OLA
OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Report on Internal Control Over Statewide Financial Reporting

Year Ended June 30, 2013

February 14, 2014 Report 14-04

FINANCIAL AUDIT DIVISION
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OLA **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, 2013, 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 consider the deficiencies identified in findings 1 through 4, 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.

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.

The purpose of this report is solely to describe the scope and results of our testing of the state's internal controls over financial reporting. 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 18, 2013

Report Signed On: February 13, 2014

[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. While the state met the statutory deadline for reporting the fiscal year 2013 financial statements, it continued to have some weaknesses in its internal controls over financial reporting.[1]

Our audit report contains four findings related to internal controls over the preparation of the state's financial statements. Three of the findings include concerns from our previous audit that had not been fully resolved.[2]

Findings

- The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent or detect some errors in the financial information used to compile the financial statements, including footnote disclosures. This is a repeat finding. (Finding 1, page 3)
- The Department of Management and Budget reported four prior period adjustments totaling $173.4 million to correct prior year errors, including some errors made by the Department of Transportation. (Finding 2, page 6)
- The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to certain state business systems. This is a repeat finding. (Finding 3, page 8)
- 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. This is a repeat finding. (Finding 4, page 9)

Audit Scope

We audited the state's financial statements for the fiscal year ended June 30, 2013. 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.

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[1] *Minnesota Statutes* 2013, 16A.50.
[2] Office of the Legislative Auditor's Financial Audit Division Report 13-06, *Report on Internal Control Over Statewide Financial Reporting*, issued May 17, 2013.

Financial Statement Findings and Recommendations

Finding 1

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

The Department of Management and Budget, the State Board of Investment, and the departments of Transportation and Revenue did not have adequate internal controls to prevent or detect some errors as they compiled the state's financial statements. As a result, the Department of Management and Budget had to make adjustments to its preliminary financial statements for the following errors:

- The Department of Management and Budget reversed a fiscal year 2012 journal entry that it should not have reversed. By reversing the journal entry, the department understated the General Fund's fiscal year 2013 individual income tax revenues and functional expenditures by $243 million.

- The Department of Management and Budget did not initially identify that its change in an estimation process required a reclassification of $98 million in cash from the General Fund to the Miscellaneous Special Revenue Fund.

- The Department of Management and Budget incorrectly classified some liability balances of the University of Minnesota.[3] The department did not correctly calculate the current portion of the university's accounts payable balance, overstating the current accounts payable and understating current other liabilities by $22 million. In addition, the department did not classify about $46 million in capital leases payable as a separate line item, the way it reported capital leases payable for other component units in the state's financial statements.

- The Department of Management and Budget incorrectly calculated the state's noncurrent portion of its liability for costs related to the closure of municipal solid waste landfills, overstating claims payable and functional

[3] The University of Minnesota is reported as a major component unit on the state's financial statements. The university's financial information used in the state's financial statements comes from its own externally audited financial statements.

expenditures by about $13 million each on the government-wide financial statements.[4]

- The Department of Management and Budget incorrectly recorded Department of Human Services' child support receivables, understating the General Fund's receivables and other revenues both by about $5.7 million.

- The Department of Management and Budget understated by $18.6 million both investment income and withdrawals in the Investment Trust Fund based on updated information provided by the State Board of Investment that contained inconsistent information. If the department had followed up with the board to resolve the inconsistencies between the summary information and the detailed reports, it could have prevented the errors in the draft financial statements.

- The Department of Management and Budget incorrectly stated some original budget amounts in the legal level of the budgetary control report, which is a supplement to the state's financial statements. It recorded appropriations made during the 2012 special legislative session[5] as part of the original budget amounts rather than in the final budget amounts, resulting in an $18.5 million overstatement of the original budget amounts across seven different appropriations in the budgetary report.

