OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Commerce

July 1, 2002, through June 30, 2005

June 30, 2006 **06-18**

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.

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Glenn Wilson, Commissioner
Department of Commerce

We conducted an audit of selected activities of the Department of Commerce for the period July 1, 2002, through June 30, 2005. Our audit scope included assessments to utility, telecommunications, and insurance companies; securities registration fee revenues; payroll and selected expenditure areas; and the unclaimed property program. Our objectives focused on a review of the department's internal controls over these financial activities and its compliance with applicable legal provisions. This has not been a comprehensive audit of the department.

The enclosed Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank staff from the Department of Commerce for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: April 3, 2006

Report Signed On: June 27, 2006

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Audit Participation

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

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Jennifer Chapin	Auditor
Ching-Huei Chen, CPA	Auditor
Steven Johnson, CPA	Auditor
Susan Kachelmeyer, CPA, CISA	Auditor
David Westlund	Auditor

Exit Conference

We discussed the results of the audit with the following representatives of the Department of Commerce at an exit conference on June 20, 2006:

Glenn Wilson	Commissioner
Mike Blacik	Assistant Commissioner
Dennis Munkwitz	Chief Financial Officer
Tim Jahnke	Financial Services Director
Bob Schram	Accounting Officer Principal
Lee Spelbrink	Market Assurance Manager

Report Summary

Key Findings:

- The department did not pursue collection of some past due receivables for assessments to insurance companies. (Finding 1, page 9)
- The process the Department of Commerce used to refund securities registration fees through agents is questionable. (Finding 2, page 10)
- The department did not adequately restrict employee access to the state's accounting system. (Finding 3, page 16)
- The department did not comply with statutory retainage requirements for some professional-technical service contracts. (Finding 4, page 17)
- The department did not reconcile all unclaimed securities held in its custodial bank to the securities recorded in its unclaimed property database and did not completely inventory its tangible unclaimed property. (Findings 6 and 7, page 21)

The audit report contained seven findings related to internal control and legal compliance. The current audit included two unresolved prior audit findings.

Audit Scope:

Audit Period:
July 1, 2002, through June 30, 2005

Programs Audited:
- Assessments for Energy, Telecommunications, and Insurance Fraud
- Securities Registration Fee Revenue
- Payroll, Equipment, and Professional-Technical Services Contract Expenditures
- Unclaimed Property

Agency Background:

The Department of Commerce regulates utilities, financial institutions, licensed businesses and individuals, retail businesses, and commercial activity. It recovers its operating costs through fees and assessments.

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Chapter 1. Introduction

The Department of Commerce regulates utilities, financial institutions, licensed businesses and individuals, retail businesses, and commercial activity. The department's mission is to:

> *Ensure equitable commercial and financial transactions and reliable utility services by: regulating and licensing business activity in more than 20 industries; investigating and resolving consumer complaints; advocating the public's interest before the Public Utilities Commission; and administering various state programs.*[1]

The department is organized into five divisions, each with specific responsibilities:

- The ***Administration Division*** manages financial, human resources, and information system operations, and it licenses various businesses and individuals.[2] The division also administers the Petroleum Tank Release Cleanup Fund and Unclaimed Property Program.

- The ***Financial Examinations Division*** licenses, examines, and regulates insurance companies, credit unions, state chartered banks, mortgage companies, finance companies, and other financial institutions to ensure that they remain safe and financially solvent.

- The ***Market Assurance Division*** enforces compliance and responsible business conduct by regulated businesses and individuals, evaluates insurance policies and rates to ensure fair rates and compliance with Minnesota law, and registers securities sold in Minnesota. In 2004, the department received authority to add an Insurance Fraud Investigation Unit to investigate fraudulent claims made against insurance companies.[2]

- The ***Energy & Telecommunications Division*** advocates for the public interest, enforces federal and state energy and telecommunications laws, and promotes access to reliable, reasonably priced, efficient, and economical energy and telecommunication services. The division administers federal energy assistance programs for low-income households and the Telecommunications Access Minnesota Program for deaf and hearing-impaired citizens.

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[1] Department of Commerce website at: *http://www.state.mn.us/portal/mn/jsp/home.do?agency=Commerce*

[2] In January 2006, the department's licensing function moved from the Administration Division to the Market Assurance Division.

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- The ***Weights and Measures Division*** ensures accuracy in all transactions based on weight or measure, ensures consistent quality of petroleum products, and provides precision mass, temperature, density, and volume measurement services to businesses.

The department is under the leadership of Commissioner Glenn Wilson who was appointed by Governor Tim Pawlenty effective on January 6, 2003.

Each division is funded from General Fund appropriations and operates special revenue fund programs where they use dedicated revenues to pay program costs. Table 1-1 shows the financial activity of the department's governmental and fiduciary funds for fiscal year 2005.

