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, 2008

February 13, 2009 **Report 09-03**

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February 13, 2009

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Tom Hanson, Commissioner
Department of Finance

In auditing the State of Minnesota's basic financial statements for the year ended June 30, 2008, 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 and did not identify any noncompliance to report.[1] This report contains our findings and recommendations on internal control 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 described in Findings 1 through 4, related to the preparation of the basic financial statements, to be material weaknesses. A material weakness is a deficiency, or combination of 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. We consider the internal control deficiencies reported in Findings 5 through 8 to be significant deficiencies. 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.

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.

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

This report is intended solely for the information and use of the State of Minnesota's management and the Legislative Audit Commission; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 13, 2009.

/s/ James R. Nobles	*/s/ Cecile M. Ferkul*
James R. Nobles Legislative Auditor	Cecile M. Ferkul, CPA, CISA Deputy Legislative Auditor

End of Fieldwork: December 9, 2008

Report Signed On: February 10, 2009

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Report Summary

Conclusion

The state's financial statements were fairly stated in all material respects. However, the state continued to have weaknesses in internal control over financial reporting as noted below.

The audit report contains seven findings related to controls over the preparation of the state's financial statements. Three of the findings related to prior audit recommendations that have not been fully resolved.

Findings

The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements. (Finding 1 page 3)

Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls. (Finding 2, page 5)

The Department of Employment and Economic Development lacked effective controls over accounts receivable and accounts payable calculations that resulted in material misstatements in the Unemployment Insurance Fund's preliminary financial statements. (Finding 3, page 6)

The Department of Human Services did not have an effective process to ensure that one of its major program subsystems reconciled to the state's accounting system. (Finding 4, page 7)

Several state agencies need to improve controls over financial reporting including: Finance (Finding 5, page 8); Transportation (Finding 6, page 9); and Education (Finding 7, page 10).

Audit Scope

We audited the state's financial statements for the year ended June 30, 2008. Our audit encompassed work at many large state agencies that managed financial activities that were significant to these financial reports.

Background

The Department of Finance is responsible for preparing the state's annual financial statements, which are included in the *State of Minnesota's Comprehensive Annual Financial Report*.

The issues contained in this report relate to internal controls in the state's financial reporting process as a whole.

Financial Statement Findings and Recommendations

Finding 1

The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

The state did not have a comprehensive internal control structure over its financial reporting processes to ensure that a material misstatement of the state's financial statements would be prevented or detected and corrected on a timely basis. While state agencies generally could describe their internal control policies and procedures for financial reporting, most controls were not documented. In addition, most agencies had not designed those controls based on thorough assessments of their financial reporting risks or monitored the effectiveness of existing internal control procedures. As a result, agencies had not identified or taken action to remedy certain internal control deficiencies in their financial reporting processes.

The Department of Finance[1] did assess risks to its basic financial reporting process, but did not fully extend that assessment to risks that exist at other state agencies on which it relies for important financial information, such as accounts receivable and accounts payable accruals. Department of Finance's policy on internal control requires each agency head to develop and maintain an effective internal control structure.[2]

Weaknesses in the internal control structure existed at the departments of Education, Employment and Economic Development, Finance, Human Services, Revenue, Transportation, and at the State Board of Investment, the Minnesota State Retirement System, and the Teachers Retirement Association.

A comprehensive control structure has the following key elements:

- Personnel are trained and knowledgeable about financial reporting goals and applicable policies and procedures.

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[1] Effective June 2008 the Legislature reorganized the Department of Finance to include the duties of the Department of Employee Relations. Although still identified in statute as the Department of Finance, in October 2008, the department changed its name to Minnesota Management and Budget. The department will seek legislative approval for the name change in the 2009 legislative session.

[2] Department of Finance Policy 0102-01.

- Management identifies risks associated with financial reporting and develops policies and procedures to effectively address the identified risks.

- Management continuously monitors the effectiveness of the controls, identifies weaknesses and breakdowns in controls, and takes corrective action.

- Management focuses on continual improvement to ensure an acceptable balance between controls and costs.

A comprehensive internal control structure is critical to accurate financial reporting and safeguarding of state resources. The state prepares its financial statements in a high risk environment. The state's primary accounting system cannot generate accurate financial statements without significant manual calculations and adjusting entries. In addition, Finance relies on personnel in other state agencies to accurately account for many unique financial transactions according to a complex set of governmental accounting principles. Because the Department of Finance has ultimate, statutory responsibility to prepare the state's annual financial reports, it must ensure the reliability of the internal control structures of other state agencies on which it relies for important financial information.

Findings 2 through 4 identify specific deficiencies in agencies internal control procedures that created an unacceptable risk of error. Additionally, Findings 5 through 7 identify specific deficiencies in agency internal control procedures that did not detect or prevent errors from occurring. Specific control deficiencies included excessive or incompatible access to state business systems, ineffective analytical procedures and review processes, undocumented processes to determine financial statement amounts, changes in methods used to estimate accruals without sufficient consideration of accounting principles, and a lack of monitoring of the effectiveness of reconciliations of financial data underlying the financial statements. If the state had a comprehensive internal control structure, it could have identified some of these deficiencies, assessed the degree of risk these deficiencies had on the ability to accurately determine financial statement amounts, designed control procedures to address significant risks, and monitored whether the controls were working as designed and effective in reducing the risks to an acceptably low level. It is likely that the state will continue to have weaknesses in its financial reporting process until it operates within a comprehensive internal control structure.

Recommendation

- *The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.*

Finding 2

Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Many state agencies authorized employees to have inappropriate access to the state's accounting system, the state's payroll system, or state agency subsystems. The Department of Human Services also authorized employees to perform incompatible duties in its fiscal operations receipt center. Inappropriate system access is either access to incompatible business functions or access that is not necessary for the employee's job duties. Allowing employees to have inappropriate access to business systems or to perform incompatible functions increased the risk that errors or fraud could occur without detection and compromised the integrity of financial transactions underlying the financial statements.

