



---

**OFFICE OF THE LEGISLATIVE AUDITOR**  
**STATE OF MINNESOTA**

Financial-Related Audit

---

**Department of Revenue**  
**Administration of Property and Sales Tax Rebates**  
**Three Fiscal Years Ending June 30, 2000**



---

---

## Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

---

This document can be made available in alternative formats, such as large print, Braille, or audio tape, by calling 651-296-1727 (voice), or the Minnesota Relay Service at 651-297-5353 or 1-800-627-3529.

All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at [auditor@state.mn.us](mailto:auditor@state.mn.us)



**OFFICE OF THE LEGISLATIVE AUDITOR**  
State of Minnesota • James 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 conducted a financial related audit of the Department of Revenue's administrative expenditures for the 1997 and 1998 property tax rebate programs and the 1999 sales tax rebate program for the three fiscal years ended June 30, 2000. Our audit scope included payroll, printing, professional/technical services, computer and systems services, communications, and other expenditures identified in the state's accounting system as related to the rebate programs.

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 December 29, 2000.

*/s/ James R. Nobles*

James R. Nobles  
Legislative Auditor

*/s/ Claudia J. Gudvangen*

Claudia J. Gudvangen, CPA  
Deputy Legislative Auditor

End of Fieldwork: November 30, 2000

Report Signed On: December 21, 2000

# Department of Revenue

---

## Table of Contents

---

	Page
Report Summary	1
Chapter 1. Introduction	2
Chapter 2. Property Tax Rebate Administrative Expenditures	4
Chapter 3. Sales Tax Rebate Administrative Expenditures	8

### **Audit Participation**

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA,	Audit Manager
Scott Tjomslund, CPA	Auditor-In-Charge
Kathy Fisher	Auditor

### **Exit Conference**

This report was discussed with the following staff of the Department of Revenue at the exit conference held on December 19, 2000:

Matthew Smith	Commissioner
Dennis Erno	Deputy Commissioner

---

## Report Summary

---

### Audit Conclusions:

- The Department of Revenue incurred significant costs to administer the property tax rebates. Because the rebate was an integral part of the income tax process, determining the actual cost of administering the rebates was difficult and somewhat subjective. However, the department did not sufficiently document the methods and rationales it used to determine the actual costs of administering the rebates, or how it determined what expenditures to charge to the rebate appropriations. Without sufficient documentation, we cannot conclude with certainty that the department used the property tax rebate administrative appropriations to pay only for costs associated with the property tax rebates. The department maintains that the actual costs it incurred to administer each property tax rebate exceeded the administrative appropriations it received.
- Generally, the Department of Revenue appropriately used its 1999 appropriation to administer the 1999 sales tax rebate. However, the department inappropriately charged \$7,526 to the 1999 sales tax rebate that should have been charged to the 2000 sales tax rebate appropriation. While we were satisfied that certain of the administrative costs were appropriate charges to the sales tax rebate appropriation, the department could have done a better job in documenting the basis for those charges. Finally, the department should review its special expense policy and procedures to insure compliance.

**Financial-Related Audit Reports** address internal control weaknesses and noncompliance issues found during our audits of state departments and agencies. The scope of our work at the Department of Revenue focused on the administrative appropriations to the department for the 1997 and 1998 property tax rebate programs and the 1999 sales tax rebate program. The Laws of Minnesota for 2000, Chapter 490, Article 1, Section 3 (b) directed us, to determine whether the funds appropriated were expended consistent with the purpose of the appropriations.

# Department of Revenue

---

## Chapter 1. Introduction

---

The State of Minnesota's General Fund has experienced significant budget surpluses in recent years. In an effort to return some of the surplus to Minnesota taxpayers, the Minnesota Legislature created property and sales tax rebate programs that were administered by the Minnesota Department of Revenue.

The 1997 Minnesota Legislature established a property tax rebate for homeowners and renters. The property tax rebate was in addition to Minnesota's other property tax refund programs. The rebate was equal to 20 percent of the qualified property tax paid in calendar year 1997. It was shown as a refundable credit on a separate line of the 1997 Minnesota individual income tax return, to be filed by April 15, 1998. According to department records, over \$417 million in 1997 property tax rebates were paid.

The 1998 Minnesota Legislature also approved a property tax rebate for the 1998 income tax year. The 1998 rebate was equal to 20 percent of the qualified property tax paid in calendar year 1998. It was shown as a refundable credit and reported on a separate line of the 1998 Minnesota individual income tax return, to be filed by April 15, 1999. According to department records, almost \$410 million in 1998 property tax rebates were paid to homeowners and renters. This was the last year for the property tax rebates.