Table 1-1
Financial Activity by Fund
Fiscal Year 2005

	General Fund	Special Revenue Funds	Gift and Agency Funds
Sources of Funds:			
Appropriations	$27,849,991	$ 18,543,203	$ 0
Cancellations (Note 1)	(3,085,976)	(499,799)	0
Dedicated Receipts (Note 2)	0	106,877,357	100,660
Other Sources:			
Transfers In (Note 3)	2,715,906	2,491,100	0
Balance Forward In	831,889	12,042,449	166,573
Total Sources	$28,311,810	$139,454,310	$267,233
Uses of Funds:			
Payroll	$17,955,262	$4,553,175	$ 0
Rent	1,211,256	458,290	0
Professional/Technical Services	339,389	6,347,717	31,086
Claims	4,429,991	15,144,894	0
Grants	412,835	85,230,300	0
Other Expenses	2,690,750	6,103,441	24,060
Other Uses:			
Transfers Out (Notes 3 and 4)	213,276	7,473,049	0
Balance Forward Out	1,059,051	14,143,445	212,087
Total Uses	$28,311,810	$139,454,310	$267,233

Note 1: General Fund cancellations of $2.7 million were for collections transferred in from special revenue fund accounts for insurance exams and telecommunication assessments.
Note 2: The department also collected over $61 million of fees, assessments, fines, and license receipts, which are deposited as nondedicated revenue into the state's General Fund and not available for department spending. An additional $47 million of unclaimed property was collected and is being held for claims.
Note 3: Internal agency transfers made between accounts within the same fund were eliminated.
Note 4: Approximately $4.6 million of the Transfer-Out balance were made from the department's Petroleum Tank Clean-up Fund to the Remediation Fund managed by the Pollution Control Agency.

Source: Minnesota Accounting and Procurement System for fiscal year 2005, as of December 31, 2005.

Department of Commerce

In addition to dedicated revenue shown in Table 1-1, the Department of Commerce also collected a substantial amount of nondedicated revenue that is not available for its spending. They deposited nondedicated revenues for fees, assessments, fines, and license receipts into the state's General Fund. Non-dedicated General Fund revenues are used to fund general operations and obligations of the state as a whole.

We previously examined selected department activities and programs considered material to the *State of Minnesota's Comprehensive Annual Financial Report* for fiscal years 2003 and 2004. In addition, we annually examined a major federal program at the Department of Commerce for the *State of Minnesota's Financial and Compliance Report on Federally Assisted Programs.* The scope of our annual federal audit work included expenditures for the federal Low Income Home Energy Assistance Program (CFDA[3] #93.568), which totaled $76 million for fiscal year 2005.

The Office of the Legislative Auditor selected the Department of Commerce for additional audit work based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources.

The current audit focused on selected financial activities and was not a comprehensive audit of the department. We analyzed accounting system transactions and programs and met with department management to identify areas for audit coverage. Our audit scope included assessments to utility, telecommunications, and insurance companies; securities registration fees; payroll, professional-technical services contracts, and equipment expenditures; and the unclaimed property program. We did not include federal heating assistance grants (CFDA #93.568) paid to low-income households during this audit.

Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the office's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission,[4] as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the office complied with financial-related legal provisions that are significant to the audit. In determining the department's compliance with legal

[3] The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.
[4] The Treadway Commission (formally known as the National Commission on Fraudulent Financial Reporting) and its Committee of Sponsoring Organizations (COSO) were established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of "internal control" that organizations should have in place to prevent inappropriate financial activity.

provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the Department of Commerce's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations, and we examined documents supporting the agency's internal controls and compliance with laws, regulations, and contract provisions.

Chapter 2. Assessments and Securities Registration Revenues

Chapter Conclusions

The Department of Commerce's internal controls provided reasonable assurance that assessments for energy, telecommunications, and insurance fraud prevention costs, and fees for securities registration were accurately calculated, adequately safeguarded, and properly recorded in the accounting records. However, the department did not pursue unpaid receivables assessed to insurance companies for the insurance fraud prevention program. In addition, the department mistakenly refunded some securities registration fees to former agents that had previously represented mutual fund investment companies.

For the items tested, the department complied with significant finance-related legal provisions governing the assessments of costs and calculation of security registration fees and refunds.

Audit Objectives

The primary objectives of our review of assessments for energy, telecommunications, and insurance fraud prevention costs and securities registration fee revenue were to answer the following questions:

- Did the department's internal controls provide reasonable assurance that assessments and securities registration fee revenues were accurately determined, adequately safeguarded, and properly recorded in the accounting records?
- Did the department adequately pursue uncollected accounts receivables and appropriately refund securities registration fees?
- Did the department comply with material finance-related legal provisions governing assessments and securities registration fees?

Background

The Department of Commerce recovers its operating costs for energy, telecommunications, and the Insurance Fraud Prevention Program through assessments. It also collects securities registration fees from mutual investment fund companies. Table 2-1 shows the department's revenue for these areas for fiscal years 2003, 2004, and 2005.

