



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Minnesota State Retirement System

Financial Statement Audit

Year Ended June 30, 2013

February 13, 2014

Report 14-03

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

February 13, 2014

Senator Roger Reinert, 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, 2013, 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), Reidar Gullicksrud, CPA, (Auditor-in-Charge), assisted by auditors Cassie Harlin, Nick Ludwig, and Natalie Mehlhorn.

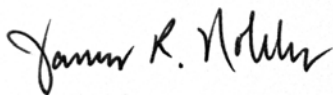
Our audit opinion on the financial statements was included in the system's annual financial report. Access to the report is available at the following web site:
<http://www.msrs.state.mn.us/pdf/2013CAFR.pdf>.

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.

Senator Roger Reinert, Chair
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Mr. David Bergstrom, Executive Director
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We discussed the results of the audit with the Minnesota State Retirement System at the completion of the audit. 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.

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
Legislative Auditor



Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: December 13, 2013

Report Signed On: February 10, 2014

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Report Summary

Conclusion

The Minnesota State Retirement System's basic financial statements for the fiscal year ended June 30, 2013, were fairly presented in all material respects.¹ However, the retirement system had a weakness in internal control over financial reporting, as noted below.

The Minnesota State Retirement System fully resolved the prior audit finding.² In fiscal year 2013, the retirement system improved internal controls in order to correctly classify refunds and health care reimbursements in the defined contribution funds financial statements.

Finding

- The Minnesota State Retirement System submitted a financial statement footnote for audit that overstated the short term debt securities subject to interest rate risk by approximately \$370 million. ([Finding 1, page 3](#))

Audit Objectives and Scope

Audit Objectives:

- To audit Minnesota State Retirement System's basic financial statements for the fiscal year ended June 30, 2013.
- To report on Minnesota State Retirement System'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
- Benefit Payments and Refunds
- Transfers

¹ The Minnesota State Retirement System's financial statements, including our audit opinion, can be located on its Web site at: <http://www.msrs.state.mn.us/pdf/2013CAFR.pdf>.

² Minnesota Office of the Legislative Auditor, Financial Audit Division Report 13-03, *Minnesota State Retirement System, Report on Internal Control Over Financial Reporting*, February 14, 2013.

Finding and Recommendation

The Minnesota State Retirement System submitted a financial statement footnote for audit that overstated the short term debt securities subject to interest rate risk by approximately \$370 million.

Finding 1

The Minnesota State Retirement System's draft financial statement footnotes overstated by nearly \$370 million the short term category of debt securities subject to interest rate risk.³ The error occurred because the retirement system did not revise the schedule when it received updated debt security investment information from the State Board of Investment. The retirement system's financial reporting process did not include internal controls to ensure the accuracy of the updated information from the State Board of Investment in its footnote disclosures.

Generally accepted accounting principles require this footnote disclosure so that users of the financial statements can assess how changes in interest rates over time would affect the fair value of debt security investments.⁴ Increases in market interest rates decrease the fair value of debt securities paying lower interest rates, while decreases in market interest rates have the reverse effect. Debt securities that are short term may have a lower risk that interest rate changes would negatively affect their fair value before the securities mature or are sold. At June 30, 2013, the retirement system's short term debt securities had average maturities of less than three months. By overstating the amount of short term debt securities, the retirement system may have led a financial statement user to underestimate the overall interest rate risk.

Recommendation

- *The Minnesota State Retirement System should strengthen its internal controls over financial reporting to ensure footnote disclosures accurately incorporate updated information received from the State Board of Investment.*

³ Minnesota State Retirement System 2013 Comprehensive Annual Financial Report; Exhibit 6, page 44.

⁴ Government Accounting Standards Board (GASB) 2013 Codification of Governmental Accounting and Financial Reporting Standards, Section I50, paragraph 141.



February 7, 2014

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 note disclosure finding and recommendation resulting from the financial audit of our fiscal year 2013 financial statements. We appreciate the work of your staff and always look for opportunities to further strengthen our controls.

Listed below are the corrective actions we will take to ensure that this finding does not repeat itself:

- If the State Board of Investment (SBI) sends us revised information in the future, we will seek a better understanding of what is being revised, the reason for the revision, and its financial reporting impact. We will document this understanding and discuss it during the MSRS financial reporting team's daily status meetings.
- We will monitor all revisions to MSRS financial statement amounts and related note disclosures to ensure that they are reviewed for accuracy, completeness, and compliance with generally accepted accounting principles by someone on the financial reporting team other than the individual who processed the revision.

The MSRS financial reporting team is responsible for resolution of this audit issue. This team is comprised of:

Joan Weber, Finance Division Manager,
Cheryl Jahnke, Finance Project Manager, and
Judy Hunt, Assistant Executive Director – Finance, Records, and Contract
Administration.

The target date for resolution of this audit issue is December 31, 2014.

Although our draft financial statement footnotes did not reflect the revised SBI information, the amounts reported in our comprehensive annual financial report for the

James R. Nobles
February 7, 2014
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fiscal year ended June 30, 2013 accurately incorporated the updated SBI information.
This public report is available online at: <http://www.msrs.state.mn.us/info/fincl.html>).

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,

A handwritten signature in dark ink, reading "Dave Bergstrom". The signature is written in a cursive, flowing style with a large initial "D" and "B".

Dave Bergstrom
Executive Director

cc: Judy Hunt
Joan Weber
Cheryl Jahnke