- The State Board of Investment overstated by $5.1 million the Supplemental Retirement Fund's contributions and withdrawals because the board's accounting system did not differentiate those items from transactions that rebalanced the investments within the fund. Generally accepted accounting principles do not include rebalancing activity in the definition of contributions and withdrawals.[6]

- 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. It did not accurately obtain data from its tax system, understating the General

[4] The government-wide financial statements consolidate all of the state's financial activity, including assets and liabilities, using the full accrual basis of accounting.
[5] *Laws of Minnesota* 2012, 1st Special Session, Chapters 1 and 2.
[6] Government Accounting Standards Board Statement 34: *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, paragraph 109 specifies that operating statements for fiduciary funds should follow pension plan financial presentation requirements. Governmental Accounting Standards Board Statement 25: *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* defines contributions and withdrawals (refunds) respectively in paragraphs 29 and 30.

Fund's receivables and deferred revenue each by about $52 million. This is a repeat finding.[7]

- The Department of Revenue incorrectly reported the refunds payable for individual and corporate income tax and sales tax based on incomplete information it obtained from the state's accounting system, overstating the General Fund's payables and understating tax revenues by about $17.6 million.

- The Department of Transportation did not accurately report the infrastructure asset balance to the Department of Management and Budget for inclusion in the state's financial statements. The Department of Transportation omitted about $15 million of assets that it expensed but should have capitalized as infrastructure assets.[8]

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 had numerous errors in actuarial information included in its pension note disclosures and required supplementary information related to pensions. The department understated the 2011 actuarial accrued liability by $131.5 million in the required supplementary information for the Legislators Retirement Fund.[9] The department also made several errors in its pension note disclosures by not updating or accurately reporting some actuarial information. These errors occurred because the department did not verify the amounts to the relevant actuary reports.

  Financial statement users rely on the accuracy of the presentation of the required pension information as one measure to assess the financial health of the state. Bond rating agencies have increased their focus on pension information included in financial statements because of the significance of government commitments to pay future defined benefit pension benefits and public concern over how those benefits will be funded.

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[7] Office of the Legislative Auditor, Financial Audit Division Report 13-06, *Report on Internal Control Over Statewide Financial Reporting*, issued May 17, 2013 (Finding 3).

[8] The cost of certain assets (those whose costs are significant and have useful lives extending beyond one year) are capitalized (spread out over several years) rather than expensed in a single year.

[9] Government Accounting Standards Board (GASB) Statement 27: *Employers with Defined Benefit Pension Plans*, paragraphs 19 through 22, requires that employers with defined benefit plans include information from the most recent actuarial report as well as the previous two years. At the time the Department of Management and Budget prepared its 2013 financial statements, the most recent actuarial reports were as of July 2012.

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. The Department of Management and Budget's and 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 unexpected variances between fiscal years, recalculations, and a final supervisory verification of financial data.

Recommendations

- *The Department of Management and Budget should strengthen internal controls by conducting sufficient reviews of financial data, including actuarial information, to ensure the state prepares accurate financial statements and footnote disclosures.*

- *The State Board of Investment should strengthen its internal controls to ensure that it properly classifies contributions and withdrawals for investment information submitted to the Department of Management and Budget.*

- *The departments of Revenue and Transportation should strengthen their internal controls to ensure the accuracy and completeness of financial data submitted to the Department of Management and Budget to ensure the accurate presentation of assets and liabilities in the state's financial statements.*

Finding 2

The Department of Management and Budget reported four prior period adjustments totaling $173.4 million to correct prior year errors, including some errors made by the Department of Transportation.

The Department of Management and Budget identified and recorded four prior period adjustments to the state's financial statements. The need to adjust prior period financial statements shows that the prior period's financial reporting process had some deficiencies, which increased the risk that the current period's process could allow similar errors to occur without detection. We adjusted our audit procedures to address this increased risk and highlighted the prior period adjustments in our audit opinion.

The prior period adjustments corrected the following errors in prior year financial statements:

- The Department of Transportation had in prior years inappropriately expensed $86.9 million of nondepreciable infrastructure that it should have capitalized.