Table 2-1
Assessment Cost Recoveries and Securities Registration Fees
Fiscal Years 2003 to 2005

	2003	2004	2005
Securities Registration Fees (Note 1)	$25,028,104	$25,024,688	$25,012,967
Energy Cost Assessments (Note 2)	3,028,329	4,433,144	4,067,713
Telecommunications Cost Assessments (Note 3)	3,481,302	1,806,508	1,692,156
Insurance Fraud Prevention (Note 4)	0	1,504,850	1,546,400
Total	$31,537,735	$32,769,190	$32,319,236

Note 1: The department refunds the amount of Securities Registration Fees that exceed $25 million annually. The amounts shown exceed $25 million because, pursuant to *Minnesota Statutes*, 80A.28, subd. 1(c), refunds are not required for amounts calculated at less than $100 for a fiscal year.
Note 2: Fluctuations from fiscal years 2003 to 2005 are due to assessment timing differences.
Note 3: The higher assessment level in fiscal year 2003 was due to a one-time direct charge for one company.
Note 4: The Legislature created the Insurance Fraud Prevention Program beginning in fiscal year 2004.

Source: Minnesota Accounting and Procurement System for fiscal years 2003, 2004, and 2005, as of December 31, 2005.

Securities Registration Fees

Mutual investment fund companies that offer or sell securities in the state must register those securities with the Department of Commerce. Companies complete a registration form that indicates the amount of securities to be offered. *Minnesota Statutes* 2005, 80A.28, subd. 1, specifies the securities registration fee based on the maximum aggregate offering price of the securities. When registration fees exceed $25 million in a fiscal year, the department is required to issue pro rata refunds to those who paid fees for that fiscal year. The department is not required to issue refund amounts calculated to be less than $100.

In addition to collecting securities registration fees, the department has the authority to assess fines and penalties to companies that do not comply with Minnesota statutes and rules. The department may assess a company up to $10,000 per violation. The amount of the fine varies based on factors, such as the nature of the violation, the citizens affected, the economic incentive of the violation, as well as the deterring affect of the fine. In some cases, the department works with other states to take multi-state action against companies with major violations. The department collected fines totaling $849,931, $5,880,295 and $519,469 for fiscal years 2003, 2004, and 2005, respectively. In fiscal year 2004, the department collected large fines from Minnesota's involvement in multi-state class action suits against two mutual investment fund companies.

Energy and Telecommunication Assessments

Minnesota Statutes 2005, 216B, 216C, and 237 authorizes the department to recover its costs of performing duties related to energy and telecommunications from the gas, electric, and telephone companies operating in Minnesota. On a semiannual basis, the department assesses the direct costs of specific projects to the companies involved in those projects. On a quarterly basis, the department assesses the indirect costs not associated with specific projects to all regulated gas, electric, and telephone companies. It allocates indirect costs based on the proportion of each company's revenue to the total revenues of all regulated companies in the industry. The department makes estimated quarterly assessments, with an adjustment in the following year for the difference between the estimated and actual indirect costs.

The department deposited energy cost recoveries as nondedicated revenue into the state's General Fund, and that money was not available for department spending. The department deposited telecommunications cost recoveries as dedicated revenue where it was used to fund costs for telecommunications investigations. At the end of each fiscal year, the department must cancel any telecommunications cost recoveries in excess of $25,000. For fiscal year 2005, the department transferred $1.6 million to the General Fund where it was cancelled.

The Department of Commerce partners with the Public Utilities Commission for similar recovery of its energy and telecommunications costs from the gas, electric, and telephone companies. The department maintains the assessment computer system, generates invoices for both agencies, and maintains the accounts receivable records. The commission is responsible to collect, deposit, and record their assessment receipts.

Insurance Fraud Prevention Division

The Legislature created the Insurance Fraud Prevention Division in 2004 to establish a law enforcement function to investigate insurance fraud. The unit examines fraudulent claims against insurance companies, researches insurance data to look for patterns of fraud, investigates insurance fraud cases, and initiates criminal charges against individuals who commit insurance fraud. The director of the Insurance Fraud Prevention Division is a licensed peace officer and acts as the chief law enforcement officer. The division has the authority to make arrests for offenses related to insurance fraud.

The department makes an annual assessment to insurance companies doing business in Minnesota based on the insurer's total assets and written premiums for the preceding fiscal year. Assessments are due on or before June 1 of each year. The department deposited assessments totaling about $1.5 million annually into the insurance fraud prevention account.

Our audit of assessment and securities registration fee revenue identified the following issues.

Findings and Recommendations

1. The Department of Commerce did not monitor and pursue collection of unpaid receivables totaling $77,200 for insurance fraud prevention assessments.

