



---

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

**FINANCIAL AUDIT DIVISION REPORT**

---

**State Board of Investment**

**Financial Statement Audit**

**Year Ended June 30, 2011**

**April 17, 2012**

**Report 12-09**

---

FINANCIAL AUDIT DIVISION

Centennial Building – Suite 140

658 Cedar Street – Saint Paul, MN 55155

Telephone: 651-296-4708 • Fax: 651-296-4712

E-mail: [auditor@state.mn.us](mailto:auditor@state.mn.us) • Web site: <http://www.auditor.leg.state.mn.us>

Through Minnesota Relay: 1-800-627-3529 or 7-1-1





## OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Representative Michael Beard, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Minnesota State Board of Investment Board of Trustees

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

In auditing the Minnesota State Board of Investment's basic financial statements for the year ended June 30, 2011, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements. This report contains our finding and recommendation on internal controls and compliance 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.

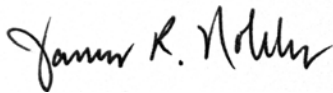
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. This report meets the audit standard 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, (Audit Coordinator), and assisted by auditors Chau Nguyen, CPA, Lindsay Tietze, CPA, Zach Yzermans, CPA, and Reidar Gullicksrud, CPA.

Our audit opinion on the financial statements was included in the board's annual financial report. Access to the report is available at the following web site:  
<http://www.sbi.state.mn.us/publications/2011AnnualReport.pdf>

We consider the deficiency described in Finding 1 to be a material weakness and noncompliance with financial reporting requirements. A material weakness is a 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.

We discussed the results of the audit with the State Board of Investment on April 5, 2012. 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 17, 2012.



James R. Nobles  
Legislative Auditor



Cecile M. Ferkul, CPA, CISA  
Deputy Legislative Auditor

End of Fieldwork: February 1, 2012

Report Signed On: April 13, 2012

# Table of Contents

	<u>Page</u>
Report Summary .....	1
Finding and Recommendation .....	3
1. 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.....	3
Agency Response.....	5

---



# Report Summary

## Conclusion

The Minnesota State Board of Investment's (SBI) basic financial statements were fairly presented in all material respects. However, SBI had a weakness in its internal controls over financial reporting, a prior audit finding that it had not resolved, as noted below.

## Finding

- 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. ([Finding 1, page 3](#))

## Audit Scope

We audited SBI's basic financial statements for the fiscal year ended June 30, 2011.

---

<sup>1</sup> Office of the Legislative Auditor's Financial Audit Division Report 11-16, *State Board of Investment*, issued June 16, 2011.

---





## Finding and Recommendation

**Prior Finding Partially Resolved:<sup>2</sup> The State Board of Investment did not sufficiently identify, analyze, and document internal controls related to financial reporting and business operations.**

### Finding 1

The State Board of Investment made progress this year in developing its comprehensive internal control structure. It documented several reconciliation processes for comparing investment pool totals to the participant ownership totals. The board also developed procedures for verifying daily share investment values. However, SBI has not comprehensively identified controls to address the risks or monitoring activities to ensure the controls were effective, as required by the Department of Management and Budget's policy.<sup>3</sup> We first reported this weakness in our fiscal year 2008 audit of SBI's financial reporting process.

Until SBI designs and implements a comprehensive risk assessment, it has an increased likelihood of additional financial reporting errors and control deficiencies. The State Board of Investment had the following errors and noncompliance either because it had not designed effective controls or had not monitored staff performance of those controls to ensure they were operating as expected:

- SBI provided incorrect debt securities investment values for disclosure in the Public Employee Retirement Association's (PERA) financial statement footnotes. SBI incorrectly reported to PERA that the value of its deferred compensation investments in debt securities was \$110 million when it was actually \$8.5 million, resulting in a potential overstatement of investments that could affect PERA's credit risk exposure by \$101.5 million.<sup>4</sup>
- SBI sent incorrect weighted average maturity information to PERA and the Department of Management and Budget regarding investments in debt

---

<sup>2</sup> Office of the Legislative Auditor's Financial Audit Division Report 11-16, *State Board of Investment*, issued June 16, 2011.

<sup>3</sup> Department of Management and Budget Policy Number 0102-01.

