



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Office of the Attorney General
July 1, 1999, through December 31, 2000



MAY 24, 2001

01-27

Financial Audit Division

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

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

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

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

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

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

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

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

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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



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

The Honorable Mike Hatch
Attorney General

We have conducted a financial-related audit of the Office of the Attorney General for the period January 1, 1999, through December 31, 2000. Our audit scope included funding sources and other revenue, payroll expenditures, employee business and travel expense reimbursements, and purchased goods and services.

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 Office of the Attorney General complied with provisions of laws, regulations, and contracts that are significant to the audit. The office's management is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of the Attorney General. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 24, 2001.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 30, 2001

Report Signed On: May 21, 2001

Office of the Attorney General

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Thomas Donahue, CPA	Audit Manager
Susan Rumpca, CPA	Auditor-in-Charge
George Deden, CPA	Auditor
Jess Frenzel	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of the Attorney General at an exit conference held on May 10, 2001.

Rebecca Spartz	Director of Administration
Terry Pohlkamp	Director of Fiscal Services
Sandra Caron	Director of Human Services
Pat Gallatin	Docketing Supervisor
Susan Jaeger	Fiscal Services

Report Summary

Overall Conclusions:

The Attorney General's Office (AGO) properly collected, deposited, and recorded revenue for AGO services, fines, restitutions, and settlements in the state's accounting system. The Attorney General's Office also properly authorized payroll, employee business and travel expense reimbursements, and disbursements for the purchase of goods and services and accurately recorded those transactions in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and the bargaining unit agreements except for the findings indicated below.

Key Findings and Recommendations:

- **PRIOR FINDING NOT RESOLVED:** The Attorney General's Office did not bill its full cost for legal services provided to state agencies for non-general funded activities. The Attorney General's Office should bill the full cost of providing legal services to state agencies for non-general funded activities or seek a statutory revision to Minn. Stat. Section 8.15, subd. 5. (Finding 1, page 6)
- The Attorney General's Office used the incorrect liability date when entering expenditures into the accounting system. The Attorney General's Office should enter the date it received the goods and services as the record date. (Finding 2, page 10)

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 Office of the Attorney General included funding sources and other revenue, payroll expenditures, employee business and travel expense reimbursements, and purchased goods and services. The Office of the Attorney General's response to our recommendations is included in the report.

Office of the Attorney General

Chapter 1. Introduction

The Office of the Attorney General (AGO) was established by Article V of the constitution of the State of Minnesota. The mission of the AGO is to protect the interests of Minnesota citizens through law enforcement, agency representation, and defense of claims.

The Attorney General is a member of the Executive Council, the Pardons Board, the Land Exchange Board, and the State Board of Investment. Mike Hatch was elected to a four-year term as Minnesota's Attorney General in November 1998. He took office on January 4, 1999.

Table 1-1 provides a summary of the AGO's expenditure activity for fiscal year 2000.

Table 1-1
Summary of Expenditures by Fund
Fiscal Year 2000

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Other Funds</u>
Expenditures:			
Payroll	\$25,912,404	\$1,262,202	\$430,500
Travel	211,565	23,337	0
Rent	2,957,273	89,636	0
Supplies and Equipment	1,184,785	19,014	0
Purchased Services	1,260,849	186,681	9,591
Claims	415,751	14,737	1,149,090
Other	<u>182,070</u>	<u>951,705</u>	<u>0</u>
Total	<u>\$32,124,697</u>	<u>\$2,547,312</u>	<u>\$1,589,181</u>

Source: Financial information obtained from the state's accounting system.

On May 8, 1998, the Attorney General's Office, on behalf of the State of Minnesota, reached an out-of-court settlement with the tobacco industry. As a result of that court-approved settlement, the State of Minnesota was awarded approximately \$6.4 billion to be distributed over 25 years. During the audit period, the AGO received \$166 million in tobacco settlement funds and deposited them to the state's General Fund. The Attorney General's Office did not have access to tobacco settlement funds for its own use. Beginning during fiscal year 1999, the tobacco companies sent settlement funds directly to the agencies responsible for administering those funds.

