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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Minnesota State Retirement System
Fiscal Year Ended June 30, 2004



JUNE 30, 2005

05-39

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Carl Otto, CPA, CISA	Auditor-In-Charge
Kathy Fisher, CPA	Auditor-In-Charge
Gena Hoffman	Senior Auditor

Report Summary

Audit Conclusions:

- We issued an unqualified opinion on the financial statements of the Minnesota State Retirement System as of and for the year ended June 30, 2004.
- We issued our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* of the United States. We did not report any material weaknesses involving the internal control over financial reporting and its operation or noncompliance that would be required to be reported under *Government Auditing Standards*. However, the report discusses a noncompliance issue that was resolved by a 2004 legislative change.

Background Information:

The Minnesota State Retirement System administers six defined benefit retirement plans and two defined contribution plans:

- State Employees
- State Patrol
- Correctional Employees
- Judges
- Legislators
- Elected State Officials
- Unclassified Employees
- Health Care Savings

The plans cover most state government and University of Minnesota employees and selected public-service organizations. In addition, the system contracts for the administration of a deferred compensation plan available to state employees and other public employees throughout the state.

At June 30, 2004, the Minnesota State Retirement System's total net assets (excluding the deferred compensation plan) were \$8.4 billion. For the year ended June 30, 2004, MSRS received contributions of about \$248 million and paid benefits and refunds of about \$432 million.



**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Minnesota State Retirement System Board of Directors

Mr. David Bergstrom, Executive Director
Minnesota State Retirement System

We have audited the financial statements of the Minnesota State Retirement System as of and for the year ended June 30, 2004, and have issued our report thereon dated November 19, 2004. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Minnesota State Retirement System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned function. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Minnesota State Retirement System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement

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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 that are required to be reported under *Government Auditing Standards*.

Other Issues

During the audit period and in prior years, the Minnesota State Retirement System did not comply with *Minnesota Statutes* 356.611, Subd. 1, which limited certain covered salary amounts for pension purposes to 95 percent of the Governor's salary. The Minnesota State Retirement System accepted contributions based on salaries that exceeded the salary cap established in Section 356.611. According to Minnesota State Retirement System records, there were 328 members whose salaries were subject to and exceeded the limitation. However, *Laws of 2004*, Chapter 267, Article 2, Sections 6 and 9, adopted in May 2004, provided an exception to the salary cap limitation and ratified retirement annuities for the affected members, retroactive to April 28, 1994. As a result of this 2004 change in the law, the Minnesota State Retirement System is now in compliance with *Minnesota Statutes* 356.611, Subd. 1.

This report is intended solely for the information and use of the Legislative Audit Commission and the Minnesota State Retirement System and is not intended to be and should not be used by anyone other than those specified parties.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 19, 2004

Report Signed On: June 20, 2005

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Status of Prior Audit Issues

Most Recent Audits

April 20, 2005, Legislative Audit Report 05-24 was a special review of the Minnesota State Retirement System's administration of the Minnesota Deferred Compensation Fund from January 1, 2002, through December 31, 2004. We conducted this special review in response to concerns raised by an MSRS employee. Our review was not a full audit of the deferred compensation plan. We focused this special review primarily on controls over financial activity of the plan's administrative account. We did not find evidence of financial wrongdoing by MSRS employees. In addition, we did not find evidence that MSRS employees were actively involved in the administration of other tax-sheltered annuity plans. However, we identified several weaknesses in MSRS's administration of the state's deferred compensation plan, including weaknesses in controls over the administrative account, contract administration, and system access. We did not review the status of these findings because our current audit scope did not include the deferred compensation plan.

January 15, 2004, Legislative Audit Report 04-04 covered the fiscal year ended June 30, 2003. The audit scope included employer and employee contributions, annuity benefits, and refunds. We audit the Minnesota State Retirement System on an annual basis. There were no reportable issues in that report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.