



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Office of the State Auditor
January 1, 1999, through December 31, 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



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 Judith Dutcher
State Auditor

We have audited the Office of the State Auditor for the period January 1, 1999, through December 31, 2000. Our audit scope included audit practice receipts, payroll, and other administrative expenditures including rent, travel, and supplies and equipment, as well as appropriation control.

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 State Auditor complied with provisions of laws, regulations, and contracts that are significant to the audit. The management of the Office of the State Auditor 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 Office of the State Auditor. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 31, 2001.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: May 4, 2001

Report Signed On: May 24, 2001

Office of the State Auditor

Table of Contents

	Page
Report Summary	1
Chapter 1. Introduction	2
Chapter 2. Appropriation Control	4
Chapter 3. Audit Practice Revenue	6
Chapter 4. Payroll and Other Administrative Expenditures	8
Status of Prior Audit Issues	11

Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
John Hakes, CPA	Auditor

Report Summary

Overall Audit Conclusion:

The Office of the State Auditor (OSA) appropriately managed its financial operations and ensured that its revenues and expenditures were accurately accounted for and in compliance with applicable legal requirements. The OSA spent its state appropriation within its appropriation authority.

Our audit scope included a review of the OSA's appropriation, audit practice revenue, personnel services, and administrative expenditures for the period from January 1, 1999, through December 31, 2000.

Agency Background:

The OSA was established by Article V of the State Constitution and operates under Minnesota Statute Chapter 6. Minnesota voters elect the State Auditor to a four-year term. Judith Dutcher has served as State Auditor since January 1995 and is currently in her second term. The mission of the OSA is to help ensure financial integrity, accountability, and cost-effectiveness in over 4,300 governmental entities throughout the state. The State Auditor also serves on the State's Executive Council, State Board of Investment, Land Exchange Board, State Housing Finance Agency Board, Rural Finance Administration Board, the Public Employees Retirement Association Board, and the Board of Government Innovation and Cooperation.

The OSA receives support for its operations in the form of state appropriations. Minn. Stat. Section 6.58 requires the OSA to bill audit clients for the costs of audits and examinations at a rate sufficient to cover the cost of its audits. The audit practice receipts collected from clients are deposited as nondedicated receipts.

Chapter 1. Introduction

The OSA was established by Article V of the State Constitution and operates under Minn. Stat. Chapter 6. Minnesota voters elect the State Auditor to a four-year term. Judith Dutcher is the current State Auditor. She began her second term in January 1999. The State Auditor serves on the State's Executive Council, State Board of Investment, Land Exchange Board, Minnesota State Housing Finance Agency Board, Rural Finance Authority Board, Public Employees Retirement Association Board, and the Board of Government Innovation and Cooperation.

The OSA is divided into six divisions:

- The Constitutional Office Division oversees the operation of the Office of the State Auditor.
- The Audit Practice Division conducts financial and legal compliance audits for 86 counties; the cities of Duluth, Minneapolis, and St. Paul; and organizations affiliated with counties and cities. In addition, this division annually reviews approximately 450 single audit reports submitted by cities, counties, school districts, nonprofit agencies, and other agencies for compliance with federal reporting requirements and generally accepted government auditing standards.
- The Government Information Division promotes financial accountability and cost effective public services in local governments. The division prescribes the chart of accounts and reporting requirements for cities and towns.
- The Special Investigations Division promotes integrity and accountability in local government by investigating allegations of financial wrongdoing.
- The Pension Division monitors investment, financial, and actuarial reporting for public pension funds to ensure financially stable retirement systems and compliance with Minnesota statutes governing these activities.
- The Tax Increment Financing Division audits and monitors the financial condition and legal compliance of tax increment financing districts throughout the state. The division collects and analyzes financial information that local governments are required to report annually regarding their use of tax increment financing.

The OSA's activities are financed primarily through General Fund appropriations. The OSA's appropriations for fiscal years 1999, 2000, and 2001 were \$7,916,000, \$8,967,000, and \$9,311,000, respectively. We discuss appropriations more fully in Chapter 2.

Minn. Stat. Section 6.58 requires that the OSA collect fees from audited organizations to cover the cost of its audits. The Audit Practices Division bills the political subdivisions it audits based on a fee schedule that OSA adjusts annually if necessary. According to Minn. Stat. Section

Office of the State Auditor

16A.6701, the fees collected for audit services are deposited in the General Fund. We discuss the audit practice revenue in Chapter 3.

The OSA incurs administrative costs in carrying out its statutory responsibilities. Payroll is the most significant administrative cost. Other material costs include rent, supplies and equipment, and travel. We discuss OSA expenditures in Chapter 4.