Appendix A provides more detail about specific security access weaknesses at the departments of Employment and Economic Development, Human Services, and Transportation and at the state's three retirement systems. Especially noteworthy is that system access to incompatible duties at the Department of Human Services resulted in a fraud totaling over $1 million in the medical assistance program.

Finance's internal control policy[3] 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. If agencies are unable to adequately separate incompatible duties, the Department of Finance requires them to develop and document their controls designed to mitigate the risk that error or fraud will not be detected.[4] These controls typically include some analysis and review of transactions processed by the employees with inappropriate access. Agency management needs to monitor that these controls are performed as designed and effective in reducing the risks.

Finance's policies have not resolved continuing deficiencies in agencies' internal controls caused by employees' inappropriate access and incompatible duties. Finance did not provide sufficient oversight to ensure that agencies' controls were effective and that agencies monitored implementation and effectiveness of those controls. In addition, Finance had not followed up with two agencies that had not provided evidence of mitigating controls over payroll transactions. Finance had not resolved a prior audit finding from April 2008 about state agencies' excessive or incompatible access to the state's accounting system.[5] By not properly monitoring state agencies who have given employees incompatible access to state business systems, Finance increased the risk of errors and fraud.

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[3] Department of Finance Policy 0102-01.
[4] Department of Finance Policy 1101-07 and HR 045.
[5] Office of the Legislative Auditor's Financial Audit Division Report 08-14, *Professional/ Technical Services Contracts*, issued April 4, 2008.

In addition to the system access weaknesses, the Department of Human Services did not separate incompatible duties in its fiscal operations receipt center. During fiscal year 2008, the center received and processed $101 million of medical assistance rebates from drug companies for the department, motor vehicle renewals for the Department of Public Safety, and certain extended insurance payments for the Department of Finance. The department allowed all seven employees of the fiscal operations receipt center the ability to generate the receipt register, complete the bank deposit, and reconcile the receipt register to the deposits in the state's accounting system. These duties are incompatible because they would allow an employee to hide errors or fraud.

Recommendation

- *The Department of Finance and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes. When incompatible access or duties exist, the Department of Finance and the state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented and effective.*

Finding 3

The Department of Employment and Economic Development lacked effective controls over accounts receivable and accounts payable calculations that resulted in material misstatements in the Unemployment Insurance Fund's preliminary financial statements.

The Department of Employment and Economic Development (DEED) did not sufficiently assess whether changes in its calculation of year-end accounts receivable and accounts payable accruals complied with generally accepted accounting principles. The department's use of different criteria to determine accounts receivable and accounts payable amounts resulted in a material overstatement of fund assets and understatement of liabilities for the Unemployment Insurance Fund. Audit adjustments totaling $42.7 million were necessary to correct the financial statements.

The department's methods to determine accounts receivable and payable estimates were deficient as follows:

- <u>Accounts Receivable</u> – DEED changed its method for determining accounts receivable accrual amounts. For unemployment overpayments, the department expanded the period of overpayments it included as receivable from those occurring within the past two years to those occurring within the past six years, increasing the estimate by $23.8 million. For outstanding employer taxes, the department included $5.2 million owed by companies who no longer had employees and may have been out of business. In both these cases, the department is less likely to collect the full amounts due. Generally accepted accounting principles require that accounts receivable be reported net of uncollectible amounts.

- Accounts Payable – DEED also changed its method for determining unemployment benefits payable at the end of the fiscal year. Rather than estimate the amount based on actual July and August payments for benefits due before June 30, it used a five-year average. Because unemployment benefit payments were lower in the earlier years, this method understated the liability at the end of fiscal year 2008 and total unemployment expenses for that year by about $13.7 million The department changed its method because its new benefit payment system did not provide a report of the payable amount and department staff did not have the access necessary to obtain the information from the system's database.

The department's analytical review process did identify the material changes in the account balances between fiscal years 2007 and 2008, but did not result in a meaningful evaluation of the reasons for the variances or the criteria used to estimate the accrual amounts. In one case, the analysis noted that a DEED employee was looking into the variance but no one followed up on the status of the review or corrected the amount based on this research.

Recommendations

- *DEED should assess any changes to its accrual estimates to ensure that the amounts determined are in compliance with generally accepted accounting principles.*

- *DEED should evaluate material variances in financial account balances to determine whether they reflect legitimate changes in financial activity or are due to error or omission when determining financial statement amounts.*

Finding 4

The Department of Human Services did not have an effective process to ensure that one of its major program subsystems reconciled to the state's accounting system.

The Department of Human Services did not have an effective reconciliation process to ensure that staff identified and resolved differences between the detailed transaction data for one of its major program subsystems and transactions recorded on the state's accounting system. The department used the subsystem to provide nearly $640 million of family support and cash assistance aid. Since the transactions on the state's accounting system were the basis for the state's financial statements, it was essential that those transactions balanced to the subsystem that initiated them.

The department had not documented its reconciliation process, and staff newly responsible for the reconciliation did not know what factors might cause discrepancies between the subsystem and the state's accounting system. In previous years, the department completed a monthly reconciliation as a control to support that financial activity on the MAXIS subsystem agreed with the state's accounting system (MAPS). The monthly reconciliation provided to the auditors during fiscal year 2008 included other extraneous information and unrelated transactions. The department's reconciliation process also did not require any reporting that would have alerted department management that staff had not performed the reconciliations in a way that would provide effective detection of error or fraud. Without an effective monitoring process, the department did not ensure that the reconciliations were completed or whether they were accurate.