The department did not ensure all insurance companies paid their legal assessments for the Insurance Fraud Prevention Program. The department properly invoiced the companies after determining the assessment amount. However, it did not send follow-up invoices or notify companies that did not pay the original amount invoiced. Uncollected receivables totaled $49,650 for fiscal year 2004 and $27,550 for fiscal year 2005. The lack of effective receivable monitoring and a timely follow-up process increases the likelihood of delinquency and nonpayment. Due diligence in pursuing collection of outstanding receivables is important to ensure the state receives all assessments due, and all insurance companies pay their equitable share. If the department's collection efforts are unsuccessful after 120 days, it must refer the debt to the Minnesota Collection Enterprise for collection, pursuant to *Minnesota Statutes* 2005, 16D.04, subd. 2(b).

Recommendation

- *The department should monitor and pursue collection of past due receivables for the insurance fraud prevention assessments. If uncollected, the department should refer the debt to the Minnesota Collection Enterprise.*

2. The process the Department of Commerce used to refund securities registration fees through agents is questionable.

The department sent securities registration refund checks to agents that no longer represented the company for whom they initially filed. As a result, the department had to recover refunds from those former agents and reissue refund checks to the company's new agent. The process of refunding securities registration fees through agents, instead of directly back to the investment company, is problematic and increases risk.

Mutual investment fund companies use agents to facilitate and pay their securities registration filings in several states, including Minnesota. When total securities registration fees collected for the fiscal year exceeded $25 million, the department issued pro rata refunds back to those agents. During the three-year audit period, the department refunded over $5.8 million. The department attempts to keep agent information current, but it must rely on companies to alert them when a change occurs.

Sending refunds to agents increased the risk that some companies may not receive their refunds. The department must rely on the agent to properly send that refund money back to the investment company they filed on behalf of. Furthermore, the company may not be aware that a refund was due from Minnesota. Sending refunds directly to the investment company, instead of their agent, would lessen the risk of the agent not sending that money back to the company.

Recommendation

- *The department should send refunds directly to the investment companies that registered securities instead of their agents. If the department continues to refund through agents, it must ensure its database contains current agent information for each investment company before sending refunds, and it should directly notify the investment company of the refund amount.*

Chapter 3. Payroll Expenditures

Chapter Conclusions

The Department of Commerce's internal controls provided reasonable assurance that it accurately compensated employees and maintained employee leave records, and that it properly recorded payroll expenditures in the appropriate fund in the accounting system.

For the items tested, the department paid employees in compliance with significant finance-related legal provisions contained in bargaining unit contracts and personnel plans.

Audit Objectives

Our audit of personnel and payroll expenditures focused on the following questions:

- Did the department's internal controls provide reasonable assurance that it accurately compensated employees and maintained employee leave records and properly recorded payroll expenditures in the correct fund in the accounting system?
- Did the department pay employees in compliance with significant finance-related legal provisions contained in bargaining unit contracts and personnel plans?

Background

Payroll is a significant expenditure for the State of Minnesota and the Department of Commerce. During fiscal year 2005, payroll expenditures for the state were nearly $3.1 billion. Payroll was the second largest expenditure for the department, totaling $22.5 million for fiscal year 2005 and comprising about 16 percent of its total expenditures.

Most of the department's payroll is funded from General Fund appropriations; however, other funding sources are also available. Approximately 82 percent of the department's payroll costs were paid from the state's General Fund appropriations. This included employee compensation and fringe benefits for providing general administration, market assurance, banking and insurance financial examinations, and licensing. In addition, the department's federally funded share of payroll totaled about 7 percent for managing the low-income home energy assistance and weatherization programs. The remaining 11 percent involved department payroll costs for special revenue programs that provide telecommunications services for the deaf and hearing impaired, administration for petroleum tank cleanup, rate regulation for workers' compensation, and enforcement for the Insurance Fraud Program.

Table 3-1 shows that the department spent over $68 million on total personnel and payroll costs during fiscal years 2003, 2004, and 2005.

Table 3-1
Payroll Expenditures by Fund
Fiscal Years 2003 through 2005

Funding Source	2003	2004	2005
General	$19,458,195	$18,249,162	$17,955,262
Federal	1,633,443	1,717,681	1,675,127
Special Revenue	1,993,297	2,494,596	2,878,048
Total	$23,084,935	$22,461,439	$22,508,437

Source: Minnesota Accounting and Procurement System for fiscal years 2003, 2004, and 2005, as of December 31, 2005.

In January 2005, department employees began using a new self-service process to enter their hours worked and leave taken into the state's payroll system. This automated employee timesheets and allowed for electronic supervisory approvals. The department used a designed exception report to monitor transactions where an employee did not enter their own time or where the primary supervisor did not authorize hours worked.

The commissioner of Employee Relations is the chief personnel and labor relations manager for the executive branch. In this capacity, the commissioner of Employee Relations oversees a wide array of functions, from negotiating compensation plans to maintaining the civil service classification system. To fulfill these duties, *Minnesota Statutes* give the commissioner of Employee Relations the authority to further delegate certain responsibilities to individual state agencies. DOER has granted delegated authority to the Department of Commerce for certain human resources decisions and activities.