Table 1-1 summarizes the financial activity of the OSA for fiscal year 2000.

**Table 1-1
Summary of OSA Financial Activity**

	<u>Fiscal Year 2000</u>
Sources:	
General Fund:	
Operating Appropriation ⁽¹⁾	\$8,967,000
Balance Forward In – TIF Account ⁽¹⁾	720,331
Special Revenue Fund:	
Dedicated Revenue ⁽²⁾	24,800
Balance Forward In	7,719
Total Sources	<u>\$9,941,569</u>
Uses:	
Expenditures:	
Payroll	\$7,809,742
Rent	346,448
Travel	174,537
Supplies	115,733
Capital Equipment	150,612
Miscellaneous Expenditures	240,205
Total Expenditures	<u>\$8,837,277</u>
Other Uses:	
Balance Forward Out – General Fund	1,094,330
Balance Forward Out – Special Revenue Fund	598
Transfer Out	9,364
Total Other Uses	<u>\$1,104,292</u>
Total Uses	<u>\$9,941,569</u>

Notes:

(1) Minn. Stat. Section 469.177, subd. 11 created the tax increment financing (TIF) division. The division received funding from a .25 percent charge on TIF districts. The State Treasurer collects the funds, deposits the money in the General Fund, and transfers the funds to the Office of the State Auditor. This funding appropriation does not cancel and remains available until spent.

(2) Dedicated revenue is collected for seminar and workshop activities.

Source: Minnesota Accounting and Procurement System.

Chapter 2. Appropriation Control

Chapter Conclusions

The Office of the State Auditor complied with appropriation laws and operated within its legally authorized funding level. Expenditures were recorded properly on the state's accounting system. Residual funds were canceled or carried forward as required by law.

Background

The OSA received funding for its operations through a General Fund appropriation. The OSA allocates the appropriation to five operating divisions and accounts for expenditures by division. Table 2-1 summarizes financial activity for these divisions for fiscal year 2000.

Table 2-1
Summary of General Fund Appropriation
Allocation for Fiscal Year 2000

<u>Division</u>	<u>Appropriation</u>	<u>Amount Expended</u>	<u>Balance Forward to FY 2001</u>
Audit Practice (includes Single Audit)	\$6,870,000	\$6,313,391	\$556,609
Government Information	632,000	574,946	57,054
Special Investigations	539,000	490,661	48,339
Constitutional Office	327,000	309,479	17,521
Pension	<u>599,000</u>	<u>415,509</u>	<u>183,491</u>
Total Appropriation	<u>\$8,967,000</u>	<u>\$8,103,986</u>	<u>\$863,014</u>

Source: Minnesota Accounting and Procurement System.

The portion of the OSA appropriation that is spent on oversight of police and fire pension funds and the government information function reduces police and fire state aid and local government aid administered by the Department of Revenue. In accordance with Minn. Stat. Section 477A.014, subd. 4, the OSA certifies costs related to the government information function to the Department of Revenue for a reduction in local government aids. The local government aid offset is limited to \$217,000 per year. The OSA also certifies costs related to the Pension Division to the Department of Revenue in accordance with Minn. Stat. Section 69.021, subd. 5. The Department of Revenue reduces police and fire state aids by the amount of OSA costs associated with the audits or exams of the police and firefighters relief associations.

Office of the State Auditor

In addition to the General Fund appropriation, the OSA receives funding for the cost of examining the use of tax increment financing (TIF). Under Minn. Stat. Section 469.177, subd. 11, the TIF division received funding from a .25 percent charge on tax increment financing districts in fiscal year 2000. The Office of the State Treasurer collects the funds from the county treasurers, deposits the money in the General Fund, and subsequently transfers the funds to the OSA. TIF revenue collections in fiscal year 2000 totaled \$720,331. Total TIF division expenditures in fiscal year 2000 were \$708,900. The division carried forward \$231,315 to fiscal year 2001.

Audit Objectives and Methodology

Our audit of OSA appropriations addressed the following questions:

- Did the office comply with appropriation laws?
- Were expenditures properly recorded in the accounting system?
- Were residual funds canceled, carried over, or transferred as required by law?

To answer these questions, we reviewed appropriation laws and accounting system summary information and supporting documentation. We discussed appropriation activity with OSA personnel. We also used computer software to analyze financial data.

Conclusions

The Office of the State Auditor complied with the provisions of the appropriation laws and operated within its legally authorized funding level. Expenditures were properly recorded in the accounting system. Residual funds were administered in the proper manner required by law.

Chapter 3. Audit Practice Revenue

Chapter Conclusions

The OSA properly processed and collected audit practice receipts. The method for generating client billings was accurate and supported by properly updated accounts receivable control and subsidiary claims ledgers.

