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MINNESOTA STATE SENATE

YEAR ENDED JUNE 30, 2004

MANAGEMENT LETTER

(Including Communication to Rules and Administration Committee)



June 29, 2005

Minnesota State Senate
State of Minnesota
St. Paul, Minnesota

In planning and performing our audit of the financial statements of the Minnesota State Senate, State of Minnesota (Senate) for the year ended June 30, 2004, we considered the Senate'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 Senate's staff. As always, you should consider the costs of making improvements to the expected benefits. We previously reported on the Senate's internal control in our report dated June 29, 2005. This letter does not affect our report dated June 29, 2005, on the financial statements of the Minnesota State Senate.

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 Senate 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 Senate and is not intended to be, and should not be, used by anyone other than the specified parties.

Virchow Krause & Company

Minneapolis, Minnesota
June 29, 2005

NEW AUDITING STANDARD

As part of our audit of your financial statements for the year ended June 30, 2004 we were required to follow a significant new auditing standard, or rule.

The new standard has been designed to increase the likelihood of finding unidentified material fraud. SAS 99 (Statement on Auditing Standards) requires the auditor to identify and assess risks due to fraud which could result in materially misstated financial statements.

The purpose of an audit is for the auditor to express an opinion as to whether the financial statements of the organization are materially correct. In other words, do the financial statements present the organization's financial position and results of operations fairly and consistently? The term material is used to describe the concept that the audit is focused on dollar amounts in the financial statements that are significant, rather than auditing small and, perhaps, less meaningful amounts. This is done to make the audit process more efficient and less costly.

The auditing standards state that the auditor is to obtain reasonable assurance that the financial statements are free of material misstatement. SAS 99 requires the auditor to specifically identify and assess risks due to fraud that may result in materially misstated financial statements. (The auditor does not have the same responsibility for errors or fraud which are not material to the financial statements.) Management is still responsible for establishing the appropriate controls to prevent, deter, and detect fraud.

How does this impact your organization? As auditors, we still have the same responsibility for detection of material financial misstatement due to fraud as we did in the past. Now we are more focused on how to do that, and we are required to document our efforts in new ways. For example, we now ask more questions about internal controls, segregation of duties and management's internal assessment of fraud risk. The audit team brings a heightened level of professional skepticism to the audit.

The new standard will benefit you and the public with financial statements that are more useful and accurate, with less risk of unidentified fraud occurring. But even a properly planned and completed audit may not detect a material fraud because deception and concealment are a natural part of any fraud. Auditing standards continue to clearly state that it is management's responsibility to design and implement procedures and controls to prevent, deter, and detect fraud.

Some ideas on how management can contribute to the success of the organization in the area of fraud prevention are listed below. Some of these have already been implemented by your entity.

- You should implement job applicant screening procedures when hiring employees with access to assets that are susceptible to misappropriations.
- You should complete an evaluation of fraud risks within your entity.
- You should communicate the importance of ethical behavior and appropriate business practices to all employees.
- Whenever possible, you should implement controls to address fraud risks. Such controls should help prevent, deter and detect fraud.
- Controls that you implement should be monitored for proper use, and continuity.
- The governing body should be aware of the organization's fraud risks and controls related to those risks.
- Management should assess and be aware of any issues of non-compliance with laws and regulations within the organization.

NEW AUDITING STANDARD (cont.)

- Management should assess and be aware of employees with significant financial difficulties.

In a nutshell, you should consider where fraud may occur in your organization, and do what you can to minimize that risk, within reasonable cost parameters. Management has many procedures and policies already in place that help prevent, deter and detect fraud. However, this is a continuous process, and you need to be aware of the entity's fraud risk and should continue to look for ways to improve the entity's procedures and controls.

Finally, this increased emphasis on fraud is a direct result of frauds that have occurred throughout the United States in the past several years. As a result of those frauds, the new auditing standard SAS 99 was passed. This is not the end of the changes. More new auditing standards are expected to be passed in the future which will further impact what we are required to do as auditors and how we communicate with you, the governing body.