Personnel and payroll responsibilities are shared by the Department of Commerce and two central oversight agencies: the departments of Employee Relations and Finance. The two oversight agencies maintain the central personnel and payroll system used by all state agencies. This computer system has many edits that ensure personnel and payroll transactions comply with legal provisions and terms in compensation plans. The system also has extensive on-line policies and procedures to help state agencies record their decisions. However, Department of Commerce personnel officers and payroll staff are ultimately responsible for understanding and complying with compensation plan terms and other pertinent legal provisions.

The conclusions reached in this report are based solely on work done at the Department of Commerce. In addition, the Office of the Legislative Auditor also performed audit work to assess the adequacy of centralized personnel and payroll controls administered by the departments of Employee Relations and Finance. Legislative Audit Report #03-47, issued in August 2003, focused on security controls that protect the integrity and confidentiality of data in the personnel and payroll system. It also assessed the adequacy of central controls over pay rates, leave accruals, and payroll processing. Due to the significance of payroll costs to the State of Minnesota, we continue to examine central personnel and payroll controls and will be issuing another report to the departments of Employee Relations and Finance at a later date.

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Chapter 4. Equipment and Professional-Technical Service Contracts

Chapter Conclusions

The Department of Commerce's internal controls provided reasonable assurance that it accurately paid vendors for equipment and professional/technical services received and properly recorded these expenditures in the accounting system. However, the department did not sufficiently restrict employee access to the accounting system and incorrectly recorded equipment obligation dates in the accounting records.

For the items tested, the department paid contract and equipment expenditures in compliance with significant finance-related legal provisions. However, the department did not always comply with requirements to retain ten percent of each professional-technical service contract until work was satisfactorily completed.

Audit Objectives

The primary objectives of our review of equipment and professional-technical service contract expenditures were to answer the following questions:

- Did the department's internal controls provide reasonable assurance that it accurately paid vendors for equipment and professional-technical services received and properly recorded these expenditures in the accounting system?

- Did the department comply with significant finance-related legal provisions involving equipment purchases and professional-technical contracts?

Background

Table 4-1 shows equipment and professional-technical services expenditures for fiscal years 2003 through 2005.

Table 4-1
Selected Administrative Expenditures
Fiscal Years 2003 through 2005

	2003	2004	2005
Professional-Technical Services	$10,962,896	$7,361,036	$6,718,192
Equipment	$283,092	$773,574	$808,826

Source: Minnesota Accounting and Procurement System for fiscal years 2003, 2004, and 2005, as of December 31, 2005.

Professional-Technical Services

The department contracted with private companies for certain professional-technical services. The department's largest contract was with Communication Services for the Deaf to operate and maintain the relay service for the Telecommunications Access Minnesota Program. The department also incurred large professional-technical service expenditures for financial examinations and investigations of Minnesota companies and to design a database for its federal energy assistance program.

Equipment

The department used the state's Fixed Assets Inventory System to monitor and control its equipment and fixed assets that exceed $2,000, as well as sensitive equipment such as computers, Insurance Fraud Division equipment, and handheld computers. The department updated the Fixed Asset Inventory System for equipment purchases, transfers, retirements, and disposals. In addition, the department conducted a periodic physical inventory and made a comparison to assets recorded on the Fixed Asset Inventory System.

Our audit of equipment and professional-technical contracts identified the following concerns.

Findings and Recommendations

3. The Department of Commerce did not adequately restrict certain employee access to incompatible financial functions in the accounting system.

The department gave six employees who use the state's accounting system the ability to purchase and encumber funds, enter invoices, receive data, and process payments. Generally, the functions of procurement and processing payments should be segregated to provide appropriate control over expenditures. The risks of errors and improprieties diminish when employee duties are separated, and they are unable to access incompatible financial functions. If restricting access is not feasible, Department of Finance Operating Policy and Procedure No. 1101-07 requires the department to develop a written plan identifying compensating controls such as having an independent person review the activity.

Recommendation

- *The department should eliminate incompatible employee access to the accounting system, or develop mitigating controls that provide independent scrutiny and review of the activity processed by those users.*

4. The department did not ensure compliance with contract retainage requirements for professional-technical services.

The department did not retain ten percent of the amount due under each contract for 7 of 15 professional-technical services contracts tested. *Minnesota Statutes* 2005, 16C.08, subd. 5(b) requires that no more than 90 percent of the contract be paid until the final work product is reviewed and the contractor has satisfactorily fulfilled terms of the contract. Department contracts included the required statutory retainage clause; however, they did not always withhold the retainage amount, or the amount withheld was insufficient.

