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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Report on Internal Control Over Statewide Financial Reporting

Year Ended June 30, 2012

May 17, 2013 **Report 13-06**

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Roger J. Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. James Schowalter, Commissioner
Department of Management and Budget

In auditing the State of Minnesota's basic financial statements for the year ended June 30, 2012, we considered the state's internal controls over financial reporting. We also tested the state's compliance with significant legal provisions impacting the basic financial statements.[1] This report contains our findings and recommendations on compliance and internal controls over the state's financial reporting process taken as a whole. However, given the limited nature of our audit work, we do not express an overall opinion on the effectiveness of the State of Minnesota'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.

We reported a significant noncompliance with financial reporting requirements in Finding 1. We consider the deficiencies identified in findings 1 through 5, which relate to the preparation of the basic financial statements, to be material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal controls 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 consider Finding 6 to be an other matter that is significant to the state's financial operations.

Individual agency responses to our findings and recommendations are presented in the accompanying section of this report titled, *Agencies' Responses.* We did not audit the responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the State of Minnesota's management, the Legislative Audit Commission, and federal grantor agencies; it 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 May 17, 2013.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: March 22, 2013

Report Signed On: May 16, 2013

[1] We separately report the results of our tests of compliance with federal programs.

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Report Summary

Conclusion

The State of Minnesota's financial statements were fairly stated in all material respects. However, the state did not comply with the statutory deadline for issuing the financial statements and continued to have weaknesses in internal controls over financial reporting.

Our audit report contains five findings related to internal controls over the preparation of the state's financial statements and one finding related to delays in drawing federal funds to reimburse for federal grant program expenditures. Three of the findings include concerns from our previous audit that have not been fully resolved.[1]

In addition, we previously reported to the Department of Management and Budget system security issues in the new accounting system (SWIFT) related to incompatible security roles and the development and assessment of mitigating controls for conflicting security access and incompatible duties.[2,3] Establishing and maintaining appropriate security access in the new accounting system is fundamental to the state's ability to ensure the integrity of its financial operations.

Key Findings

- The Department of Management and Budget did not finalize financial statements in order to report the state's financial operations to the Legislature in a timely manner. (Finding 1, page 3)
- The Department of Management and Budget did not adequately resolve some issues resulting from the implementation of the new accounting system. (Finding 2, page 4)
- Prior Finding Partially Resolved: The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors and inaccuracies in the financial information used to compile the financial statements and footnote disclosures. (Finding 3, page 5)
- Prior Finding Partially Resolved: Some agencies allowed employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls. (Finding 4, page 11)
- Prior Finding Partially Resolved: Some agencies lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements. (Finding 5, page 12)

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[1] Office of the Legislative Auditor's Financial Audit Division Report 12-03, *Report on Internal Control Over Statewide Financial Reporting*, issued February 16, 2012.
[2] Office of the Legislative Auditor, Financial Audit Division, Report 11-24, *Statewide Integrated Financial Tools (SWIFT) Application Security Controls*, issued November 3, 2011.
[3] Office of the Legislative Auditor, Financial Audit Division, Report 12-23, *Department of Management and Budget: Statewide Integrated Financial Tools (SWIFT)*, issued November 16, 2012.

Audit Scope

We audited the state's financial statements for the fiscal year ended June 30, 2012. Our audit encompassed many large state agencies that had financial activities significant to the financial statements.

Background

The Department of Management and Budget is responsible for preparing the state's annual financial statements, which are included in the *State of Minnesota's Comprehensive Annual Financial Report*. To prepare the statements, the department uses information from a variety of sources, including information provided by other agencies. The issues contained in this report relate to weaknesses in internal controls in the state's financial reporting process as a whole.

Financial Statement Findings and Recommendations

Finding 1

The Department of Management and Budget did not finalize financial statements in order to report the state's financial operations to the Legislature in a timely manner.

The department did not adequately design, develop and test its new financial reporting process to allow it to meet the statutory requirement to complete its 2012 financial report by December 31, 2012.[4] According to the department, the implementation of a new accounting system in July 2011 and a redesign of the financial reporting process resulted in it being unable to produce timely financial statements for fiscal year 2012.[5] While it is understandable that the implementation of a new accounting system would impact the financial reporting process, the department did not adequately anticipate the challenges of converting prior year account balance information and the difficulty of obtaining system data necessary for financial reporting. As late as November 2012, 17 months after the new system's implementation, important elements of the state's financial reporting process were not fully functional.

The department did not establish realistic financial reporting due dates for itself or other state agencies. Although the financial reporting process was not fully developed or tested, the department's due date schedule for elements of the financial reports was about the same as for the previous year. The schedule did not seem to take into account issues the department was already aware of or allow time to resolve difficulties likely to be encountered in the first year of a new process. In addition, the department underestimated the difficulty agencies would have using the new accounting system to obtain the information needed to develop reasonably accurate estimates of some accrual amounts. Even as they were unable to meet some critical due dates, department staff stated that they continued to work toward the December 31 deadline.

In early November, we notified the commissioner that we believed the department was at risk of not meeting the year end deadline. Finally, by early December, the commissioner formally acknowledged that the department would miss the deadline, but stated that they would issue the financial statements by the end of January 2013. Ultimately, the department issued the fiscal year 2012 financial statements on March 27, 2013.

[4] Minnesota Statute, Chapter 16A, section 50.
[5] The new accounting system, called the Statewide Integrated Financial Tools (SWIFT), is an Oracle PeopleSoft Enterprise Resource Planning System.

As a result of the late financial reporting, the department was required to disclose on the Municipal Securities Rulemaking Board's electronic municipal market access website[6] that it would not be filing (and subsequently did not file) its 2012 financial reports by the end of year. These disclosures may have raised some doubt about the state's financial stability and could have put the state's bond ratings at risk. In addition, as of May 1, 2013, the department had not finalized its Schedules of Expenditures of Federal Awards and did not meet the fiscal year 2012 Single Audit reporting deadline of March 31, 2013.[7]

Issuing audited financial statements is an important way that the state is accountable and provides transparency for its operations. The statutory deadline reinforces the conclusion there is a time limit on the value of this financial information. Because we believed that the lateness of the state's 2012 financial report diminished its usefulness to the Legislature, state agencies, investors, and citizens, we included a paragraph in our audit opinion noting the noncompliance with the statutory December 31 reporting requirement.

