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**LEGISLATIVE COMMISSIONS AND  
JOINT AGENCIES  
LEGISLATIVE COORDINATING COMMISSION  
STATE OF MINNESOTA**

MANAGEMENT LETTER

JUNE 30, 2006



Legislative Coordinating Commission  
State of Minnesota  
St. Paul, Minnesota

In planning and performing our audit of the financial statements of the Legislative Commissions and Joint Agencies under the authority of the Legislative Coordinating Commission, State of Minnesota except the Legislative Audit Commission (LCC) for the year ended June 30, 2006, we considered the LCC's internal control to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The following comments are related to procedural matters which can be implemented by the LCC's staff. As always, you should consider the costs of making improvements to the expected benefits. This letter does not affect our report dated January 31, 2007, on the financial statements of the Legislative Commissions and Joint Agencies.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various LCC personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This report is intended solely for the information and use of management and the LCC and is not intended to be, and should not be, used by anyone other than the specified parties.

*Virchow Krause & Company 226*

Minneapolis, Minnesota  
January 31, 2007

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## **RECORDING ACCOUNTS PAYABLE**

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At June 30, 2006, the LCC had accrued expenditures of over \$100,000 for goods and services which were ordered but not yet received. We understand that part of the issue is because the accounting software will automatically post invoices back into the fiscal year when a purchase order is entered in the system based on the purchase order date. However, it is not proper accounting practice (i.e., is not compliant with generally accepted accounting principles) to accrue expenditures prior to the receipt of the goods or services.

The LCC should not accrue expenditures in the accounting records prior to the receipt of the goods or services. To ensure payables are properly recorded at year-end, you may need to void any open purchase orders (encumbrances) as of June 30, and re-enter them into your accounting software as of July 1 of the subsequent fiscal year.

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## **NEW AUDITING STANDARD – STATEMENT ON AUDITING STANDARDS (SAS) NO. 103**

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As part of an audit of your financial statements for the year ended June 30, 2007 and subsequent fiscal years, your auditors will be required to follow a significant new auditing standard, or rule.

The new standard establishes standards and provides guidance to an auditor on audit documentation. Audit documentation is an essential element of audit quality. Although audit documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate audit documentation contributes to the quality of an audit.

Among other things, the SAS:

- Requires the auditor to prepare audit documentation in connection with each engagement in sufficient detail to provide an experienced auditor with no previous connection to the audit a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached.
- Provides enhanced guidance on matters that should be documented, including guidance on documentation that should be retained.
- States that oral explanations on their own do not represent sufficient support for the work the auditor performed or conclusions the audit reached, but may be used by the auditor to clarify or explain information contained in the audit documentation.
- Requires the auditor to document audit evidence that is identified as being contradictory or inconsistent with the final conclusions, and how the auditor addressed the contradiction or inconsistency.
- Requires that the auditor assemble the audit documentation to form the final audit engagement file within 60 days following the report release date. After this date, the SAS requires the auditor not to delete or discard existing audit documentation, and to appropriately document any subsequent additions.

How does this impact your organization? As auditors, we still have the same responsibility as we did in the past. Now we are required to document our efforts in new ways. For example, the new rule requires that we date our audit opinion when we are ready to release the final reports. In the past, we were required to date the opinion as of the last day we did fieldwork at your office. This

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**NEW AUDITING STANDARD – STATEMENT ON AUDITING STANDARDS (SAS) NO. 103**  
(cont.)

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change is significant because we are also required to do many of our audit procedures through the date of our opinion. The new rule will require us to perform a number of inquiries and do procedures for several weeks to several months past the old date. This, of course, will require more time to do the audit, and may cause some timing problems with issuing the final audited documents.

The new standard is supposed to benefit you and the public with financial statements that have less risk of unidentified significant events occurring after year end, but not being disclosed in the statements.

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**NEW AUDITING STANDARD – STATEMENT ON AUDITING STANDARDS (SAS) NO. 112**

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SAS No. 112, *Communicating Internal Control Related Matters in an Audit*, provides guidance to an auditor on communicating internal control matters to the governing body.

Among other things, SAS No. 112:

- Defines the term “material weakness” more broadly than before.
- Describes situations in which the auditor would most likely determine that a “material weakness” exists. It is likely that many more organizations will now have material weaknesses than in the past.
- Changes the current terminology of “reportable condition” to “significant deficiency”.

How does this affect your organization? The new rule will require us to review many factors to determine if a material weakness exists within your organization. There are two new factors in particular which may cause a material weakness in many organizations for the first time.

- Identification by the auditor of a material misstatement in the books and records for the year under audit (i.e. the auditor proposes material journal entries not provided by the client).
- The auditor prepares the annual financial statements and footnotes for the client.

The new audit standard requires that these two factors be reported as material weaknesses. These factors were not reported as a material weakness under the previous reporting rules.

What are the impacts of a material weakness to your organization?

- The governing body's perception of your organization may change.

What should you do?

To avoid the condition of material journal entries, you would need to present the books and records in such a condition that the audit finds no material changes. If you wish to achieve that goal, our audit team will need to meet with you to develop a plan prior to your next fiscal year end.

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**NEW AUDITING STANDARD – STATEMENT ON AUDITING STANDARDS (SAS) NO. 112**  
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To avoid the condition regarding auditor prepared statements, you would need to demonstrate the skills to prepare the entire financial statement document internally. Whether or not your personnel have that ability is a matter of judgment, which needs to be discussed with the auditor in charge of your engagement.

Conversely, you could continue with business as usual, except that the internal control report may be changed as described above.

