



Internal Controls Over Statewide Financial Reporting

Year Ended June 30, 2016

February 16, 2017
REPORT 17-05

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

Office of the Legislative Auditor Financial Audit Division

The Financial Audit Division at the Office of the Legislative Auditor (OLA) performs three types of audits of entities within the state's executive and judicial branches:

- **Financial Statement** audits determine whether an entity has prepared its Comprehensive Annual Financial Report in accordance with governmental accounting principles. The division provides audit opinions on the financial reports for the State of Minnesota, the state's three large public pension plans, and the Minnesota Sports Facilities Authority.
- **Federal Grant Compliance** audits determine whether the state has complied with federal requirements for many of its largest federal programs. Often called the *Single Audit*, the federal government requires these audits as a condition of receiving federal grants.
- **Internal Controls and Legal Compliance** audits determine whether an entity has internal controls to effectively manage the risks of its financial operations and whether it has complied with legal compliance requirements chosen for testing.

The Financial Audit Division has a staff of about 35 auditors, many of whom are licensed CPAs and hold other certifications. The division conducts its audits in accordance with *Government Auditing Standards* established by the Comptroller General of the United States.

One requirement of the audit standards is a periodic review of the division's system of quality control by audit peers from across the country. The division's most recent peer review report is available at: www.auditor.leg.state.mn.us/fad/pdf/fadpeer.pdf

OLA also has a **Program Evaluation Division** that evaluates topics periodically selected by members of the Legislative Audit Commission.

In addition, OLA may conduct a **Special Review** in response to allegations and other concerns brought to the attention of the Legislative Auditor. The Legislative Auditor conducts a preliminary assessment in response to each request for a special review to determine what additional action, if any, OLA should take.



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 16, 2017

Members of the Minnesota State Legislature

The Honorable Mark Dayton, Governor

Mr. Myron Frans, Commissioner, Department of Management and Budget

Mr. John Jaschke, Executive Director, Board of Water and Soil Resources

Mr. Tom Roy, Commissioner, Department of Corrections

Ms. Ramona Dohman, Commissioner, Department of Public Safety

This report describes the scope of our testing of internal controls and compliance, and the results of that testing, performed as part of our audit of the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2016. The report is required by the auditing standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We discussed the results of the audit with the Department of Management and Budget's staff at an exit conference on February 7, 2017.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

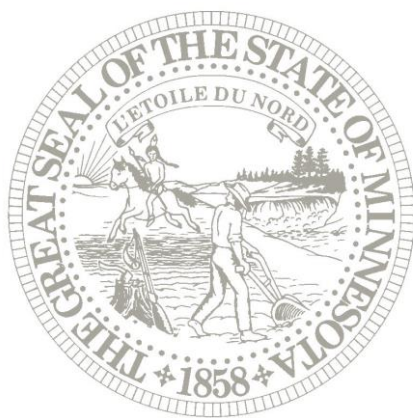
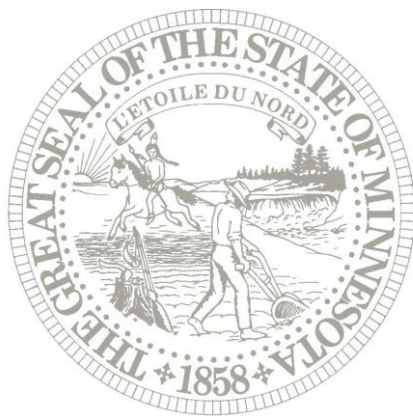


Table of Contents

| | <u>Page</u> |
|--|-------------|
| Report Summary | 1 |
| Independent Auditor's Report on Internal Controls Over Financial Reporting and on Compliance Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> | 3 |
| Finding and Recommendations..... | 5 |
| 1. The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities..... | 5 |
| Agencies Responses..... | 9 |
| Department of Management and Budget | 9 |
| Board of Water and Soil Resources | 11 |
| Department of Corrections..... | 13 |
| Department of Public Safety | 15 |



Report Summary

Annually, the Department of Management and Budget prepares the State of Minnesota's *Comprehensive Annual Financial Report*. Included in that report are the state's basic financial statements for the past fiscal year. To prepare the statements, the Department of Management and Budget uses information from a variety of sources, including information provided by other agencies. Our audit of the state's financial statements for the fiscal year ended June 30, 2016, resulted in an opinion on the basic financial statements, providing assurance that the statements are fairly stated, in all material respects, in accordance with generally accepted government accounting principles.