Chapter 2. Funding Sources and Other Revenue

Chapter Conclusions

The Attorney General's Office properly collected, deposited, and recorded revenue for AGO services, fines, restitutions, and settlements in the state's accounting system. In addition, for the items tested, the Attorney General's Office complied with material finance-related legal provisions relating to fines, restitutions, and settlements. However, the AGO did not bill for the full cost of services for non-general funded activities.

The Office of the Attorney General has a unique and fairly complex funding mechanism, which reflects practices developed over the last decade. In the past, the AGO was funded solely by a General Fund appropriation. Currently, the AGO is funded by a General Fund appropriation and dedicated receipts from partner agencies that are major users of legal services. The funding process has included input from many agencies with differing viewpoints and perspectives, such as the Legislature, the Department of Finance, state departments and agencies, and other constituencies served by the AGO.

The budget of the AGO includes the cost of providing legal services to state agencies, quasi-state agencies, and political subdivisions. During fiscal year 2000, the AGO received a General Fund appropriation of \$25.5 million and collected approximately \$13 million in dedicated receipts. The General Fund appropriation covered legal services to "pooled agencies." Pooled agencies are state agencies that do not have an agreement with the AGO for legal services. Pooled agencies were required to pay the AGO for legal services rendered in connection with non-general funded activities. These reimbursements were not appropriated to the AGO but were deposited to the State's General Fund as non-dedicated receipts. The AGO sent billings for all services to the pooled agencies. The billings for general funded activities were informational only since the AGO's appropriation funded the services. During fiscal year 2000, pooled agencies reimbursed the General Fund approximately \$13.2 million.

Alternatively, some agencies paid the AGO directly for legal services. These agencies were called "partners." Minn. Stat. Section 8.15, subd. 3, provides the authority for the AGO to enter into agreements with state departments and agencies for legal services. The AGO and the partner agencies worked together to determine the anticipated need for legal services. The AGO established an agreement with each partner agency specifying terms and conditions. The agreements varied from partner to partner depending on the needs of each particular agency. Some partner agencies were required to pay an additional amount for all services provided in excess of an agreed-upon level. Some partner agencies were refunded a portion of the agreement amount if the AGO provided services below an agreed-upon level. Although it varied with each agreement, as a general rule, the AGO does not "settle up" at fiscal year end for differences

Office of the Attorney General

between actual and estimated services since the current level of services provided becomes the primary consideration for the next year's agreement.

The cost of legal services for a state agency that had an agreement with the AGO was generally provided for within that partner agency's budget. The partner agency then remitted the agreed-upon amount to the AGO based on the agreement terms. Partner agencies either paid by interagency payments or by appropriation transfers. In accordance with Minn. Stat. Section 8.15, subd. 3, funds received under the agreements were collected and deposited to the General Fund and were appropriated to the AGO. Fees in excess of the agreement amounts were not appropriated to the AGO but were deposited to the state's General Fund as non-dedicated receipts.

During fiscal year 2000, the AGO had partner agreements with 20 agencies. As shown in Table 2-1, the AGO received approximately \$13 million from partner agencies during fiscal year 2000. These amounts were consistent with the agreements signed with the agencies. The AGO actually provided 169,507 billable hours of legal services under those agreements, slightly less than the projected level of services. Overall, as shown in Table 2-1, the AGO collected slightly less than the estimated amounts reflected in the agreements.

