



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Office of the State Auditor
Internal Control and Compliance Audit
January 1, 2007, to January 31, 2009

May 29, 2009

Report 09-20

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

May 29, 2009

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Rebecca Otto, State Auditor
Office of the State Auditor

This report represents the results of our internal control and compliance audit of the Office of the State Auditor for the period January 1, 2007, through January 31, 2009.

We discussed the results of the audit with Office of the State Auditor's staff on May 21, 2009. The audit was conducted by Amy Jorgenson, CPA (Audit Manager) and Xin Wang, CPA (Auditor-in-Charge), assisted by auditors Tyler Billig and Tracia Gimbut.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Office of the State Auditor. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 29, 2009.

We received the full cooperation of the Office of the State Auditor's staff while performing this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Office of the State Auditor's internal controls were generally adequate to ensure that it safeguarded assets, produced reliable financial information, and complied with finance-related legal requirements. For the items tested, the office complied with finance-related legal requirements over its financial activities. The office had one weakness in internal control, as noted below.

Finding

- The Office of the State Auditor did not establish sufficient internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system. ([Finding 1, page 7](#))

Audit Objectives and Scope

| <u>Objectives</u> | <u>Period Audited</u> |
|---------------------|---|
| • Internal Controls | January 1, 2007, through January 31, 2009 |
| • Legal Compliance | |

Programs Audited

- Appropriation Control
- Audit Practice Revenue
- Payroll and Travel Expenditures
- Selected Administrative Expenditures

Background

The Office of the State Auditor was established by Article V of the *Minnesota Constitution* and operates under [Minnesota Statutes](#) 2008, Chapter 6. The Office of the State Auditor is charged with overseeing funds spent by local governments in Minnesota. It performs audits of local governments' financial statements and reviews documents, data, reports, and complaints reported to the office. The office is primarily funded through General Fund appropriations. The office deposits audit practice revenue to the General Fund; this revenue is not available to the office to fund its operations. Rebecca Otto was elected the State Auditor in November 2006 and took office on January 2, 2007.

Office of the State Auditor

Agency Overview

The Office of the State Auditor was established by Article V of the *Minnesota Constitution* and operates under [Minnesota Statutes](#) 2008, Chapter 6. The State Auditor is a constitutional officer elected to a four-year term in the statewide general election. Rebecca Otto was elected the State Auditor in November 2006 and took office on January 2, 2007. The State Auditor serves on six state boards: the State Executive Council, State Board of Investment, Land Exchange Board, Minnesota Housing Finance Agency, Public Employees Retirement Association, and Rural Finance Authority Board.

The office is primarily funded through General Fund appropriations. Its appropriation was about \$8.3 million for fiscal year 2007 and \$9.2 million for fiscal years 2008 and 2009. [Minnesota Statutes](#) 2008, 6.58, requires the office to collect fees from audited entities to cover its audit costs. The office deposits this revenue to the General Fund, and it is not available to fund the office's operations. Payroll is the most significant administrative cost. Table 1 summarizes the office's financial activities for fiscal year 2008.

The office has several locations throughout the state. The main office in Saint Paul handles all accounting activities for the office.

Table 1
Summary of Financial Activity
Fiscal Year 2008¹

| Sources | General Fund | Special Revenue Fund |
|--|----------------------------|-----------------------------|
| Operating Appropriation | \$ 9,234,000 | \$ 0 |
| Balance Forward In from Fiscal Year 2007 | 1,727,827 | 2,159 |
| Dedicated Revenue ² | 0 | 62,252 |
| Transfer In – Technology Carry-Forward | 0 | 200,000 |
| Transfer In – Tax Increment Financing Account ³ | <u>1,074,819</u> | 0 |
| Total Sources | <u>\$12,036,646</u> | <u>\$264,411</u> |
| Uses | | |
| Payroll | \$ 7,836,055 | \$ 10,810 |
| Other Administrative Costs ⁴ | 585,887 | 91,988 |
| Rent | 416,027 | 1,359 |
| Balance Forward Out to Fiscal Year 2009 | <u>3,198,677</u> | <u>160,254</u> |
| Total Uses | <u>\$12,036,646</u> | <u>\$264,411</u> |

¹ Our audit scope was January 1, 2007, through January 31, 2009. This scope included the last half of fiscal year 2007, all of fiscal year 2008, and the first half of fiscal year 2009. This table presents activity for fiscal year 2008 only, because it was the full fiscal year in our audit scope.

² The office collected dedicated revenue for seminar and workshop activities.

³ The Tax Increment Finance Division received funding in fiscal year 2008 from a charge on tax increment financing districts, as specified by *Minnesota Statutes 2008, 469.177, subd. 11*. The Treasury Division of the Department of Management and Budget collected the funds, deposited the money in the General Fund, and then transferred the funds into the office's accounts.

⁴ Other administrative costs included travel, equipment, supplies, professional/technical services contracts, computer services, communications, employee development, and other operating costs.

