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

**FINANCIAL AUDIT DIVISION REPORT**

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# **Minnesota State Board of Investment**

## **Financial Statement Audit**

### **Year Ended June 30, 2009**

**April 6, 2010**

**Report 10-13**

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FINANCIAL AUDIT DIVISION

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Howard J. Bicker, Executive Director  
Minnesota State Board of Investment

In auditing the State Board of Investment's Supplemental Investment Fund and Post Retirement Investment Fund financial statements for the year ended June 30, 2009, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements and did not identify any issues to report. This report contains our finding and recommendation on internal controls over financial reporting. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the State Board of Investment's internal controls or compliance. In addition, our work may not have identified all significant control deficiencies or instances of noncompliance with legal requirements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. This report meets the audit standard requirements of the American Institute of Certified Public Accountants and the Government Accountability Office to communicate internal control matters identified in a financial statement audit. The audit was conducted by Jim Riebe, CPA (Audit Manager) and Carl Otto, CPA, (Auditor-in-Charge), assisted by auditors Xin Wang, CPA, Lat Anantaphong, Lindsay Tietze, Kathy Rootham, and Alex Weber.

We consider the deficiency described in Finding 1 to be a material weakness. A material weakness is a significant deficiency, or 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 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.

Management's response to our finding and recommendation is presented in the accompanying section of this report titled, *Agency Response*. We did not audit the response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State Board of Investment'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. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 6, 2010.

*/s/ James R. Nobles*

James R. Nobles  
Legislative Auditor

*/s/ Cecile M. Ferkul*

Cecile M. Ferkul, CPA, CISA  
Deputy Legislative Auditor

End of Fieldwork: December 30, 2009

Report Signed On: April 5, 2010

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# Report Summary

## Conclusion

The Minnesota State Board of Investment's (SBI) financial statements for the Supplemental Investment Fund and the Post Retirement Investment Fund were fairly presented in all material respects. However, SBI had a weakness in internal control over financial reporting, as noted below.

## Finding

- Prior Finding Partially Resolved: The State Board of Investment did not sufficiently identify, analyze, and document internal controls related to financial reporting and business operations.

## Audit Scope

We audited SBI's Supplemental Investment Fund and Post Retirement Investment Fund financial statements for the fiscal year ended June 30, 2009.

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## Finding and Recommendation

### Finding 1

**Prior Finding Partially Resolved:**<sup>1</sup> The State Board of Investment did not sufficiently identify, analyze, and document internal controls related to financial reporting and business operations.

Although SBI made progress this year by documenting some key risks associated with financial reporting and business operations, it had not specifically identified controls to address the risks or monitoring activities to ensure the controls were effective, as required by Department of Management and Budget policy.<sup>2</sup> Until it designs and implements a comprehensive risk assessment, SBI has an increased likelihood of financial reporting errors and control deficiencies.

The State Board of Investment had the following deficiencies in its internal controls this year:

- SBI provided the three state retirement systems incorrect foreign investment values for inclusion in the retirement systems' footnote disclosures. It incorrectly reported to the retirement systems about \$82 million of cash and \$27 million of fixed income securities as invested in "other" foreign currency denominations instead of allocating the amounts to the specific foreign countries the funds were invested in. The incorrect amounts could have resulted in misleading financial statement disclosures about the retirement systems' risk due to foreign currency investments.

Because SBI invests the pension funds' assets, the retirement systems rely on SBI to provide information for financial statement preparation. Generally accepted governmental accounting principles require that if a government's deposits or investments are exposed to foreign currency risk, the government should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and investment type.<sup>3</sup>

- SBI's fiscal year 2009 draft financial statements submitted for audit required two material adjustments and one smaller adjustment. It did not report \$58 million of securities lending net earnings or \$10 million of fourth quarter management fees payable for the pooled investments

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<sup>1</sup> Office of the Legislative Auditor's Financial Audit Division [Report 09-15](#), State Board of Investment, issued April 2, 2009.

<sup>2</sup> Department of Management and Budget Policy Number 0102-01.

<sup>3</sup> Government Accounting Standards Board Statement 40: *Deposit and Investment Risk Disclosures*, paragraph. 17.

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accounts financial statements. It also overstated the Supplemental Investment Fund's bond management fees by \$190,000; absent effective controls, this error could have been more significant.

- SBI submitted an incorrect withdrawal request to its fiduciary bank, State Street Bank, to fund annuity payments due in May 2009. As a result of an account coding error, the amount of the withdrawal exceeded the annuity payments due by \$423,023. SBI's procedures to verify the withdrawal request to the supporting documentation failed to identify the error, which the Department of Management and Budget's treasury office identified and worked with SBI to resolve.

#### *Recommendation*

- *The State Board of Investment should ensure its controls over its business operations are operating effectively by:*
    - *Continuing its efforts to develop a comprehensive control structure that identifies and documents its financial reporting and business risks and control procedures and establishes an effective monitoring function that ensures controls operate as designed.*
    - *Ensuring it provides accurate information on foreign currency investments to the retirement systems.*
    - *Verifying the accuracy of its draft financial statements to detect errors before submitting them for audit.*
    - *Establishing monitoring controls to ensure the effectiveness of procedures to prevent errors in withdrawal requests submitted to State Street Bank.*
-

**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



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April 5, 2010

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to your report on internal control over the State Board of Investment financial reporting process.

Prior Finding Partially Resolved: The State Board of Investment did not sufficiently identify, analyze, and document internal controls related to financial reporting and business operations.

Recommendation: The State Board of Investment should ensure its controls over its business operations are operating effectively by:

- Continuing its efforts to develop a comprehensive control structure that identifies and documents its financial reporting and business risks and control procedures and establishes an effective monitoring function that ensures controls operate as designed.
- Ensuring it provides accurate information on foreign currency investments to the retirement systems.
- Verifying the accuracy of its draft financial statements to detect errors before submitting them for audit.
- Establishing monitoring controls to ensure the effectiveness of procedures to prevent errors in withdrawal requests submitted to State Street Bank.

**Response:**

- While the State Board of Investment continues to believe that overall the current internal controls are adequate, we do recognize that additional documentation of existing controls and procedures can be improved. The State Board of Investment will continue working to develop and maintain an effective internal control structure in accordance with Department of Management and Budget policy.

Mr. James R. Nobles  
April 5, 2010  
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- For a number of years the State Board of Investment reported the foreign currency risk for cash and fixed income investments in summary totals as no single currency amount was above the reportable level. When your auditors raised the issue of reporting foreign currency risk for cash and fixed income of currencies for which there was a reportable equity amount, we immediately updated the reporting on foreign currency investments to the retirement systems. The State Board of Investment will continue to report the information on foreign currency investments in accordance with this new interpretation in future years.
- The State Board of Investment will perform additional reviews to verify the accuracy of the draft financial statements prior to submitting them for audit.
- The State Board of Investment has reviewed the procedures related to the withdrawal requests submitted to State Street Bank and has established monitoring controls which should prevent future errors.

Person Responsible: Steve Schugel, Administrative Director

Implementation Date: June 30, 2010

Thank you for the opportunity to respond to your report's findings and recommendations.

Sincerely,



Howard Bicker  
Executive Director