OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit

Office of the State Treasurer

January 1, 2001, through December 31, 2002

JUNE 5, 2003 03-30

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.

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- 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.

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OLA

OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dan McElroy, Commissioner
Department of Finance

We have conducted a financial and compliance audit of the Office of the State Treasurer for the two calendar years ended December 31, 2002. Our audit scope included revenue, bank fees, payroll, and travel. The audit objectives and conclusions are highlighted in the individual chapters of this report.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *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 Office of the State Treasurer complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. The management of the Office of the State Treasurer 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 Office of the State Treasurer. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 5, 2003.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 24, 2003

Report Signed On: June 2, 2003

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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
James Riebe, CPA	Audit Manager
Susan Kachelmeyer, CPA, CISA	Auditor-in-Charge
Heather White	Auditor

Exit Conference

We discussed the results of the audit with the following individuals on May 14, 2003:

Carol Johnson	Former State Treasurer
John Manahan	Former Deputy State Treasurer
Jerry Engebretson	Director of Treasury Operations, Department of Finance

Report Summary

Overall Audit Conclusion:

The Office of the State Treasurer properly safeguarded assets and accurately recorded receipts and expenditures in the state's accounting and payroll systems. The office was in compliance with applicable finance-related legal provisions with the exception of department head expense limits. We concluded that the office exceeded its department head expense limit by $1,655 from July 1, 2000, to January 6, 2003. We recommended that the Treasury Division of the Department of Finance (the division that assumed the Treasurer's duties as of January 6, 2003) follow executive branch policies and procedures when determining the appropriateness of similar expenditures in the future. (Finding 1, page 9)

Agency Background:

The Office of the State Treasurer was abolished on January 6, 2003 as result of a constitutional amendment that was approved by the voters during the November 1998 election. Carol Johnson served as the last State Treasurer beginning in January 1999 and ending on January 6, 2003. An administrative order signed by the Governor and the Commissioner of Administration in December 2002 transferred the duties and responsibilities of the State Treasurer to the Department of Finance. The new Treasury Division will continue to provide banking services for most state agencies. These services include cash control, receipt processing, and warrant redemption. In addition, the division will continue to make debt service payments on outstanding general obligation bonds and collect various fees and assessments transmitted from the 87 counties.

Auditee Responses:

In her response to our audit report, former State Treasurer Carol Johnson disagreed with our audit finding. She believes providing coffee to staff should have been considered part of the Treasurer's Office operating budget. We also requested a response from the Department of Finance since the department has assumed responsibility for the treasury functions. The department agreed with our recommendation.

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Chapter 1. Introduction

The former Office of the State Treasurer's primary mission was to provide banking services for most state agencies. The scope of that statewide responsibility was significant. Receipt transactions, including investment redemptions and maturities, totaled $179.1 billion in fiscal year 2002. The office also verified and redeemed state warrants used by state agencies to satisfy obligations of the state. During fiscal year 2002, the Treasurer's Office processed warrants totaling approximately $11.1 billion. In addition, the office initiated $16.5 billion electronic fund transfers based on state agency authorizations.

Another responsibility of the office was to maintain records and make payments for principal and interest on the state's general obligation bonds. During fiscal year 2002, the Office of the State Treasurer made debt service payments totaling approximately $362 million. At June 30, 2002, the outstanding general obligation bonds payable totaled $3 billion.

Finally, the office monitored collateral pledged to secure funds deposited in the various state depository accounts. At June 30, 2002, banks pledged $80 million in collateral to secure these accounts.

In addition to these statewide responsibilities, the Office of the State Treasurer's financial operations included the collection of certain state revenues. Administrative expenditures of the office included payroll, bank fees, travel, and other miscellaneous areas. We discuss the office's other financial activities more fully in the following chapters.

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Chapter 2. Revenue

Chapter Conclusions

The Office of the State Treasurer properly collected and reported revenue in the accounting records. For the revenue collections that we tested, the Office of the State Treasurer complied with applicable legal provisions.

The Office of the State Treasurer collected the state general property tax, various fees, fines, and assessments. County governments collected substantially all of the monies in accordance with various statutory provisions and transmitted them to the State Treasurer. The office deposited the majority of the receipts in the General Fund as non-dedicated revenue. Table 2-1 shows the receipts collected by the Office of the State Treasurer for the past two calendar years.