Recommendation

- *The Department of Human Services should ensure staff complete key reconciliations at appropriate intervals; that reconciliation procedures are documented, complete, and accurately account for all financial activity; and that differences found in reconciliations are investigated and resolved or documented with adequate explanations.*

Finding 5

Prior Finding Partially Resolved: The Department of Finance did not ensure that its preliminary financial statements accurately included information provided by other agencies and appropriately adjusted for financial activity between state agencies.

The Department of Finance's analytical procedures (comparing current year account balances to prior year account balances) and its review process did not prevent or detect errors it made when incorporating financial information provided by other state agencies into the state's financial statements and when adjusting for financial activity between state agencies. The Department of Finance's analytical procedures and review processes did not detect the following errors:

- Finance incorrectly recorded $95 million of the Metropolitan Council's *unrestricted net assets* as *restricted net assets* when incorporating the Metropolitan Council's audited financial statements into the state's report. These classifications provide report users with important information about whether financial resources are available or unavailable for future use. An internal review of the financial statements did not detect the misclassification of net assets.

- The Department of Finance made an erroneous $14.3 million misclassification in the state's financial statements related to indirect costs. The error occurred when staff made a needed expense reclassification twice rather than once, resulting in a misclassification between expense categories. The error could have been detected if Finance staff had reviewed adjustments made after the normal comparison of current year adjustments to prior year adjustments occurred.

The purpose of analytical procedures is to determine whether there are variances between fiscal years and related accounts that might indicate error. The department's review process should verify that elements of the financial statement preparation process that are more subject to error, such as use of data from other agencies and adjustments, are accurately accounted for.

Recommendations

- *Finance should ensure that it accurately incorporates separately-issued financial statements into the state's report.*

- *Finance should review any adjustments made after the normal comparison of current year adjustments to prior year adjustments has been completed to ensure financial activity is accurately reported in the financial statements.*

Finding 6

Prior Finding Partially Resolved: The Department of Transportation did not sufficiently analyze the infrastructure and land capital asset amounts it reported to the Department of Finance in error.

The Department of Transportation inaccurately reported to the Department of Finance $7.8 million related to the reconstruction of the 35W bridge as *infrastructure capital assets* rather than as *land capital assets*. The department's 2008 additions to infrastructure totaled $540 million and to land totaled $57 million. The misclassification between asset types did not impact fund balance or net assets. Generally accepted accounting principles require that these categories be separately reported.

The department provided other infrastructure information to Finance based on an inaccurate query into state accounting system information. The query was intended to identify payments made after June 30, 2008, that should be included in the state's fiscal year 2008 financial statements. However, the query erroneously excluded the expenditure data processed on July 1, 2008, and did not identify $4.7 million for that day's expenditures. The error overstated transportation expenses and understated infrastructure capital assets. Even though another person reviewed the query, the error was not detected.

Because the infrastructure and right of way calculations are complex, the department needs to incorporate into its reporting process ways to ensure the accuracy of the calculations. Our prior audits in four of the past five fiscal years identified errors in the infrastructure and/or right of way amounts submitted to the Department of Finance. The secondary review of the calculations did not identify these errors or discrepancies.

Recommendation

- *The Department of Transportation should analyze and review expenditure data obtained from their accounting systems to ensure that it provides the Department of Finance accurate information about its land and infrastructure transactions.*

Finding 7

The Department of Education did not establish controls to ensure it accurately calculated school aid payable amounts for inclusion in the Federal Fund financial statements.

The Department of Education had not documented its process for determining the school aid payable amount or established a comprehensive review process to ensure the accuracy of the calculation. When it assigned the responsibility for the payable calculation to a different employee this year, the department staff was unable to determine an accurate payable amount. After initially submitting inaccurate amounts to the Department of Finance, the department involved other staff to revise and resubmit the payable amounts. The department's initial inaccurate submittal of school aid payable amounts and the subsequent revision to those amounts delayed the state's financial reporting process and our verification of financial statement balances. Audit tests determined that the department's revised amounts for the Federal Fund's school aids payable were not complete because they did not include payables for the state's charter schools. This resulted in a $7 million audit adjustment.

Recommendation

- *The Department of Education should establish internal controls to ensure that it accurately reports school aid payable amounts to the Department of Finance for inclusion in the state's financial statements.*

Appendix A – Additional Details Supporting Finding 2, Inadequate Security Access Controls Over State Business Systems

Employment and Economic Development

- The Department of Employment and Economic Development did not mitigate the risks associated with allowing call center employees certain access to the Unemployment Insurance System. The department had 173 employees with the ability to change the unemployed applicant's bank routing account numbers. No mitigating controls were in place to monitor the accuracy and appropriateness of the changes, including possibly the independent verification of any changes back to the unemployed person.

Human Services

- Prior Finding Not Resolved:[6] As of September 2008, the Department of Human Services had 14 employees who had incompatible security access to the state's accounting system. The incompatible profiles allowed these employees the ability to create vendors, process purchase orders, encumber funds, and pay invoices through the state's accounting system. These incompatible profiles should not be assigned to the same person unless the department designs controls to mitigate the risk of fraud or error not being detected. In addition, the department allowed three employees access to the accounts of the Department of Education and the Department of Health in order to update and change cash receipts handled through the Department of Human Services' fiscal operations receipt center. Since the department no longer processed financial activity for these agencies, these employees did not need this access.

  Poor system security and other internal control weaknesses at the Department of Human Services allowed an agency employee to initiate 23 fraudulent transactions, totaling $1.164 million, between August 2003 and September 2008. The amount consisted of $811,000 of state funds and $353,000 of federal funds charged to the medical assistance program (CFDA 93.778). Until February 2008, the employee had incompatible security access to the state's accounting system. The access allowed the employee to authorize and enter the fraudulent transactions into the state's accounting system. After the department limited her access, she used her

[6] Office of the Legislative Auditor's Financial Audit Division Report 08-14, *Professional/Technical Services Contracts*, issued April 4, 2008.

authority to authorize payments and had others enter the fraudulent payments into the state's accounting system.

