statements to the Office of the Legislative Auditor in the future and we will improve our communication with the audit managers.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: September 30, 2003

James R. Nobles  
March 10, 2003  
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### **Recommendation**

The Department of Finance needs to work with certain state agencies to improve the accuracy of the financial information submitted for external financial reporting.

### **Response**

We agree with this recommendation. The department is committed to ensuring the accuracy of the state's financial statements. The department will request MnDOT to report the additional accounts payable to the Department of Finance. The department will ensure the information is reflected in the financial statements. The department developed a mechanism to automate the preparation of agency prepared governmental funds to avoid revenue classification differences in the future. In relation to the federal aid receivable, the department agrees that an understanding of the calculation of this amount should be reviewed. The department will work with MnDOT and the Office of the Legislative Auditor to ensure proper accounting of the federal aid receivable.

The department is currently working with the Department of Human Services and the Office of the Legislative Auditor to ensure the accuracy and adequacy of the accounts receivable for financial reporting purposes. The department is also in the process of drafting an accounts receivable policy for financial reporting purposes to address recent accounting changes.

The department will request additional accounts payable information from the Department of Children, Families, and Learning's subsystem that will be reimbursed by the federal government.

The department is working with the employee from Iron Range Resources and Rehabilitation Agency that prepares Giants Ridge financial statements to ensure the transactions are properly reflected in the financial statements.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: June 30, 2003

Sincerely,



Dan McElroy  
Commissioner