

**STATE BOARD OF INVESTMENT
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1989**

JANUARY 1990

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

90-7

**STATE BOARD OF INVESTMENT
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1989**

JANUARY 1990

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Veterans Service Building • St. Paul, MN 55155
612/296-4708

STATE BOARD OF INVESTMENT

FINANCIAL AUDIT FOR THE YEAR ENDED JUNE 30, 1989

Public Release Date: February 2, 1990

No. 90-7

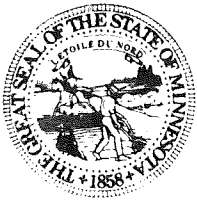
OBJECTIVES:

- EXAMINE THE BOARD'S FINANCIAL STATEMENTS.
- EVALUATE INTERNAL CONTROL STRUCTURE: Investment purchases and sales, investment custody and valuation, investment income collection and allocation, management fee payments and reimbursements, and administrative disbursements.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

- We issued an unqualified opinion on the financial statements.
- We found the internal control structure to be effective.
- We found one departure from finance-related legal provisions, relating to the interest rate used by retirement systems for late transfers to the Post Retirement Fund.

Contact the Financial Audit Division for additional information.
(612) 296-1730



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator John E. Brandl, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the State Board of Investment

Howard J. Bicker, Executive Director
State Board of Investment

Audit Scope

We have audited the financial statements of the State Board of Investment as of and for the year ended June 30, 1989 and issued our report thereon dated December 1, 1989. We have also made a study and evaluation of the internal control structure of the State Board of Investment in effect at June 30, 1989.

We conducted our audit in accordance with generally accepted government auditing standards, including Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

As part of our examination of the financial statements and our study and evaluation of the internal control structure, we performed tests of the State Board of Investment's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the State Board of Investment is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- investment purchases and sales,
- investment custody and valuation,
- investment income collection and allocation,
- management fee payments and reimbursements, and
- administrative disbursements.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

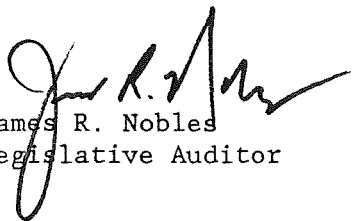
Conclusions

In our opinion, the internal control structure of the State Board of Investment in effect at June 30, 1989, taken as a whole, was sufficient to meet the objectives stated above insofar as those objectives pertain to the prevention or detection of errors or irregularities in amounts that would be material in relation to the financial transactions of the State Board of Investment.


The results of our tests indicate that, except for the issue discussed in finding #1, with respect to the items tested, the State Board of Investment complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the State Board of Investment had not complied, in all material respects, with those provisions.

Senator John E. Brandl, Chairman
Members of the Legislative Audit Commission
Members of the State Board of Investment
Howard J. Bicker, Executive Director
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This report is intended for the information of the Legislative Audit Commission and management of the State Board of Investment. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 2, 1990.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: December 1, 1989

REPORT SIGNED ON: January 29, 1990

STATE BOARD OF INVESTMENT

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

| | |
|------------------------|----------------------------|
| John Asmussen, CPA | Deputy Legislative Auditor |
| Claudia Gudvangen, CPA | Audit Manager |
| Cecile Ferkul, CPA | Auditor-in-Charge |
| Judy Cammack, CPA | Auditor |
| Marla Conroy, CPA | Auditor |
| Beth Hammer, CPA | Auditor |
| Eric Jacobson | Auditor |
| Steve Pyan, CPA | Auditor |
| Pat Ryan, | Auditor |
| Frank Safinia | Intern |

EXIT CONFERENCE

The finding and recommendation in this report were discussed with the following officials from the State Board of Investment at an exit conference on January 11, 1990:

| | |
|--------------------|------------------------------|
| Howard J. Bicker | Executive Director |
| Beth Lehman | Assistant Executive Director |
| L. Michael Schmitt | Administrative Director |

STATE BOARD OF INVESTMENT

I. INTRODUCTION

Article XI, Section 8 of the Constitution of the State of Minnesota creates the State Board of Investment consisting of the governor, state auditor, state treasurer, secretary of state, and attorney general. The board administers and directs the investment of state funds. Minn. Stat. Chapter 11A establishes general guidelines and standards governing investment activities of the board. The board is also subject to certain general legal provisions which affect the financial management of most state agencies.