Minnesota State Retirement System

- The Minnesota State Retirement System (MSRS) lacked formal processes to request, review, and authorize initial employee access to its business systems and to periodically recertify that ongoing access was appropriate.
- MSRS had 24 employees with the ability to make changes to sensitive member account information. No adequate mitigating controls were in place within the organization to monitor the accuracy or appropriateness of these changes, which increased the chances of employee errors or fraud.
- In addition, MSRS had six employees who had incompatible access to the state's accounting system without adequate mitigating controls in place.

Public Employees Retirement Association

- Prior Finding Not Resolved:[7] The Public Employees Retirement Association (PERA) lacked formal processes to request, review, and authorize initial employee access to its business systems and to periodically recertify that ongoing access was appropriate.
- PERA had 42 employees with the ability to make changes to sensitive member account information. No adequate mitigating controls were in place within the organization to monitor the accuracy or appropriateness of these changes, which increased the chances of employee errors or fraud.

Teachers Retirement Association

- Prior Finding Not Resolved:[8] The Teachers Retirement Association (TRA) lacked formal processes to request, review, and authorize initial employee access to its business systems and to periodically recertify that ongoing access was appropriate.
- TRA had 38 employees with the ability to make changes to sensitive member account information. No adequate mitigating controls were in place within the organization to monitor the accuracy or appropriateness of these changes, which increased the chances of employee errors or fraud.
- In addition, TRA had five employees who had incompatible access to the state's accounting system without adequate mitigating controls in place.

[7] Office of the Legislative Auditor's Financial Audit Division Report 08-18 *Public Employees Retirement Association - Information Technology Audit*, issued August 14, 2008.
[8] Office of the Legislative Auditor's Financial Audit Division Report 07-23 *Teachers Retirement Association - Information Technology Security Controls*, issued August 30, 2007.

Transportation (MnDOT)

- Prior Finding Partially Resolved:[9] As of November 2008, MnDOT had 59 employees with incompatible access to the state´s accounting system. Of these employees, 58 had incompatible access to create a purchase order, encumber funds, receive goods, and make payments. Any payments made by those 58 employees were not subject to approval since MnDOT uses online approvals that do not cover payments made for procurements. One other employee had incompatible access to accounts receivable data. This individual could record customer receipts and make edits to the customers' accounts.

[9] Office of the Legislative Auditor's Financial Audit Division Report 08-14, *Professional/ Technical Services Contracts*, issued April 4, 2008.

MINNESOTA Management & Budget

February 9, 2009

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

Dear Mr. Nobles:

Thank you for the opportunity to discuss your audit findings for the Statewide Report on Internal Controls over Statewide Financial Reporting. Our response will specifically address those findings related to our department while the remainder of the findings will be addressed by the specific agency involved. 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. Our 23-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 stronger.

Recommendation

Finding 1. The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Response

We agree that adequate internal control structure over financial reporting to mitigate the risk of potential misstatements in the financial statements is essential. Strong financial management is critical and we are committed to the highest levels of financial integrity.

As you noted, we did assess risks to our financial reporting process and will continue to revise and enhance our risk assessment as this is a continuous process. In this process, we continue to prioritize risks and weigh the costs and benefits of controls.

We work with agencies throughout the year to identify and address financial statement risks and issues. This is an ongoing process to assess risks and improve internal controls to mitigate material risks of misstatement. We also require agencies to certify the accuracy of the financial

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information they submit. We will continue annual communications with agencies and periodic training in complex and material reporting areas.

In addition, we conduct extensive independent reviews of work performed by our financial reporting team. These reviews are designed to prevent material misstatements to the financial statements. We continuously make judgments to utilize our resources based on the risk and materiality of the potential misstatement.

We recognize the need to further strengthen internal controls over financial reporting on a statewide basis and are taking several actions in response to this need. We are holding two financial forums this month. The first will be directed toward large agencies and the second toward small agencies, boards, and commissions. These financial forums will focus on the highest standards for sound and strong financial management. In addition, we are mandating that all agencies implement the Code of Conduct policy. This policy reinforces the requirement to create a values-based ethical framework. Agency heads, as well as employees with material financial information duties, must ensure accountability, provide governances processes, ensure the timely detection of significant internal control deficiencies, and ensure the accuracy and reliability of the state's comprehensive annual financial report and other state and federal reports, including tax filings, single audit and other grant reports. Both agency heads and employees falling within the scope of this policy will be required to sign an annual certification stating they understand the requirements of the Code of Conduct policy and will carry out these requirements. We are in the process of updating the training materials to help agencies implement the Code of Conduct.

We also recognize that agencies are facing many pressures as budgets tighten and employees in key positions turn over. Additional training and tools are necessary to ensure that agencies place a high emphasis on strong financial management including their internal control structure. We have a responsibility to provide oversight, set policies and procedures, and provide guidance and training to agencies. Agency management has primary responsibility to ensure an effective internal control structure is in place. To help strengthen our financial oversight capabilities, the Governor has recommended the creation of an internal control support unit within our department. This unit will augment existing training and support for all state agencies and provide training and tools to agencies in areas such as internal controls and risk assessments. This will help agencies gain an understanding of effective internal control structures and provide guidance in its implementation. In addition, we plan to take a more active role in ensuring Legislative Auditor findings are implemented and working with the Legislative Auditor to identify emerging issues.

As you noted, agencies generally could describe their internal control policies and procedures, but lacked comprehensive risk assessments and documentation of controls. Effective internal control structures are very complex and require detailed risk assessments and extensive documentation of controls. In addition, agencies must test controls to ensure they are operating as designed. Agencies must start by identifying and prioritizing material financial risks and then documenting and ensuring that key controls are in place to mitigate these risks. In this process, agencies will need to continually weigh the costs of mitigating controls against the level of acceptable risk. As this is an on-going process, agencies must constantly monitor their controls and refine their risk assessments as needed to ensure an effective internal control structure remains in place.