The Department of Commerce contracts for a wide range of professional-technical services. Each division has unique contract deliverables or work products, and staff indicated they do not typically make final payments until they are satisfied with the work. However, we encountered the following problems applying contract retainage requirements:

- Some contracts itemized specific deliverables and had payment dates scheduled. However, the final payment specified in the contract was sometimes scheduled at less than ten percent. As the work was done, the department made the payments according to schedule, causing the final retainage amount to be insufficient. When negotiating contracts, the department should ensure that the final contract payment being scheduled is at least ten percent.

- Master contracts were problematic due to overstated estimates of contract work orders. The department entered into master contracts to allow efficient assignment of work orders to the contractors on an as-needed basis. They estimated the amount of contract work orders and specified that no more than 90 percent be paid until it reviewed the final product. However, some of the contracts never reach the 90 percent level to cause the department to hold back or retain a portion of the contract. For example, one examination contract for $260,000 would require retainage when reaching $234,000. However, actual payments totaled $105,000, and the department did not retain a portion since it never reached $234,000. Similarly, another contract for $1,050,000 had no retainage since final expenditures totaled $610,000. The department needs to improve its estimates so that retainage has a financial effect and creates leverage until the work is done. It should consider two options: withhold ten percent of the total contract work order or withhold ten percent of each payment.

Withholding a portion of the contract to ensure satisfactory completion of services is important to create financial leverage or recourse against the contractor. Planning contract payments and retainage takes coordination between the department's program and financial staff. The Department of Administration Professional-Technical Contracts Manual encourages agencies to create a central repository of contract documents to help coordinate and ensure contract requirements are met.

Recommendation

- *The department should coordinate contract payment schedules and improve its contract estimates to ensure it retains ten percent of each contract until work is satisfactorily completed.*

5. The Department of Commerce did not record proper obligation dates for some equipment purchases in the state's accounting system.

For 14 of 21 purchases tested, the department incorrectly recorded the date that the state was obligated for the purchase. Generally, that date is the date the state actually took possession of the assets. Instead, the department used the invoice date because they did not have packing slips or a documented date that the equipment actually arrived. The Department of Finance relies on accurate obligation dates to determine the state's outstanding liabilities at year-end for financial reporting purposes. Entry of improper dates causes unreported obligations.

Recommendation

- *The department should ensure it documents the obligation date for equipment purchases and properly enters that date into the accounting system.*

Chapter 5. Unclaimed Property

Chapter Conclusions

The Department of Commerce's internal controls provided reasonable assurance that it accurately recorded unclaimed property receipts and claims in the state's accounting system. However, the department continues to have problems efficiently reconciling its bank holdings to the unsold securities recorded in its unclaimed property database. They successfully matched approximately 2/3 of the unclaimed investment portfolio; however, reconciling the balance was complicated by dividend reinvestments causing differences between the bank and database. In addition, the department did not completely inventory unclaimed tangible property.

For the items tested, the department complied with material finance-related legal provisions governing unclaimed property.

Audit Objectives

The primary objectives of our review of unclaimed property were to answer the following questions:

- Did the department establish internal controls to adequately safeguard unclaimed property, properly record remittances from unclaimed property holder reports, and accurately pay and record claims in the accounting system?
- Did the department comply with significant finance-related legal provisions requiring annual reporting of unclaimed property, a holding period for unclaimed securities, and recording receipts from sales in the state's General Fund?

Background

Minnesota Statutes 2005, 345.43, require holders of unclaimed property to transfer the property to the Department of Commerce. Examples of the types of unclaimed property are abandoned savings accounts, Certificate of Deposits, stocks and bonds, and insurance proceeds; uncashed paychecks, travelers' checks, and tax refunds; and the contents of abandoned safe deposit boxes. The state considers the property unclaimed if the owner does not provide evidence of any interest or control over the property for several years. The specific number of years depends on the type of property. The department's goal is to return unclaimed personal property to the rightful owners.

Table 5-1 shows the unclaimed property receipts collected by the department and claims made by owners for fiscal years 2003 through 2005.

Table 5-1
Unclaimed Property Program Receipts and Claims
Fiscal Years 2003 to 2005

	2003	2004	2005
Receipts	$43,944,472	$60,943,957	$63,621,560
Claims	$14,333,761	$13,451,573	$16,521,686

Source: Minnesota Accounting and Procurement System for fiscal years 2003, 2004, and 2005, as of December 31, 2005.

The department has an agreement with a custodian bank to directly receive all unclaimed securities, to monthly liquidate unclaimed securities held for one year or more, and to process approved transfers of shares. Holders of unclaimed securities remit the securities directly to the department's custodian bank. As of June 30, 2005, the market value of the unclaimed securities held at the bank was $45.8 million.

The department informed us of an error that occurred in fiscal year 2006. The department's custodian bank mistakenly sold approximately $1 million of securities that it had held for only a few months. *Minnesota Statutes* 2005, 345.47, subd. 3a, requires unclaimed securities to be held for one year prior to selling them. The inappropriate early sale of these securities was caused by a bank employee who incorrectly entered the date they were received. The department is working with the bank who has agreed to resolve the situation, including repurchase of those securities if a claim is made before the one-year holding period.