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**NEW AUDITING STANDARDS EFFECTIVE FOR FISCAL YEARS BEGINNING AFTER DECEMBER 31, 2006 – STATEMENT ON AUDITING STANDARDS (SAS) NOS. 104 - 111**

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In March of 2006, the American Institute of Certified Public Accountants issued eight new auditing standards (SAS No.'s 104-111) that will change the way auditors approach the audit process. The new standards are intended to improve the auditors' understanding of you, the client, the environment in which you operate, your internal controls, and the risks involved in the audit.

The new standards will result in some relatively significant changes to the way an audit is conducted. The major changes can be broken down into three main areas:

1. **Understanding Your Business and the Environment in Which You Operate** – The new standards require us to perform a more rigorous assessment of your business and the current environment in which you operate, such that we are better able to identify the key risks inherent in the engagement. This increased emphasis will lead to an audit approach that will focus testing on the key risk areas that we identify. Gaining and documenting this understanding will take place primarily "behind the scenes", and will involve, among other things, brainstorming sessions amongst our engagement team, research and review of relevant industry news and publications, and inquiries of various members of your organization, including personnel outside of the accounting department.
2. **Understanding Key Risks Associated With Your Information Technology (IT) Infrastructure** – We will also be required to perform a more thorough review of your IT environment, including an assessment of the information system and application controls that exist. We will be utilizing IT specialists to perform these reviews in many cases, and those professionals will be spending time with your IT department to evaluate those controls.
3. **Understanding and Evaluating Your Internal Controls** - The new audit standards require that the auditor *"evaluate the design of the controls relevant to an audit of financial statements and to determine whether they have been implemented."* In the past we were only required to *"gain an understanding"* of the controls so that we could plan the audit. This distinction may seem small; however, it will result in a significant increase in procedures that we will need to perform. Auditor inquiry alone will not be sufficient for the evaluation process. We will need to perform "walkthroughs" and other procedures to verify the controls are designed correctly and that they have been implemented. This could also lead to additional communications to your governing body pertaining to the ability of your accounting department to perform such duties.

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**NEW AUDITING STANDARDS EFFECTIVE FOR FISCAL YEARS BEGINNING AFTER  
DECEMBER 31, 2006 – STATEMENT ON AUDITING STANDARDS (SAS) NOS. 104 – 111  
(cont.)**

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3. Cont. The evaluation and documentation of internal controls will most likely have the most significant impact on your organization. The key accounting processes, and the related controls that exist within those processes, will need to be documented in order for us to perform a proper evaluation, this responsibility for documenting internal controls ultimately lies with you. As a result, you will need to first become familiar with how to properly complete this documentation, and then actually complete the documentation process. You may choose to utilize us to perform this function in conjunction with our evaluation of the design and implementation of your controls; however, this would fall out of the scope of the audit, and we would need to reach an appropriate arrangement for our services.

Virchow Krause is in the process of developing tools and templates to assist our professionals and our clients in the internal control documentation process. We are evaluating options for client training programs for the purpose of educating our clients on the basics of internal controls and the documentation process and potentially utilizing the tools and templates noted above.

In summary, the new Risk Assessment Audit Standards require auditors to develop the audit strategy with an emphasis on understanding the client and its internal controls, including controls over information technology, and to use that understanding to identify key risks associated with the engagement in order to tailor audit procedures to address those key risks. We can no longer choose to place no reliance on internal controls as a matter of efficiency. Instead we must now evaluate the design and implementation of internal controls, and then determine whether or not to rely on those controls in developing our audit strategy.

This approach will in most cases result in additional engagement hours, especially in the initial year of adoption of the new standards (next year). In addition, many of these hours will need to be spent during the planning phase of the engagement, which means that we will need to spend additional time with you prior to our traditional fieldwork.

Finally, we anticipate that you will receive some tangible benefits from the new audit process. The documentation of your key accounting processes and the related controls will help you understand where key weaknesses may lie in your system. Our increased understanding of your organization and your controls will in many cases lead to additional opportunities to provide you with value-added and meaningful management letter comments. Please feel free to contact your audit team if you would like clarification or additional information on the new risk assessment audit standards.

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**COMMUNICATION TO THE COMMISSION**

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Professional standards require that we provide you with the following information related to our audit.

***Our Responsibility Under U.S. Generally Accepted Auditing Standards and Government Auditing Standards***

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the LCC. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the LCC's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

***Significant Accounting Policies***

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the LCC are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. These policies do not conform to accounting principles generally accepted in the United States of America because we are only reporting on the activity of the Legislative Coordinating Commission and not the entire State of Minnesota. We noted no transactions entered into by the LCC during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

***Accounting Estimates***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

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**COMMUNICATION TO THE COMMISSION (cont.)**

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***Audit Adjustments***

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the LCC's financial reporting process. Matters underlying adjustments proposed by the auditor could potentially cause future financial statements to be materially misstated. In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the LCC, either individually or in the aggregate, indicate matters that could have a significant effect on the LCC's financial reporting process.

All audit and bookkeeping adjustments we prepared were included in your financial statements. Copies of these adjustments are available from management.

***Disagreements with Management***

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

***Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Issues Discussed Prior to Retention of Independent Auditors***

We may discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the LCC's auditors. These discussions, if any, occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing our audit.

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**CONCLUSION**

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We thank you for allowing us to be of service to the Legislative Commissions and Joint Agencies. Please contact us if you have any questions or comments regarding this report or the financial statements. If you have any special accounting or consulting needs including training, computer implementation, consulting and record keeping assistance, we are available to provide those services.