We will continue to assess risks over financial reporting and work with agencies to help improve the accuracy of the financial statement information provided to us. We strongly believe an internal control support unit would be valuable to agencies and provide the additional training, support and tools they are requesting to help them improve their internal control structures.

Person Responsible: Lori Mo, Accounting Services Assistant Commissioner

Implementation Date: July 31, 2009 implementation plan complete (specifics contingent on resources)

Recommendation

Finding 2. Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Response

During the past year, we have done considerable work with state agencies to reduce incompatible system access. We believe excellent progress has been made on the SEMA4 Human Resource/Payroll/Benefits system, with more modest success on the MAPS Accounting/Procurement system. We provided agencies with improved tools for identifying problematic access, support of emergency backup access, improved instruction on appropriate separation of duties, and consultation on the adequacy of proposed mitigating controls. However, additional steps should be taken and we have plans in place to facilitate further improvements.

For the SEMA4 Human Resource/Payroll/Benefits system, we identified incompatible security profiles and worked with agencies to clean up incompatible access. During this process, an oversight occurred with two agencies. The security access for individuals in these two agencies has since been corrected. We will continue to provide annual review of incompatible access and oversight to ensure agency procedures are in place and documentation is complete and accurate.
For the MAPS Accounting/Procurement system, we sent special correspondence to agency accounting directors, alerting them to MAPS incompatible access within their agencies. We provided them with the names of specific MAPS users who may have the power to perform incompatible functions. For any agencies that still have not eliminated this incompatible access or provided certification of adequate mitigating controls, we now plan to correspond directly with agency heads to ensure they are aware of this issue. Any further steps will be determined on a case-by-case basis. We will also continue to provide on-going review and oversight of potential incompatible assess, to ensure that agencies continue to monitor and update employee MAPS access as necessary.

Person Responsible: Jeff Mosner, MAPS IS Director

Implementation Date: August 31, 2009

Recommendation

Finding 5. The Department of Finance did not ensure that its preliminary financial statements accurately included information provided by other agencies and appropriately adjusted for financial activity between state agencies.

Response

We continue to place a high emphasis on our review process. Unfortunately, in order to complete the state's financial statements on a timely basis, we submit preliminary drafts of statements before our entire review process is complete. We believe our final review process would have identified the reclassification of net assets. Metropolitan Council financial statements are completed very early in the state's financial statements cycle. Our final high level review comparing this year's numbers to prior year had not been complete at the time the preliminary statements went to the auditors. The final review identified several similar adjustments in other financial statements relating to the net asset category.

As you noted, the indirect cost entry related to a reclassification between expense categories on the government-wide financial statements and did not impact total nets assets. During the current year, we strengthened our procedures related to a broader area that covered this indirect cost elimination. Unfortunately, this resulted in a miscommunication of responsibilities in this narrower area. As a result, a late entry was made after we had performed the detailed comparison of adjustments to the prior year. We will review and approve any late adjustments in the future.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: December 31, 2009

Sincerely,

Tom J. Hanson

Tom J. Hanson
Commissioner

February 6, 2009

James Nobles
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1063

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings for the Minnesota Department of Education ("Department") which were included in the audit of the State of Minnesota's consolidated financial statements for the year ended June 30, 2008. Specific findings for the Department include findings 1 and 7. The response to each finding, person responsible for implementation and timeframe is included with each finding.

The Department is in agreement with both findings and plan to begin corrective action and/or implementation on both immediately.

Finding 1: "The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in financial statements."

OLA Recommendation: "The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process."

While the Department does not have resources to add staff to manage this project, it is a high priority to resolve this finding. Over the next year, we expect to complete the risk assessment process and identify policies to document all controls. We will use the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Governance Institute COBIT frameworks and direction provided by Minnesota Management and Budget as our guide through this process. It is expected that this entire process will take two years to complete with our tentative schedule included below. The manager responsibility for implementation of this finding will be Tammy McGlone, key team members are Al Louismet and Robert Niemala. Other staff will be assigned as necessary. All staff will be made aware of the internal controls responsibilities.

Deadlines for resolving Finding #1:
June 30, 2009: Completion of framework for the risk assessment.
September 30, 2009: Completion of the risk assessments for all agency programs.
December 31, 2009: Evaluation of the risk assessment findings and identification of risk.
December 31, 2010: Completion of all policy revisions including documentation of internal controls.

Finding 7: "The Department of Education did not establish controls to ensure it accurately calculated school aid payable amounts for inclusion in the Federal Fund financial statements."

OLA Recommendation: "The Department of Education should establish internal controls to ensure that it accurately reports school aid payable amounts to the Department of Finance for inclusion in the state's financial statements."

Part of this will be addressed as outlined above. However, prior to the completion of finding 1, staff in the Division of Program Finance will document the process for calculation of school aid payables for the state financial statements and will make sure process is in place to report payables accurately and timely for the next financial statements. Tom Melcher, Director of Program Finance, will be responsible for resolving this finding and the Department expects this finding to be resolved by July 1, 2009.

I appreciate the opportunity to respond to the findings for the Department. Please contact Tammy McGlone at 651-582-8835 if you have any questions or comments.

Sincerely,

Alice Seagren

Alice Seagren
Commissioner

C: Chas Anderson
Tom Melcher
Tammy McGlone
Al Louismet

February 9, 2009

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations related to the Department of Employment and Economic Development's internal control over financial reporting as a result of the audit of the State of Minnesota's financial statements for the year ended June 30, 2008.