Recommendation

- *The Department of Management and Budget should re-evaluate its financial reporting process and continue to work toward creating a more efficient financial reporting model and a realistic schedule to ensure the timely completion of the state's financial statements.*

Finding 2

The Department of Management and Budget did not adequately resolve some issues resulting from the implementation of the new accounting system.

Unresolved issues created by the implementation of the state's new accounting system impacted the department's ability to finalize certain key internal control and accounting processes with critical information needed for its fiscal year 2012 financial reports. The department had not adequately resolved the following issues:

- Throughout fiscal year 2012, the Department of Management and Budget was unable to fully identify and resolve differences between the detailed transactional entries recorded in the accounting system and the general ledger. Ultimately, as a fundamental control, the general ledger cash should reconcile with the transactions recorded in the accounting system

[6] The Municipal Securities Regulatory Board regulates the municipal bond market. Its electronic municipal market access website is the official repository for information on all municipal securities and a key way for the board to promote a fair and efficient municipal market.

[7] Office of Management and Budget Circular A-133 requires a single audit of the state's compliance in administering federal awards and requires a single audit report be completed by nine months after the end of the fiscal year.

and with the cash in the bank to ensure the overall integrity of the recorded financial activity. For financial reporting purposes, it took the department until November 2012 to adequately identify the reasons for the $373 million difference between the June 30, 2012, cash balance in the accounting system and the cash held at the bank.[8] While some of the reconciling items were due to normal timing differences between when the state recorded receipts and expenditures and when the bank actually received the deposits or cleared the payments, other differences were due to errors or misunderstandings about how the accounting system recorded certain types of financial transactions. It took the department until February 2013 to finalize the adjustments necessary to correct the cash balances in the preliminary financial statements.

- Due to difficulties with the implementation of the new accounting system's capital asset module, the department had to manually adjust the final June 30, 2012, capital asset balances. The department tried to use the system to obtain the majority of the capital asset information; however, some state agencies, struggled to determine reasonably accurate amounts and submitted manual ledgers instead. The resulting delays contributed to the department's inability to finalize capital asset financial information until January 2013.

- Due to complications in the new system's grants module and the accounts receivable module, state agencies had difficulty estimating certain significant accruals. These difficulties led to the governmental funds' financial statements not being completed and submitted for audit until February 2013, over three months later than originally scheduled.

Recommendation

- *The Department of Management and Budget should resolve issues resulting from the implementation of the new accounting system to minimize the effect on the state's financial reporting process.*

[8] The June 30, 2012, reconciliation included an unexplained difference between the cash balance recorded in the accounting system modules and the general ledger of about $5 million. While this was not a significant amount for financial reporting purposes, it was an unacceptable discrepancy in relation to the department's financial oversight responsibility.

Finding 3

Prior Finding Partially Resolved: The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

The Department of Management and Budget and the departments of Human Services, Education, Employment and Economic Development, and Revenue did not have adequate internal controls, or the controls were not effective, to prevent and detect errors as they compiled the state's financial statements.

The implementation of the state's new accounting system in July 2011 increased the state's financial reporting risks because it changed the underlying financial data and the way the state used that data to create its financial statements. To address the risks, the Department of Management and Budget updated its overall financial reporting risk assessment for known factors resulting from the implementation of the new accounting system; however, it did not assess the risks of the unanticipated financial reporting complications and data challenges that resulted in the delayed financial reports. It also did not update the detailed risk assessments for accounts receivable or accounts payable because staff believed the overall risks did not change, and they were assessing and designing new system controls as they developed the new financial reporting process.

No internal control structure can completely eliminate the risk of errors. The occurrence of errors is not necessarily an indication that the overall internal control structure is deficient. As agencies continue to monitor and maintain their internal control structures, a key to their ongoing effectiveness will be how well the agencies identify weaknesses and update controls when the controls do not work as expected to prevent or detect errors or in response to changes in policy, personnel, and regulations. The Department of Management and Budget worked with agencies on financial reporting issues due to the implementation of the new accounting system and on the application of governmental accounting principles and internal controls.

Despite the monitoring and updating of their comprehensive internal control structures, the Department of Management and Budget and other agencies had weaknesses in their review processes that allowed some errors to occur and not be detected. The Department of Management and Budget's preliminary financial statements contained the following errors:[9]

- The Department of Management and Budget incorrectly reported the financial activity related to the merger of three local police and fire pension funds that had participated in the Supplemental Investment Trust Fund until they merged with the state's Public Employees Police and Fire

[9] For each of these errors, we proposed adjustments to the financial statements, and the Department of Management and Budget made the adjustments necessary to accurately present the financial information.

Fund in fiscal year 2012.[10] The department recorded the financial activity within the Supplemental Investment Trust Fund and the state's Public Employees Police and Fire Fund statements rather than restating the beginning fund balance as a change in fund structure as required by generally accepted accounting principles.[11] As a result, it overstated the Supplemental Investment Trust Fund's beginning net assets by $184 million, contributions and investment earnings by $304 million and $9 million respectively, and withdrawals by $479 million. The department had similar errors in the Police and Fire Fund financial statements. The classification errors offset each other and did not impact ending net assets in either fund. The department's internal controls did not identify or prompt further review of the material variances in the financial statements from the prior year that could have detected the errors.

- The Department of Management and Budget inaccurately classified as Unassigned the $769 million fund balance for the Tobacco Securitization Authority, a blended component unit reported as a special revenue fund. Generally accepted accounting principles stipulate that a fund balance in a special revenue fund cannot be considered unassigned due to the inherent dedicated nature of the fund.[12] The department's review process did not identify this error. The department adjusted the classification of fund balance to properly reflect the nature of the fund by showing the cash and investment portions as Restricted and the remainder of the fund balance as Assigned.

