OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Administration
Fiscal Year Ended June 30, 2001

JANUARY 24, 2002 **02-05**

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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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

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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
Jeanine Leifeld, CPA, CISA	Audit Manager
Laura Peterson, CPA	Auditor-in-Charge
Pat Ryan	Team Leader
Patrick Phillips, CPA	Senior Auditor
John Hakes, CPA	Senior Auditor
Dave Massaglia	Auditor
Tessa Lee	Intern

Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Department of Administration on January 15, 2002:

David Fisher	Commissioner
Kirsten Cecil	Deputy Commissioner
Laura Bishop	Assistant Commissioner, Public Affairs
Kent Allin	Assistant Commissioner, Operations Management Bureau
Jack Yarbrough	Assistant Commissioner, InterTechnologies Group
Regenia David	Assistant Commissioner, Office of Technologies
Larry Freund	Director, Financial Management and Reporting
Julie Poser	Accounting Director, Financial Management and Reporting
Judy Hunt	Internal Auditor
Bob Olsen	Chief Information Officer
Judy Plante	Director, Management Analysis Division
Marcia Hansen	Executive Assistant to the Commissioner

Report Summary

Key Findings and Recommendations

- The Department of Administration did not consistently allocate certain InterTechnologies Group costs to the correct fiscal year. We recommended the InterTechnologies Group work with the Financial Management and Reporting Division to ensure all costs are correctly allocated. (Finding 1, page 3)

- The Materials Management Division did not restrict users' clearances into the Administration Fee Check Tracking System for its Pharmaceutical Outreach Program. We recommended the division restrict users' security clearances into that system to ensure an adequate separation of incompatible duties and to prevent unauthorized access to data and programming. (Finding 2, page 4)

- The Print Communications Division did not monitor certain portions of its accounts receivable. We recommended the division periodically review the "Completed Jobs (shipped) Not Yet Invoiced" report and follow up on any jobs that appear unusual. In addition, we recommended the division develop a systematic method of identifying and valuing the customer orders partially shipped as of the end of the reporting period. (Finding 3, page 4)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally-funded programs. The scope of our work in individual agencies is limited. During the fiscal year 2001 audit, our work at the Department of Administration focused on selected components of the state's Internal Services Fund, selected building construction projects, and selected components of the Pharmaceutical Outreach Program. The department's response to our recommendations is included in the report.

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. David Fisher, Commissioner
Department of Administration

We have performed certain audit procedures at the Department of Administration as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 2001. We have also reviewed certain department procedures related to the state's compliance with the federal requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to the department for the year ended June 30, 2001. We emphasize that this has not been a comprehensive audit of the Department of Administration.

Table 1 identifies the financial activities within the Department of Administration that were material to the state's financial statements. We performed certain audit procedures on these activities as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2001, were free of material misstatements.

Table 1
Activities Material to the State's Financial Statements
Fiscal Year 2001

Revenue Areas	
InterTechnologies Fund sales revenue	$80,299,000
Plant Management Fund lease revenue	37,631,000
Travel Management Fund vehicle rental revenue	10,023,000
Central Stores Fund sales revenue	8,459,000
Risk Management Fund insurance revenue	7,731,000
Print Communication Program sales revenue	5,704,000
Pharmaceutical Outreach Program revenue	3,944,000
Expenses/Expenditures	
Building Construction Division expenditures (1)	$10,556,000
InterTechnologies Fund:	
Purchase services	45,890,000
Depreciation (2)	6,282,000
Plant Management Fund purchase services	10,828,000
Central Stores Fund cost of goods sold	6,740,000
Print Communication Fund cost of goods sold	5,267,000
Travel Management Fund vehicle depreciation (2)	5,001,000
Risk Management Fund claims expense	3,771,000

(1) Selected projects.
(2) Our audit scope also included the InterTechnologies Fund and Travel Management Fund fixed asset balances at June 30, 2001. Those net fixed asset balances were $10,197,000 and $22,648,000, respectively.

