OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Office of the State Auditor

Internal Controls and Compliance Audit

January 1, 2009, through December 31, 2010

June 30, 2011 **Report 11-17**

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June 30, 2011

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable State Auditor Rebecca Otto
Office of the State Auditor

This report presents the results of our internal control and compliance audit of the Office of the State Auditor for the period January 1, 2009, through December 31, 2010. The audit scope includes the last two years of State Auditor Otto's first term in office.

The audit was conducted by Jim Riebe, CPA (Audit Manager) and Joan Haskin, CPA, CISA (Auditor-in-Charge), assisted by auditors Chau Nguyen, CPA, and Reidar Gullicksrud.

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 June 30, 2011.

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

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

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The Office of the State Auditor's internal controls were adequate to ensure that it safeguarded assets, accurately paid employees and vendors in accordance with management's authorizations, 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 implemented the prior audit recommendation.[1] Specifically, the office established adequate internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system for administrative expenditures.

Audit Objectives and Scope

Objectives
- Internal Controls
- Legal Compliance

Period Audited
January 1, 2009, through December 31, 2010

Programs Audited
- Appropriation Control
- Audit Practice Revenue
- Payroll and Travel Expenditures
- Administrative Expenditures

[1] Office of the Legislative Auditor, Financial Audit Division, Report 09-20, *Office of the State Auditor,* issued May 29, 2009.

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* 2010, 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, to serve a four-year term through 2010; she was reelected in November 2010. (The scope of this audit includes the last two years of State Auditor Otto's first term in office.) The office 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 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 operating appropriation was about $9.2 million for fiscal years 2009, 2010, and 2011. *Minnesota Statutes* require the office to collect fees from audited entities to cover its audit costs.[2] The office deposits this revenue to the General Fund; the revenue 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 2010.

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

[2]*Minnesota Statutes* 2010, 6.58.

Table 1
Summary of Financial Activity
Fiscal Year 2010[1]

Sources	General Fund	Special Revenue Fund
Operating Appropriation	$ 9,178,000	$ 0
Stimulus Appropriation[2]	680,000	0
Balance Forward In from Fiscal Year 2009	2,999,340	1,429
Dedicated Revenue	0	42,975
Transfer In – Tax Increment Financing Account[3]	986,316	0
Budget Reductions[4]	(1,032,000)	0
Total Sources	$12,811,656	$44,404
Uses		
Payroll	$ 8,054,185	$10,056
Other Administrative Costs	542,248	29,966
Rent	423,474	918
Balance Forward Out to Fiscal Year 2011	3,791,749	3,464
Total Uses	$12,811,656	$44,404

[1]Our audit scope was January 1, 2009, through December 31, 2010. This scope included the last half of fiscal year 2009, all of fiscal year 2010, and the first half of fiscal year 2011. This table presents activity for fiscal year 2010 only, because it was the full fiscal year in our audit scope.

[2]The office received this appropriation for additional audit activities under the American Recovery and Reinvestment Act of 2009.

[3]The office's Tax Increment Finance Division received funding in fiscal year 2010 from a charge on tax increment financing districts, as specified by *Minnesota Statutes 2010, 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]*Minnesota Laws of 2009*, chapter 101, article 1, section 5 ($1,000,000) and *Minnesota Laws of 2010*, chapter 215, article 12, section 5 ($32,000).

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, 2009, to December 31, 2010:

- Were the office's internal controls adequate to ensure that it safeguarded its assets, accurately paid employees and vendors in accordance with management's authorizations, complied with legal requirements, and produced reliable financial data?
- 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 controls 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.[3] 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.

Conclusion

The Office of the State Auditor's internal controls were adequate to ensure that it safeguarded its assets, accurately paid employees and vendors in accordance with management's authorizations, complied with legal requirements, produced reliable financial data, and conducted its operations in a reasonable and prudent manner. For the items tested, the office complied with finance-related legal requirements over its financial activities.

The office implemented the prior audit recommendation. Specifically, the office established adequate internal controls to mitigate the risk created when it gave employees incompatible access to the state's accounting system for administrative expenditures.

[3] 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.