- The Department of Management and Budget incorrectly recorded as deferred revenue certain Department of Human Services receipts (drug rebates and medical provider credits) that should have been recorded as reductions to expenditures, overstating the General Fund's deferred revenue and expenditures both by $81 million, respectively.[13]

- The Department of Human Services did not include $44 million of the health maintenance organization provider surcharge revenues in its June 30, 2012, estimate of General Fund accounts receivable it submitted to the Department of Management and Budget. The department collects provider surcharges from medical organizations including nursing homes, hospitals, health maintenance organizations, and nonstate owned intermediate care facilities for persons with developmental disabilities.[14] Because of the omission, the accounts receivable and deferred revenue in

[10] The Minneapolis Firefighters Relief Association and the Minneapolis Police Relief Association merged on December 30, 2011. The Fairmont Police Relief Association merged on June 29, 2012.
[11] Accounting Principles Board Opinion No. 16, *Business Combinations*, paragraph 56, requires that the financial statements show the financial activity of the merged entities as if the merger occurred as of the beginning of the period.
[12] Governmental Accounting Standards Board (GASB) Statement 54, paragraph 17.
[13] Governmental Accounting Standards Board No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.*
[14] *Minnesota Statutes* 2012, 256.9657.

the state's General Fund were both understated by $44 million. Since the Department of Human Services had not included these provider surcharges as accounts receivable for several years, the omission also resulted in a $44 million prior period adjustment in the government-wide financial statements.

- The Department of Education overstated Federal Fund education aids accounts payable by approximately $87 million. The department's method to calculate the payable was not consistent with generally accepted accounting principles because it did not limit the payables to the amount of allowable costs eligible for reimbursement that school districts and other subrecipients incurred by June 30.[15]

- The Department of Employment and Economic Development overstated the Unemployment Insurance Fund liability by $15 million for fiscal year 2012 for benefits paid to applicants after July 1, 2012. The department used an Unemployment Insurance system report that erroneously overstated the amounts paid to applicants who had worked for multiple employers over the benefit period. In addition, as a result of the benefit liability error, the department overstated the fund's accounts receivable balance by $6.3 million for the recoverable portion from the federal government and employers that reimburse the fund.

- Prior Finding Not Resolved:[16] The Department of Revenue did not accurately calculate the property taxes receivable amounts it reported to the Department of Management and Budget for inclusion in the state's financial statements. This resulted in a $3.3 million understatement of General Fund property taxes receivable. The department also did not accurately calculate and report receipts during the close, which resulted in a $11.1 million misclassification of General Fund property tax revenue as deferred revenue. In addition, the department did not accurately calculate and report the portion of the receivable from prior tax periods, which resulted in a $8 million misclassification of property taxes revenue as unearned revenue on the Government-wide statements. These errors occurred, in part, because the department had not reconciled and verified the integrity of property tax data recorded in its internal tax system to property tax forms and the state's accounting system. Although the error did not result in a material misstatement for fiscal year 2012, it increased the risk that a material misstatement could occur without detection.

- The Department of Revenue incorrectly reported the total sales tax receipts collected in July and August 2012 related to tax periods ending June 30, 2012 or earlier, as General Fund receivables when a portion

[15] Governmental Accounting Standards Board No. 33, *Accounting and Financial Reporting for Nonexchange Transactions, Paragraphs 20 and 21*.
[16] Office of the Legislative Auditor, Financial Audit Division, Report 12-03, *Report on Internal Control Over Statewide Financial Reporting*, issued February 16, 2012 (Finding 3).

should have been allocated to other funds. This resulted in a $21 million overstatement of General Fund sales taxes receivable and a corresponding understatement in the Heritage Fund.[17] In addition, because the department did not separately identify $3 million in sales taxes from the Minnesota State Lottery on its accrual memo, the Department of Management and Budget did not back it out of the accrual to avoid duplicate reporting of the amount.

- The Department of Revenue did not use a consistent methodology to estimate the amount of collectable receivables for tax returns filed by taxpayers from September 2012 to December 2012.[18] It used one method for September and a slightly different methodology for the other months. Although this inconsistent methodology did not result in a material misstatement for fiscal year 2012, it increased the risk that a material misstatement could occur without detection.

The Department of Management and Budget also had some deficiencies in the footnotes to the financial statements. Because footnote disclosures are an integral part of the financial statements, they may be misleading if the disclosures are inaccurate, inconsistent with financial statement amounts, or missing required information. The department did not detect the following deficiencies in its draft footnote disclosures:

- The department understated the actuarial accrued liability and the unfunded actuarial accrued liability for the Legislators Retirement Fund by $131.5 million. The understatement of the unfunded actuarial accrued liability misstated the funding ratio as 23 percent funded instead of 9 percent funded. The department reported the actuarial accrued liability and the unfunded actuarial accrued liability in the Schedule of Funding Status contained in both the notes to the financial statements and in required supplemental information. The error occurred because the department did not use the amount determined by the actuary's reports to comply with generally accepted accounting principles. The department revised the footnotes to correct this error.

- The Department of Management and Budget did not consider whether the changes in actuarial assumptions that the Legislature approved in the 2012 Omnibus Retirement Bill[19] had a material impact on the financial report's

[17] The state's financial statements use one fund, the Heritage Fund, to account for the financial activities of the four "Legacy Amendment" funds. A 2008 amendment to the state's Constitution (Article XI, Section 15) increased the sales tax rate and dedicated the additional revenue to the four legacy funds: Outdoor Heritage, Arts and Cultural Heritage, Clean Water, and Parks and Trails.

[18] The estimate for corporate income taxes also included receivables to be derived from tax returns filed by taxpayers in January and February 2013.

[19] The 2012 Omnibus Retirement Bill contained in the *Laws of Minnesota*, 2012 Regular Session, Chapter 286, Article 1 amended *Minnesota Statutes* 2011, 356.215, subd. 8. The statutory changes

pension related disclosures. Department staff told us they used July 2011 actuarial reports instead of the available July 2012 actuarial reports because that was consistent with the timeframe of disclosures in prior years.[20] Generally accepted accounting principles requires the disclosure of information from the most recent actuarial valuation and requires that a new valuation be performed if significant changes have occurred since the previous valuation that affect the results of the valuation.[21] While our analysis of the impact of the changes in actuarial assumptions did identify a significant impact on the disclosures related to certain pension plans, the changes were not significant to the state's overall financial status. For example, the most significant change reduced the funded status of one the four funds included in the state's disclosures (the State Patrol Retirement Fund) from 80.33 percent to 72.84 percent, but the corresponding increase in the fund's unfunded actuarial liability was only $68,859.

The Department of Management and Budget conducted the final overall financial statement reviews and relied on agencies to provide accurate and complete information for use in developing the financial statements. Some agencies' internal reviews of the financial data were not effective to detect the errors noted above. Examples of effective internal review processes include analytical procedures to determine changes resulting in excessive variances between fiscal years, recalculations, and a final supervisory verification of financial data.

