Department of Revenue

Financial Audit
For the Period July 1, 1996, through March 31, 1999

October 1999

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-57

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SUMMARY

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Department of Revenue

Financial Audit
For the Time Period July 1, 1996, through March 31, 1999

Public Release Date: October 7, 1999 No. 99-57

Agency Background

The Department of Revenue is responsible for managing the state's tax systems. During fiscal years 1997 and 1998 the department operated under the direction of Commissioner James Girard. He resigned in December 1998 and Matthew Smith became acting commissioner until January 20, 1999, when Governor Ventura appointed him as commissioner of Revenue.

The department collects approximately $11 billion a year through various tax types. We audit the largest of these revenue programs annually as part of our Statewide Audit. In order to fund these activities, the Legislature appropriates monies to the department to fund its administrative operations.

Audit Scope and Conclusions

The scope of this audit included a review of payroll, professional/technical services, computer and system services, rent, supplies and equipment, and the Minnesota Collection Enterprise (MCE) for the period from July 1, 1996, through March 31, 1999.

The Department of Revenue designed and implemented internal controls to provide reasonable assurance that MCE transactions were adequately documented, approved, accurately recorded on the state's accounting system, and in compliance with applicable legal provisions and However, the department did not reconcile the transactions recorded on its collections system to the Minnesota Accounting and Procurement System (MAPS), or transfer collection fees to the General Fund in a timely manner.

The department's payroll transactions were adequately supported, approved, and accurately reported in the state's accounting records. In addition, for the items tested, the department processed its payroll transactions in compliance with material finance-related legal provisions and applicable bargaining unit agreements. The department also appropriately authorized and accurately paid and recorded expenditures for professional/technical services, computer and system services, rent, and supplies and equipment. The department also properly executed contracts with outside vendors in accordance with state requirements and procedures. The department also properly recorded its fixed assets on its fixed asset system. In addition, for the items tested, the department complied with applicable finance-related legal provisions.

In its audit response, the Department of Revenue agreed with the audit findings and is taking corrective action to resolve the issues.

STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Matthew Smith, Commissioner
Department of Revenue

We have audited selected components of the Department of Revenue for the period July 1, 1996, through March 31, 1999, as further explained in Chapter 1. Our audit scope included payroll, rent, professional/technical services, computer and systems services, supplies and equipment, and the Minnesota Collection Enterprise.

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 also require that we design the audit to provide reasonable assurance that the Department of Revenue complied with provisions of laws, regulations, and contracts significant to the audit. The management of the Department of Revenue is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, and contracts.

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 issued as a public document on October 7, 1999.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: July 9, 1999

Report Signed On: October 4, 1999

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA,	Audit Manager
David Poliseno, CPA, CISA,	Auditor-In-Charge
Fubara Dapper, CPA, CISA	Auditor
Eric Roggeman	Auditor
Jill Weber	Auditor

Exit Conference

This report was discussed with the following staff of the Department of Revenue at the exit conference held on September 23, 1999:

Matthew Smith	Commissioner
Dennis Erno	Deputy Commissioner
Larry Collette	Director, Administrative Management
Jerry McClure	Director, MCE
Jean Jochim	Revenue Accounting
Jim Maurer	Internal Audit Manager
Stephen Krovitz	Internal Auditor

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 worked to win compliance through a balanced interaction of efforts that focused on developing sound tax policies, educating citizens, providing expedient customer service, and providing administrative and enforcement services in the area of tax collections and assessment. During fiscal years 1997 and 1998, the department operated under the direction of Commissioner James Girard until his resignation in December 1998. The Governor appointed Matthew Smith as commissioner on January 20, 1999.

The Department of Revenue collects approximately $11 billion annually through various tax programs. We audit the largest of these revenue programs annually as part of our Statewide Audit. The departments operations are primarily funded through General Fund appropriations. Table 1-1 shows a summary of the department's administrative expenditures for fiscal years 1997 and 1998:

Table 1-1
Summary of Administrative Expenditures
Fiscal Years 1997 and 1998

Expenditures:	1997	1998
Employee Payroll	$57,096,759	$59,272,438
Rent	7,031,080	7,513,765
Professional/Technical Services	5,727,399	5,569,077
Supplies and Equipment	4,025,281	2,213,465
Communications	3,193,737	3,427,184
Computer and Systems Services	2,894,105	2,811,234
Printing	1,995,541	2,272,760
Other Administrative Expenditures	4,896,881	4,412,159
Total Administrative Expenditures	$86,860,783	$87,492,082

Source: Minnesota Accounting and Procurement System (MAPS) reports.