As part of our audit, we reviewed the state's internal controls over its financial reporting process and its compliance with legal requirements related to financial reporting. While the state resolved the internal control findings related to its financial reporting process from our previous audit,¹ it had a significant deficiency in its internal controls over financial reporting during the current audit.

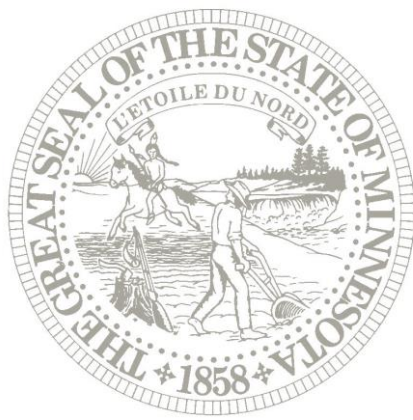
Finding

- The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities. (Finding 1, page 5)

Audit Scope

We audited the state's financial statements for the fiscal year ended June 30, 2016. Our audit scope included many large state agencies that had financial activities significant to the financial statements.

¹ Office of the Legislative Auditor's Financial Audit Division Report 16-05, *Internal Controls Over Statewide Financial Reporting*, issued February 11, 2016.





**Independent Auditor's Report on Internal Controls Over Financial Reporting and on Compliance Based on an Audit of Financial Statements Performed in Accordance With
*Government Auditing Standards***

Members of the Minnesota State Legislature

The Honorable Mark Dayton, Governor

Mr. Myron Frans, Commissioner, Minnesota Management and Budget

We have audited the basic financial statements of the State of Minnesota, as of and for the year ended June 30, 2016, and have issued our report thereon dated December 16, 2016.¹ The financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Minnesota, and the related notes to the financial statements, collectively comprise the state's basic financial statements. We conducted our audit in accordance with the 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.

Our report includes a reference to other auditors who audited the financial statements of the Minnesota State Colleges and Universities, Housing Finance Agency, Metropolitan Council, University of Minnesota, Office of Higher Education, Public Facilities Authority, and Workers' Compensation Assigned Risk Plan, as described in our report on the state's financial statements. The financial statements of the Housing Finance Agency and Workers' Compensation Assigned Risk Plan were not audited in accordance with *Government Auditing Standards*. This report does not include the results of the other auditors' testing of internal controls over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Controls Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the state's internal controls over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the state's internal controls. Accordingly, we do not express an opinion on the effectiveness of the state's internal controls.

Our consideration of internal controls was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal controls that might be

¹ Our audit report on the financial statements was included in the state's comprehensive annual financial report. Access to the report is available at the following website: <http://www.mn.gov/mmb/accounting/reports/>.

material weaknesses or significant deficiencies.² Therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, we did not identify any deficiencies in internal controls that we consider to be material weaknesses. We did identify a deficiency in internal controls, described in the accompanying *Finding and Recommendations* section as Finding 1, which we consider to be a significant deficiency.

Compliance and Other Matters

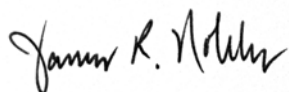
As part of obtaining reasonable assurance about whether the state's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

State of Minnesota's Responses to Finding

The state's responses to the finding identified in our audit are provided in the accompanying *Agencies Responses* section. The state's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinions on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal controls and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the state's internal controls or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the state's internal controls over financial reporting and compliance as part of our financial statement audit. Accordingly, this communication is not suitable for any other purpose.