The department deposits all unclaimed money and money received from the sale of unclaimed securities held for over one year into the state's General Fund. Once deposited, unclaimed property program staff enter information from the holder report into the unclaimed property database. In addition to receipts, the department also stores unclaimed tangible property found in safe deposit boxes in a secured vault. The department received contents from approximately 600 safe deposit boxes each year. Periodically, the department conducts auctions to sell unclaimed tangible property.

Holders of unclaimed property must report the names and last known addresses of the owners of the unclaimed property by November 1 each year. The department publishes the list of owners' names on its website and in major newspapers throughout Minnesota. The owners of the property can claim their property by contacting the Department of Commerce and submitting a notarized claim form along with evidence of ownership. Unclaimed property division staff receive the claim forms and verify the claimant's request with information previously collected in the unclaimed property database. Claims found to be legitimate are approved and forwarded to the administration division for payment.

Findings and Recommendations

6. PRIOR FINDING PARTIALLY RESOLVED: The department did not reconcile all unclaimed securities held by its custodian bank to the securities recorded in its unclaimed property database.

The Department of Commerce continues to have problems reconciling unclaimed securities held by the custodian bank to the securities recorded in its unclaimed property database. The securities are held by the bank for one year before liquidation and deposit of money into the state's General Fund. Reconciliation of unclaimed securities between the bank and the department's database is critical to control claims being made by rightful owners during the one-year holding period.

The department designed an automated reconciliation process that successfully matched approximately 2/3 of the unclaimed investment portfolios. However, staff could not balance the remaining portfolios because of reinvested dividends earned by unclaimed accounts. The department does not record reinvested dividends in its unclaimed property database, causing ongoing differences between the database and the bank. *Minnesota Statutes* 2005, 345.45, state that the rightful owner is not entitled to any income earned while the securities were held in unclaimed status by the department.

Recommendation

- *The department should work with its custodian bank and continue its effort to develop a reconciliation of all securities held by the bank to securities recorded in the unclaimed property database.*

7. PRIOR FINDING PARTIALLY RESOLVED: The department did not completely inventory its tangible unclaimed property.

The Department of Commerce did not inventory the contents of all unclaimed safe deposit boxes turned over to the state. As of March 2006, the department has inventoried approximately half of the safe deposit boxes. Unclaimed property personnel use the bank's holder remittance reports to identify the owner name, last known address, and the number of boxes received in the unclaimed property database based on holder remittance reports. However, department staff do not specify the contents of the safe deposit boxes into the database until they inspect and inventory the specific items actually contained in the boxes. The bank submits the holder remittance report listing tangible items contained in the boxes; however, department delays in verifying the items could be brought into question if the listed items differ from actual contents.

To maintain effective control over the unclaimed property in its possession, the department needs to verify that tangible property turned in actually contains the items specified in the bank's holder remittance report. Without timely inventory, the ability to resolve discrepancies decreases.

Recommendation

- *The department should ensure it compares contents of abandoned safe deposit boxes to holder remittance reports in a timely manner.*

Status of Prior Audit Issues
As of April 3, 2006

Fiscal Year 2005 Statewide/Single Audit

Legislative Audit Report 06-06, issued in March 2006, for the fiscal year ending June 30, 2005 covered one major federal program included in the *State of Minnesota's Financial and Compliance Report on Federally Assisted Programs.* The scope of our work included expenditures for the federal Low-Income Home Energy Assistance Program (CFDA # 93.568). We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs, as described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement.* The report contained two audit findings. One finding identified the need for the department to improve documentation for its testing and verification of household eligibility for federal heating assistance. The second finding reported the need to identify all federal program numbers in the accounting system.

Fiscal Year 2004 Statewide/Single Audit

Legislative Audit Report 05-14, issued in March 2005, involved an audit of the department's Unclaimed Property Program considered to be material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2004. In addition, the audit examined the federal Low-Income Home Energy Assistance Program (CFDA #93.568). The audit contained two findings. One finding related to the reconciliation of unclaimed property investments. We have repeated portions of that finding in this report as Finding 6. A second finding, related to monitoring of subrecipient organizations, was resolved.

Legislative Audit Report 03-45, issued in August 2003, covered the three fiscal years ending June 30, 2002. The audit scope included financial management, telephone and energy assessments, payroll, rent, professional contract services expenditures, and insurance settlement agreements. The report contained two audit findings. The first finding reported that two appropriation accounts were incorrectly allowed to carry-forward funding between fiscal years. The second finding identified an insurance settlement agreement with questionable terms and a confidentiality provision that we felt was inappropriate.

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.

Department of Commerce

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June 27, 2006

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

Dear Mr. Nobles:

Thank you for your recent audit of selective activities conducted by the department. We realize the importance of regularly auditing significant aspects of our business and we appreciate the effort you and your staff invested in the review. As with all audits and reviews, we welcome your guidance and will do our best to implement your recommendations. The department's response to the audit findings are listed below.

