

Management Letter

State Agricultural Society
For the Year Ended October 31, 2002



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

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Audit Participation

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA, CISA	Audit Manager
Chris Buse, CPA, CISA	Audit Manager
Scott Tjomsland, CPA	Auditor-in-Charge
Marissa Isenberg	Auditor
Jacqueline Wessel	Intern

Exit Conference

We discussed the results of the audit at an exit conference with the following staff of the State Agricultural Society on April 1, 2003:

Jerry Hammer	Executive Vice President
Marshall Jacobson	Controller

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Report Summary

Key Findings and Recommendations

- The State Agricultural Society has not appropriately resolved the information technology security risks we identified in our prior audit report. We found significant security weaknesses during our review of information technology controls at the Society. We recommended that the Society build a comprehensive security infrastructure that addresses current information technology risks. (Finding 1, page 5)
- The Society did not completely reconcile its general ledger cash account to bank cash balances. We recommended that the Society improve its cash reconciliation procedures to completely reconcile cash balances in bank accounts to cash recorded in the general ledger each month. In addition, it should consider maintaining separate cash accounts in the general ledger for each bank account or consolidating its bank accounts. (Finding 2, page 5)
- The Society did not establish internal controls to ensure the accuracy of the daily average ticket price of carnival tickets sold at the State Fair. We recommended that the Society establish these internal controls. (Finding 3, page 6)
- The Society made \$300 contributions to the deferred compensation accounts of two employees who were not entitled to the benefit. We recommended that the Society recover the contributions made to the two employees' deferred compensation accounts. (Finding 4, page 7)

Background

The State Agricultural Society operates Minnesota's annual state fair and maintains the state fairgrounds. The Society earned about \$27.9 million in operating revenues during fiscal year 2002 and had total assets of over \$33 million on October 31, 2002.

The primary objective of our audit was to issue an opinion on the financial statements of the State Agricultural Society for the year ended October 31, 2002. The Society's Annual Report for fiscal year 2002 includes our opinion thereon dated March 14, 2003. This report addresses internal control weaknesses we found during our audit. The Society's response to the issues is included in the report.

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

Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Howard Recknor, President
Board of Managers
State Agricultural Society

Members of the State Agricultural Society

Mr. Jerry Hammer, Executive Vice President
State Agricultural Society

We have audited the financial statements of the State Agricultural Society as of and for the year ended October 31, 2002, and have issued our report thereon dated March 14, 2003. 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.

Compliance

As part of obtaining reasonable assurance about whether the State Agricultural Society's 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 one instance of noncompliance that is required to be reported under *Government Auditing Standards*, as described in Finding 4 of the accompanying section entitled *Current Findings and Recommendations*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State Agricultural Society's 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 internal

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control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be 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 the State Agricultural Society's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. We describe reportable conditions as Findings 1 through 3 in the accompanying section entitled *Current Findings and Recommendations*.

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 and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described in Finding 1 to be a material weakness. This report is intended solely for the information and use of the State Agricultural Society's management and the Legislative Audit Commission 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

March 14, 2003

Current Findings and Recommendations

1. PRIOR FINDING PARTIALLY RESOLVED: The State Agricultural Society has not appropriately resolved its information technology security risks.

Our prior audit of the State Agricultural Society identified significant information technology security weaknesses. The Society lacked a comprehensive security foundation and had not addressed many relevant technology risks. We communicated the general nature of these weaknesses to Society's management in our written audit report. However, to minimize exposure to the organization, we also provided the Society with a confidential report of specific, detailed security findings and recommendations.

The Society's systems remain vulnerable to unauthorized access. It has taken steps to address some of the weaknesses. However, more work needs to be done to reduce the organization's exposure to an acceptable level. We are concerned that the Society still does not have a written information technology security policy, procedures, or standards. This documentation is important because it constitutes the framework to positively control information technology resources. We also are concerned that many high-risk findings in our confidential report have not been addressed.

Recommendation

- *The State Agricultural Society should build a comprehensive security infrastructure that addresses current information technology risks.*

2. The Society did not completely reconcile its general ledger cash account to bank cash balances.

During fiscal year 2002, the Society was unable to completely reconcile cash balances in its four bank accounts to the cash balance recorded in its general ledger. As a result, at year-end the Society had to write off \$7,300 of cash recorded in the general ledger to equal the cash balances in the bank accounts. Some of the difference appears to have been caused by errors in posting subsidiary accounting transactions to the general ledger. Other differences relate to voided checks.

Although the Society attempted to monthly reconcile the cash balances in the bank accounts to the general ledger cash balance, it did not identify the reasons for some differences. In addition, the Society did not make immediate corrections to resolve identified reconciling items, which made subsequent reconciliations more complicated. Completely reconciling the cash balances in the bank accounts to the cash balance in the general ledger is a key control to ensure that cash is properly accounted for, and that the Society's financial activity is accurately recorded in the general ledger.

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The Society's reconciliation process was further complicated by the fact that it had four bank accounts, but a single cash account in the general ledger. One of the four bank accounts was the primary account, while the other three were clearing accounts for specific activities. To reconcile the three clearing accounts, the Society compared the account bank balances to the amount of uncleared checks from those accounts, but did not verify that the related financial activity had been accurately recorded in the general ledger. In addition, Society transfers to the three clearing accounts did not always match the actual amount of checks generated from those accounts, which created reconciling items between bank accounts. However, these reconciling items were not apparent in the general ledger, because the Society's general ledger only had one cash account. Establishing separate general ledger cash accounts for each bank account would eliminate transfer errors as reconciling items, would allow the Society to record transfers between accounts in the general ledger, and would allow the Society to use the monthly reconciliations to ensure that all cash activity in the accounts is accurately recorded in the general ledger. Alternatively, consolidating the bank accounts into a single account would also improve the effectiveness of the reconciliations by eliminating transfer activity altogether.