The 1999 Minnesota Legislature authorized a \$1.3 billion dollar sales tax rebate. Individual rebate amounts were computed according to a schedule established in law, which was based on income levels. Unlike the property tax rebates, the sales tax rebate was a direct payment to the taxpayers. The legislature directed the Department of Revenue to begin paying the rebates to eligible individuals by August 1, 1999. For the most part, the rebate was automatic and required no action on the part of the taxpayer. As of September 30, 1999, approximately \$1.281 billion had been rebated to eligible taxpayers.

As shown in Table 1-1, the legislature appropriated \$4,017,000 to the Department of Revenue for administration of the 1997 and 1998 property tax rebates, and \$1,257,000 for administration of the 1999 sales tax rebate.

# Department of Revenue

---

---

**Table 1-1**  
**Property and Sales Tax Rebates**  
**Administrative Appropriations**

<u>Administration of:</u>	<u>Year of Authorization</u>	<u>Fiscal Year</u>	
		<u>1998</u>	<u>1999</u>
1997 Property Tax Rebate	1997	\$2,132,000	\$ 48,000
1998 Property Tax Rebate	1998		\$1,837,000
1999 Sales Tax Rebate	1999		\$1,257,000

Note 1: The 1997 appropriation was for administration of the property tax rebate and other programs or activities established in the authorizing legislation.

Note 2: The 1999 appropriation for the sales tax rebate is available until June 30, 2001.

Source:

---

The department established separate appropriation accounts in the Minnesota Accounting and Procurement System (MAPS), the state's accounting system, for each administrative appropriation.

Laws of Minnesota 2000, Chapter 490, Article 1, Section 3(b) directed the Office of the Legislative Auditor to determine whether the administrative funds appropriated to the department were expended consistent with the purpose of the appropriations. Our audit of the administrative appropriations to the Department of Revenue focused only on the property tax rebate and sales tax rebate administrative expenditures as specified in Chapter 490. We did not review other administrative expenditures of the department. We also did not review expenditures made from a fiscal year 2000 appropriation for administration of the 2000 sales tax rebate.

Chapters 2 and 3 of this report provide our conclusions concerning the department's expenditures for administration of the 1997 and 1998 property tax rebates and the 1999 sales tax rebates, respectively.

---

## Chapter 2. Property Tax Rebate Administrative Expenditures

---

### *Chapter Conclusions*

*The Department of Revenue incurred significant costs to administer the property tax rebates. Because the rebate was an integral part of the income tax return processing, determining the actual cost of administering the rebates was difficult and somewhat subjective. However, the department did not sufficiently document the methods and rationales it used to determine the actual costs of administering the rebates, or how it determined what expenditures to charge to the rebate appropriations. Without sufficient documentation, we cannot conclude with certainty that the department used the property tax rebate administrative appropriations to pay only for costs associated with the property tax rebates. The department maintains that the actual costs it incurred to administer each property tax rebate exceeded the administrative appropriations it received.*

---

### **Background**

While considering the bill for the first property tax rebate, the Minnesota Legislature requested a fiscal note from the Department of Revenue to estimate the cost of administering the rebate. Based on its tax research, the department assumed it would receive 130,000 additional income tax returns as a result of the rebate, and that it would owe refunds to an additional 400,000 taxpayers. The department also assumed it would receive more requests for tax forms, and would have to add a line, a schedule, and instructions to the individual income tax forms.

Based on those assumptions, the department estimated the extra costs it would incur due to the rebate. Estimated costs included programming changes to its information systems; additional processing costs for more returns, more lines and schedules, and more refunds; additional costs due to increased taxpayer questions; and additional communications costs for the additional returns and for rebate publicity. The Legislature appropriated \$2.18 million to the department for administration of the property tax rebate as well as other provisions of Laws of 1997, Chapter 231.

The department created a Property Tax Rebate Budget Team to oversee the rebate appropriation. The team required each division within the department affected by the rebate to prepare detailed estimates of its additional costs due to the rebate. The divisions estimated additional costs of \$2.276 million. Based on those estimates, the team allocated the rebate appropriation to the divisions. The team instructed divisions to record a unique activity code on all expenditure transactions related to the rebate. The team also required each division that received an allocation from the rebate appropriation to present a plan for validating rebate expenditures.