- The Department of Transportation had in prior years inappropriately expensed $10.5 million of miscellaneous towers related to the 911 Services Fund as system preservation charges that it should have capitalized.

- The Department of Transportation reduced by $29.9 million the amount it had previously expensed as depreciation for buildings due to an error in the date used to calculate depreciation. Correction of this error allowed the department to realign its internal rate development with depreciation in its internal accounting system.

- The Department of Management and Budget identified an error in reversing journal entries in prior years that resulted in a $46.1 million understatement of cash and fund balance in the General Fund. The department made an adjusting journal entry in fiscal year 2012 that affected cash without validating the integrity of the adjustment and its impact on the cash balance. The Department of Management and Budget's staff told us that the fiscal year 2012 implementation of the state's new accounting system and the department's redesigned internal controls allowed it to identify this prior period error and record the necessary adjustment.

Generally accepted accounting principles limit adjustments of prior periods to the correction of significant errors.[10] Auditing standards suggest auditors include information about prior period adjustments in their audit opinion because this information is important for users' understanding of the financial statements as they assess the entity's financial information.[11]

Recommendation

- *The departments of Transportation and Management and Budget should strengthen internal controls by conducting sufficient reviews of financial data or transactions that resulted in prior period adjustments to ensure the state prepares accurate financial statements for the current reporting period.*

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[10] Government Accounting Standards Board (GASB) Statement 62: *Consolidation of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* paragraphs 58 through 61, 72, 88, and 89.
[11] American Institute of Certified Public Accountants, *Statement of Auditing Standards* (Codified) AU-C 706.06.

Finding 3

The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to certain state business systems. This is a repeat finding.

The departments of Education and Human Services did not have adequate internal controls to ensure that they limited employee access to only those systems, programs, applications, and data necessary for the employee to perform their job functions and responsibilities, and that they had developed effective controls to mitigate the risk of error or fraud occurring without detection.[12] 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.[13] 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:

- 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 plan to periodically review and recertify employee access rights, it had not fully implemented this plan as of December 2013. The department 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 report for fiscal year 2009.[14] State policy requires agencies to review and evaluate the appropriateness and reasonableness of employee access rights at least annually.[15] This is a repeat finding.

- The Department of Human Services did not fully implement internal controls to restrict access to its child support enforcement system. During fiscal year 2012, the department identified the security roles that posed high risks and, during fiscal year 2013, the department defined the

[12] Department of Management and Budget Policy 1101-07.
[13] Department of Management and Budget Policy 1101-07.
[14] Office of the Legislative Auditor, Financial Audit Division Report 10-01, *Report on Internal Control over Statewide Financial Reporting*, issued February 11, 2010 (Finding 2).
[15] Department of Management and Budget Policy 1101-07.

combinations of those roles creating incompatibilities and identified mitigating controls to reduce risk. As of November 2013, the department had not implemented those mitigating controls. During fiscal year 2013, the department processed about $578 million of child support payments through this system. This is a repeat finding.

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 implement its system access plan and monitor internal controls to mitigate the risk of error or fraud in their state business systems.*

Finding 4

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. This is a repeat finding.

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 relies 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.[16] 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.

[16] Department of Management and Budget Policy 0102-01.

The departments of Education and Revenue did not make sufficient progress in their implementation of a comprehensive internal control structure for the fiscal year 2013 financial reporting period. They have repeatedly missed their initial and revised target implementation dates over the last five years since the Office of the Legislative Auditor first reported these internal control structure deficiencies for fiscal year 2008.[17] The agencies had the following deficiencies:

- The Department of Education made some progress towards developing its comprehensive internal control structure during fiscal year 2013. It documented and assessed some risks related to financial reporting; however, it had not identified and documented internal controls designed to limit those risks. This is a repeat finding.