Recommendations

- *The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.*
- *The Department of Management and Budget should ensure the accuracy of footnote disclosures to the financial statements including using the amounts calculated in accordance with the appropriate actuarial reports and assumptions when reporting pension note disclosures and required supplementary information.*

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in actuarial assumptions included changes to the state's assumed investment rate of return and payroll adjustments, and other changes based on actuarial experience studies in several funds.

[20] When the state completes its financial reports by December 31, the most recent actuarial reports available are usually as of the beginning of the financial report's fiscal year. However, because of the lateness of the fiscal year 2012 financial reports, actuarial reports were available as of the end of fiscal year 2012.

[21] *Codification of Governmental Accounting and Financial Reporting Standards*, Section P20, paragraph 106.

Prior Finding Partially Resolved: The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to state business systems.

Finding 4

The departments of Education and Human Services did not have adequate internal controls to ensure that they limited individual employee access to only those systems, programs, applications and data necessary for the individual to perform their job functions and responsibilities,[22] and that they had developed effective controls to mitigate the risk of error or fraud occurring without detection. Employees with unnecessary system access or unmitigated incompatible system access increased the risk that errors or fraud could occur without detection and could compromise the integrity of financial transactions underlying the financial statements.

The state's security and access policy requires separation of incompatible duties so no one employee has control over an entire transaction or process that could result in errors or fraudulent transactions going undetected.[23] If agencies are unable to adequately separate incompatible duties, state policies require them to develop and document their controls designed to mitigate the risk that error or fraud will not be detected. These controls typically include analysis and supervisory review of transactions processed by the employees with inappropriate access. Agency management should document these mitigating controls and monitor that these controls are performed as designed and are effective in reducing the risks.

These agencies had the following system security access weaknesses:

- Prior Finding Not Resolved: The Department of Education lacked a formal process to periodically review and recertify employee access rights to its internal business systems. Although the department had developed a process for new security access requests, it had not recertified employees who had been granted access in the past, including the employees whose lack of documented authorization we first cited in our 2011 report.[24] State policy requires agencies to review and evaluate the appropriateness and reasonableness of employee access rights at least annually.[25]

- Prior Finding Partially Resolved: The Department of Human Services did not fully identify the combinations of security roles that allowed users in its child support enforcement system to have incompatible access. During fiscal year 2012, the department identified the security roles that posed high risks but did not define the combinations of those roles creating

[22] Department of Management and Budget Policy 1101-07 and HR 045.
[23] Department of Management and Budget Policy 1101-07.
[24] Office of the Legislative Auditor, Financial Audit Division, Report 11-02, *Report on Internal Control over Statewide Financial Reporting*, issued February 18, 2011 (Finding 2).
[25] Department of Management and Budget Statewide Operating Policy 1101-07.

incompatibilities. Because it had not identified the incompatible combinations of security roles, the department had not developed internal controls to mitigate the risks created by the incompatibilities. During fiscal year 2012, the department processed about $535 million of child support payments through this system.

- Prior Finding Not Resolved: The Department of Human Services did not have internal controls to mitigate the risk created because one employee had incompatible access to the Medicaid Management Information System during fiscal year 2012. The department determined that the employee needed the incompatible access to perform their job duties. The incompatible access allowed the employee to update both provider claims and provider demographics. Without effective mitigating controls, the employee could make unauthorized changes to provider demographic or claims data without detection.

Recommendations

- *The Department of Education should periodically review and recertify the access it has granted to employees to its internal business systems.*

- *The Department of Human Services should identify and eliminate incompatible access to state business systems. If the department determines that it is not possible to eliminate certain incompatibilities, it should design, document, implement, and monitor internal controls to mitigate the risk of error or fraud.*

Finding 5

Prior Finding Partially Resolved: The departments of Education and Revenue each lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

The departments of Education and Revenue continued to lag in their development and monitoring of a comprehensive internal control structure for their financial reporting processes to ensure that they would prevent or detect and correct a material misstatement of the state's financial statements on a timely basis. A comprehensive internal control structure is essential to accurate financial reporting and safeguarding of state resources because the state prepares its financial statements in an environment that has a high risk of error.

The financial reporting environment is high risk because of several factors, including, 1) the state needs to estimate some significant financial activity, such as certain accounts receivable and payable after the end of the fiscal year, and

2) the Department of Management and Budget relies on other state agencies to accurately account for many unique financial transactions according to a complex set of governmental accounting principles. Although the Department of Management and Budget has ultimate, statutory responsibility to prepare the state's annual financial reports, it must rely on the internal control structures of other agencies to provide complete and accurate financial information for inclusion in the state's financial reports. The state's policy on internal controls requires each agency head to develop and maintain an effective internal control structure.[26] It is likely the state will continue to have weaknesses in its financial reporting process until all agencies operate within a comprehensive internal control structure.

The departments of Education and Revenue did not make sufficient progress in their implementation of a comprehensive internal control structure for the fiscal year 2012 financial reporting period. They have repeatedly missed the target implementation dates they established when the Office of the Legislative Auditor first reported these internal control structure deficiencies in fiscal year 2009,[27] and repeated in 2010, 2011, and 2012. The agencies had the following deficiencies:

- Prior Audit Finding Not Resolved: The Department of Education made limited progress towards developing its comprehensive internal control structure. The department hired an internal auditor in April 2012 and made that person responsible for the development of a comprehensive internal control structure; however, work on that task did not begin until July 2012.

- Prior Finding Partially Resolved: The Department of Revenue made progress toward developing its comprehensive internal control structure during fiscal year 2012. It documented and assessed potential fraud risks in all aspects of its operations, and documented internal controls designed to limit those risks. It also continued to perform and monitor controls related to security access to its business systems. However, the department had not fully assessed and documented its financial reporting risks.

Recommendations

- *The Department of Management and Budget should continue to provide training and oversight to state agencies related to the state's overall financial reporting process and work with those state agencies cited as they continue to develop and maintain comprehensive internal control structures for their financial reporting processes and responsibilities, especially related to the state's new accounting system.*

[26] Department of Management and Budget Policy 0102-01.
[27] Office of the Legislative Auditor, Financial Audit Division, Report 09-03, *Report on Internal Control Over Statewide Financial Reporting for the Year Ended June 30, 2008,* issued February 13, 2009.