<sup>4</sup> The Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, requires footnote disclosure of the risk related to investments in debt securities. The disclosure of the rating assigned by an independent credit rating company allows a financial statement user to assess the amount of risk associated with the credit worthiness of the issuer's security.

---

securities.<sup>5</sup> Uncorrected, the error in the weighted average maturity would have understated the interest rate risk associated with \$304 million of mortgage backed securities reported in the state's financial statements, prepared by the Department of Management and Budget, and \$33 million reported in the Public Employees Retirement Association's financial statements.

- **Prior Finding Not Resolved:** SBI did not submit final financial statement and notes to us for audit until January 18, 2012, over two months later than planned. As a result, SBI did not publish its June 30, 2011, annual report until late February 2012. Some of the delay resulted from significant changes to the process SBI used to prepare its financial statements and changes in personnel. *Minnesota Statutes* require SBI to issue its annual report, including its financial statements, by December 31 each year.<sup>6</sup>
- **Prior Finding Partially Resolved:** SBI had some errors in the interest, dividends, and other income amounts reported in its fiscal year 2011 financial statements. On the statement of changes in net assets for the retirement funds, SBI understated interest, dividends, and other income and overstated net increase in the fair value of investments by \$35.4 million. On the statement of changes in net assets for other funds under management, it understated the interest, dividends, and other income since it did not include current year accrued income totaling \$3.5 million. Despite these errors, SBI had significantly fewer financial statement misstatements this year.

#### *Recommendation*

- *SBI should continue to develop a comprehensive internal control structure in order to provide accurate information to the retirement systems and the Department of Management and Budget and prepare accurate and timely financial statements. The internal control structure should identify and document SBI's financial reporting and business risks, related control procedures, and ways to monitor controls to ensure they are effective and operate as designed.*

---

<sup>5</sup> The GASB requires a government to disclose the risk that changes in interest rates will adversely affect the fair value of its investment in debt securities, and that the government use an appropriate method to determine that risk, such as weighted average maturity, which reflects the time when investments will mature weighted to reflect the dollar size of the individual investments within an investment type.

<sup>6</sup> *Minnesota Statutes* 2010, 11A.07, subd. 4 (8) and 11A.14, subd. 14. Legislation introduced in the 2012 session (House File 1555 and Senate File 927) would eliminate the requirement for SBI to include financial statements in its annual report in the future.

---

MINNESOTA  
STATE  
BOARD OF  
INVESTMENT



**Board Members:**

Governor  
Mark Dayton

State Auditor  
Rebecca Otto

Secretary of State  
Mark Ritchie

Attorney General  
Lori Swanson

**Executive Director:**

Howard J. Bicker

60 Empire Drive  
Suite 355  
St. Paul, MN 55103  
(651) 296-3328  
FAX (651) 296-9572  
E-mail:

[minn.sbi@state.mn.us](mailto:minn.sbi@state.mn.us)  
[www.sbi.state.mn.us](http://www.sbi.state.mn.us)

An Equal Opportunity  
Employer

April 11, 2012

Mr. James R. Nobles  
Legislative Auditor  
Office of the Legislative Auditor  
Room 140 Centennial Building  
658 Cedar Street  
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your report on the results of the SBI financial audit. We take any audit finding very seriously and have already made significant progress in corrective action, as noted below.

***Finding 1 – 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.***

We are aware of the necessity of resolving this finding and have made substantial progress on this issue as noted in the report. Please note that two staff unexpectedly left the SBI during the critical production of financial data for the year-end reports. Having fewer staff lead to delays in preparing the reports in a timely manner.

We are continuing to develop a comprehensive internal control plan to ensure the accuracy of our reports. We have worked with our custodian book of record to develop an audit and check-off process to ensure the accuracy and validity of the data. We are also completing risk assessments for each line of information on the reports and developing procedures and mitigating controls to ensure the accuracy of the information. We see the development of internal controls as an ongoing process that will need continual review, monitoring, and development. However, we believe the bulk of the comprehensive plan will be in place for the production of the next financial statement.

Persons Responsible for resolution of this audit issue:

Paul Anderson	Administrative Director
Bill Nicol	Accounting Director
Kathy Leisz	Information Technology

Target Date for Resolution: June 30, 2013

Sincerely,

A handwritten signature in dark ink, appearing to read "Howard J. Bicker".

Howard Bicker  
Executive Director