Table 2-1
Summary of Receipts by Calendar Year
(in thousands)

	2001	2002
State General Property Tax[1]	$ 0	$572,748
Criminal and Traffic Offense Surcharge	18,959	23,876
Civil and Probate Filing Fees	14,329	15,840
County Recording Surcharge	5,930	8,579
State Share Fines	5,541	5,512
Court Fines	3,731	3,767
Other Fines	2,146	2,181
Birth/Death Certificate Surcharge	1,522	1,848
Forfeitures	1,712	1,656
Conciliation Filing Fees	1,295	1,581
Marriage License Fees and Surcharges	1,305	1,362
Other Surcharges	1,079	913
Interest and Miscellaneous Receipts	976	922
Tax Increment Administrative Fees	775	884
Total	$59,300	$641,669

Note (1) The state began collecting a general property tax on commercial-industrial and seasonal-recreational property in 2002.

Source: Minnesota Accounting and Procurement System (MAPS).

Office of the State Treasurer

During the 2001 first special session, the Minnesota Legislature enacted a state general property tax levy on commercial-industrial and seasonal-recreational property. The Legislature enacted this law as part of its overall plan to fund part of higher education at the state level rather then the local level. The Department of Revenue calculated the amount of tax owed by each county. The county treasurers collected the state property tax and remitted the amounts to the state in June and December 2002, with a catch-up payment due in January 2003. The state general levy for 2002 was $592 million. The state collected $573 million of this amount in calendar year 2002. The balance was due January 2003.

Audit Objective and Methodology

The primary objective of our audit of revenue was to address the following questions:

- Did the Office of the State Treasurer appropriately collect and properly report revenues in the accounting records?

- Did revenue collections comply with applicable legal provisions?

The methodology we used to audit revenue included interviewing key department employees to gain an understanding of applicable policies and procedures, testing receipt transactions and supporting documentation, and performing analytical procedures. We also gained an understanding of the Department of Revenue's role in assessing the state general property tax.

Conclusions

The Office of the State Treasurer properly collected and reported revenue in the accounting records. For the revenue collections that we tested, the office complied with applicable legal provisions.

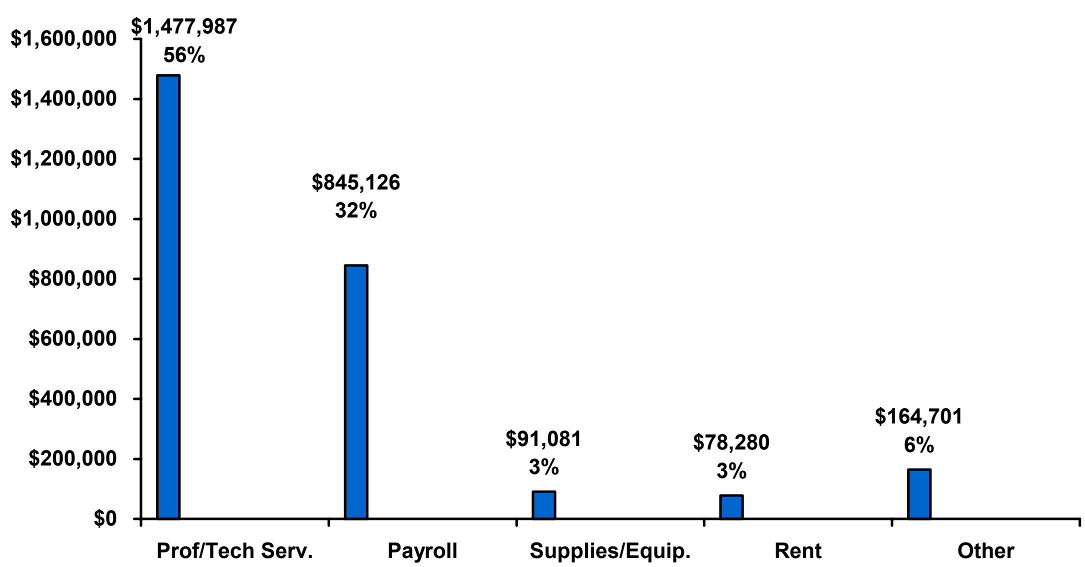
Chapter 3. Administrative Expenditures

Chapter Conclusions

The Office of the State Treasurer ensured that payroll and other administrative expenditures were properly processed and recorded in the accounting records. The office was in compliance with applicable finance-related legal provisions with the exception of department head expense limits, which are established in Minn. Stat. Section 15A.081. We noted that the office exceeded its department head expense limit by $1,655.