EXPENDITURES IN CARRYFORWARD ACCOUNT

Under Minnesota Statute 16A.281, unexpended appropriations that are carried over from one biennium to the next are limited as to how they can be expended. The use of these funds is limited to three purposes: 1) non-recurring expenditures in investments that enhance efficiency or improve effectiveness, 2) expenses associated with special sessions, interim activities or public hearings or public outreach efforts, or 3) severance costs for involuntary terminations.

During our audit, we noted over \$185,000 of expenditures charged against the beginning appropriations carry forward that did not meet one of these three purposes. An adjustment was made, and the Senate's June 30, 2004 financial statements show these expenditures as being paid with the current biennium appropriation, rather than reducing the carryforward balance.

We recommend careful monitoring by management to help preclude repetition of this type of reporting error.

VOIDED CHECK PROCEDURES

During our audit, we noted that on occasion checks were voided for various reasons and when this occurred they were properly destroyed. However, we were unable to view supporting documentation to verify that these checks had been destroyed.

We recommend that fiscal services implements a process for documenting the destruction of voided checks which includes the signatures of two fiscal services staff confirming that they have witnessed the destruction of the checks.

CROSS-TRAINING AND TRANSITION PLANNING

We would like to take this opportunity to stress the importance of cross-training within the fiscal services office. Optimizing staff resource dollars is a crucial component of effective management in any organization. As salary and benefits costs continue to increase, protecting the fiscal investment in staff resource allocations is vital.

CROSS-TRAINING AND TRANSITION PLANNING (cont.)

We believe that the use of effective cross-training would provide additional internal control within the fiscal services office. We understand that each fiscal services staffer performs various parts of the payroll or account payable processes. It is extremely important to know that, if needed, the payroll assistant could perform all the duties of the payroll supervisor and the accounts payable assistant could perform all the duties of the accounts payable supervisor. Then, if something unforeseen should happen, fiscal related services of the Senate would continue without interruption.

Transition planning is also an important area to consider when evaluating your staffing situation. If there are key positions in which you anticipate turnover, it is important to have a proactive plan of action. Often, this is an excellent opportunity to redesign the current organizational structure or to realign key tasks and core process workflow. Any change in staff responsibilities should consider the need for additional employee training.

By taking a proactive approach to optimizing staff resources and properly planning for transition periods, you can maximize your investment in your employees, which will protect your fiscal investment in overall staff resources. Should you have questions or need more information, we are available to assist you.

PRIOR YEAR COMMENTS

Expenditure Cut-Off

The previous auditor noted instances where payments for goods and services were not recorded in the proper fiscal year.

Status: We also noted one invoice that was recorded in the improper fiscal year and recommend you take extra care at fiscal year-end to ensure that invoices are recorded in the proper fiscal year.

Preparation of Financial Statements

The previous auditor indicated that there have been a number of significant changes implement related to the financial statements for governmental entities. While the Department of Finance has not communicated additional disclosures or accounting requirements to the Senate related to preparation of the Senate's financial statement, the Senate should be aware of these requirements and be prepared to implement the changes if needed.

Status: We also recommend that Senate continue to be aware of these requirements and be prepared to implement changes, if necessary to comply with State of Minnesota guidelines.

Senator Phone Bills

In previous years, it was noted that there were several Senator long distance telephone bills that were not signed by them as required by law as evidence of approval.

Status: During our testing of Senator phone bills, we did not note any unsigned long distance phone bills.

COMMUNICATION TO THE RULES AND ADMINISTRATION COMMITTEE

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 Minnesota State Senate. 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 Minnesota State Senate'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 Minnesota State Senate 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. We noted no transactions entered into by the Minnesota State Senate 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.

COMMUNICATION TO THE RULES AND ADMINISTRATION COMMITTEE (cont.)

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 Minnesota State Senate'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 Minnesota State Senate, either individually or in the aggregate, indicate matters that could have a significant effect on the Minnesota Senate's financial reporting process.

All audit and bookkeeping adjustments we prepared were included in your financial statements. The following summarizes audit adjustments, we prepared:

	<u>Amount</u>
Record accrued payroll	\$ 62,166
Adjustments to accounts payable	153,038
Record prepaid items	29,936
Adjustments to Senate Carryforward	185,728

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 generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Minnesota State Senate's auditors. However, these discussions 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.