In 1994, the Legislature passed the Debt Collection Act (Minn. Stat. Section 16D), which established a centralized collection entity within the department known as the Minnesota Collection Enterprise (MCE).

In the fall of 1998, the department moved from its location south of the Mississippi River to the capitol complex area on Robert Street. The cost of the new building was approximately $75 million. The Department of Administration received an appropriation of $5.35 million to relocate the department. As of June 1999, the relocation expenses have totaled approximately $4.4 million dollars. The department anticipates using the remainder of the appropriation to complete some relocation projects.

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Chapter 2. Minnesota Collection Enterprise

Chapter Conclusions

The Department of Revenue designed and implemented internal controls to provide reasonable assurance that Minnesota Collection Enterprise (MCE) transactions were adequately documented and approved, and accurately recorded on the state's accounting system and in compliance with applicable legal provisions and management's authorization. However, the department did not reconcile MCE transactions recorded on its collections system to MAPS or transfer collection fees to the General Fund in a timely manner.

MCE provides collection services to state agencies as well as to counties and district courts. State agencies must transfer accounts to MCE when they become 121 or more days past due. The ultimate responsibility for the debt, including the reporting of the debt to the commissioner of Finance and the decision with regard to the continuing collection of the debt and noncollectible debt, remains with the referring state agency.

MCE's collection services include locating the debtor, contacting the debtor, arranging and receiving payment immediately or through payment plans, monitoring payment plans, locating and evaluating assets, issuing liens and levies, and seizing assets. MCE provides collection services based on a signed debt qualification plan, which is an agreement between a referring agency and MCE. It defines the terms and conditions of MCE's collection services to the referring agency.

MCE's activity has grown significantly in recent years. Table 2-1 shows the amounts collected and transferred during the audit period. As of October 1998, MCE reported approximately $65.4 million in accounts it was pursuing. In April 1999, that amount grew to approximately $145.7 million. The increased growth reflects the cooperation of referring agencies to turn over outstanding accounts to MCE. The largest portion of the outstanding amount relates to delinquent child support payments.

MCE operations for fiscal years 1998 and 1999 were funded through General Fund appropriations of $2.1 and $2.2 million, respectively. Minn. Stat. Section 16D.11, Subd. 2, directs MCE to assess a collection cost of 15 percent of the debt. The collection cost is increased to 25 percent if more severe remedies are required, such as litigation. Minn. Stat. Section 16D.11, Subd. 1, also directs MCE to deposit collection costs to the General Fund as nondedicated receipts.

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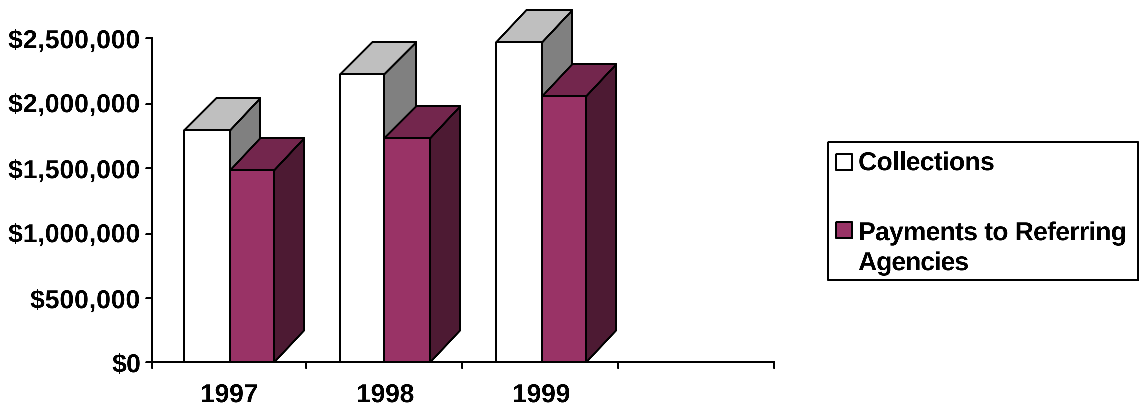
Figure 2-1 shows debts collected, including collection costs, and payments made to referring agencies. The difference between collections and amounts paid to referring agencies represent collection costs that should be transferred to the General Fund.

