



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Department of Revenue
Fiscal Year Ended June 30, 2001



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 fifty 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 and one best practices review.

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, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us



Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Matthew Smith, Commissioner
Department of Revenue

We have audited selected areas of the Department of Revenue for the period July 1, 2000, through June 30, 2001. Our audit scope included payroll, rent, professional/technical services, supplies, equipment, and travel. The audit objectives and conclusions are highlighted in the individual chapters of this report. We emphasize that this has not been a comprehensive audit of all of the Department of Revenue's financial activities.

We conducted our audit in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Department of Revenue complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Revenue is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Revenue. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 2, 2002.

/s/ James R. Nobles

/s/ Claudia J. Gudvangen, CPA

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 18, 2002

Report Signed On: April 29, 2002

Department of Revenue

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Tony Toscano	Auditor-in-Charge
Steve Johnson, CPA	Senior Auditor
John Hakes, CPA	Senior Auditor
Marisa Zenk	Auditor
Darcie Stadum	Intern

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Report Summary

Overall Conclusion

The Department of Revenue's internal controls provided reasonable assurance that payroll expenditures were properly authorized, adequately supported, and accurately recorded in the state's accounting and payroll systems. For the items tested, the department complied with material finance-related legal provisions relating to payroll, professional/technical services, rent, supplies, and equipment.

Agency Background

The Department of Revenue is responsible for managing the state's tax systems. The department's operations are funded through appropriations from the General Fund. Governor Ventura appointed Matthew Smith as commissioner on January 20, 1999.

During fiscal year 2001, the Department of Revenue collected approximately \$11.3 billion from various tax programs, such as individual income, sales, corporate franchise, petroleum, environmental, gambling, cigarette and tobacco, alcohol, and insurance. The department's operations are primarily funded through General Fund appropriations. We focused this audit on selected administrative expenditures of the department, including payroll, rent, professional/technical services, supplies, equipment, and travel. Total expenditures for department operations during fiscal year 2001 were approximately \$102 million.

Financial-Related Audit Reports address internal control weaknesses and noncompliance issues found during our audits of state departments and agencies. The scope of our audit of selected department programs in this report was supplemental to the audit work performed as part of the annual Statewide Audit, the purpose of which is to render an opinion on the State of Minnesota's financial statements for fiscal year 2001. On December 7, 2001, we issued an unqualified opinion on the State of Minnesota's *Comprehensive Annual Financial Report* for the year ended June 30, 2001. We did not identify any financial statement findings or concerns as a result of our statewide audit work at the Department of Revenue.

Chapter 1. Introduction

The Department of Revenue is responsible for managing the state's tax systems. Minnesota relies on the voluntary compliance of its citizens with those tax laws. The department works to promote compliance through several different efforts, including developing sound tax policies, educating citizens, providing expedient customer service, and providing administrative and enforcement services in the area of tax assessment collections. Governor Ventura appointed Matthew Smith as commissioner on January 20, 1999.

During fiscal year 2001, the Department of Revenue collected approximately \$11.3 billion from various tax programs, such as individual income, sales, corporate franchise, petroleum, environmental, gambling, cigarette and tobacco, alcohol, and insurance. The department also oversees the uniform application of the property tax laws by providing instructions in property valuation and tax determination to county assessors, auditors, and treasurers. The department also pays out nearly \$1 billion annually in state aid to counties, cities, towns, and special taxing districts.

The current audit was supplemental to the work we performed during our annual Statewide Audit of the state's financial statements. The purpose of the Statewide Audit was to give an opinion on the State of Minnesota's *Comprehensive Annual Financial Report*. An unqualified opinion was issued on December 7, 2001, for the fiscal year ended June 30, 2001.

The department's operations are primarily funded through General Fund appropriations. The department's administrative expenditures for fiscal year 2001 totaled approximately \$102 million. We focused this audit on selected administrative expenditures of the department, including payroll, rent, professional/technical services, supplies, equipment, and travel.

Chapter 2. Administrative Expenditures

Chapter Conclusions

The Department of Revenue's internal controls provided reasonable assurance that payroll and other administrative expenditures were properly authorized, adequately supported, and accurately recorded in the state's accounting and payroll systems. For the items tested, the department complied with material finance-related legal provisions relating to payroll, professional/technical services, rent, supplies, and equipment.

The Department of Revenue incurs various costs to fund its operations and fulfill its mission. Total administrative expenditures for fiscal year 2001 were approximately \$102 million, as shown in Table 2-1.