- The Department of Revenue made progress toward developing its comprehensive internal control structure during fiscal year 2012, but did not make any additional progress during fiscal year 2013. It documented and assessed risks related to financial reporting and documented internal controls designed to limit those risks; however, the documented risks and internal controls lacked sufficient detail. In addition, for some of those controls, the department did not identify and document monitoring procedures to ensure the effectiveness of the controls. This is a repeat finding.

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.*

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

[17] Office of the Legislative Auditor, Financial Audit Division Report 09-03, *Report on Internal Control Over Statewide Financial Reporting*, issued February 13, 2009.

February 10, 2014

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 discuss with 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 28-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 Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect some errors in the financial information used to compile the financial statements, including footnote disclosures.

Response

We appreciate the acknowledgment on issuing the financial statements by the statutory deadline. This was a significant undertaking. We are pleased to see that the specific concerns identified last year have been addressed and we will continue to work to strengthen our internal controls.

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. However, in order to ensure that we met our statutory deadline, we sent preliminary financial statements to the auditors while we were in the process of completing our final reviews.

As we are no longer in an implementation year, we are currently implementing and performing proactive processes, procedures, and reviews prior to year end. This will help minimize the workload during our busiest time of the year and allow additional time for reviews.

Person Responsible: Barb Ruckheim, Financial Reporting Director
Implementation Date: December 31, 2014

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Recommendation

Finding 2. The Department of Management and Budget reported four prior period adjustments totaling $173.4 million to correct prior year errors, including some errors made by the Department of Transportation.

Response

As noted above, we place a high emphasis on our review process to ensure our financial statements are not materially misstated. The prior period adjustment that we identified related to an isolated error on a specific journal entry reversal not identified in fiscal year 2012. During fiscal year 2013, we implemented additional internal controls and reviews of reversing entries and discovered this error.

The remaining prior period adjustments relate to the Department of Transportation. Please refer to their submitted response.

Person Responsible: Barb Ruckheim, Financial Reporting Director
Implementation Date: Implemented

Recommendation

Finding 4. 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

The Internal Control and Accountability Unit provides ongoing training and risk assessment facilitation to all executive branch agencies. MMB will continue to work with the Departments of Revenue and Education as they develop and document their internal control structures over financial reporting.

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

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

February 12, 2014

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

Dear Mr. Nobles:

Thank you for your work on behalf of the citizens of the State of Minnesota and the opportunity to respond to the findings for the Minnesota Department of Education (MDE) which were included in the Report on Internal Control Over Statewide Financial Reporting for the year ended June 30, 2013. Since this report includes all findings statewide, our response will specifically address only those findings related to MDE.

Audit Finding 3: The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to certain state business systems. This is a repeat finding.

Audit Recommendation:

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

Agency Response:
MDE has been working closely with MN.IT Services @ MDE to address this issue and we continue to make progress. Mainframe modernization continues to be the biggest challenge for the MDE's compliance and it is being addressed through the MN.IT Services Tactical Plan. Over this biennium, the intent is to migrate the Unisys ClearPath mainframe to a modern platform, as it is running an ANSI 1974 Cobol code base.

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

In the interim, MN.IT Services @ MDE and MDE have determined that resolution of this finding will be accomplished as part of the ongoing 'IT Security Audit Remediation Project' for the 13-20 OLA report findings. This issue will be addressed as part of remediation efforts for finding 13-20-5, which we anticipate to be resolved by June 30, 2014. These remediation efforts include an ongoing process in which we are reviewing and removing obsolete user access and roles, both from our Active Directory and MIMDS systems. Once this has been accomplished (estimated June 30, 2014), agency business units will be expected to regularly review the appropriateness and reasonableness of employee access rights.

Resolution of this finding is the responsibility of Denise Anderson, MDE Chief Financial Officer and Matthew Porett, MN.IT Services @ MDE, CIO.

Audit Finding 4: 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. This is a repeat finding.