The Office of the State Treasurer had an appropriation of $2.7 million for fiscal year 2002 that it expended on bank fees and operations. Its largest administrative expenditure related to professional/technical fees for state banking services. The payments are based on contracts with local depositories. Payroll was another significant expenditure category. The office employed as many as 16 employees during the time period covered by our audit. Figure 3-1 shows the office's major expenditures for fiscal year 2002.

Figure 3-1
Expenditures by Type
Fiscal Year 2002

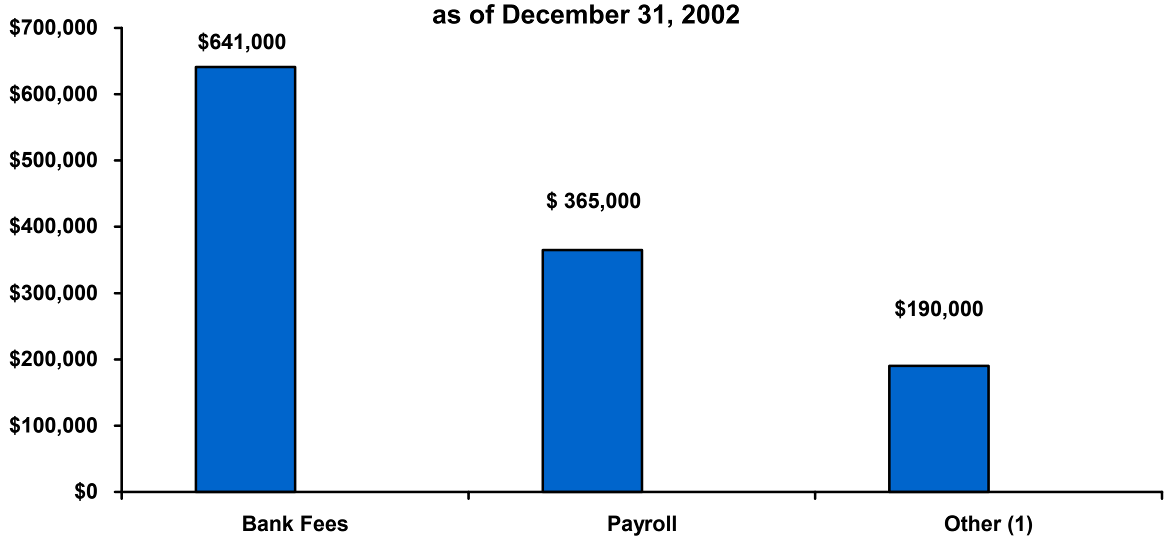


Source: Minnesota Accounting and Procurement System (MAPS).

Office of the State Treasurer

In fiscal year 2003, the Office of the State Treasurer received an appropriation of approximately $2.3 million after budget reductions. At December 31, 2002, the office had spent $1.05 million. As of December 31, 2002, encumbrances totaled approximately $1.2 million, as highlighted in Figure 3-2. December bank fees, payroll, and severance payments of $87,000, $35,000 and $28,000, respectively, were paid in calendar year 2003.

Figure 3-2
Encumbrances by Type
as of December 31, 2002



Note 1: The majority of the other encumbrances consisted of computer-related professional/technical contracts and the office's lease agreement with the Department of Administration.

Source: Minnesota Accounting and Procurement System (MAPS).

Audit Objectives and Methodology

We focused our review of administrative expenditures on the following objectives:

- Did the Office of the State Treasurer ensure that administrative expenditures were authorized and properly recorded in the accounting records?

- Did the Office of the State Treasurer comply with significant finance-related legal provisions?

To complete the audit, we interviewed key agency employees to gain an understanding of the controls over payroll and other administrative expenditures. We performed analytical procedures to identify any unusual transactions. We reviewed a sample of travel reimbursements, three key service contracts, and the space rental lease for reasonableness. We tested the State Treasurer's salary to ensure that it complied with statutory limits. We reviewed certain other expenditures to determine if the Office of the State Treasurer complied with material finance-related legal provisions. In addition, we reviewed encumbrances as of December 31, 2002, the final Office of the State Treasurer payroll expenditures, and severance payments.