Figure 2-1
Minnesota Collection Enterprise
Fiscal Years 1997-1999 (1)



(1) Fiscal year 1999 records through March 1999 (9 months).

Source: Minnesota Accounting and Procurement System (MAPS) for fiscal years 1997-1999.

Audit Objectives and Methodology

Our review of MCE operations focused on the following questions:

- Did the department design and implement internal controls to provide reasonable assurance that its MCE collection transactions were adequately supported, approved, and accurately reported in the state's accounting system?
- Did the department process its MCE collection transactions in compliance with material finance-related legal provisions?

To answer these questions, we interviewed key employees to gain an understanding of MCE controls over collecting, depositing, and recording of debt receipts. We reviewed MCE records to determine if the required collection fees were retained and if payments to referring agencies were properly recorded.

Conclusions

The Department of Revenue designed and implemented internal controls to provide reasonable assurance that MCE transactions were adequately documented, approved, accurately recorded on the state's accounting system, and in compliance with applicable legal provisions and management's authorizations. However, the department did not reconcile the transactions recorded on its collections system to MAPS, as discussed in Finding 1. In addition, as explained in Finding 2, the department did not transfer collection fees to the General Fund in a timely manner.

1. The department did not reconcile collections recorded on its computer system to the corresponding deposits recorded on the Minnesota Accounting and Procurement System (MAPS).

MCE did not reconcile collections recorded on its Minnesota Collection Enterprise Account Tracking System (MATS) to the deposits recorded on MAPS. The department developed MATS as its accounts receivable system to account for its collection activity. The department sets up the outstanding accounts on MATS, records the payments received, and records the distributions to the referring agencies. The department uses the Computer Assisted Collection System (CACS) to generate billing notices it sends to the debtors. The notices include bar-coded information about the account. The debtor sends the notice back to the department along with their payment, which the department processes through its regular tax processing system. The department scans the notices and records the information on MATS and CACS to update the customer's account. The department also deposits the payment into the state treasury and records the transaction on MAPS. However, the department did not reconcile the information recorded on MATS to MAPS to ensure that all of the money received was properly deposited into the state treasury and properly recorded to the debtor's account.

Recommendation

- *The department should reconcile transactions posted to MATS to the deposits recorded on MAPS.*

2. The department did not properly transfer the collection fees to the General Fund.

The department did not transfer the collection fees it collected to the General Fund in a timely manner. Minn. Stat. Section 16D.11 requires MCE to assess each account a collection fee of 15 percent of the amount collected, or 25 percent if legal action such as liens, levies, or seizures must be used. The statute further requires the department to deposit the collection fees in the General Fund as nondedicated receipts. MCE used MATS to account for the collection fees. The department accumulated the collection fees in MATS, but did not transfer the amount to the General Fund until March 1999.

The collection fees imposed from fiscal year 1994 through fiscal year 1998 amounted to $1,300,000. The department maintained these amounts in various agency accounts. The department identified the appropriate accounts and made four separate transfers totaling $1,300,000. The first transfer occurred in March 1999 and amounted to $1,000,000. As of August 1999, the department has not transferred collection fees totaling $378,000 for fiscal year 1999. By making frequent transfers, the department will help ensure that all of the collection fees are transferred and that they are coded to the proper fiscal year.

Recommendation

- *The department should transfer all collection fees to the General Fund on a regular basis.*

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Chapter 3. Payroll

Chapter Conclusions

The Department of Revenue designed and implemented internal controls to provide reasonable assurance that its payroll transactions were adequately supported, approved, and accurately reported in the state's accounting records. In addition, for the items tested, the department processed its payroll transactions in compliance with material finance-related legal provisions and applicable bargaining unit agreements.

Employee payroll represents the largest administrative expenditure for the Department of Revenue. During the "non-tax season" the department employs approximately 1,200 full and part-time employees. During the period January through April the number of staff increases to approximately 1,400. The increase is due to the department hiring additional staff to assist in processing all of the tax returns it receives during this time period.

The Department of Revenue had total payroll costs for fiscal years 1997 and 1998 of approximately $116 million. Full-time employees accounted for 89 percent of department's total payroll expenditures. Table 3-1 shows the department's payroll summarized by fiscal year and payroll description.

Table 3-1
Summary of Payroll Expenditures
Fiscal Years 1997 and 1998

Description	1997	1998
Full-time Pay	$51,072,759	$52,465,707
Part-time Pay	4,860,953	5,515,932
Separation Pay	952,168	1,014,191
Overtime Pay	176,533	225,752
Premium Pay	34,346	50,856
Total	$57,096,759	$59,272,438

Source: Minnesota Accounting and Procurement System (MAPS).

