



FINANCIAL AUDIT DIVISION REPORT

State Agricultural Society

Financial Statement Audit

Two Years Ended October 31, 2009

June 10, 2010

Report 10-19

FINANCIAL AUDIT DIVISION

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State of Minnesota • James Nobles, Legislative Auditor

June 10, 2010

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Mr. Denny Baker, President
State Agricultural Society Board of Managers

Members of the State Agricultural Society

Mr. Jerry Hammer, Executive Vice President
State Agricultural Society

In auditing the State Agricultural Society's basic financial statements for the two years ended October 31, 2009, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements. We did not identify any instances of noncompliance with legal provisions material to the financial statements. This report contains our findings and recommendations on internal controls over financial reporting and business operations. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the State Agricultural Society's internal controls or compliance. In addition, our work may not have identified all significant control deficiencies or instances of noncompliance with legal requirements.

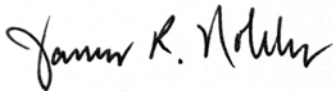
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. This report meets the audit standard requirements 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), Carl Otto, CPA, (Audit Coordinator), assisted by auditors Zach Yzermans, CPA, Tyler Billig, and Xin Wang, CPA.

We consider the deficiency described in Finding 1 to be a significant deficiency. 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. Finding 2 does not have a direct or material effect on the financial statements; however, it addresses a control weakness in the society's business operations.

We discussed the results of the audit with State Agricultural Society's staff on May 26, 2010. Management's response to our findings and recommendations 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 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. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 10, 2010.



James R. Nobles
Legislative Auditor



Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: March 30, 2010
Report Signed On: June 8, 2010

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Report Summary

Conclusion

The State Agricultural Society's financial statements for the two years ended October 31, 2009, were fairly presented in all material respects. However, the society had some weaknesses in internal control over financial reporting and business operations, as noted below.

The society resolved a prior audit finding by fully funding its debt service reserve account, as required by a bond covenant.¹

Findings

- The State Agricultural Society's staff did not consistently perform an independent review of payroll transactions to mitigate the risk associated with incompatible payroll duties. ([Finding 1, page 3](#))
- The State Agricultural Society did not have a written contract for towing services and had not established formal policies and procedures for service contracts. ([Finding 2, page 3](#))

Audit Scope and Objectives

We audited the State Agricultural Society's basic financial statements for the two years ended October 31, 2009, and reviewed controls over financial operations and compliance with finance-related legal provisions. We also determined the status of a prior audit finding that the society had under-funded its debt service account in fiscal year 2008, which resulted in noncompliance with a bond covenant.

¹ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 09-21, *State Agricultural Society Financial Statement Audit, Two Years Ended October 31, 2008*, issued June 4, 2009.

Findings and Recommendations

The State Agricultural Society's staff did not consistently perform an independent review of payroll transactions to mitigate the risk associated with incompatible payroll duties.

Finding 1

During fiscal year 2009, staff had not performed an independent review of payroll reports for five of six pay periods we tested. The society required the review as a mitigating control to ensure the propriety of payroll transactions it processed. The review alleviated the risk caused by a lack of segregation of duties in the payroll process. One employee was responsible for processing payroll, including the employee's own transactions, and for recording human resources data in the payroll system. Society payroll amounted to approximately \$9 million or about 25 percent of total expenses for fiscal year 2009.

Segregation of incompatible duties is an important, fundamental internal control to prevent an employee from initiating, processing, and approving transactions without involvement of other staff. Without proper segregation, an employee could manipulate payroll transactions to benefit themselves or others without detection. Although eliminating the incompatible access would be the strongest control, a well-designed mitigating control can be effective to reduce the risk of error or fraud.

Recommendation

- *The society should ensure that staff independent of the payroll process periodically review payroll reports to ensure the propriety of payroll transactions. Alternatively, it should segregate incompatible duties in its payroll process.*

The State Agricultural Society did not have a written contract for towing services and had not established formal policies and procedures for service contracts.

Finding 2

The society did not execute a written contract for towing services provided by a vendor during fair time. The most recent contract with the vendor expired in 2005. Although the society initiated renewal of the contract in the summer of 2005 and the vendor provided a list of rates for towing services, the society never executed a written contract. In fiscal year 2009, the society paid approximately \$19,000 to the vendor for towing services. Senior management indicated the society should have executed a contract for the towing services. A written contract could have protected the society from liability due to possible damages

incurred as a result of the towing services provided on fair property by including a liability clause in the contract and by requiring evidence of insurance from the vendor.

The society did not have written guidelines for staff to follow when developing contracts. State statutes exempt the society from having to advertise for or publicly request bids for contract services.² However, good business practices would expect management to specify when a contract is required for services, the duration of the contract, and the types of bidding procedures to be followed to provide assurance the society obtains the required services at the best possible value.

Recommendation

- *The society should:*
 - *Execute a written contract for the towing services provided during the fair.*
 - *Develop and ensure compliance with policies and procedures for contractual services that address dollar thresholds for when contracts should be executed, when bids or solicitations should be obtained, the duration of contracts, and vendor insurance considerations.*

² *Minnesota Statutes 2009, 37.19.*



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

June 1, 2010

Dear Mr. Nobles,

Response to finding one: The Society has begun the process of further segregating duties relating to the payroll process, and has increased the frequency of periodic payroll reviews.

Response to finding two: The Society has carefully reviewed the 209 agreements processed through our contracts management department for the '09 State Fair and we have found no other issues. The Society does, in fact, follow good business practices with long-standing policies and procedures for service contracts including duration of agreements and bidding procedures. These policies and procedures will be documented in writing.

Our thanks to you, Jim Riebe and the audit team for your help.

Sincerely,

Jerry Hammer
Executive Vice President