James R. Nobles
Legislative Auditor



Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

December 16, 2016
Saint Paul, Minnesota

² A deficiency in internal controls exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the state's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Finding and Recommendations

The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities.

Finding 1

The state uses its accounting system as the basis for much of the financial information it includes in its comprehensive annual financial report. However, some financial activity is not recorded in the accounting system by the time the state prepares its financial report. For example, state agencies may have received goods and services before the end of the fiscal year (June 30) but have not paid the related invoices.

Determining the correct fiscal year in which to recognize these costs is an important responsibility necessary to good financial reporting. The Department of Management and Budget typically asks state agencies to review financial activity occurring after the end of the fiscal year to identify accounts payable that should be recognized in the financial report for the prior year.

The Board of Water and Soil Resources and the departments of Corrections and Public Safety incorrectly identified and reported to the Department of Management and Budget the amount of unrecorded accounts payable for fiscal year 2016. These errors collectively overstated the payables by about \$43.7 million. Table 1 shows the funds affected by the overstatements.

Table 1
Accounts Payable Overstatements by Fund (in millions)
Fiscal Year 2016

| <u>Fund</u> | <u>Fund Type</u> | <u>Amount</u> |
|-------------------------------|-----------------------|---------------|
| General | Major Governmental | \$8.4 |
| Federal | Major Governmental | 9.5 |
| Heritage | Nonmajor Governmental | 15.5 |
| Building | Nonmajor Governmental | 7.4 |
| Miscellaneous Special Revenue | Nonmajor Governmental | 1.1 |
| Trunk Highway | Nonmajor Governmental | 0.7 |
| 911 Services | Nonmajor Enterprise | 1.1 |
| Total | | <u>\$43.7</u> |

Source: State of Minnesota's accounting system.

The Department of Management and Budget subsequently corrected the overstatements prior to publishing the financial statements.

To determine the fiscal year 2016 accounts payable amount, the Department of Management and Budget asked all state agencies to do the following:

- Review expenditures between July 1, 2016, and August 12, 2016, that exceeded \$500,000 and were not recorded as fiscal year 2016 payables in the state's accounting system, and report back any amounts that should be reported as a fiscal year 2016 payable.
- Review fiscal year 2016 encumbrances¹ with unspent balances exceeding \$500,000 as of August 12, 2016, and report back any amounts that should be reported as a fiscal year 2016 payable.

In its request, the department accurately explained that agencies should report as fiscal year 2016 payables the expenditures and encumbrances for, 1) goods and services received on or before June 30, 2016, and 2) grant obligations where grantees met all eligibility requirements for payment on or before June 30, 2016. The department included the information provided by the various state agencies in the accounts payable amounts reported in its draft fiscal year 2016 financial statements.

We reviewed supporting documentation for a sample of the payables reported by the various state agencies, which included some of the payables reported by the Board of Water and Soil Resources and the Department of Public Safety and all of the payables reported by the Department of Corrections. We found several instances where the payables reported by the board and those departments were not related to goods or services received on or before June 30, 2016, or to grant obligations where grantees met all eligibility requirements for payment on or before June 30, 2016. Based on conversations with staff at those agencies, they either did not completely understand how to properly identify the fiscal year 2016 payables or did not obtain and review sufficient documentation to allow them to properly identify the fiscal year 2016 payables.

After we provided the errors we identified to the Department of Management and Budget, the department reviewed documentation for the payables reported by the Board of Water and Soil Resources and the Department of Public Safety that we did not test and found additional errors.

The incorrectly reported fiscal year 2016 payables were as follows:

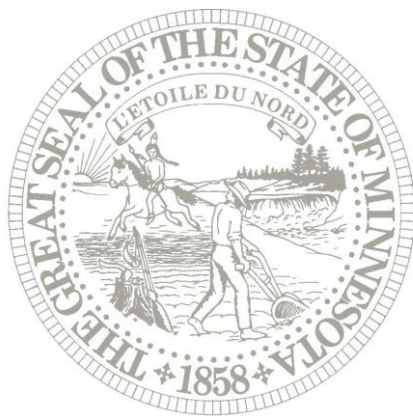
- The Board of Water and Soil Resources reported payables of \$25.2 million, but \$25.1 million were not fiscal year 2016 obligations.