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

Agency Response:
MDE believes strongly in financial integrity and concurs with this finding. During this review period, the department continued its intensive agency-wide risk assessment efforts. We are on target to complete the risk assessment phase of numerous business processes by June 30, 2014. Based on the results of the risk assessments, the agency will identify the most significant risk areas and begin the internal control review process for those areas with a goal for completion of December 31, 2014. In addition, a plan will be developed and implemented to ensure the on-going review of risks and internal controls. We will continue to work with MMB on training and oversight needs to assist us in this process.

Resolution of this finding is the responsibility of Denise Anderson, MDE Chief Financial Officer.

I appreciate the opportunity to respond to these findings for the Minnesota Department of Education. Please contact Denise Anderson at 651-582-8560 if you have any questions.

Sincerely,

Brenda Cassellius

Dr. Brenda Cassellius
Commissioner

cc: Denise Anderson, MDE CFO
Matthew Porett, MN.IT Services @ MDE CIO

Minnesota Department of **Human Services**

February 12, 2014

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

Dear Mr. Nobles:

Thank you for the opportunity to review and comment on the draft report titled "*Report on Internal Control Over Statewide Financial Reporting Year Ended June 30, 2013*." It is our understanding that our response will be published in the Office of the Legislative Auditor's final audit report.

The audit results confirm our belief that we have built a strong control environment over Financial Reporting, and we appreciate your efforts to help us maintain and improve these controls. Below is our response to the Department of Human Services' finding.

Audit Finding #3

The departments of Education and Human Services had weaknesses in their internal controls to ensure appropriate access to certain state business systems. This is a repeat finding.

Audit Recommendation #3

Recommendations

- *The Department of Human Services should implement its system access plan and monitor internal controls to mitigate the risk of error or fraud in their state business systems.*

Department of Human Services'
Response to the Legislative Draft Audit Report titled
Report on Internal Control Over Statewide Financial Reporting
for the Year Ended June 30, 2013

<u>Agency Response to Audit Recommendation #3</u>

The department agrees with this finding and recommendation. Children and Family Services PRISM staff invested considerable time and effort into evaluating incompatible security profiles and developing a comprehensive solution that we believe mitigates the risk of error or fraud in PRISM. Despite the time and effort invested this past year, we were unable to implement our solution in time to affect the period covered by this report. We are pleased to report that we have now fully implemented controls that we believe properly restrict access to PRISM.

Person Responsible: Jeff Jorgenson
Estimated Completion Date: Completed

Thank you again for the professional and dedicated efforts of your staff during this audit. 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

Lucinda E. Jesson
Commissioner

MINNESOTA · REVENUE

February 12, 2014

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the audit findings pertaining to the Department of Revenue contained in your audit of the State of Minnesota's financial statements for the year ended June 30, 2013.

Finding (1): 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. (See page 4 for DOR detail). This is a repeat finding. Further, the Department of Revenue incorrectly reported the refunds payable for individual and corporate income tax and sales tax based on incomplete information it obtained from the state's accounting system. (See page 5 for DOR detail).

Agency Response: Beginning in fiscal year 2013, the Department of Revenue added the statewide property tax data into the integrated tax system to provide a sound basis for financial reporting. However, the report functionality was not completed, so ad hoc reports were used. These reports caused an overstatement of the first half payment by $52 million and a corresponding understatement of the estimated second half payment by $52 million. The reporting function is currently being completed and will be in place for fiscal year 2014 reporting.

The Department of Revenue strengthened the SWIFT reporting system in fiscal year 2013 by moving to the data warehouse. The SWIFT data was correct, however, a critical date was missing from the receipt table which caused July and August refunds to be attributed to FY14 rather than FY13. DOR has already corrected SWIFT reports.

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

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Finding (4): Prior Finding Partially Resolved: The Department of Revenue made progress toward developing its comprehensive internal control structure during fiscal year 2012, but did not make any additional progress during fiscal year 2013. It documented and assessed risks related to financial reporting and documented internal controls designed to limit that risk; however, the documented risks and internal controls lacked sufficient detail. (See page 10 for DOR detail). This is a repeat finding.