Audit Finding 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Recommendation:

- *The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.*

Response: The department agrees with the finding and recommendation. While DEED does maintain internal controls over financial reporting, those controls are not well documented and monitored. Cindy Farrell, Chief Financial Officer, will oversee the establishment of a more comprehensive internal control structure over financial reporting to be completed by October 1, 2009.

Audit Finding 2: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Recommendation:

- *The Department of Finance and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business process. When incompatible access or duties exist, the Department of Finance and the state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented and effective.*

Response: The department partially agrees with the finding and recommendation. The department disagrees with the assertion in the audit report that there are no mitigating controls in place to monitor the accuracy and appropriateness of its call center employee's entry of changes to the bank routing and account numbers of unemployment insurance applicants. The audit report fails to recognize that these applicants are dependent upon their weekly benefit payment and will contact the department if the expected payment is not received. The department recognizes that this may not prevent employee fraud from occurring, however it does consider this to be an effective control designed to detect fraud in a timely manner. Each change to the bank routing and account numbers is stored on a system table with the date/time and user ID of the person making the change.

This would enable the department to quickly determine who made the change in the event that an employee did make a fraudulent entry. During 2008, there were only 155 changes to bank routing and account numbers made by UI staff out of 315,707 initial accounts established. In addition, to try to detect fraud the department runs a cross match each week to search for applicant accounts with the same bank routing and account numbers. If there are two or more accounts with the same numbers, they are flagged in a report and reviewed by the Unemployment Insurance Special Accounts team. The department does acknowledge that it can do a better job of documenting these controls and will consider implementing additional monitoring controls designed to prevent and detect fraud. Kathy Nelson, Unemployment Insurance Director, will complete this activity by June 30, 2009.

Audit Finding 3: The Department of Employment and Economic Development lacked effective controls over accounts receivable and account payable calculations that resulted in material misstatements in the Unemployment Insurance Fund's preliminary financial statements.

Recommendations:

- *DEED should assess any changes to its accrual estimates to ensure that the amounts determined are in compliance with generally accepted accounting principles.*
- *DEED should evaluate material variances in financial account balances to determine whether they reflect legitimate changes in financial activity or are due to error or omission when determining financial statement amounts.*

Response: The department agrees with the finding and recommendations. The department must rely on estimates of accounts receivable and accounts payable for presentation in the financial statements. The finding related to accounts receivable stems from the department's estimate of its allowance for doubtful accounts. A law change that became effective during FY 2008 increases the collectability of debts owed to the department for benefit overpayments. However, it will be several years before the department has adequate history for this to be helpful in estimating a reasonable allowance for doubtful accounts. In the interim, the department will continue to fine tune and better document its estimating methodology. Any material variances identified will be fully investigated and resolved prior to the submission of the financial statements. Cindy Farrell, Chief Financial Officer, will implement these changes by October 1, 2009.

If you have any questions or need additional information please contact Cindy Farrell at Cindy.Farrell@state.mn.us or 651-259-7085.

Sincerely,

Dan McElroy
Commissioner

Minnesota Department of **Human Services**

February 9, 2009

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

Dear Mr. Nobles:

The enclosed material is the Department of Human Services response to the findings and recommendations included in the draft audit report titled, "Report on Internal Control Over Statewide Financial Reporting" for the fiscal year ended June 30, 2008. It is our understanding that our response will be published in the Office of the Legislative Auditor's final audit report.

The Department of Human Services policy is to follow up on all audit findings to evaluate the progress being made to resolve them. Progress is monitored until full resolution has occurred. If you have any further questions, please contact David Ehrhardt, Internal Audit Director, at (651) 431-3619.

Yours sincerely,

Cal R. Ludeman

Cal R. Ludeman
Commissioner

Enclosure

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Department of Human Services'
Response to the Report Titled, "Report on Internal Control Over Statewide Financial Reporting"
For the Year Ended June 30, 2008

Audit Finding #1

The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Audit Recommendation #1

- *The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.*

Department Response #1

The department agrees with the recommendations. The department continues to improve internal controls associated with its role in the state's financial reporting process. In preparation for the state fiscal year 2008 process, the department developed a comprehensive tracking document that has lead to improved coordination and staff understanding of the state's financial reporting process and its significance.

Person Responsible: Martin Cammack

Estimated Completion Date:

Although these internal controls have been improved, the effort to improve internal controls within the department is continuous.

Audit Finding #2

Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Audit Recommendation #2

- *The Department of Finance and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business* *systems and incompatible duties in state business processes, such as the Department of Human Services fiscal operations receipt center. When incompatible access or duties exist, the Department of Finance and the state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented and effective.*

Department Response #2

The department agrees with the recommendations. The department concurs with this recommendation. With regard to employee MAPS security, the department has eliminated all unnecessary and incompatible access within the Central Office, including the Receipt Center. Within State Operated Services, compensating controls are in place to address the remaining situations of MAPS incompatible duties. The Receipt Center operates an industry-standard system of specialized receipt processing software and equipment. This system is highly integrated and efficient, and includes built in internal controls. Traditional separation of duty controls may not be practical or applicable. The department has initiated a review of the procedures in place at the Receipt Center and will ensure adequate internal controls are in place and documented.

Person Responsible: Martin Cammack

Estimated Completion Date: July 1, 2009

Audit Finding #4

The Department of Human Services did not have an effective process to ensure that one of its major program subsystems reconciled to the state's accounting system.

<u>Audit Recommendation #4</u>

- *The Department of Human Services should ensure staff complete key reconciliations at appropriate intervals; that reconciliation procedures are documented, complete, and accurately account for* *all financial activity; and that differences found in reconciliations are investigated and resolved or documented with adequate explanations.*

Department Response #4

The department does agree that the reconciliation process needs to be adequately documented. The department uses a daily reconciliation to reconcile MAXIS system transaction data to the state's accounting system (MAPS).

Person Responsible: Martin Cammack

Estimated Completion Date:

Documenting of the reconciliation process will be completed by July 1, 2009.