Department of Revenue employees belong to various unions that include the following compensation plans:

- American Federation of State, County, and Municipal Employees (AFSCME)
- Minnesota Association of Professional Employees (MAPE)
- Middle Management Association (MMA)
- Managerial Plan
- Commissioner's Plan

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Audit Objectives and Methodology

Our review of the department's payroll transactions focused on the following questions:

- Did the department design and implement internal controls to provide reasonable assurance that its payroll transactions were adequately supported, approved, and accurately reported in the state's accounting records?

- Did the department process its payroll transactions in compliance with material finance-related legal provisions and applicable bargaining unit agreements?

To answer these questions, we made inquiries of the department's staff to gain an understanding of the payroll and personnel process. We tested a sample of payroll transactions to ensure that there was adequate documentation and authorization for those transactions and also to determine if controls were implemented. We reviewed overtime and part-time payroll transactions to ensure the compensation amounts paid to employees were in agreement with employee union contracts. Finally, we tested the commissioner's salary to ensure it did not exceed 85 percent of

Conclusions

The Department of Revenue designed and implemented internal controls to provide reasonable assurance that its payroll transactions were adequately supported, approved, and accurately reported in the state's accounting records. In addition, for the items tested, the department processed its payroll transactions in compliance with material finance-related legal provisions and applicable bargaining unit agreements.

Chapter 4. Administrative Expenditures

Chapter Conclusions

The Department of Revenue appropriately authorized and accurately paid and recorded expenditures for professional/technical services, computer and system services, rent, and supplies and equipment. The department also properly executed contracts with outside vendors in accordance with state requirements and procedures. The department also properly recorded its fixed assets on its fixed asset system. In addition, for the items tested, the department complied with applicable finance-related legal provisions.

In addition to payroll, the department's administrative expenditures included payments for professional/technical services, computer and system services, rent, and supplies and equipment expenditures.

Contract Services

The department contracts with outside vendors and other state agencies to provide goods and services to the department. Table 4-1 shows the department's professional/technical services and computer and system services expenditures summarized for fiscal years 1997 and 1998.

Table 4-1
Summary of Contract Expenditures
Fiscal Years 1997 and 1998

Description	1997	1998
Professional/Technical Services:		
Computer Systems Development	$4,536,116	$4,515,546
General Management and Fiscal Services	1,016,865	978,979
Other	174,418	74,552
Total Professional/Technical Services	$5,727,399	$5,569,077
Computer and System Services:		
Production and Maintenance	$2,636,308	$2,702,777
Software Purchase and Rental	257,797	108,457
Total Computer and System Services	$2,894,105	$2,811,234

Source: Minnesota Accounting and Procurement System (MAPS) reports.

The department primarily used contract services for its collections and information system development divisions. The collections division utilized contracts with collection agencies to follow up on delinquent accounts. The information system development division supplemented its staff through the use of contractors or consultants to deliver computer services to the entire department. Contract services for the two years ended June 30, 1998, for the collections and information system development divisions were approximately $1.1 million and $6.4 million, respectively.

In addition, the department also incurs charges for computer services provided by the Department of Administration's Intertechnologies Group (Intertech). The department is charged for computer processing time on the state's mainframe computer and telecommunications. Intertech sends out monthly billings to the department that the information system development division staff review and approve for payment. The department spent approximately $2 million per year for Intertech's services in fiscal years 1997 and 1998.

Rent

The Department of Revenue 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 office space in such cities as Bloomington, Brainerd, and Ely. Outside of Minnesota, the department rents office space in major cities such as Chicago, Dallas, and New York City. For fiscal years 1997 and 1998, the department spent $7,004,639 and $7,465,620, respectively, to rent office space. In November 1998, the department relocated to its new building in the capitol complex area. The rent at its prior location was $560,699 per month compared to $520,693 per month in the new building.

Supplies and Equipment

The department spent $6,238,745 for various supplies and equipment purchases for the two years ended June 30, 1998. Table 4-2 shows the department's expenditures for supplies and equipment summarized by fiscal year.