- *The departments of Education and Revenue should assess risks and develop a comprehensive internal control structure for their financial reporting processes and responsibilities.*

Finding 6

The Department of Management and Budget did not ensure that state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

Several state agencies were delayed in their ability to request reimbursement for federal grant program expenditures because they were unable to use financial information from the new accounting system. The reimbursement delays resulted in significant negative cash balances in some federal appropriation accounts, and, in effect, borrowing from the state's General Fund. The following state agencies did not request timely federal reimbursements:

- The Department of Public Safety requested federal reimbursements quarterly during fiscal year 2012 rather than bi-weekly, as in the preceding fiscal year, resulting in negative quarterly cash balances ranging from $1.36 million to $19 million for a major federal program.

- The Department of Employment and Economic Development delayed its drawdowns from July 2011 through December 2011 and temporarily used state money to fund over $36 million in federal program costs for the Vocational Rehabilitation and the Workforce Investment Act programs and the federal administrative costs for the Unemployment Insurance program. The department requested sufficient federal funds in late December 2011 to make up the negative cash balances.

- The Department of Human Services was unable to use the new accounting system to determine its daily federal cash balances. In addition, the department did not include certain federal recovery or refund transactions when determining its federal draw, which resulted in it requesting incorrect reimbursement amounts from the federal government.

- The Department of Military Affairs had significant delays (up to three months) in requesting federal reimbursements because it was unable to extract the necessary information, such as project number and work order number, from the new accounting system's grants module to file federal reimbursements.

As of April 2013, the departments continued to work with the Department of Management and Budget to develop alternative procedures to monitor daily federal cash balances, obtain the necessary information to process reimbursement requests timely and to account for federal recovery or refund transactions.

Recommendation

- *The Department of Management and Budget should continue to work with the departments of Public Safety, Employment and Economic Development, Human Services, and Military Affairs to ensure the necessary information is available in the accounting system in order for agencies to request federal cost reimbursements timely from the federal government to minimize adverse effects on state's cash flow.*

May 13, 2013

James R. Nobles, Legislative Auditor
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Dear Mr. Nobles:

Thank you for the opportunity to discuss with you and your staff the audit findings in the Report on Internal Control over Statewide Financial Reporting. Since this report includes all findings statewide, our response will specifically address only those findings related to the Department of Management and Budget. The remainder of the findings will be addressed by the specific agency involved. However, we will continue to work with agencies to ensure all findings in this report are implemented.

We place a high priority on continuing our long history of issuing high quality, accurate financial statements in compliance with Generally Accepted Accounting Principles (GAAP). Our 27-year history of receiving unqualified audit opinions and the "Certificate of Achievement for Excellence in Financial Reporting" from the Government Finance Officers Association is important to us. We value suggestions which will make our existing process even stronger.

Recommendation
Finding 1. The Minnesota Department of Management and Budget did not finalize financial statements in order to report the state's financial operations to the legislature in a timely manner.

Response
We are highly committed to accurate and timely reporting of the state's financial statements. As you are aware, our new accounting and procurement system went live as our accounting system of record effective July 1, 2011. As a result, fiscal year 2012 was our first reporting cycle using the new system. We retired our stand-alone financial reporting system and developed new financial reporting processes using functionality imbedded in the new software.

The learning curve associated with a new system of this size and complexity was considerable. This impacted our internal staff as well as state agency personnel who contributed various elements necessary for reporting. Additionally, there was a substantial commitment of time to design, develop, and test the new reports needed to produce the financial statements and related disclosures.

Other jurisdictions have experienced similar delays in issuing financial statements when implementing a new system. It is generally not an issue to the bond markets unless there is a pattern of delays. The state experienced no market penalty as a result of the delay and the bond rating agencies have not cited the delay as a credit concern.

We are very committed to returning to timely issued financial statements. We will continue to redesign processes and work with agencies to improve the efficiency of obtaining necessary information to issue the financial statements timely.

Person Responsible: Barb Ruckheim, Financial Reporting Director
Implementation Date: December 31, 2013.

Recommendation
Finding 2. The Department of Management and Budget did not adequately resolve some issues resulting from the implementation of the new accounting system.

Response
We recognize that there was a significant learning curve and business process redesign in moving from a single ledger system to a highly complex integrated system.

Cash activity including cash receipts, cash disbursements and investment transactions were reconciled to the original entries into the accounting system. The majority of the reconciling difference was determined on a timely basis; however, the detailed activity between the modules was not fully reconciled for certain types of transactions. We have developed tools to capture the flow of this activity through the accounting system to facilitate the reconciliations.

We will continue to develop tools and perform process redesigns to improve the efficiencies of reconciliations. We will also work with agencies to ensure transactions are processed timely and accurately in the accounting system to minimize the volume of reconciling items and improve the timeliness of the completion of the reconciliations.

Persons Responsible: Barb Ruckheim, Financial Reporting Director
Ron Mavetz, Agency Assistance Director
Implementation Date: December 31, 2013

Recommendation
Finding 3. The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

Response
We continue to place a high emphasis on our review process. Extensive analysis and supervisory reviews are conducted of work performed by our financial reporting team. These reviews are designed to prevent material misstatements to the financial statements and note

disclosures. We will continue to review the financial statements and disclosures to minimize the risk of material misstatements.

Person Responsible: Barb Ruckheim, Financial Reporting Director
Implementation Date: December 31, 2013

Finding 5. The departments of Education and Revenue each lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Response
MMB continues to work with all executive branch agencies to help them document their internal control structures. As of July 31, 2013, most executive agencies will be required to submit agency-specific risk assessment plans. Each plan will indicate which key business processes or functions need to have risk assessments performed sufficient to support the agency head's annual certification of internal control structure. The Internal Control and Accountability Unit is available to provide training and facilitation of agency risk assessment efforts.

Person Responsible: Jeanine Kuwik, Director of Internal Control and Accountability
Implementation Date: Implemented.

Finding 6. The Department of Management and Budget did not ensure that state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

Response
We worked with agencies to identify and resolve issues associated with federal draws. We are also working on a system modification to further streamline the federal draw process.

Person Responsible: Ron Mavetz, Agency Assistance Director
Implementation Date: July 1, 2014

Again, thank you for the opportunity to discuss and respond to the audit findings of the department. We value your work to improve Minnesota's internal control structure.