Table 2-1
Department of Revenue
Summary of Administrative Expenditures
Fiscal Year 2001

Expenditures:	<u>2001</u>
Employee Payroll	\$ 64,259,995
Professional/Technical Services	14,416,261
Rent	7,595,241
Supplies and Equipment	5,796,347
Travel	998,870
Other Operating Expenditures	<u>8,676,119</u>
Total Administrative Expenditures	<u>\$101,742,833</u>

Source: Minnesota Accounting and Procurement System through September 7, 2001.

Payroll

Employee payroll represents the largest administrative expenditure for the department. For fiscal year 2001, the department's payroll costs were approximately \$64 million or 63.2 percent of its total administrative expenditures. The department processes bi-weekly payroll transactions through the Department of Employee Relations' State Employment Management System (SEMA4).

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Professional/Technical Services

The department contracts with outside vendors and other state agencies to provide goods and services to the department. The department's professional/technical services and computer system and services expenditures for fiscal year 2001 totaled approximately \$14.4 million. The department mainly used these services to develop, maintain, and enhance the many computerized systems used throughout the department.

Rent

The department incurs rental costs for its office space. The department rents office space throughout the state of Minnesota as well as in selected other states. In addition to its main offices in St. Paul, the department also rents space in such cities as Bloomington, Brainerd, and Ely. Outside the state of Minnesota, the department rents office space in major cities such as Chicago and Dallas. The department's rent expenditures for fiscal year 2001 totaled approximately \$7.6 million.

Supplies and Equipment

The department purchases supplies and equipment needed to carry out its mission. Buyers within the department have varying levels of authorization to purchase these items. During fiscal year 2001, the department spent approximately \$1.1 million on supplies and \$4.6 million on equipment.

Travel

The department reimburses employees for job-related travel expenses, such as mileage, meals, airfare, lodging, and parking. Employees submit reimbursement requests that are approved by their supervisor prior to payment. During fiscal year 2001, the department spent approximately \$1 million on travel expenses.

Audit Objectives and Methodology

Our audit of the Department of Revenue's payroll and other administrative expenditures focused on the following questions:

- Did the department's internal controls provide reasonable assurance that payroll and other administrative expenditures were properly authorized, adequately supported, and accurately recorded in the state's accounting and payroll systems?
- Did the department's internal controls provide reasonable assurance that other administrative expenditures were properly authorized, adequately supported, and accurately recorded in the state's accounting system?

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- For the items tested, did the department comply with material finance-related legal provisions relating to payroll, professional/technical services, rent, supplies, and equipment?

To meet these objectives, we interviewed staff from the Department of Revenue to gain an understanding of the internal control structure over payroll and administrative expenditures. We performed analytical reviews and tested payroll transactions to ensure large variances from prior years could be adequately explained. We performed detailed tests of administrative expenditures to ensure payments were proper, were made in accordance with management's authorization, and complied with applicable leases, contracts, and procurement requirements.

Conclusion

The Department of Revenue's internal controls provided reasonable assurance that payroll and other administrative expenditures were properly authorized, adequately supported, and accurately recorded in the state's accounting and payroll systems. For the items tested, the department complied with material finance-related legal provisions relating to payroll, professional/technical services, rent, supplies, and equipment.

**Status of Prior Audit Issues
As of January 18, 2002**

Most Recent Audit

FY 2001 Statewide Audit

We examined the department's activities and programs material to the State of Minnesota's *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2001. We issued an unqualified opinion on the State of Minnesota's *Comprehensive Annual Financial Report* for the year ended June 30, 2001, dated December 7, 2001. We did not identify any financial statement findings or concerns as a result of our work at the Department of Revenue.

FY 2000 Statewide Audit

We examined the department's activities and programs material to the State of Minnesota's *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2000. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2000. We issued an unqualified opinion on the State of Minnesota's *Comprehensive Annual Financial Report* for the year ended June 30, 2000, dated December 1, 2000. We did not identify any financial statement findings or concerns as a result of our work at the Department of Revenue.

Legislative Audit Report 99-57, issued in October 1999, focused on payroll and other administrative expenditures as well as the Minnesota Collection Enterprise. The report contained two findings relating to the receipts collected by the Minnesota Collection Enterprise. The Minnesota Collection Enterprise was not part of the scope of the current audit; therefore, we did not follow up on the recommendations made in the prior audit 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 and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.