Recommendation #1: *The department should monitor and pursue collection of past due receivables for the insurance fraud prevention assessments. If uncollected, the department should refer the debt to the Minnesota Collection Enterprise.*

Response #1: The Department of Commerce will comply with this recommendation.

The department will follow-up with those companies that have past due invoices. If after 120 days they remain outstanding, we will turn over any uncollected items to the Minnesota Collection Enterprise. We will follow this procedure in all future insurance fraud prevention assessments.

Staff Responsible for Implementation: Lee Spelbrink
Expected Date of Completion: October 31, 2006

Recommendation #2:
The department should send refunds directly to the investment companies that registered securities instead of their agents. If the department continues to refund through agents, it must ensure its database contains current agent information for each investment company before sending refunds, and it should directly notify the investment company of the refund amount.

Response #2:

The Department of Commerce will comply with this recommendation.

For fiscal year 2006 refunds, the department will continue to issue refunds through the agent that has paid throughout the year on behalf of a particular investment company. We will continue to submit a list of potential refunds to each agent for review to ensure a valid relationship continues to exist between them and the particular investment company eligible for a refund. Once confirmation is returned to the department, the refund will be processed or the necessary changes will be made to ensure the refund is returned to the current agent. Because this procedure resulted in no errors or reissuance of any refund checks in 2005, we have much confidence in this process.

In the future, the department hopes to have the resources necessary to take advantage of applications available in the marketplace to ensure the necessary information is readily available to directly return these refunds to the investment company per your recommendation. In the meantime, the department will work with the agents to ensure current contact information for each investment company is maintained in the department's database.

Staff Responsible for Implementation: Lee Spelbrink
Expected Date of Completion: December 31, 2006

Recommendation #3:
The department should eliminate incompatible employee access to the accounting system, or develop mitigating controls that provide independent scrutiny and review of the activity processed by those users.

Response #3:
The Department of Commerce has complied with this recommendation.

The department has reviewed all security profiles for its employees and removed all incompatibility to ensure the necessary separation of duties exists.

Staff Responsible for Implementation: Tim Jahnke
Expected Date of Completion: Completed June, 2006.

Recommendation #4:
The department should coordinate contract payment schedules and improve its contract estimates to ensure it retains ten percent of each contract until work is satisfactorily completed.

Response #4:
The Department of Commerce will comply with this recommendation.

The department will begin retaining 10% of each invoice it receives from a contractor on July 1, 2006.

Staff Responsible for Implementation: Tim Jahnke
Expected Date of Completion: July 1, 2006

Recommendation #5:
The department should ensure it documents the obligation date for equipment purchases and properly enters that date into the accounting system.

Response #5:
The Department of Commerce will comply with this recommendation.

The department has implemented the necessary procedure to ensure the obligation date is properly recorded in MAPS.

Staff Responsible for Implementation: Tim Jahnke
Expected Date of Completion: July 1, 2006

Recommendation #6:
The department should work with its custodian bank and continue its efforts to develop a reconciliation of all securities held by the bank to securities recorded in the unclaimed property database.

Response #6:
The Department of Commerce will comply with this recommendation by developing a new reconciliation process for all future securities received.

In response to the previous audit finding, the department took steps to complete this necessary reconciliation. With a significant amount of staff investment, about 2/3 of the reconciliation has been completed. Several types of problems have been discovered while researching the outstanding items. The remaining balance would require a tremendous investment of staff time with an uncertain outcome. We've considered many factors in arriving at our decision to abandon this reconciliation and move forward with our plan to ensure all future securities received will be reconciled on a monthly basis. In addition, we are implementing a new unclaimed property database application this summer that will help tremendously with this effort.

Staff Responsible for Implementation: Dennis Munkwitz
Expected Date of Completion: December 31, 2006

Recommendation #7:
The department should ensure it compares contents of abandoned safe deposit boxes to holder remittance reports in a timely manner.

Response #7:
The Department of Commerce will comply with this recommendation.

Each year the department receives thousands of new items of unclaimed property including the contents of abandoned safe deposit boxes. The department takes steps to ensure the database is updated as soon as possible to reflect the new property received. While this effort updates the database to reflect the owner of each safe deposit box, it does not record the actual inventory of each box. Historically the department has recorded the actual inventory under one of the following conditions: 1) when an owner makes a claim, 2) when staff resources are available, or most likely 3) when a public auction is being planned. It is important to note that over the last several years, the department has not recorded a single exception to the inventory report submitted by the financial institution for each box's contents. In an effort to resolve this finding, the department has recently brought in additional resources to do inventory work.

Staff Responsible for Implementation: Dennis Munkwitz
Expected Date of Completion: September 30, 2006

Sincerely,

Glenn Wilson, Commissioner