Sincerely,

James Schowalter
Commissioner

Minnesota Department of
Education

May 14, 2013

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

Dear Mr. Nobles:

Thank you for your work on behalf of the citizens of the State of Minnesota and for the opportunity to respond to the findings for the Minnesota Department of Education (MDE), which were included in the State of Minnesota's financial statements audit for the June 30, 2012 year end.

Specific to the department are findings 3, 4, and 5. The response to each finding, person responsible for implementation and timeframe is included with each response.

Finding 3 (Finding Partially Resolved): The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

- The Department of Education overstated Federal Fund education aids accounts payable by approximately $87 million. The department's method to calculate the payable was not consistent with generally accepted accounting principles because it did not limit the payables to the amount of allowable costs eligible for reimbursement that school districts and other sub recipients incurred by June 30.

OLA Recommendation: The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.

Response: The Department agrees with this recommendation and began to work on resolving this finding after June 30, 2012. Revision to the original Federal Fund education aids payable submitted on November 27, 2012 were re-submitted on January 3, 2013 and on January 9, 2013, resulting in a reduction to the payables submitted of $84 million. To resolve this, MDE worked in consultation with the OLA and our IT division to further analyze our subsystem information (SERVS), and analyze the use of service dates within the system to identify how the error occurred. It was determined that more accurate from the SERVS system was needed.

Going forward the MDE's plan is to limit, within SERVS, the correct use of service dates by school districts and other sub recipients thus facilitating the accurate reporting of the payables. Analysis of the prior year actual expenditures will be compared to the estimates to determine if changes to the established methodology are warranted. Improvements made to the SWIFT accounting system warehouse tables after June 30, 2012 will now serve to provide additional verification of the subsystem expenditures verifying SERVS. Additionally, the MDE accounting division will be continuing to work collaboratively with our IT division to analyze and create more accurate reporting information from the SERVS system.

Resolution of this finding is the responsibility of Al Louismet, Director of Agency Finance. This finding is expected to be fully resolved by June 30, 2013.

Finding 4 (Finding Partially Resolved): The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to state business systems.

- Prior Audit Finding Not Resolved: The Department of Education lacked a formal process to periodically review and recertify employee access rights to its internal business systems. Although the department had developed a process for new security access requests, it had not recertified employees who had been granted access in the past, including the employees whose lack of documented authorization we cited in our 2010 report. State policy requires agencies to review and evaluate the appropriateness and reasonableness of employee access rights at least annually.

OLA Recommendation: The Department of Education should periodically review and recertify the access it has granted to employees to its internal business systems.

Response: Mainframe modernization is the biggest challenge for the Department of Education's compliance with finding number 4, and is being addressed through the MN.IT Services Tactical Plan. Over the next biennium, the intent is to migrate the Unisys ClearPath mainframe to a modern platform, as it is running an ANSI 1974 Cobol code base. What we have done is:

- In April 2013 we analyzed the capabilities of the out-of-the-box Unisys Secure Access Control Module to see if we could improve upon our current mainframe security by replacing our current home-grown mainframe security (built on top of the core Unisys SYSTEM/MAKEUSER utility). We determined that the Unisys Secure Access Control Module manages user credentials completely different from our current systems and it would require significant changes across our mainframe applications to implement it.

- We have purchased a suite of Locum security software tools which were deployed to our upgraded mainframe system at the end of April 2013. The Locum security software suite offers features for access controls and monitoring. We are investigating the capabilities of these features right now and we are planning to develop policies and procedures for our mainframe systems based on these features later this summer.

- We are also developing a plan for mainframe modernization in accordance with the MN.IT Tactical Plan. As mainframe systems are migrated to a modern platform, the secure access controls will be modernized as well.

Finding 5 (Finding Partially Resolved): The departments of Education and Revenue each lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

- Prior Audit Finding Not Resolved: The Department of Education made limited progress towards developing its comprehensive internal control structure. The department hired an internal auditor in April 2012 and made that person responsible for the development of a comprehensive internal control structure; however, work on that task did not begin until July 2012.

Recommendation: The Department of Education and Revenue should assess risks and develop a comprehensive internal control structure for their financial reporting processes and responsibilities.

Response: The Department of Education is continuing efforts to implement agency-wide risk assessment and internal control programs. It is expected that both of these processes will provide significantly more robust programs that cohesively provide managed oversight and control for the organization in these areas. For both programs, this includes development of a new format of tools that better support performing risk and internal control analysis and testing within a broader array of agency-wide business process areas. This will ultimately allow for a more thorough review and strengthen the overall risk management and internal control environment for the agency.

Progress steps made include the following:

- An Internal Auditor position was recruited and hired as of April 25, 2012. The position is within the Agency Finance and Operations division and is designated to be responsible for agency-wide efforts with risk assessment, internal control, and internal audit functions.

- The agency has revisited and updated its annual certification report to Minnesota Management and Budget (MMB) for the state fiscal year ended 2012 meeting requirements under state statute (MN Statute §16A.057 and Statewide Operating Policy 0102-01), which includes completing the Control Environment Self-Assessment Tool. This process included gathering up-to-date input throughout the agency with review from management.

- The agency Internal Audit department has developed risk assessment and internal control program tools that are designed to facilitate performing these functions on an agency-wide basis.

- A risk assessment policy for the agency was developed and approved with issuance to all agency personnel as of September 13, 2012. This clearly establishes protocol with roles and responsibilities for adhering to a program that achieves compliance requirements.

- Project plans have been outlined for both undertaking and completing a risk assessment and internal control review for the agency. It is intended that the risk assessment would be undertaken first so that feedback from that effort can be incorporated in the internal control program.

- The risk assessment program has completed its initial review of three pilot business process areas, and prioritized the next divisional areas for implementation of the risk assessment tool.

- Internal control review is pending to occur simultaneously with completing risk assessment.

Due to the complexity and breadth of achieving agency-wide risk assessment and internal control review, the current expectation is that the agency will need to fully establish both programs throughout fiscal year 2014. The agency is targeting full completion of an initial cycle of risk and internal control review by June 30, 2014. Resolution of this finding is the responsibility of Al Louismet, Agency Finance Director.