Our analysis showed the OSA complied with Minn. Stat. Section 6.58 that requires the OSA to establish charges for examinations at a level sufficient to cover the costs of such examinations.

Background

The OSA is responsible for collecting fees from audited organizations to recover audit costs. Minn. Stat. Section 6.58 states that the General Fund shall be used to provide personnel, pay other expenditures, and to acquire equipment used in connection with reimbursable examinations and other duties pursuant to law.

The law also states that the OSA shall review and adjust the schedule of charges for such examinations at least annually to ensure that the amount collected is sufficient to pay all costs connected with such examinations during the fiscal year. In August 2000, the Department of Finance approved an hourly rate increase for the OSA that took effect in January 2001. The increase will result in all audit class rates going up by \$1 to \$2 dollars per hour.

The OSA, by authority of Minn. Stat. Section 16A. 6701, deposits audit practice receipts into a special revenue account. These receipts, however, are not available for expenditure by the OSA, as its spending is limited to the appropriation authority discussed in Chapter 2.

For fiscal year 2000, the OSA collected approximately \$6,011,000 in audit practice receipts coded to budget fiscal year 2000. OSA bills audit clients with current work-in-progress on a monthly basis. The basis for billing a client includes approved audit charges and travel costs. The OSA has the authority to charge interest on delinquent accounts of undisputed bills that are 60 days past due.

Audit Objectives and Methodology

The primary objective of our audit of audit practice revenues was to answer the following questions:

- Did the Office of the State Auditor properly collect and deposit audit practice receipts?

Office of the State Auditor

- Was the method for summarizing employee hours and related travel costs accurate?
- Were billings accurate and sufficient to recover audit practice costs?

To answer these questions, we interviewed office employees to gain an understanding of the internal control structure over the billing and collection process. We tested the client billing and accounts receivable process to determine whether billed amounts were substantiated. We also analyzed audit practice revenue transactions and supporting documentation for proper authorization, recording, collection, and deposit of client payments pursuant to Minnesota statutes. Finally, we performed a cost recovery analysis to assess whether the OSA recovered its costs for the audit examinations it conducts.

Conclusions

The Office of the State Auditor properly billed clients for audit examinations performed. The OSA properly processed, collected, and deposited audit practice receipts. The OSA also generated sufficient revenues to recover reimbursable audit costs as required by Minn. Stat. Section 6.58, and it completed an annual overall evaluation of revenues and expenditures to determine the accuracy of its billing rates.

Chapter 4. Payroll and Other Administrative Expenditures

Chapter Conclusions

The OSA appropriately processed and recorded payroll and other administrative expenditure transactions. The expenditures were allocated to the appropriate divisions. The OSA complied with applicable finance-related legal provisions and bargaining unit agreements for the items tested.

Background

The OSA incurs administrative expenditures for personnel services, travel, supplies and equipment, rent, and other miscellaneous expenses. Personnel services represented over 88 percent of total expenditures. Travel, rent, and supplies and equipment represent the majority of other administrative expenditures. We discuss payroll and other administrative expenditures in the following sections.

Payroll

OSA employs approximately 145 employees located in offices throughout the state. The employees are covered by various bargaining unit agreements. The OSA administers a separate personnel plan for those employees not covered by the bargaining unit agreements. Table 4-1 highlights the types of payroll expenditures for fiscal year 2000.

**Table 4-1
Payroll Expenditures
Budget Fiscal Year 2000**

<u>Payroll Type</u>	<u>Amount</u>
Full-time Salaries	\$7,507,703
Part-time Salaries	114,564
Overtime	69,651
Severance/Vacation Payoffs/Other	<u>117,823</u>
Total Payroll	<u>\$7,809,742</u>

Sources: OLA summary of expenditures for budget fiscal year 2000 through December 31, 2000.

Bi-weekly payroll transactions and pay rate changes are processed through the Department of Employee Relations' State Employee Management System (SEMA4). These transactions are

Office of the State Auditor

also recorded in the Minnesota Accounting and Procurement System (MAPS) through a computer system interface.

Audit Objectives and Methodology

While conducting our audit, we considered the following objectives:

- Were employees paid in accordance with material finance-related legal provisions of state bargaining unit agreements?
- Were payroll transactions accurately recorded in the state's accounting systems and allocated to the appropriate divisions?

The methodology we used to meet these objectives included inquiries and analytical procedures. We reviewed bargaining unit agreements and interviewed key department employees to gain an understanding of the internal control structure over payroll and personnel functions. In addition, we analyzed a sample of transactions for legal compliance provisions, propriety of transactions, reasonableness, and proper recording in the accounting system.