Table 2-1
Partner Projected Services and Payments
Fiscal Year 2000

<u>Agency</u>	<u>Services Projected Under Agreement</u>	<u>Partner Payments per Agreement</u>
Administration - Risk Management	\$ 150,000	\$ 146,799
Agricultural Utilization Research Institute	10,000	12,956
Department of Children, Families & Learning	1,326,000	1,255,152
Department of Corrections	145,275	133,624
Department of Finance	41,000	35,666
Department of Health	905,500	897,131
Higher Education Services Office	12,300	12,530
Housing Finance Agency	430,500	477,550
Department of Human Services	1,954,500	1,899,573
Iron Range Resources and Rehabilitation Board	61,500	61,500
Medical Practices Board	1,416,000	928,166
Minnesota State Retirement System	27,650	23,074
MnSCU	1,628,150	1,447,315
Department of Natural Resources	1,618,600	1,590,404
Petroleum Tank Release Compensation Board	123,000	120,344
Pollution Control Agency	1,850,250	1,887,654
Public Employees Retirement Association	67,150	72,505
Department of Public Safety	123,000	123,000
Teachers Retirement Association	23,700	42,134
Department of Transportation	<u>1,770,000</u>	<u>1,906,813</u>
Total	<u>\$13,684,075</u>	<u>\$13,073,890</u>

Source: Auditor prepared from AGO service hours report submitted to the Legislature, per Minn. Stat. Section 8.15, subd. 4.

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Table 2-2 shows the hourly rates the AGO charged for legal services under the partner agreements.

Table 2-2
AGO Billing Rates
Fiscal Year

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Attorneys	\$79	\$82	\$84
Legal Assistants	\$60	\$57	\$59

Source: Office of the Attorney General Billing Rate History. These rates were determined in consultation with the Commissioner of Finance as required by Minn. Stat. Section 8.15, subd. 1.

During the audit period, the AGO maintained a billing system to track attorney and legal assistant charges. The AGO sent out monthly invoices and informational reports to both partner and pooled agencies for general and non-general funded activities. The agencies used the reports to monitor the legal services provided by the AGO.

The AGO also collected and deposited fines, restitutions, and settlement payments received as a result of court cases. The AGO deposited the fines and most settlements to the state's General Fund as non-dedicated receipts. The office deposited most restitution payments to an agency fund and later distributed the funds to the claimants specified in the respective court orders. During fiscal year 2000, the AGO collected and deposited approximately \$666,000 in fines, \$1.8 million in restitutions, and \$808,000 in settlements. It paid over \$1.5 million to claimants in fiscal year 2000.

Audit Objectives and Methodology

Our review of funding sources and other revenue focused on the following questions:

- Did the AGO properly collect, deposit, and record revenue for AGO services, fines, restitutions, and settlements in the state's accounting system?
- Did the AGO comply with material finance-related legal provisions relating to AGO services, fines, restitutions, and settlements?

To answer these questions, we interviewed AGO employees to gain an understanding of the process used to bill, collect, deposit, and record revenue. We reviewed a sample of partner agency agreements and accounting records to determine if the AGO received all the revenue it was entitled to receive under the agreements. We reviewed the determination of the attorney and legal assistant billing rates to determine if the process was systematic and reasonable and complied with applicable legal provisions. We also reviewed the process of making restitution payments to claimants according to a court order.

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Conclusions

The Attorney General's Office properly collected, deposited, and recorded revenue for AGO services, fines, restitutions, and settlements in the state's accounting system. In addition, for the items tested, the Attorney General's Office complied with material finance-related legal provisions relating to fines, restitutions, and settlements. However, as explained in Finding 1, the AGO did not bill for the full cost of services for non-general funded activities.

1. PRIOR FINDING NOT RESOLVED: The AGO did not bill its full cost for legal services provided to state agencies for non-general funded activities.

The AGO did not bill its full cost for legal services provided to state agencies for non-general funded activities. The AGO used calculated hourly billing rates for attorneys and legal assistants as the mechanism to recover the costs of legal services provided. However, when the AGO calculated the rates, it did not include rent expenditures and a one-time information technology appropriation in the calculation.

Minn. Stat. Section 8.15, subd. 1, provides that the AGO, in consultation with the commissioner of Finance, shall develop a fee schedule to be used by the AGO in developing the (partner) agreements. Minn. Stat. Section 8.15, subd. 5, provides that:

State agencies receiving legal services from the attorney general for nongeneral funded activities shall reimburse the full cost of those services to the general fund based on periodic billings prepared by the attorney general. Payment must be made to the attorney general for deposit to the general fund as a nondedicated receipt. The attorney general, in consultation with the commissioner of finance, shall develop reimbursement policies and procedures related to legal services.