Again, thank you for the opportunity to respond to the findings for the Minnesota Department of Education. If you have further questions, please do not hesitate to contact my office.

Sincerely,

Jessie Montano

Jessie Montano
Deputy Commissioner

Cc: Al Louismet
Matthew Porett
Paul Kurtenbach

May 15, 2013

Mr. James Nobles
Legislative Auditor
First Floor, Centennial Building
658 Cedar Street
St Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations related to the audit report of the State of Minnesota financial statements for the year ending June 30, 2012. The Department of Employment and Economic Development (DEED) was referenced in the following two findings:

Audit Finding 3: Prior Finding Partially Resolved: The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

DEED Audit Finding 3: The Department of Employment and Economic Development overstated the Unemployment Insurance Fund liability by $15 million for fiscal year 2012 for benefits paid to applications after July 1, 2012. The department used an Unemployment Insurance system report that erroneously overstated the amounts paid to applicants who had worked for multiple employers over the benefit period. In addition, as a result of the benefit liability error, the department overstated the fund's accounts receivable balance by $6.3 million for the recoverable portion from the federal government and employers that reimburse the fund.

Recommendation

- *The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.*

Response: This audit finding has been resolved. Unemployment insurance benefit payments must be segregated by program type (standard UI, federal extensions, state extension, Trade Adjustment Assistance, etc.) and also by employer type. This requires complex system coding to determine the percentage of a payment distribution which is allocable to each employer type (federal, military, Minnesota taxpaying and Minnesota reimbursing). An isolated coding error resulted in overstated payables for applicants who had worked for multiple employers during the benefit year. The amount of the error represents approximately 0.9% of the total benefits paid in SFY 2012. The report has been corrected.

Audit Finding 6: The Department of Management and Budget did not ensure that state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

DEED Audit Finding 6: The Department of Employment and Economic Development delayed its drawdowns from July 2011 through December 2011 and temporarily used state money to fund over $36 million in federal program costs for the Vocational Rehabilitation and Workforce Investment Act programs and the federal administrative costs for the Unemployment Insurance program. The department requested sufficient federal funds in late December 2011 to make up the negative cash balances.

Recommendation

- *The Department of Management and Budget should continue to work with the departments of Public Safety, Employment and Economic Development, Human Services and Military Affairs to ensure the necessary information is available in the accounting system in order for agencies to request federal cost reimbursements timely from the federal government to minimize adverse effects on state's cash flow.*

Response: This audit finding has been resolved. DEED is regularly and timely requesting federal cash draw downs in compliance with federal requirements. The adverse effects on the state's cash flow and negative cash balance has been addressed. Minnesota Management and Budget (MMB) worked with DEED to identify and resolve issues related to federal draw downs. MMB instructed DEED to use the projects billing module in SWIFT to facilitate cash draws. MMB initially ran this process and discovered it was very onerous because there were thousands of lines which made it difficult to manage. In addition, there were a number of issues that surfaced related to how to reduce the draws for the match and program income. The federal draws were delayed while MMB was working on a solution as to how to set up the cash draws in the SWIFT project billing module and addressing the issues that had surfaced. At DEED's request, MMB turned off the projects billing module for DEED draws in December 2011. Since then, DEED has been using a manual process, which is meeting its cash draw needs in a timely manner.

If you have any questions or need additional information, please contact Julie Freeman, chief financial officer, at Julie.freeman@state.mn.us or 651-259-7081.

Regards,

Kathryn Clark Sieben

Kathryn Clark Sieben
Commissioner

Minnesota Department of **Human Services**

May 14, 2014

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

Dear Mr. Nobles:

The enclosed material is the Department of Human Services' response to the findings and recommendations included in the draft audit report titled, "Report on Internal Control Over Statewide Financial Reporting" for the fiscal year ended June 30, 2012. It is our understanding that our response will be published in the Office of the Legislative Auditor's final audit report.

The Department of Human Services policy is to follow up on all audit findings to evaluate the progress being made to resolve them. Progress is monitored until full resolution has occurred. If you have any further questions, please contact Gary L. Johnson, Internal Audit Director, at (651) 431-3623.

Sincerely,

Lucinda E. Jesson
Commissioner

Enclosure

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Department of Human Services
Response to the Legislative Audit Report on
Internal Control Over Statewide Financial Reporting
For the Period July 1, 2011, through June 30, 2012

Audit Finding #3

Prior Finding Partially Resolved: The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

Audit Recommendation #3

The Department of Management and Budget and other state agencies should conduct sufficient reviews of financial data to ensure the state prepares accurate financial statements.

Agency Response to Audit Finding #3

The department agrees with this finding and recommendation. We will continue to refine our process of compilation and review of financial data submitted to Minnesota Management and Budget for the preparation of the financial statements.

Persons Responsible: Martin Cammack, Financial Operations Director
Estimated Completion Date: December 31, 2013

Audit Finding #4

Prior Finding Partially Resolved: The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to state business systems.

Audit Recommendation #4

The Department of Human Services should identify and eliminate incompatible access to state business systems. lf the department determines that it is not possible to eliminate certain incompatibilities, it should design, document, and implement, and monitor internal controls to mitigate the risk of error or fraud.

Agency Response to Audit Finding #4

The Department agrees with this finding and recommendation. We have resolved the issue in our Medicaid Management Information System and are working to define those combinations of security roles that present incompatible access issues in our Child Support Enforcement System.

Persons Responsible: Jeff Jorgenson, Deputy Director, Child Support Enforcement Division
Betty Smothers, MMIS, Systems Analysis Unit Supervisor
Estimated Completion Date: December 31, 2013

Department of Human Services
Response to the Legislative Audit Report on
Internal Control Over Statewide Financial Reporting
For the Period July 1, 2011, through June 30, 2012

Audit Finding #6

The Department of Management and Budget did not ensure that state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

Audit Recommendation #6

The Department of Management and Budget should continue to work with the departments of Public Safety, Employment and Economic Development, Human Services and Military Affairs to ensure the necessary information is available in the accounting system in order for agencies to request federal cost reimbursements timely from the federal government to minimize adverse effects on state's cash flow.

Agency Response to Audit Finding #6

The department agrees with this finding and recommendation. DHS will continue to work with MMB to identify processes that ensure all federal recovery and refund transactions are included when determining federal draw amounts.