The department used the same general process for the second property tax rebate. The Legislature appropriated \$1.837 million, which the budget team allocated to divisions affected by the rebate.



# Department of Revenue

## Audit Objectives and Methodology

We focused on the following objectives during our audit of the property tax rebate administrative appropriations:

- Did the department use the property tax rebate administrative appropriations to pay for the costs of administering the property tax rebates?
- Did the department incur reasonable administrative costs for the property tax rebates?

To answer these questions, we interviewed department staff to gain a general understanding of the department's process to estimate its costs related to the property tax rebates, to allocate the property tax rebate appropriations to its divisions, and to monitor expenditures from those appropriations. We also reviewed individual expenditures from the appropriations to determine if they were appropriate and reasonable costs for the property tax rebate programs.

## Audit Observations

The following Table 2-1 shows expenditures charged to each property tax rebate administrative appropriation.

Expenditures:	1997 Property Tax Rebate <sup>(1)</sup>	1998 Property Tax Rebate
Information Systems Division		
Systems Development	\$ 705,102	\$ 0
Equipment	21,803	0
Individual Income Tax Division		
Payroll – permanent staff	134,483	291,608
Payroll – seasonal staff	68,227	62,117
Printing	118,373	229,919
Other Expenses	46,020	48,353
Document Processing Division		
Payroll – permanent staff	0	240,000
Payroll – seasonal staff	247,145	216,268
Telefiling System	<sup>(2)</sup> 289,837	237,141
Equipment	0	18,725
Other Divisions		
Payroll – permanent staff	23,869	0
Payroll – seasonal staff	94,971	135,234
InterTech Charges	250,000	164,930
Postage	137,065	165,751
Other Expenses	<u>42,987</u>	<u>24,456</u>
<b>Total Expenditures</b>	<b><u>\$2,179,882</u></b>	<b><u>\$1,834,502</u></b>

(1) Includes expenditures for administration of the property tax rebate and other programs or activities established in the authorizing legislation.

(2) Includes \$49,511 in payroll for permanent staff.

Source: Minnesota Accounting and Procurement System (MAPS).

## Department of Revenue

We noted the following when reviewing expenditures charged to the administrative appropriations:

- After the department processed 1997 and 1998 individual income tax returns, it compared the number of returns filed and refunds processed each year to the comparable numbers for the 1996 tax year, which was the year before the first property tax rebate. Taxpayers submitted 177,815 additional returns for the 1997 tax year and 228,633 additional returns for the 1998 tax year. The department processed 415,533 more refunds for the 1997 tax year and 439,582 more refunds for the 1998 tax year than for the 1996 tax year. Assuming the property tax rebates caused the majority of the differences, the department's preliminary estimates of additional returns and refunds used in preparing its fiscal note were relatively accurate.
- During fiscal year 1998, the department contracted with a private vendor to implement a Telefiling system to allow taxpayers to submit individual income tax returns via telephone. The department determined that this system would offset much of the cost it would incur to process additional returns submitted for the property tax rebate, and would alleviate the impact on its existing systems. Therefore, the department used the property tax rebate appropriations to pay the costs of the Telefiling system, which totaled about \$527,000 in fiscal years 1998 and 1999. The department continued to operate the system in subsequent years, and paid the costs from its regular operating budget.
- The department's Information System Division (ISD) utilized its staff and private consultants to update existing department systems for new data, edits, and links related to the property tax rebate. ISD also developed programs to identify candidates for filing individual income tax returns electronically or through the Telefiling system. Finally, ISD developed links between the new Telefiling system and the department's existing systems and programs. The department spent about \$450,000 from the first property tax rebate appropriation to cover those costs.
- The department incurred additional refund processing and postage costs due to the increased number of refunds that resulted from the property tax rebates. The department processed refunds through the state's mainframe computer maintained by the Department of Administration's InterTech Division, which bills agencies for usage. The department estimated it cost \$1 to process and mail a single refund during the year of the first property tax rebate, \$.68 for the InterTech charges, and \$.32 for postage. It estimated it cost \$.94 to process and mail a single refund during the year of the second property tax rebate, \$.61 for the InterTech charges, and \$.33 for postage. The department charged about \$718,000 to the property tax rebate appropriations for InterTech charges and postage. Assuming the property tax rebates caused all the additional refunds, the refund processing and postage costs for the additional refunds exceeded the amount the department charged to the rebate appropriations. However, the department could not provide documentation to support its estimate for InterTech charges, but stated it had used that estimate for several years in its fiscal note process. The department did decrease the estimate for the second year of the rebate in response to

## Department of Revenue

an Informational Bulletin from the Department of Administration that stated InterTech's rates would decrease by 11 percent.