Recommendations

- *The Society should improve its cash reconciliation procedures to completely reconcile cash balances in bank accounts to cash recorded in the general ledger each month. It should resolve all differences and promptly make adjusting entries, as needed.*
- *The Society should consider maintaining separate cash accounts in the general ledger for each bank account or consolidating its bank accounts.*

3. The Society did not establish internal controls to ensure the accuracy of the daily average ticket price of carnival tickets sold at the State Fair.

The Society did not establish procedures to ensure its calculations of daily average ticket prices of carnival tickets sold at the State Fair were accurate. These calculations formed the basis for payments to carnival ride and game operators. Carnival ride and game operators collected tickets from customers then turned in the tickets collected each day to the Society. The Society used the average carnival ticket price to calculate the gross revenue earned by the operators for the tickets collected. The Society then paid each operator the appropriate percent of the gross revenue as specified in operator license agreements.

During the 2002 State Fair, the Society miscalculated the average ticket price of carnival tickets for 7 of the 12 days. One of those errors caused the Society to overpay carnival ride and game operators by more than \$19,000, while the other errors resulted in smaller overpayments or underpayments to those operators. Because the Society sold carnival tickets at a variety of prices, depending on quantities purchased, it calculated an average carnival ticket price each day. Society staff performed the calculation of average price on manual worksheets at the end of each day. However, the ticket price worksheets for seven days contained errors, which included using

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the wrong number of tickets sold and a variety of mathematical errors. To ensure it accurately pays carnival ride and game operators, the Society needs to accurately calculate the average carnival ticket price.

Recommendation

- *The Society should establish internal controls to ensure the accuracy of the daily average ticket price of carnival tickets sold at the State Fair.*

4. The Society made \$300 contributions to the deferred compensation accounts of two employees who were not entitled to the benefit.

The Society made \$300 contributions to the deferred compensation accounts of two employees who also converted vacation hours to their deferred compensation accounts in the same year. The Society's employee plan states that employees may either convert up to 80 hours of vacation to deferred compensation accounts or receive a \$300 matching contribution to deferred compensation accounts from the Society. In each instance, the employee received the \$300 contribution from the Society in the first half of the year, then converted vacation hours at the end of the year. Since the value of the converted vacation hours is greater than the \$300 Society matching contribution, the Society should recover the \$300 from each employee.

Recommendation

- *The Society should recover the contributions made to the two employees' deferred compensation accounts.*

Status of Prior Audit Issues
As of March 14, 2003

Most Recent Audit

The Office of the Legislative Auditor performs an annual audit of the State Agricultural Society. Legislative Audit Report 02-23, dated April 4, 2002, covered the fiscal year ended October 31, 2001. The audit scope included those areas material to the Society's financial statements. The report contained one finding, related to the Society's technology security risks. While the Society has taken some steps to address the issue, further action is necessary to fully resolve the finding. Therefore, we repeat the issue as Finding 1 in this report.



Jeanine Leifeld, CPA, CISA
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar St.
St. Paul, MN 55155

April 11, 2003

Dear Jeanine,

Response to finding number one:

The OLA's prior audit presented specific recommendations to improve computer system security, and it was understood that this would be a multi-year project. We responded that we expected to make significant progress with security issues in the coming year, and we believe that we have. The majority of the recommendations have been implemented and the others will be undertaken with the assistance of computer security specialists and OLA staff.

Response to finding number two:

Our general ledger and cash-balancing systems have worked very well, as approved by the OLA, for decades. In '02, we experienced a few challenges with accounting entries due chiefly to employee turnover. We expect no such problems in the future.

Response to finding number three:

With our current reconciliation and payment system, daily ticket price averages are computed in a very short time period during the graveyard shift in order to facilitate next-day payment to ride and game operators. Because of time constraints, we recognize that errors will sometimes occur, so we compensate by allowing for adjustments to be made on the succeeding day's report. Also, the State Fair retains all of the revenue from tickets that are purchased but not redeemed at any ride or game; in '02, that total was \$54,340. That being said, we agree with the finding and are currently looking at alternatives to streamline our current system and eliminate the need for overnight calculations, and we anticipate that this will be implemented for the '03 fair. Further, within two to three years, it is highly likely that the entire Midway and Kidway operation will be on a bar coded ticket system, eliminating the need for our current system.

Response to finding number four:

We respectfully disagree with the finding and the recommendation. In 1999, the OLA recommended that the State Fair reduce its reliance on custom software, and we agreed. As a result, we installed an off-the-shelf payroll software package in 2000 and immediately experienced software-related difficulties with accurate accrual of vacation

and sick leave; neither fair staff nor the software manufacturer could solve the problem. To correct the situation, finance staff conducted a manual audit of all full-time staff time cards covering the past two years and discovered that one employee had been cheated out of earned vacation time. We also discovered that another had erroneously been given the \$300 retirement account contribution. To be completely fair to the staff member who lost earned vacation time, we provided that employee with the \$300 contribution. The other situation was a software-related error for which we do not believe the employee should be penalized. We will not seek reimbursement from either of the two staff members.

Our thanks to you and your team for the service provided by the OLA. We appreciate your efforts on our behalf.

Sincerely,

/s/ Jerry Hammer

Jerry Hammer
Executive Vice President