Persons Responsible: Martin Cammack, Financial Operations Director
Estimated Completion Date: December 31, 2013

DEPARTMENTS OF THE ARMY AND THE AIR FORCE
JOINT FORCE HEADQUARTERS MINNESOTA
OFFICE OF THE ADJUTANT GENERAL
20 12TH STREET WEST
SAINT PAUL, MN 55155-2004

May 8, 2013

The Adjutant General

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
140 Centennial Office Building
658 Cedar Street
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the recommendation outlined in the draft audit report of the federal programs under CFDA 12.401, National Guard Military Operations & Maintenance Projects. This is our written response to the audit finding and recommendation outlined in the draft audit report.

Audit Finding #6

The Department of Management and Budget did not ensure that state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

Several state agencies were delayed in their ability to request reimbursement for federal grant program expenditures because they were unable to use financial information from the new accounting system. The reimbursements delays resulted in significant negative cash balances in some federal appropriation accounts, and, in effect, borrowing from the state's general fund. The following state agencies did not request timely federal reimbursements:

The Department of Military Affairs had significant delays (up to three months) in requesting federal reimbursements because it was unable to extract the necessary information, such as project number and work order number, from the new accounting system's grants module to file federal reimbursements.

Audit Recommendation

The Department of Management and Budget should continue to work with the departments of Public Safety, Employment and Economic Development, Human Services and Military Affairs to ensure the necessary information is available in the accounting system in order for agencies to request federal cost reimbursements timely from the federal government to minimize adverse effects on state's cash flow.

Agency Response to Recommendation

The department concurs with the recommendation. With one of the SWIFT consultant's assistance, the department was able to customize SWIFT queries to extract critical federal accounting information. Hence, the department is current with the billing process. However, the department needs to work with the Department of Management and Budget to improve the department's current reports to extract various accounting related information more efficiently.

Person Responsible: CW2 Ben LaBelle, Comptroller, Department of Military Affairs
Estimated Completion Date: September 30, 2013

Again, thank you for the opportunity to review and respond to the department's audit finding. If you have any further questions or concerns, please do not hesitate to contact me.

Sincerely,

/s/ Richard C. Nash

Richard C. Nash
Major General, Minnesota
Army National Guard
The Adjutant General

CF:
Donald Kerr
Ben LaBelle
David Poliseno

Alcohol and Gambling Enforcement

Bureau of Criminal Apprehension

Driver and Vehicle Services

Emergency Communication Networks

Homeland Security and Emergency Management

Minnesota State Patrol

Office of Communications

Office of Justice Programs

Office of Traffic Safety

State Fire Marshal

Office of the Commissioner

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May 14, 2013

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

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the findings in the Report on Internal Control Over Statewide Financial Reporting for the year ended June 30, 2012.

Finding 6 – The Department of Management and Budget did not ensure that the state agencies had the information they needed to draw federal reimbursement in compliance with federal requirements.

- ***The Department of Public Safety requested federal reimbursements quarterly during fiscal year 2012 rather than bi-weekly, as in the preceding fiscal year, resulting in negative quarterly cash balances ranging from $1.36 million to $19 million for a major federal program.***

The Department of Public Safety has experienced difficulty with using information from the new accounting system. We continue to improve in the timeliness of our federal reimbursement requests and are currently processing these on a monthly basis. We will continue to work with the Department of Management and Budget to make further improvements in this process to improve the state's cash flow.

If you have any questions or concerns, please contact me.

Sincerely,

Ramona L Dohman

Ramona L. Dohman, Commissioner

cc: Mary Ellison
Larry Freund
Cori Calhoun

MINNESOTA · REVENUE

May 13, 2013

James R. Nobles
Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Following is our response to the audit of the State of Minnesota's financial statements for the year ended June 30, 2012.

Finding (3): Prior Finding Partially Resolved

The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect errors in the financial information used to compile the financial statements, including footnote disclosures.

Bullet Point #7

The Department of Revenue did not accurately calculate the property taxes receivable amounts it reported to the Department of Management and Budget for inclusion in the state's financial statements.

Response: The Department of Revenue used a manual process to calculate property taxes receivable in FY 2012. This process was difficult to manage and increased the probability of errors. Statewide Property Tax was converted to our new integrated tax system (GenTax), in February 2012. FY 2013 will be the first complete year of property tax data in GenTax. As it has for other tax types, GenTax will provide more comprehensive reporting data. In addition, the function of reporting the data to the Department of Management and Budget has been reassigned from our Property Tax Division to our Financial Management Division. Changes will be in place for FY 2013 reporting.

Person responsible for resolving the finding: Peter Skwira, Financial Management Agency Chief Financial Officer and John Hagen, Property Tax Director

Expected resolution date: August 31, 2013

Bullet Point #8
The Department of Revenue incorrectly reported the total sales tax receipts collected in July and August 2012 related to tax periods ending June 30, 2012 or earlier, as all General Fund receivables when a portion should have been allocated to other funds.

Response: The Department of Revenue will provide the Department of Management and Budget with complete data regarding sales tax receipts collected in July and August, related to tax periods in the closing fiscal year or earlier that are allocated to other funds. Changes have already been discussed with the Department of Management and Budget and are in place for FY 2013 reporting.

Person responsible for resolving the finding: Jean Jochim, Financial Management, Accounting Director

Expected resolution date: Completed February 28, 2013

Bullet Point #9
The Department of Revenue did not use a consistent methodology to estimate the amount of collectable receivables for tax returns filed by taxpayers from September 2012 to December 2012.

Response: The Department of Revenue will review the methodology we use to estimate the amount of collectable taxes receivable. This will include comparing past estimates to actual receivable amounts. We will analyze the results of our review, determine the best way to improve our estimates and implement appropriate changes in our procedures. Changes will be in place for FY 2013 reporting.

Person responsible for resolving the finding: Jean Jochim, Financial Management, Accounting Director

Expected resolution date: August 31, 2013

Finding (5) Prior Finding Partially Resolved

The Departments of Education and Revenue each lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Agency Response:
The Department of Revenue will add financial reporting as a risk to the internal control risk assessment. The Department of Revenue will also conduct a study on operational processes which have risks in financial reporting.

Person responsible for resolving the finding: Mike Turner, Internal Audit Manager

Expected resolution date: Assessment deadline July 1, 2013, Study deadline December 31, 2013

Sincerely,

Myron Frans
Commissioner