For several years, the AGO has debated the issue of billing rates for attorneys and legal assistants. Many discussions have taken place both internally and with the Department of Finance regarding the cost elements to be included in these calculations. Although this issue has not been resolved, the predominant opinion within the AGO was that rent does not represent recoverable expenditures but rather a fixed cost that the General Fund incurs. However, the statutes direct the AGO to bill the full cost of services provided to agencies for non-general funded activities. The concept of full cost includes both direct and indirect costs associated with providing legal services.

Recommendation

- *The Attorney General's Office should bill the full cost of providing legal services to state agencies for non-general funded activities or seek a statutory revision to Minn. Stat. Section 8.15, subd. 5.*

Chapter 3. Payroll and Employee Travel Expense Reimbursements

Chapter Conclusions

The Attorney General's Office properly authorized and accurately recorded payroll and employee business and travel expense reimbursements in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and the bargaining unit agreements over payroll and employee business and travel expense reimbursements.

The Attorney General's Office expended approximately \$28 million on payroll during fiscal year 2000. Payroll was the largest expenditure category for the AGO. It consisted of regular pay, part-time pay, overtime pay, separation pay, and other benefits. Employees under the prior administration left employment during the audit period, resulting in separation and grievance payments. The Attorney General's Office currently employs approximately 440 full-time or part-time employees. AGO employees are represented by various compensation plans or bargaining units based on their position within the office. Most AGO employees follow the Attorney General's Plan. Other employees are covered by the American Federation of State, County, and Municipal Employees (AFSCME), Middle Management Association (MMA), or Minnesota Association of Professional Employees (MAPE).

The AGO expended approximately \$235,000 on employee business and travel expense reimbursements during fiscal year 2000. The AGO reimbursed employees for travel expenses consisting of mileage, parking, lodging, and other miscellaneous expenditures incurred for business purposes. The AGO also paid travel expenditures directly to vendors. These expenditures included car rentals, lodging, and airplane rentals.

Audit Objectives and Methodology

Our review of payroll and employee business and travel expense reimbursements focused on the following questions:

- Did the AGO properly authorize payroll and employee business and travel expense reimbursements and accurately record the expenditures in the state's accounting records?
- Did the AGO comply with material finance-related legal provisions and the bargaining unit agreements over payroll and employee business and travel expense reimbursements?

To answer these questions, we analyzed personnel and payroll transactions and employee business and travel expense reimbursements. We interviewed AGO employees to gain an

Office of the Attorney General

understanding of the personnel and payroll processes and also the employee business and travel expense reimbursement process. We tested a sample of the AGO's payroll transactions and employee business and travel expense reimbursements to determine if they were properly authorized, adequately supported, and accurately recorded. We also tested a sample of pay rate changes to determine if they complied with bargaining unit provisions.

Conclusions

The Attorney General's Office properly authorized and accurately recorded payroll and employee business and travel expense reimbursements in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and the bargaining unit agreements over payroll and employee business and travel expense reimbursements.

Chapter 4. Purchased Goods and Services

Chapter Conclusions

The Attorney General's Office properly authorized the purchase of goods and services and accurately recorded expenditures in the state's accounting records. However, the AGO used the incorrect liability date when entering expenditure transactions in the accounting system. In addition, for the items tested, the office complied with material finance-related legal provisions over the purchase of goods and services and adequately safeguarded its assets.

The Attorney General's Office expended approximately \$3 million in rent, \$1.2 million in supplies and equipment, and \$1.5 million in services during fiscal year 2000. The AGO rent expenditures were primarily for leased space in three buildings in St. Paul. The office signed multi-year leases that defined the terms of agreement. During the audit period, the AGO's main purchases were computers, modular furniture, office equipment, office supplies, and publications for its law library. It also purchased expert witness services, technology and communications services, and consultant services.