Source: *State of Minnesota Comprehensive Annual Financial Report* for the year ended June 30, 2001.

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Department of Administration

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusion

Our December 7, 2001, report included an unqualified opinion on the State of Minnesota's general purpose financial statements for fiscal year 2001. In accordance with Government Auditing Standards, we also issued our report, dated December 7, 2001, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB A-133.

As a result of our audit procedures, we identified the following weaknesses in internal control at the Department of Administration:

1. The department did not consistently allocate certain InterTechnologies Group costs to the correct fiscal year.

The InterTechnologies Group (ITG) financial statements had errors because the department did not correctly allocate certain costs to the appropriate fiscal year. We found errors in June 30 accounts payable, communications expense, prepaid expenses, and fixed assets balances as a result of these allocation problems. According to generally accepted accounting principles, expenses for goods and services should be shown in the financial statements in the period the goods were received and services were rendered.

The June 30, 2001, accounts payable and communications expenses were each understated at least $398,227. The errors resulted because ITG did not use the correct liability date when coding certain communications expenses in the state's accounting system, MAPS. The ITG received the communication services prior to June 30, 2001, and paid for them after July 1, 2001. When coding the disbursements, the ITG accounts payable division incorrectly used a fiscal year 2002 liability date rather than a fiscal year 2001 date.

In addition, the ITG June 30, 2001, prepaid expenses were overstated $129,355. ITG purchases several software licenses that extend multiple years and pays for the licenses at the beginning of the license period. Any service period remaining on the license agreement after June 30 should be shown as a prepaid expense on the balance sheet. The errors in the prepaid expenses occurred because of miscommunication concerning service periods and other calculation errors.

Finally, the ITG fixed assets and accounts payable were understated $186,596 as a result of an error in recording an equipment purchase. ITG purchased a piece of equipment that the vendor delivered in parts. ITG received the first part before June 30, 2001, and the rest after July 1, 2001. ITG waited until it received all parts to record the asset on the balance sheet. According to generally accepted accounting principles, purchased goods should be recorded on the financial statements when received. Since ITG received part of the equipment prior to June 30, 2001, it should have recorded the cost of those goods on the fiscal year 2001 financial statements.

Recommendation

- *The InterTechnologies Group should work with the Financial Management and Reporting Division to ensure costs are allocated to the correct fiscal year for financial reporting purposes.*

2. The Material Management Division did not adequately restrict certain computer security clearances for its pharmacy cooperative purchasing program.

The Materials Management Division did not adequately restrict users' clearances into the Administration Fee Check Tracking System (ACTS) for its Pharmaceutical Outreach Program. As part of the pharmacy program, pharmaceutical manufacturers pay an administrative fee based on the contract prescription drug usage of the program's 38 members. In our fiscal year 2000 Department of Administration management letter, we recommended that the Materials Management Division develop a system to accurately record and track outstanding pharmaceutical contract administrative fees. To resolve that finding, the Materials Management Division hired a consultant to develop the ACTS database. The new system provides better accounting for the administrative fees and helps identify those manufacturers who have not paid. Although the division restricted who can access the ACTS system, users have full access to all activities and functions of the system. In addition, one user of ACTS endorsed incoming checks, completed bank deposit slips, and recorded cash receipts in ACTS. By giving the user broad access into ACTS, as well as access to cash receipts, the division risks the occurrence of unauthorized or erroneous transactions.

Recommendation

- *The Materials Management Division should restrict users' security clearances into ACTS to ensure an adequate separation of incompatible duties and to prevent unauthorized access to data and programming.*

3. The Print Communications Division did not monitor certain portions of its accounts receivable.

The Print Communications Division did not periodically review the older or unusual jobs listed on the "Completed Jobs (shipped) Not Yet Invoiced" report to ensure the jobs and accounts receivable amounts were valid. This report contains the portion of the accounts receivable where the customer orders were completed and shipped as of June 30, 2001, but Print Communications had not invoiced the customer by June 30, 2001. Generally accepted accounting principles require the accounts receivable be valued at the amount the entity has earned as of the balance sheet date. Some of the jobs listed on the report showed they were completed in January 2001, but Print Communications had still not invoiced the customers as of June 30, 2001. We found three jobs that were no longer valid, two that were partial shipments and should not have been included in this report until complete, and one job that was overvalued. These errors caused the June 30, 2001, accounts receivable to be overstated by at least $34,419. We believe this report contains additional errors.