¹ An encumbrance in the accounting system represents a reservation of money for an anticipated obligation, such as for items ordered but not yet received, or contract obligations for services not yet provided. Some encumbrances may be payables because of the timing of when a state agency processes payments in the state's accounting system related to their receipts of the goods or services.

- The Department of Corrections reported payables of \$12.5 million, but \$5.8 million were not fiscal year 2016 obligations.
- The Department of Public Safety reported payables of \$18.7 million, but \$12.8 million were not fiscal year 2016 obligations.

Recommendations

- *The Board of Water and Soil Resources and the departments of Corrections and Public Safety should strengthen internal controls by training staff and conducting effective reviews to ensure they properly identify and report accounts payable to the Department of Management and Budget.*
 - *The Department of Management and Budget should work with the Board of Water and Soil Resources and the departments of Corrections and Public Safety to ensure they properly identify and report accounts payable.*
-



February 13, 2017

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 finding in the Report on Internal Control over Statewide Financial Reporting. Although the finding is directed towards other state agencies, one of the recommendations is made to Minnesota Management and Budget. Our response is limited to addressing this recommendation. The other agencies will respond to the portion of the audit report that is related to them.

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 31-year history of receiving unqualified opinions and the "Certificate of Achievement for Excellence in Financial Reporting" from the Government Finance Officers Association is important to us.

Finding

The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities.

Recommendation

The Department of Management and Budget should work with the Board of Water and Soil Resources and the departments of Corrections and Public Safety to ensure they properly identify and report accounts payable.

Response

We agree that the accuracy of amounts reported by state agencies for inclusion in the financial statements is important. As part of our commitment to accuracy, we annually assess and document the risk of material misstatements related to accounts payable and other financial cycles. We maintain a preventative approach to mitigate the risks related to accounts payable. This approach includes communicating requirements and expectations. We do this through written instructions, policies and procedures, meetings with agencies, training agency staff, and requiring agencies to complete

checklists and certifications for all submitted data. In addition, we perform variance analysis by fund and question any unusual or significant variances.

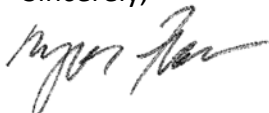
We will continue to assess risk annually and, if needed, modify our internal controls to mitigate risk. We will also provide training to the identified agencies on our policies and procedures and their responsibilities for accurately reporting information to us for the financial statements.

Person Responsible: Barb Ruckheim, Statewide Accounting Director

Implementation Date: June 30, 2017

Again, thank you for the opportunity to discuss and respond to the audit finding of the department. We value your work to improve internal controls in the state of Minnesota.

Sincerely,

A handwritten signature in black ink, appearing to read "Myron Frans", written in a cursive style.

Myron Frans
Commissioner



February 7, 2017

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the report titled "Internal Controls Over Statewide Financial Reporting Year Ended June 30, 2016." We value the Legislative Auditor's evaluation of our financial reporting, and we appreciate suggestions to improve it. Below is our response to the finding and recommendation.

Audit Finding: The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities.

Recommendation

The Board of Water and Soil Resources and the departments of Corrections and Public Safety should strengthen internal controls by training staff and conducting effective reviews to ensure they properly identify and report accounts payable to the Department of Management and Budget.

Response

The board agrees with this finding and recommendation.

