OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Minnesota State Retirement System

Report on Internal Control Over Financial Reporting

Year Ended June 30, 2012

February 14, 2013 **Report 13-03**

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

February 14, 2013

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Minnesota State Retirement System Board of Directors

Mr. David Bergstrom, Executive Director
Minnesota State Retirement System

In auditing the Minnesota State Retirement System's basic financial statements for the year ended June 30, 2012, we considered internal controls over financial reporting. We also tested compliance with significant legal provisions impacting the basic financial statements. This report contains one finding and recommendation on internal controls over financial reporting, and we did not identify any instances of noncompliance with legal provisions material to the financial statements. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the Minnesota State Retirement System'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), Carl Otto, CPA, (Audit Coordinator), Chau Nguyen, CPA, (Auditor-in-Charge), assisted by auditors Reidar Gullicksrud, CPA, Joe McMahon, CPA, and Emily Wiant.

Our audit opinion on the financial statements was included in the system's annual financial report. Access to the report is available at the following web site:
http://www.msrs.state.mn.us/info/fincl.htmls.

We consider the internal control deficiency described in Finding 1 to be a material weakness. A material weakness is a significant deficiency, or combination of significant 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 Minnesota State Retirement System at the completion of the audit. 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.

The purpose of this report is solely to describe the scope and results of our testing of the Minnesota State Retirement System's internal controls over financial reporting and compliance. Accordingly, this report is not suitable for any other purpose.

James R. Nobles	Cecile M. Ferkul, CPA, CISA
Legislative Auditor	Deputy Legislative Auditor

End of Fieldwork: December 21, 2012

Report Signed On: February 8, 2013

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Report Summary

Conclusion

The Minnesota State Retirement System's (MSRS) basic financial statements for the fiscal year ended June 30, 2012, were fairly presented in all material respects. However, MSRS had a weakness in internal control over financial reporting, as noted below.

MSRS fully resolved four prior audit findings.[1] In fiscal year 2012, MSRS developed a comprehensive internal control structure, strengthened security access controls over information systems, and improved internal controls over several financial operations and over its financial reporting process.

Finding

- MSRS's internal controls did not detect that it had misclassified refunds or health care reimbursements in three of its funds on the financial statements it submitted for audit. (Finding 1, page 3)

Audit Objectives and Scope

Audit Objectives:

- To audit MSRS's basic financial statements for the fiscal year ended June 30, 2012.
- To report on MSRS's internal controls and compliance over financial reporting.
- To follow up on the status of prior audit findings.

Audit Scope:

- Cash and investments
- Contributions and investment income
- Transfers
- Refunds and benefit payments

[1] Minnesota Office of the Legislative Auditor, Financial Audit Division, Report 12-10, *Minnesota State Retirement System*, May 10, 2012.

Finding and Recommendation

Finding 1

MSRS's internal controls did not detect that it had misclassified refunds or health care reimbursements in three of its funds on the financial statements it submitted for audit.[2]

MSRS's draft financial statements misclassified $170 million of refunds in the Deferred Compensation Fund and $3.9 million of refunds in the Hennepin County Supplemental Fund as benefit payments. The draft financial statements also misclassified $59 million of health care reimbursements in the Health Care Savings Fund. Refunds represent payments to members to return their contributions (sometimes with interest) whereas benefits represent payments to members who meet eligibility criteria to receive benefits from the funds.

Generally accepted accounting principles require that refunds and benefit payments be separately reported in the financial statements.[3] Management also intended to specifically report payments from the Health Care Savings Fund as health care reimbursements because state (and federal) laws restrict payments from the fund to reimbursements of qualified health-related expenses.[4] MSRS's internal controls did not detect the classification errors in the draft financial statements.

Recommendation

- *MSRS should strengthen its internal controls over financial reporting to ensure it properly classifies refunds and benefit payments in its financial statements.*

[2] MSRS's draft financial statements misclassified these payments as ongoing withdrawals.
[3] Government Accounting Standards Board (GASB) Statement 34: *Basic Financial Statements and Management's Discussion and Analysis*, paragraph 109.
[4] *Minnesota Statutes* 2012, 352.98, subd. 4.

MSRS Minnesota State Retirement System
MNDCP Minnesota Deferred Compensation Plan
HCSP Health Care Savings Plan

February 4, 2013

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 the finding and recommendation resulting from the financial audit of our fiscal year 2012 financial statements. As always, we appreciate the work of your staff to identify control weaknesses that need to be strengthened. Listed below are our corrective actions, already in process, to resolve finding 1.

- We are ensuring that all general ledger journal entries have been reviewed and approved by someone other than the preparer prior to being posted.

- We are expanding documentation of our general ledger chart of accounts to enhance new staff's understanding of our complex accounting and financial reporting structure.

- We are establishing procedures for performing interim account analyses of our four defined contribution funds; hopefully this action will allow more time for us to review our draft financial statements thoroughly prior to their distribution for audit, actuarial, and state financial reporting purposes.

- To conduct a more thorough review of our financial statements, we will be comparing the financial statement amounts to prior year balances for reasonableness, and investigating any material variances.

The person responsible for resolution of this audit issue is Joan Weber, Finance Division Manager. The target date for resolution of this audit issue is December 31, 2013.

Although our draft financial statements contained three misclassifications, the amounts reported in our 2012 comprehensive annual financial report are correctly stated (please refer to the financial section online at http://www.msrs.state.mn.us/info/fincl.htmls).

In closing, it is important to note that we are strongly committed establishing and maintaining an effective internal control structure.

Thank you, again, for the opportunity to respond to your report comments.

Sincerely,

Dave Bergstrom
Executive Director

cc:	Judy Hunt	Erin Leonard
	Joan Weber	Cheryl Jahnke