Agency Response: DOR will expand and document detail to its existing internal control protocol and compare it to best practices of other state agencies that had adequate detail.

Person responsible for resolving the finding: Peter Skwira, Financial Management Agency Chief Financial Officer and Mike Turner, Internal Audit Manager

Sincerely,

Myron Frans
Commissioner

MINNESOTA STATE BOARD OF INVESTMENT

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February 10, 2014

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

Dear Mr. Nobles

Thank you for the opportunity to review and respond to your report on the results of the SBI financial audit.

Finding – The State Board of Investment overstated by $5.1 million the Supplemental Retirement Fund's contributions and withdrawals because the board's accounting system did not differentiate those items from transactions that rebalanced the investments within the fund. Generally accepted accounting principles do not include rebalancing activity in the definition of contributions and withdrawals.

Although the coding error of the rebalance activity had absolutely no impact to the bottom line of any pension or plan participant, we take any audit finding very seriously and have already remedied the finding.

We have made programming changes to our computer system to code any on-line rebalance activity as a "transfer". Items coded as a transfer will not be included in the financial activity as an addition or withdrawal. We have also added steps to our risk assessment and internal control plan to test for rebalance activity to ensure the activity is coded properly in the financial statements.

The persons responsible for resolution of this audit issue are Paul Anderson, Administrative Director and Bill Nicol, Accounting Director.

This issue has been resolved.

Sincerely,

Mansco Perry III

Mansco Perry III
Executive Director

cc: Cecile Ferkul
Jim Riebe
Carl Otto
Jim Heidelberg
Paul Anderson

Minnesota Department of Transportation
395 John Ireland Boulevard
Saint Paul, MN 55155

February 12, 2014

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit of the State of Minnesota's financial statements for the year ended June 30, 2013. This letter is the Minnesota Department of Transportation (MnDOT) response to the draft report issued by the Office of the Legislative Auditor.

Finding 1 – The Department of Management and Budget and other state agencies did not have adequate internal controls to prevent and detect some errors in the financial information used to compile the financial statements, including footnote disclosures. This is a repeat finding.

Recommendation: The Department of Transportation should strengthen its' internal controls to ensure the accuracy and completeness of financial data submitted to the Department of Management and Budget to ensure the accurate presentation of assets and liabilities in the state's financial statements.

Response: MnDOT believes strongly in financial integrity. MnDOT continues to refine and improve its internal control process and will address the finding in the following manner:

- Meet with appropriate staff to ensure proper construction project attributes are assigned using GASB 34 guidelines and establish a clear line of documentation and approval for construction projects over $10 million.
- Management will monitor activity on an on-going basis to ensure projects are assigned properly per GASB 34 guidelines.

Responsible Staff: Tracy Hatch, Chief Financial Officer

Implementation Date: February, 2014

Finding 2 – The Department of Management and Budget reported four prior period adjustments totaling $173.4 million to correct prior year errors, including some errors made by the Department of Transportation.

Recommendation: The departments of Transportation and Management and Budget should strengthen internal controls by conducting sufficient reviews of financial data or transactions that resulted in prior period adjustments to ensure the state prepares accurate financial statements for the current reporting period.

Response: MnDOT believes strongly in financial integrity. MnDOT was aware of this finding in advance of the audit as a result of the department's risk assessment process within the Safeguarding MnDOT internal control program.

MnDOT continues to refine and improve its internal control process and will address the finding in the following manner:

- Meet with appropriate staff to ensure project attributes for capital costs are assigned using established guidelines and require proper approvals.
- Management will monitor project attributes on an on-going basis.

Responsible Staff: Tracy Hatch, Chief Financial Officer

Implementation Date: February, 2014

Thank you for the opportunity to respond to your findings and recommendations. MnDOT will monitor the implementation to the successful resolution of these findings. Please contact Gerald Wood, Accounting Director, at 651-366-4904 with any follow-up questions or information.

Sincerely,

Charles A. Zelle
Commissioner of Transportation