Audit Objectives and Methodology

- Did the AGO properly authorize the purchase of goods and services and accurately record expenditures in the state's accounting records?
- Did the AGO comply with material finance-related legal provisions over the purchase of goods and services?
- Did the AGO adequately safeguard its assets?

To answer these questions, we analyzed purchased goods and services expenditures. We interviewed AGO employees to gain an understanding of the process used to purchase goods and services, including the process to ensure receipt of goods and services before payment. We tested a sample of expenditure transactions to determine if they were properly authorized, adequately supported, and accurately recorded. We determined if a sample of expenditure transactions complied with purchasing guidelines and prompt payment guidelines. In addition, we determined if the AGO adequately safeguarded assets.

Office of the Attorney General

Conclusions

The Attorney General's Office properly authorized the purchase of goods and services and accurately recorded expenditures in the state's accounting records. However, as discussed in Finding 2, the AGO used the incorrect liability date when entering expenditure transactions in the accounting system. In addition, for the items tested, the office complied with material finance-related legal provisions over the purchase of goods and services and adequately safeguarded its assets.

2. The Attorney General's Office used the incorrect date when entering expenditure transactions in the accounting system.

The Attorney General's Office used the incorrect liability date when entering expenditures into the accounting system. For nearly all transactions tested, the office entered the invoice date as the record date rather than the date it received the goods or services. Department of Finance policies require that the office enter the date it received the goods or services as the record date. Finance uses this date to accumulate information for financial reporting purposes.

Recommendation

- *The Attorney General's Office should enter the date it received the goods and services as the record date.*

**Status of Prior Audit Issues
As of March 30, 2001**

Most Recent Audit

Legislative Audit Report 99-49, issued in September 1999, covered AGO funding sources and revenues, payroll, and other expenditures for the period January 1, 1997, through December 31, 1998. The report contained one finding regarding billing rates. The Office of the Attorney General continues to work with the Department of Finance to establish a process to determine appropriate billing rates that ensure the full recovery of legal service costs to the General Fund for non-general funded services. However, full compliance has not yet been accomplished. See our current Finding 1 in Chapter 2.



STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

May 17, 2001

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MIKE HATCH
ATTORNEY GENERAL

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

Re: ATTORNEY GENERAL AUDIT

Dear Mr. Nobles:

Thank you for the opportunity to respond to the recommendation provided in your recent financial audit of the Attorney General's Office. This audit covered activities in the AGO during the two-year period ending December 31, 2000.

Enclosed is my Office's response to the recommendation your auditors made about billing rates and the need to use a more accurate liability date on purchased goods and services.

As usual it has been a pleasure for our staff to work with your audit team. If my Office can be of further assistance, please contact my Director of Administration, Rebecca Spartz, or me.

Very truly yours,

/s/ Mike Hatch

MIKE HATCH
Attorney General

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OFFICE OF THE ATTORNEY GENERAL

RESPONSE TO AUDIT FINDINGS

January 1, 1999 - December 31, 2000

Chapter 2. Funding Sources and Other Revenues

AGO Billing Rates - Finding

1. The AGO did not bill its full cost for legal services provided to state agencies for non-general funded activities.

Recommendation

The AGO should bill the full cost of providing legal services to state agencies for non-general funded activities.

Response

The AGO and the Department of Finance have discussed this issue, most recently during the second AGO Funding Task Force and the development of proposed billing rates for FY 2002-2003. The issue is a difficult one to resolve because of the interplay of funds received from other agencies in payment for legal services and funds appropriated directly to the AGO. The Office will revisit this issue and make a determination as to whether it will seek a statutory revision to Minn. Stat. 8.15, subd. 5.

Chapter 4. Purchased Goods and Services

Finding: The AGO used the incorrect date when entering expenditure transactions in the accounting system.

Response

During the field work portion of the audit of the Attorney General's Office audit staff informed AGO staff about certain transaction input errors. These errors occurred because the employee entering payment transactions allowed the accounting system to provide default record dates rather than actual receipt dates. AGO staff began using correct receipt dates immediately after audit staff brought this concern to their attention.