The board employs an executive director and other staff to assist in carrying out its duties. Howard J. Bicker currently serves as Executive Director. The board also employs various private firms to invest and manage certain retirement fund assets.

Administrative activities of the board are financed from a General Fund appropriation. Fiscal year 1989 General Fund expenditures of the board were as follows:

| | |
|----------------------------------|--------------------|
| Personal Services | \$1,268,055 |
| Expense and Contractual Services | 314,351 |
| Miscellaneous Operating Expenses | 60,719 |
| Supplies and Materials | 25,886 |
| Capital Equipment | <u>23,522</u> |
| Total | <u>\$1,692,533</u> |

Minn. Stat. Section 11A.07, Subd. 5 provides that the executive director shall bill the retirement funds for a portion of the expenses incurred, based on their share of assets under management each quarter. These reimbursements are credited to the General Fund as nondedicated receipts. Collections for fiscal year 1989 totalled \$1,342,969.

STATE BOARD OF INVESTMENT

II. CURRENT FINDING AND RECOMMENDATION

1. SBI has not monitored the interest rate used for late transfers to the Post Retirement Fund.

The Post Retirement Fund has not received interest from the retirement systems at the maximum rate allowable by statute. Minn. Stat. 11A.18, Subd. 6b, requires the retirement systems to transfer the required reserves for new retirees to the Post Retirement Fund on a timely basis. These transfers are often estimated due to incomplete data, resulting in late transfers when the actual figures are known. The retirement systems are required to pay interest to the Post Retirement Fund on these late transfer amounts. The statutes specify that the interest rate should be the greater of the average short term rate earned over the prior month or the preretirement interest assumption for the Post Retirement Fund, stated as a monthly rate.

SBI has not monitored the monthly short term rate of return to determine if it exceeded the preretirement interest assumption. In June 1987, SBI instructed the retirement systems to calculate interest using the preretirement interest assumption of 8 percent (.6667 percent per month). In May 1989, the preretirement interest assumption increased to 8.5 percent. We calculated the short term earnings in the Trust Fund Pool for a sample of ten days during fiscal year 1989. Eight of the days had earnings exceeding 8 percent, with a high of 9.53 percent. The average of the ten days tested was 8.52 percent.

Having SBI determine the rate and notify the retirement systems of the rate, would ensure that the retirement systems are consistently paying the Post Retirement Fund at the maximum rate required by the statute.

RECOMMENDATION

- SBI should monitor the monthly short term earnings rate and notify the retirement systems when it exceeds the actuarial interest assumption.

MEMBERS OF THE BOARD:
GOVERNOR RUDY PERPICH
STATE AUDITOR ARNE H. CARLSON
STATE TREASURER MICHAEL A. McGRATH
SECRETARY OF STATE JOAN ANDERSON GROWE
ATTORNEY GENERAL HUBERT H. HUMPHREY III



EXECUTIVE DIRECTOR
HOWARD J. BICKER

STATE OF MINNESOTA
STATE BOARD OF INVESTMENT

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January 16, 1990

Mr. James R. Nobles
Legislative Auditor
Veterans Service Building
St. Paul, Mn. 55155

Dear Mr. Nobles

The staff of the State Board of Investment acknowledges that the retirement systems have been using an incorrect interest rate when making late transfers to the Post Retirement Fund.

Although the responsibility for making these transfers rests with the retirement systems, not the State Board of Investment, the SBI staff will institute a procedure to notify the retirement systems of the short term rate earned by them on a monthly basis.

Each month, on approximately the first working day of the month, the SBI will notify, in writing, each of the retirement systems of the rate earned by the Money Market account run by State Street Bank. This rate will be used because it is the earliest rate available in any month and will closely approximate the rate earned by all short term accounts at the SBI.

The responsibility for implementing this recommendation will be given to the Administrative Director.

Sincerely,

A handwritten signature in cursive script that reads "Howard Bicker".

Howard Bicker
Executive Director