Office of the State Treasurer

Conclusions

The Office of the State Treasurer administered payroll and other administrative expenditures in a prudent and reasonable manner. The office was in compliance with applicable finance-related legal provisions with the exception of department head expense limits. As noted in the following finding, the office exceeded its department head expense limit by $1,655.

1. The Office of the State Treasurer exceeded statutory limits for department head expenses.

The Office of the State Treasurer exceeded its department head expense limit by $1,655 from July 1, 2000, to January 6, 2003 ($626 in fiscal year 2001, $264 in fiscal year 2002, and $765 in the first half of fiscal year 2003). We identified two types of transactions, including payments for coffee routinely provided to employees and charges for seasonal office decorations, that the office inconsistently coded as department head expenses or supplies. In both cases, the types of transactions appeared identical. By including the payments coded as supplies, the office was not in compliance with statutory limits on department head expenses.

Minn. Stat. Section 15A.081 permits state department heads, including constitutional officers, to use up to $1,500 per year to pay certain expenses related to their positions. Departments of Finance and Administration policy 0809-07 governs the types of expenses that may be paid from the department head expense account. The policy emphasizes that the account "is not an unlimited personal expense account." The policy covers meals and related expenses, or coffee and pastries, for meetings with government officials and/or citizens, boards, and commissions. The policy also allows expenses related to employee morale such as coffee and cake served at service award presentations or retirement recognitions.

Officials of the Office of the State Treasurer stated that although department head expense could be used for these types of expenditures, in their opinion it was also appropriate to use the office's operating appropriation. We believe, however, that policies and procedures governing state agencies generally provide a more narrow interpretation. For example, executive branch agencies, which do not include constitutional offices, must adhere to a Departments of Finance and Employee Relations "special expense" administrative procedure for discretionary expenses. Administrative procedure 4.4 requires executive branch agencies to use a formal approval and justification process when incurring expenses for refreshments and or meals for state employees. The administrative procedure allows expenses for refreshments related to meetings of state employees if necessary "to sustain the flow of the meeting." Furthermore, the meetings should be held "no more frequently than once each quarter." We think the state statute and policies and procedures generally restrict the amount of state funds expended for discretionary, as opposed to essential, expenses.

Recommendation

- *The Treasury Division of the Department of Finance should follow statutory and executive branch policies and procedures when determining the appropriateness of discretionary expenditures in the future.*

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Status of Prior Audit Issues
As of February 24, 2003

Most Recent Audits

State of Minnesota Comprehensive Annual Financial Report 2002. Each year, as part of our statewide audit of the State of Minnesota's basic financial statements, we audit the Office of the State Treasurer's state depository cash function. Our work for fiscal year 2002 included cash control, warrant redemption, debt service expenditures, and collateral balances. We did not identify any issues during that audit that were required to be reported by *Government Auditing Standards*.

Legislative Audit Report 01-12 focused on selected state programs as part of the statewide audit for fiscal year 2000. In addition to the statewide audit scope, we reviewed other financial activities administered by the Office of the State Treasurer including receipt processing and administrative expenditures for the two calendar years ended December 31, 2000. The report contained one finding related to the allocation of surcharge receipts. The department implemented the recommendation in the 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.

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CAROL C. JOHNSON
MINNESOTA STATE TREASURER 1999 – 2003
6827 Benton Way
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651.451.8801

May 30, 2003

Mr. James R. Nobles, Legislative Auditor
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Room 140 Centennial building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Re: Audit of the Office of the State Treasurer
January 1, 2001 – December 31, 2002

Dear Mr. Nobles:

Thank you for the opportunity to respond to the above audit report. The report recognizes that the office properly performed its statutory duties of providing banking and other services for state government, including:

- $179.1 billion – receipt transactions
- $ 11.1 billion – processed warrants
- $ 16.5 billion – electronic fund transfers
- $362.0 million – debt service payments

This exemplary record was accomplished because of the talents, dedication to duty, and integrity of the State Treasurer's staff, during a time that was extremely stressful for them because of the uncertainty about the future of the office and about their job security.

Unfortunately your audit report also concludes that the office exceeded its department head expense limits by $1,655 over a two and a half year period. With respect, I do not agree with that finding.