Conclusions

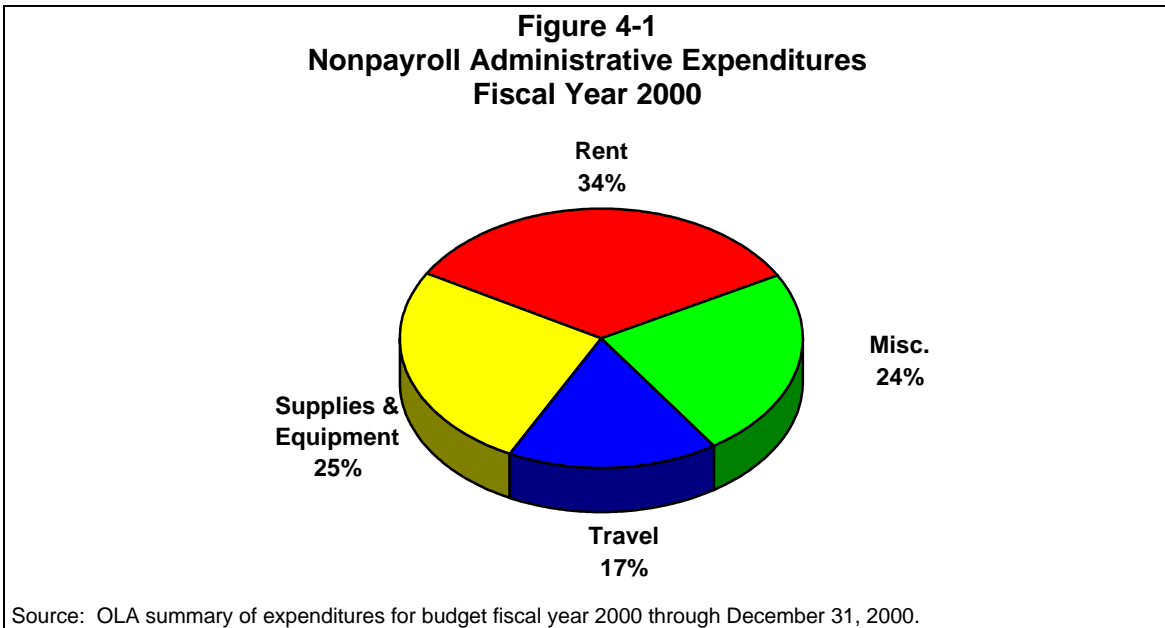
Based on our testing, the OSA complied with material finance-related legal provisions of state bargaining unit agreements for the transactions tested. In addition, the OSA's payroll transactions were accurately recorded in the state's accounting systems and allocated to the appropriate divisions.

Other (Nonpayroll) Administrative Expenditures

Other administrative expenditures accounted for approximately 12 percent of total operating costs. The OSA incurred administrative expenditures in the following categories: rent, travel, supplies and equipment, and other miscellaneous expenses.

The largest nonpayroll expenditure is for the lease of office space. The Real Estate Management Division of the Department of Administration assists the OSA in negotiating lease agreements. The OSA is currently leasing office space for employees in St. Paul and nine other locations around the state. For fiscal year 2000, the office paid approximately \$346,500 for rent. This amount includes payments for office space, equipment rentals, room rentals, and parking spaces.

Figure 4-1 illustrates the fiscal year 2000 nonpayroll administrative expenditures by type. The miscellaneous category on the chart is comprised mainly of professional/technical services, purchased services, and communication expenses.



Audit Objectives and Methodology

We focused our review of rent, travel, and supplies and equipment expenditures on the following objectives:

- Were expenditures properly recorded in the state’s accounting system?
- Did expenditures comply with state accounting policies and procedures?
- Were expenditures charged to the appropriate division?

To address these objectives, we interviewed agency staff to gain an understanding of the space rental, purchasing, and payment processes. We selected a sample of expenditures and verified that they were approved and properly recorded in the accounting system.

Conclusions

The OSA properly and accurately recorded expenditures in the accounting system and allocated expenditures to the appropriate division. For the items tested, the OSA complied with applicable accounting policies and procedures.

**Status of Prior Audit Issues
As of May 4, 2001**

July 1999, Legislative Audit Report 99-40 covered the two years ended December 31, 1998. The scope of the audit included appropriation control, audit practice revenues, personnel services, and other administrative expenditures. There were no findings or recommendations that resulted from the audit. The audit was conducted in accordance with the Legislative Audit Commission policy to perform financial audits of constitutional officers at both mid-term and end of the term.

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.