- The department initially attempted to isolate the costs associated with the property tax rebates incurred by various divisions. In reality, most of the costs incurred by divisions such as the Individual Income Tax and Document Processing Divisions were commingled with normal processing costs. Since the property tax rebate was a single line item on the individual income tax form, it was difficult to split the cost of processing that line item from the cost of processing the entire form.

The majority of the individual expenditure transactions from the rebate appropriations allocated to those divisions did not represent direct costs of the property tax rebates. The department charged about \$1.5 million in payroll costs and about \$529,000 in printing, equipment, and other costs incurred by the Individual Income Tax, Document Processing, and other divisions during fiscal years 1998 and 1999 to the property tax rebate appropriations. None of the employees paid from the rebate appropriations worked exclusively on rebate activities. Similarly, most of the non-payroll expenditures paid from the rebate appropriations were not exclusively for rebate activities.

Instead, the department used other methods to determine the actual rebate costs incurred by those divisions. It allowed the divisions to use the portion of the rebate appropriations allocated to them either for expenditures not yet paid, or to move expenditures originally paid from another source to the rebate appropriation. However, the department did not document the actual rebate costs incurred by those divisions. In addition, the department did not sufficiently document its rationale or methodology for allocating costs that benefited more than one activity to the appropriate funding sources.

## Conclusion

The Department of Revenue incurred significant costs to administer the property tax rebates. Because the rebate was an integral part of the income tax return processing, determining the actual cost of administering the rebate was difficult and somewhat subjective. However, the department did not sufficiently document the methods and rationale it used to determine the actual costs of administering the rebates, or how it determined what expenditures to charge to the rebate appropriations. Without sufficient documentation, we cannot conclude with certainty that the department used the property tax rebate administrative appropriations to pay only for costs associated with the property tax rebates. The department maintains that the actual costs it incurred to administer each property tax rebate exceeded the administrative appropriations it received.

---

## Chapter 3. Sales Tax Rebate Administrative Expenditures

---

### *Chapter Conclusions*

*Generally, the Department of Revenue appropriately used its 1999 appropriation to administer the 1999 sales tax rebate. However, the department inappropriately charged \$7,526 to the 1999 sales tax rebate that should have been charged to the 2000 sales tax rebate appropriation. While we were satisfied that certain of the administrative costs were appropriate charges to the sales tax rebate appropriation, the department could have done a better job in documenting the basis for those charges. Finally, the department should review its special expense policy and procedures to ensure compliance.*

---

### **Background**

The development of a plan to administer the sales tax rebates and to estimate the Department of Revenue's cost for administering the proposed sales tax rebate began several months before its passage into law. For example, the department concluded that between 1.6 and 2.5 million warrants would be issued to taxpayers and that the state did not have the capability to prepare, process, and clear the large number of warrants. As a result, the Minnesota Department of Administration, on behalf of the Department of Revenue, the Department of Finance, the State Treasurer, and the State Board of Investment sent out a Request for Proposal (RFP). The proposal was for the possibility of printing, personalizing and mailing of rebate warrants combined with a self-mailer, and for controlled disbursement banking services. Of the six proposals received, Norwest Bank Minnesota, in a joint bid with Moore Business Communication Services, submitted the successful proposal.

In addition, the department prepared a fiscal note in which it estimated \$1.257 million as its one-time cost to administer the sales tax rebate. The 1999 Legislature appropriated \$1.257 million to the Department of Revenue to administer the sales tax rebate for fiscal year 1999.

### **Audit Objectives and Methodology**

Our review of the department's expenditures relating to its administration of the 1999 sales tax rebates focused on the following questions:

- Did the department use the 1999 sales tax rebate administrative appropriation to pay for the costs of administering the 1999 sales tax rebate?
- Did the department incur reasonable administrative costs for the 1999 sales tax rebate?

## Department of Revenue

To answer these questions, we interviewed department employees to gain an understanding of the department's process in preparing fiscal notes, establishing appropriation accounts within the state accounting system, tracking expenditures, selecting certain vendors under the RFP (request for proposal) process, and using the department's special expense provisions. We reviewed the RFP proposals and the subsequent agreement with Norwest Bank Minnesota. We tested payroll transactions to determine that payroll recorded on the State Employee Management System (SEMA4) for the 1999 sales tax rebate related to the program. We selected and reviewed supporting documentation for a sample of expenditures charged to the sales tax rebate account to determine if expenditures were appropriate.