Your auditors chose to categorize all coffee-related expenses as "department head" expenses. Providing coffee should have been considered as part of the operating budget of the Treasurer's Office; if it was treated as such for accounting purposes then "department head" expenses were not exceeded as claimed in the report.

I made a determination that having coffee available within the office confines for staff was important to insuring the successful completion of our mission. I believe this determination was within my authority as a constitutional officer and is not prohibited by M.S. 15A.081.

My rationale is as follows:

1. Mission-critical work of the office is performed daily throughout the morning beginning at 6:00 am, when staff must determine the amount of funds available for investment that day (in the tens and hundreds of millions of dollars), thereby maximizing investment

earnings. Our building has no cafeteria, only a few vending machines. I decided it was prudent to have coffee readily available for staff in order to reduce employee time away from their duties during these time-sensitive hours.

2. I considered the cost of the coffee to be relatively small (approximately $3.00 per business day for the entire office) compared to the importance of getting the numbers right. For example, daily interest on $100 million approaches $10,000. Receiving a lower rate of interest by even one-eighth of one percent (.125%) reduces earnings by $125 for just one day.

3. The auditors concluded that these expenses **must** be considered department head expenses based on the following language from Policy 0809-07:

   "The department head expense account may be used for the following type of items: ....Coffee and cake served at receptions where service awards are presented..., or similar events that affect employee morale." (emphasis added)

   The quoted language simply doe snot support such an interpretation. The coffee was provided for business reasons; not for morale, nor as a part of an "unlimited personal expense account" as implied in the report, nor as part of an event or reception.

4. The guidelines in Policy 0809-07 are applicable only if it is first determined that an expense **must** be a department head expense. The guidelines make clear that they are only guidelines and that "it is difficult to precisely identify the items that can be included in the department head expense category" and that "the following examples are cited as an aid in determining whether or not an expenditure is appropriate." In effect, they provide a guide as to what **may** be included in a department head expense category, but they do not say what **must** be included in that category, nor do they suggest that whatever may be included in that category **may not** be otherwise reimbursable, (and therefore not subject to the provisions of M.S. 15A.081). For example, the auditors agreed that providing bottled water for employees is a legitimate operating expense; it is difficult to distinguish why water is acceptable, but coffee for early-morning workers is not.

I agree with the Recommendation in the report. However, I strongly suggest that policies and procedures relative to department head expenses be clarified so that people have reasonable notice of which expenses are (or are not) legitimate operating expenses, and which expenses **must** be treated as department head expenses.

Sincerely,

/s/ Carol C. Johnson

Carol C. Johnson
Treasurer (1999 – 2003)
State of Minnesota

CCJ/bhs

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May 29, 2003

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
First Floor South, Centennial Building
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Saint Paul, Minnesota 55155

RE: Audit of the Office of the State Treasurer

Dear Mr. Nobles:

Thank you for the opportunity to respond to the Recommendation in your audit report of the Office of the State Treasurer for the period January 1, 2001 through December 31, 2002. The response from the Department of Finance is attached.

The staff of the Legislative Auditor's Office conducted themselves in a very responsive and professional manner during the audit process. We appreciate your recommendation realized from the audit.

If you have any questions regarding the attached response to your recommendation, please do not hesitate to contact me.

Warmest regards,

/s/ Dan McElroy

Dan McElroy
Commissioner

Enclosure

cc: Jim Riebe, Audit Manager

RESPONSE OF THE DEPARTMENT OF FINANCE

FOR AUDIT RECOMMENDATIONS

FOR THE OFFICE OF THE STATE TREASUER

FOR THE PERIOD JANUARY 1, 2001 TO DECEMBER 31, 2002

Auditor's Recommendation

The Treasury Division of the Department of Finance should follow statutory and executive branch policies and procedures when determining the appropriateness of discretionary expenditures in the future.

Department of Finance Response

The duties of the State Treasurer were transferred to the Department of Finance on January 6, 2003. The Legislative Auditor's report covers the preceding two years when the operation of the State Treasurer's Office was under the direct supervision and management of the elected State Treasurer. However, the Legislative Auditor requested that the Department of Finance be involved in resolving the finding of the audit.

The Department of Finance concurs with the recommendation of the Legislative Auditor for the Office of State Treasurer related to department head expenses. The Department of Finance has always, and will continue to follow, statutory and executive branch policies and procedures related to expenditures.