Table 4-2
Summary of Supplies and Equipment Expenditures
Fiscal Years 1997 and 1998

	1997	1998
Supplies:		
Supplies, Materials, and Parts	$1,321,079	$ 916,785
Other Supplies	3,023	6,559
Total Supplies	$1,324,102	$ 923,343
Equipment:		
Computers and Peripherals	$2,158,086	$ 815,820
Other Equipment Purchases	391,181	328,791
Equipment Rental	151,912	145,510
Total Equipment	$2,701,179	$1,290,121

Source: Minnesota Accounting and Procurement System (MAPS) reports.

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Audit Objectives and Methodology

Our review of the department's administrative expenditures focused on answering the following questions:

- Did the department appropriately authorize, pay, and record administrative expenditures?
- Did the department appropriately follow state contracting requirements and procedures?
- Did the department record its fixed assets on the state's fixed asset system?
- Did the department comply with finance-related legal provisions?

To answer these questions, we made inquiries of department staff to gain an understanding of the controls over the purchasing and disbursement process for services, supplies, and equipment. We reviewed the department's bidding process and procedures used for its service contracts. We performed analytical reviews and tested a sample of contract and professional services, rent, and supplies and equipment expenditure transactions by tracing to supporting documentation and the accounting records. Transactions were tested to ensure that the department complied with finance-related legal provisions.

Conclusions

The Department of Revenue appropriately authorized and accurately paid and recorded expenditures for professional/technical services, computer and system services, rent, and supplies and equipment. The department also properly executed contracts with outside vendors in accordance with state requirements and procedures. The department also properly recorded its fixed assets on its fixed asset system. In addition, for the items tested, the department complied with applicable finance-related legal provisions.

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Status of Prior Audit Issues
As of March 31, 1999

The Office of the Legislative Auditor audits annually those Department of Revenue tax programs that are material to the State of Minnesota's Comprehensive Annual Financial Report.

Most Recent Audit

Legislative Audit Report 99-4, issued in January 1999, covered the fiscal year ended June 30, 1998. The audit scope included those areas material to the State of Minnesota's Comprehensive Annual Financial Report. This report contained one finding, which was a prior audit finding previously reported to the department. The finding stated that the department did not adequately verify the integrity of withholding taxes remitted by employers. The finding was first reported to the department in our fiscal year ended June 30, 1992, Legislative Audit Report 93-31, issued in June 1993. We will follow up on this finding in our fiscal year 1999 Statewide Audit.

Other Audit History

Legislative Audit Report 98-8, issued in February 1998, covered the fiscal year ended June 30, 1997. The audit scope included those areas material to the State of Minnesota's Comprehensive Annual Financial Report. This report contained four findings, one that was a prior audit finding previously reported to the department. Three of the four findings have been resolved. The one remaining finding is a prior audit finding and is repeated again in our Legislative Audit Report 99-4, as Finding 1.

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.

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Commissioner's Office St. Paul, Minnesota 55146-7100

October 1, 1999

Mr. James Nobles, Legislative Auditor
Office of the Legislative Auditor
1st Floor, Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The following are our responses to the findings and recommendations, concerning the Department of Revenue, that are contained in your audit report for the period July 1, 1996 through March 31, 1999.

1. The department did not reconcile collections recorded on its computer system to the corresponding deposits recorded on the Minnesota Accounting and Procurement System (MAPS).

Recommendation

- *The department should reconcile transactions posted to MATS to the deposits recorded on MAPS.*

DOR RESPONSE

Collections recorded in the MCE Account Tracking System (MATS) in fiscal years 1997 and 1998 were not reconciled to the corresponding deposits recorded in MAPS. A monthly reconciliation was completed for collections recorded in fiscal year 1999. In fiscal year 2000, we will continue to reconcile collections recorded in MATS and MAPS and strengthen the process by including fees and distributions to clients.

2. The department did not properly transfer the collection fees to the General Fund.

Recommendation

- *The department should transfer all collection fees to the General Fund on a regular basis.*

DOR RESPONSE

The collection fees imposed in fiscal years 1997 and 1998 were not transferred to the General Fund in a timely manner. Fees imposed in fiscal year 1999 were transferred to the General Fund before the MAPS FY99 closing. Effective beginning fiscal year 2000, fees will be reconciled monthly and transferred to the General Fund in two installments. The first transfer will be completed mid-year and the second before the MAPS fiscal year close.

Sincerely,

Matthew G. Smith
Commissioner

Cc: Dennis Erno, Deputy Commissioner
Steve Kraatz, Director, Revenue Accounting Division
Jerry McClure, Director, MCE Division
Jim Maurer, Manager, Office of Internal Audit