MINNESOTA STATE BOARD OF INVESTMENT

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February 9, 2009

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings of the Statewide Report on Internal Control Over Financial Reporting for the year ended June 30, 2008.

Audit Finding 1: Department of Finance's policy on internal control requires each agency head to develop and maintain an effective internal control structure. Weaknesses in the internal control structure existed at state agencies including the State Board of Investment.

Audit Recommendation: The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.

Audit Response: While the State Board of Investment believes that overall the current internal controls are adequate, we do recognize that some weaknesses in the internal control structure exist. The State Board of Investment will work to develop and maintain an effective internal control structure in accordance with Department of Finance policy.

Person Responsible: Howard Bicker

Implementation Date: June 30, 2009

Sincerely,

/s/ Howard Bicker

Howard Bicker
Executive Director

MSRS | Minnesota State Retirement System
MNDCP | Minnesota Deferred Compensation Plan
HCSP | Health Care Savings Plan

February 6, 2009

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 findings and recommendations contained in your report which indicates the results of the 2008 statewide financial audit. The paragraphs that follow summarize our corrective action plans for resolving the findings that specifically pertain to our agency.

Finding 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Recommendation: The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.

We concur with this finding. While we believe that we have strong, effective financial internal controls in place, we recognize that we should do more to improve documentation of our internal control structure. At a minimum, we intend to develop agency-specific financial reporting policies and procedures and to perform a formal assessment of risks and controls associated with financial reporting. Persons responsible for resolution of this audit finding include Assistant Director Judy Hunt and Accounting Director Dennis Jensen. The target date for resolution of this audit finding is December 2010.

Finding 2: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Recommendation: The Department of Finance and state agencies need to ensure that they eliminate unnecessary or incompatible access to state business systems and incompatible duties in state business processes. When incompatible access or duties

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fax 651-297-5238 | www.msrs.state.mn.us

exist, the Department of Finance and the state agencies need to ensure that controls designed to mitigate the risk of error or fraud are implemented and effective.

We concur with this finding also. In the past year, we have taken considerable action to strengthen access controls to our online participant account system. We developed a data authorization form and a formal process for requesting and terminating access to this system. We are close to completing our first annual re-certification designed to ensure that employees' ongoing access is appropriate for their assigned duties. This re-certification process extends to select employees from other retirement systems and state agencies as well as to MSRS employees. Persons responsible for resolution of this audit issue include our database administrator Deb Mulcahy and the assistant database administrator Lloyd Johnson.

As to the component of this finding that pertains to incompatible access for employees who have the ability to update sensitive member account information while processing distributions to members, we are currently exploring our options to limit their access. Assistant Directors Erin Leonard and Judy Hunt are responsible for resolving this matter prior to December 31, 2009.

The same corrective action plan applies to the component of the finding that pertains to employees with incompatible access to the state's accounting system. Mitigating controls have and will continue to be implemented when staffing limitations prevent us from eliminating such incompatibilities. Assistant Director Judy Hunt and Accounting Director Dennis Jensen are responsible for resolving this issue prior to December 31, 2009.

Again, we appreciate the opportunity to respond to your report comments. We value the work of your agency to identify areas within MSRS that need improvement. We are committed to taking appropriate actions to further strengthen our internal control structure.

Sincerely,

David Bergstrom

Dave Bergstrom
Executive Director

cc: Judy Hunt
Dennis Jensen
Lloyd Johnson
Erin Leonard
Deb Mulcahy

Public Employees Retirement Association of Minnesota
60 Empire Drive, Suite 200
Saint Paul, Minnesota 55103-2088
Member Information Services: 651-296-7460 or 1-800-652-9026
Employer Response Lines: 651-296-3636 or 1-888-892-73
PERA Fax Number: 651-297-2547 ◆ PERA Website: www.mnpera.org

February 5, 2009

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

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the internal control audit you conducted at the Department of Finance. In Finding 2 you mentioned that you believe PERA has security access weaknesses, and listed those in Appendix A. Our responses to your findings are given below.

1. ***Finding: PERA lacked formal processes to request, review, and authorize initial employee access to its business systems and to periodically recertify that ongoing access was appropriate.***

Response: We have a process in place to request and authorize initial employee access to business systems, and we do periodically recertify that ongoing access is appropriate, but that process is not a formal, documented process. We are in the midst of formalizing and documenting that process, and expect to have it complete by the end of next month.

Resolution Date: April 1, 2009

Person Responsible: Dave DeJonge

2. ***Finding: PERA had 42 employees with the ability to make changes to sensitive member account information. No adequate mitigating controls were in place within the organization to monitor the accuracy or appropriateness of these changes, which increased the chances of employee errors or fraud.***

Response: We are a service agency with 42 members of the staff who rotate the responsibility for receiving hundreds of phone calls every day. Employees who answer phone calls are able to adjust member demographic information as requested by the member. All changes are confirmed by sending a letter to the member's home address the day after any changes are initiated. Employees can not adjust social security numbers or benefit amounts, but can change other personal account data. Because service representatives can not adjust benefit or contribution amounts and can not initiate incoming or outgoing payments, we do not believe there is any significant risk of material misstatement in the financial statements.

The auditor's concern as expressed to us is that all 42 service representatives have the ability to adjust bank account information and payment addresses when requested to do so by benefit recipients. We have controls in place to minimize the risk of fraud, and we know that a benefit recipient will notify us if they do not receive their monthly benefit, but we will continue to explore and implement ways to minimize the number of employees who can adjust payment information.

We are in the process of making adjustments to our call center by adding a front-end menu system that routes the calls from members requesting demographic changes to a smaller group of service representatives. That change should be in place by March 2009.