### Audit Observations

The department established a separate appropriation account in MAPS for the 1999 sales tax rebate administrative appropriation. Table 3-1 shows that the department spent \$1,176,336 out of its appropriation to administer the 1999 sales tax rebate as of June 30, 2000.

---

---

**Table 3-1**  
**1999 Sales Tax Rebate**  
**Administrative Expenditures**  
**Budgetary Basis through June 30, 2000**

<u>Expenditures:</u>	<u>Sales Tax Rebate</u> <u>1999</u>
Payroll	\$ 136,515
Printing and Advertising	264,694
Professional/Technical Services	162,300
Computer Services	135,677
Communications	455,056
Other	<u>22,094</u>
Total	<u>\$1,176,336</u>

Source:

---

We noted the following observations when reviewing expenditures charged to the 1999 sales tax rebate administrative appropriation:

- Payroll costs of \$136,515, or 12 percent of total expenditures, were reviewed and deemed appropriate except that we noted an employee was overpaid \$464 as of June 30, 2000. The department subsequently recovered the overpayment. Additionally, the department indicated that payroll costs for temporary staff in the Sales Tax and Income Tax Divisions providing sales tax rebate support were not funded out of the sales tax rebate administrative appropriation.
- Printing and advertising expenditures were reviewed, including the \$203,434 payment to Norwest Bank, and determined to be appropriate.

## Department of Revenue

- Professional/technical services of \$162,300 represented services provided through Revenue's Information Systems Division for the 1999 sales tax rebate programming costs and were determined to be appropriate.
- Computer services of \$130,000 were paid to the Department of Administration's InterTechnologies Group. Of this amount, \$125,250 of expenditures initially charged to the department's Income Tax Division were subsequently determined to be 1999 sales tax rebate expenditures. The department posted an expenditure correction moving the expenditure to the 1999 sales tax rebate administrative appropriation. The remaining \$5,677 expenditure related to the 2000 sales tax rebate and should not have been paid out of the 1999 sales tax rebate appropriation. The department needs to make the appropriate correction.
- Communication expenditures of \$455,056 were for postal, mailing and shipping services, as well as telephone watt lines and other network services. The largest single expenditure was for \$275,000 to Moore Business Communication Services under the joint contract with Norwest Bank. We reviewed this expenditure and determined it to be appropriate.
- Other expenditures consist of travel, supplies, materials, equipment and other purchased services. We noted two expenditures totaling \$1,849 that related to the 2000 sales tax rebate, but were paid out of the 1999 sales tax rebate administrative appropriation. The department needs to make the appropriate corrections.

In addition, we also reviewed 16 expenditures totaling \$3,134 made under the department's "Special Expenses" policy. We noted that none of the 16 "Requests for Approval to Incur Special Expenses" forms had prior approval as required by department policy. All 16 requests indicated that the special expenses were work related. However, we could not determine from this description the nature or extent of the work to distinguish it from "routine staff meetings." The department's policy does not allow a special expense for routine staff meetings. The department should review its Special Expense policy periodically to ensure that it is being appropriately followed and used as intended.

- Finally, we were able to satisfy ourselves as to the appropriateness of, and in some cases, the existence of, supporting documentation as the audit progressed. However, we were concerned with the department's level of effort needed to produce or provide us with explanations or additional documentation to support certain expenditure types. For example, the department used expenditure corrections to allocate a portion of certain costs originally paid out of other appropriation accounts to the 1999 sales tax rebate. However, the reason for the expenditure correction was not always readily available. By their nature, expenditure corrections represent a process to correct or allocate costs based on a set of circumstances or assumptions. Those circumstances or assumptions should be appropriately described and documented.

## **Department of Revenue**

### **Conclusion**

Generally, the Department of Revenue appropriately used its 1999 administrative appropriation to administer the 1999 sales tax rebate. However, the department inappropriately charged \$7,526 to the 1999 sales tax rebate that should have been charged to the 2000 sales tax rebate appropriation. While we were satisfied that certain of the administrative costs were appropriate charges to the sales tax rebate appropriation, the department could have done a better job in documenting the basis for those charges. Finally, the department should review its special expense policy and procedures to ensure compliance.