Source: Minnesota Accounting and Procurement System.

Objectives, Scope, and Methodology

Our audit of the Office of the State Auditor focused on the following audit objectives for the period January 1, 2007, to January 31, 2009:

- Were the office's internal controls adequate to ensure that it safeguarded its assets, complied with legal requirements, produced reliable financial data and conducted its operations in a reasonable and prudent manner?
- Did the office comply with finance-related legal requirements?
- Did the office resolve prior audit findings?

To answer these questions, we interviewed office staff to gain an understanding of the internal controls related to financial operations. In determining our audit approach, we considered the risk of errors in the accounting records and potential noncompliance with finance-related legal requirements. We also analyzed

accounting data to identify unusual transactions or significant changes in financial operations for further review. In addition, we selected a sample of financial transactions and reviewed supporting documentation to test whether the controls were effective and if the transactions complied with laws, regulations, policies, and contract provisions.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used various criteria to evaluate internal control and compliance. We used as our criteria to evaluate the entity's controls the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.¹ We used state laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and the office's internal policies and procedures as evaluation criteria over compliance.²

Conclusions

The Office of the State Auditor's internal controls were generally adequate to ensure that it safeguarded its assets, complied with legal requirements, produced reliable financial data, and conducted its operations in a reasonable and prudent manner. However, the office did not establish sufficient internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system.

For the items tested, the office complied with finance-related legal requirements over its financial activities.

¹ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting Internal Control-Integrated Framework is the accepted accounting and auditing standard for internal control design and assessment.

² The Department of Management and Budget consists of the former departments of Finance and Employee Relations.

The office resolved all prior audit findings. Those findings related to the office's need to better certify the cost of audits and examinations of Police and Fire Relief associations to the Department of Revenue and to apply interest on past due balances.

The *Finding and Recommendations* section further explains the internal control weakness noted above.

Finding and Recommendations

The Office of the State Auditor did not establish sufficient internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system.

The office's internal controls need improvement to mitigate the risk resulting from employees having incompatible access to the state's accounting system. Because three employees could encumber funds, create contracts, enter purchase orders, receive goods, and make payments, the office assigned an employee to review the transactions processed by these employees. The purpose of the review was to ensure that the transactions were authorized and appropriate. However, the employee assigned to perform this review also had the same incompatible access. Separation of incompatible functions is a fundamental internal control that prevents an employee from handling a transaction from beginning to end without the involvement of another employee. We did not find any errors or irregularities resulting from the incompatible access.

The office also had not documented its mitigating controls. Department of Management and Budget's policy requires entities that assign users to incompatible security profiles to develop and adhere to a written plan that contains a description of the independent reviews it will perform to monitor the related transactions.³

Recommendations

- *The office should revise its mitigating controls to ensure that they are sufficient to reduce the risk of error or fraud because of incompatible access to the accounting system.*
- *The office should document in a written plan its mitigating controls related to incompatible access to the accounting system.*

³ Department of Management and Budget Policy 1101-07.

Finding 1



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STATE AUDITOR

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May 22, 2009

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the finding and recommendations included in the internal control and compliance audit of the Office of the State Auditor for the period January 1, 2007, through January 31, 2009.

Finding: The Office of the State Auditor did not establish sufficient internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system.

Recommendations:

- The office should revise its mitigating controls to ensure that they are sufficient to reduce the risk of error or fraud because of incompatible access to the accounting system.
- The office should document in a written plan its mitigating controls related to incompatible access to the accounting system.

Response: As noted in this report, the Office of the Legislative Auditor did not find any errors or irregularities resulting from giving employees incompatible access to the state's accounting system.

In addition to the changes noted below, the Office of the State Auditor will continue to perform monthly procedures to identify unusual expenditures. These procedures include preparing and reviewing a report that summarizes expenditures by object class and division to identify amounts that are greater than anticipated. Any unusual amounts are investigated to verify that only authorized payments have been made. I review each month's report in addition to it being reviewed by the Deputy State Auditors and the Director of Budget, Finance, & Technology.

Mr. James R. Nobles
May 22, 2009
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The Office of the State Auditor has implemented changes to further enhance its internal controls and to reduce the risk of error caused by incompatible access to the accounting system. The changes include:

- Assigning the task of reviewing payments to someone independent of the staff responsible for encumbering funds, creating contracts, entering purchase orders, receiving goods, and making payments.
- Reducing the number of individuals that are authorized to encumber funds, create contracts, enter purchase orders, and make payments from three to two.
- Developing a written plan documenting the mitigating controls related to incompatible access to the accounting system.

Person Responsible: Matthew Lindemann, Director of Budget, Finance, & Technology

Implementation Date: Completed.

Thank you for the opportunity to respond to the finding and recommendations.

Sincerely,

/s/ Rebecca Otto

Rebecca Otto
State Auditor