We are also in the midst of asking all benefit recipients to receive their monthly benefit via direct deposit, reducing the risk that an employee would fraudulently change the payment address to intercept a benefit payment. Out of the 73,500 payments we send each month, fewer than 5,000 are now sent via paper warrant, a decrease of 3,500 since the audit. We will continue that effort through July 2009.

During this next year we will provide members the ability to update their own demographic information using My PERA, the members-only portion of our website. Once these three changes are rolled out, we hope to decrease the number of internal staff who are authorized to change bank account and payment address information.

Resolution Date: January 1, 2010

Person Responsible: Dave DeJonge

Sincerely,

/s/ Mary Most Vanek

Mary Most Vanek
Executive Director

MINNESOTA · REVENUE

February 9, 2009

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:

Below is our response to finding 1 of your audit of the State of Minnesota's financial statements for the year ended June 30, 2008.

Response:

The Minnesota Department of Revenue understands the importance of finding 1 and the importance of a comprehensive internal control structure over financial reporting. We have developed strong lines of communication with Minnesota Management and Budget (MMB), aimed at ongoing improvement of our financial reporting process. We acknowledge that our internal control procedures related to financial reporting are not well documented.

We will work to have an improved internal control plan for MMB's financial reporting process in place by June 30, 2009, and will work with MMB on a comprehensive structure. Dan Ostdiek, Revenue's Director of Financial Management will be responsible for resolving the above finding.

Sincerely,

Ward Einess
Commissioner

Teachers Retirement Association

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651.296.2409 • 800.657.3669 • 651.297.5999 FAX • 800.627.3529 TTY

February 9, 2009

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

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your report on the internal control over the state's financial reporting process. Two findings and recommendations involve the Teachers Retirement Association (TRA).

Finding # 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Recommendation: The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.

TRA Response: TRA management will assess and review risks associated with financial reporting. We agree that written policies and procedures need to be developed to document the existing process and controls already established. We will also coordinate our efforts with the State Board of Investment, the custodian of TRA assets.

The TRA Board of Trustees has recently authorized the establishment of an internal audit function. One of the duties of the internal auditor will be to perform tests of controls over key processes, such as the financial reporting and the compilation of the annual Comprehensive Annual Financial Report (CAFR). The reports completed by the internal auditor will provide management a basis to review the effectiveness of the internal control structure and take corrective action if necessary.

Persons Responsible: John Wicklund, Asst. Executive Director – Administration
Robert Johnson, Accounting Director

Resolution Date: June 30, 2009

Finding # 2: Many state agencies continue to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Recommendation: The Department of Finance and state agencies need to develop a comprehensive internal control structure for the state's financial reporting process.

TRA Response: The TRA Security Management Team is responsible for establishing written policies and procedures defining initial system access and ongoing monitoring of security access of employees into TRA's business systems. The initiative is not yet completed. The TRA systems division is also evaluating the development of a new security access package that improves the ability to establish and modify access groups. The operational managers will regularly review the security access approvals for individual employees and verify that the access level is appropriate.

We will assess internal control risk and improve documentation of key and sensitive processes. As previously mentioned, the work of the new TRA internal auditor in assessing risk, testing internal controls, and performing substantive testing will reduce the chances of employee errors or fraud.

The TRA Accounting Section has already completed written procedures that address incompatible access to the state's accounting system. The new internal audit function serves as a mitigating control to reduce the risk of unauthorized transactions occurring.

Individuals Responsible: Laurie Hacking, Executive Director
Mark Roemhild, TRA Systems Manager

Resolution Date: June 30, 2009

Thank you for the valuable recommendations you have suggested to improve our internal control environment.

Sincerely,

Laurie Fiori Hacking

Laurie Fiori Hacking
Executive Director

Minnesota Department of Transportation

Transportation Building
395 John Ireland Boulevard
Saint Paul, Minnesota 55155-1899

February 9, 2009

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 financial statements.* My staff and I appreciate your effort and are committed to satisfactory resolution of the findings. Following are Mn/DOT's responses to your findings.

Finding 1: The state lacked a comprehensive internal control structure over financial reporting to sufficiently mitigate the risk of potential misstatements in the financial statements.

Response: Mn/DOT believes strongly in financial integrity and concurs with this finding. Staff will continue to work with appropriate experts from the Department of Finance (DOF) to ensure that statewide policies and guidelines are incorporated into Mn/DOT's internal control policy.

Responsible People: Kevin Gray, Chief Financial Officer; Norman Foster, Director of Budget & Resource Management.

Implementation Date: March 2, 2009 and on-going.

Finding 2: Many state agencies continued to allow employees to have inappropriate access to state business systems or perform incompatible duties without establishing mitigating controls.

Response: Staff from Mn/DOT's Office of Financial Management are analyzing and evaluating system access to ensure that the level of access is compatible with job duties.

Responsible People: Kevin Gray, Chief Financial Officer; Norman Foster, Director of Budget & Resource Management.

Implementation Date: March 2, 2009 and On-going

Finding 6 – Prior Finding Partially Resolved: The Department of Transportation did not sufficiently analyze the infrastructure and land capital asset amounts it reported to the Department of Finance in error.

Response: Mn/DOT concurs with the recommendation resulting from this finding. Additional steps have been added to Mn/DOT's existing data gathering processes whereby costs will be analyzed by object code to ensure proper categorization between infrastructure capital assets and land capital assets. In addition, all data queries will be reviewed by a second staff person and rerun independently to compare query results to ensure that costs are captured accurately for the reporting period.

Responsible People: Kevin Gray, Chief Financial Officer; Norman Foster, Director of Budget & Resource

Implementation Date: February 2009 and on-going.

Thank you for the opportunity to respond to your findings and recommendations. We will be monitoring the implementation of the resolution of these findings. Please contact Terry Lemke at 651-366-4876 for follow-up information and activity.

Sincerely,

Thomas K. Sorel

Thomas K. Sorel
Commissioner of Transportation