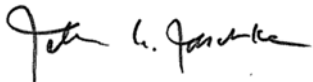
The report finds several instances where the payables reported by the board were not related to goods or services received on or before June 30, 2016, or to grant obligations where grantees met all eligibility requirements for payment on or before June 30, 2016. In these specific instances, the board had approved these payments and the funds had been encumbered, but easements were counted as liabilities before the Attorney General had approved them, or goods and services paid for by grants were counted as liabilities before they were reported. In addition to correcting these discrepancies, the board will revise its procedures for submitting the annual CAFR certification to prevent encumbrances from being reported as liabilities before specific easements are Attorney General approved, and will require reporting from specific grantees before grant encumbrances are reported as liabilities for purposes of the CAFR.

Person Responsible: Bill Eisele, Administrative Services Director
Estimated Completion date: June 1, 2017

The Board of Water and Soil Resources monitors progress on audit findings until they are resolved.

Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "John G. Jaschke". The signature is fluid and cursive, with the first name "John" being more prominent.

John G. Jaschke
Executive Director

Cc: Gerald Van Amburg, Acting BWSR Board Chair



Central Office

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February 7, 2017

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

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the finding and recommendation reported as a result of the recent *Internal Controls Over Statewide Financial Reporting* audit for the year ended June 30, 2016. There is one finding that included the Department of Corrections (DOC) that we are responding to below:

Finding 1: The Board of Water and Soil Resources and the departments of Corrections and Public Safety did not have adequate controls to ensure they properly identified accounts payable liabilities.

Recommendation

- *The Board of Water and Soil Resources and the departments of Corrections and Public Safety should strengthen internal controls by training staff and conducting effective reviews to ensure they properly identify and report accounts payable to the Department of Management and Budget.*

Response

The DOC agrees with the finding and recommendation. DOC staff inadvertently entered accounts payable liabilities on the Accounts Payable Testing report provided by the department of Management and Budget (MMB) for fiscal year 2016 liabilities. The error was discovered when OLA staff contacted the DOC and requested supporting documentation of the information reported to MMB on the previously mentioned testing report. Financial information and transactions were accurately reported in the state's accounting system. We will strengthen our process to review and verify the accuracy of financial information provided to MMB for the state's basic financial statements, to include an employee other than the preparer of the information, who is knowledgeable about the requested information.

Person Responsible:
Chris Dodge, Agency Chief Financial Officer

Estimated Completion Date:
Immediately

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Thank you again for this opportunity to respond, and for the professional work by your staff.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Tom Roy', with a stylized, looped flourish at the end.

Tom Roy, Commissioner

Cc: Lisa Wojcik, Assistant Commissioner
Chris Dodge, Chief Financial Officer
Nancy Glasenapp, Accounting Director



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February 10, 2017

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

Dear Mr. Nobles:

This letter is our response to the findings of the audit conducted of the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ending June 30, 2016.

The specific finding is the Department of Public Safety did not have adequate controls to ensure the department properly identified accounts payable liabilities.

Response:

The specific actions we will take to correct this finding and prevent it from happening again are:

1. Provide training to employees on requirements and expectations pertaining to data review prior to reporting accounts payables to the Minnesota Management & Budget.
2. Establish an internal process for required meetings, and internal and external outreach that will compile, verify, and confirm liabilities. This includes requiring appropriate management review prior to report submission.

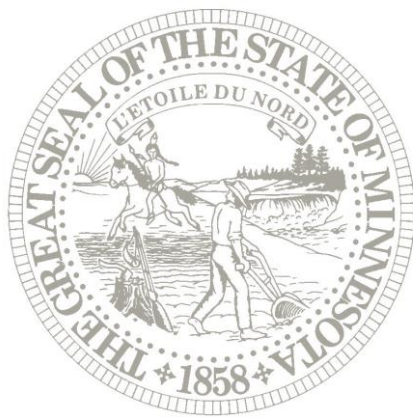
If you have any questions or concerns, feel free to contact me.

Sincerely,

A handwritten signature in blue ink that reads "Ramona L. Dohman".

Ramona L. Dohman, Commissioner

C: Cassandra O'Hern, Deputy Commissioner
Larry Freund, Chief Financial Officer
Paul Mathe, Internal Controls Manager
Mike Thone, MMB Internal Control and Accountability Unit



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