In addition, Print Communications did not have a systematic method of detecting and valuing orders that were partially shipped as of the end of the reporting period. As mentioned above, two of these jobs were incorrectly included in the "Completed Jobs (shipped) Not Yet Invoiced" report and valued as if the jobs were complete. We found three additional jobs that were partially shipped as of June 30, 2001, but not included in the accounts receivable. The omission of these three receivables resulted in the June 30, 2001, accounts receivable being understated $8,292.

Recommendations

- *Print Communications should periodically review the "Completed Jobs (shipped) Not Yet Invoiced" report and follow up on any jobs that appear unusual.*

- *Print Communications should develop a systematic method of identifying and valuing the orders partially shipped as of the end of the reporting period.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Administration. This restriction is not intended to limit the distribution of this report, which was released as a public document on January 24, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 21, 2001

Report Signed On: January 18, 2002

Status of Prior Audit Issues
As of December 21, 2001

January 5, 2001, Legislative Audit Report 01-01 examined the Department of Administration's activities and programs material to the State of Minnesota's general purpose financial statements for the year ended June 30, 2000. The report contained two findings that the Department of Administration resolved.

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.

Admin MINNESOTA Department of Administration

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January 18, 2002

James R Nobles, Legislative Auditor
First Floor South, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to discuss with your staff the results of the statewide financial audit of selected programs of the Department of Administration for the year ended June 30, 2001. We appreciate your efforts to bring areas needing improvements to our attention. We are committed to implementing the recommendations you suggested in your report.

Thank you also for the opportunity to respond to each finding and recommendation contained in the report. Summarized below are our plans to ensure the continued integrity of financial data and compliance with pertinent laws.

1. **Audit Finding: The department did not consistently allocate certain InterTechnologies Group costs to the correct fiscal year.**

<u>Resolution</u>

InterTechnologies Group (ITG) will implement procedures to ensure costs are allocated to the correct fiscal year for financial reporting purposes. Specifically, ITG will (1) take the appropriate measures to improve internal tracking processes for expenses that cross fiscal year, (2) develop a checklist to ensure expenses are reported in the correct fiscal year including the utilization of the Department of Finance year-end close instructions in coding the correct liability date, (3) communicate the manually tracked long distance phone expense and prepaid software expenditure amounts to Financial Management and Reporting (FMR) for the reporting period, (4) work with ITG managers to convert the contract termination dates on software contracts that are material to coincide with a fiscal year end date when possible, (5) develop a procedure to ensure the proper reporting of all fixed assets received by the end of the fiscal year, (6) request a new Minnesota Accounting and Procurement System (MAPS) expenditure object code from the Department of Finance to assist in the identification of multiyear contracts, and (7) work with FMR to develop a process for review of ITG financial information used in preparation of the financial statements. The projected implementation date is May 15, 2002.

Person Responsible: Ron Michaels, InterTechnologies Group Financial Manager

2. Audit Finding: The Materials Management Division did not adequately restrict certain computer security clearances for its pharmacy cooperative purchasing program.

Resolution

The Materials Management Division developed its Administrative Fee Check Tracking System (ACTS) in response to a finding from last year's Office of the Legislative Auditor (OLA) audit. The division agrees with this year's finding that security controls and separation of duties needed improvement at the time this year's audit process began.

Materials Management implemented changes to resolving the finding. Specifically, (1) implemented additional security restrictions for access to ACTS; (2) enhanced separation of duties by assigning to three different employees the (a) receiving and endorsing of checks, (b) recording cash receipts in MAPS and ACTS, and (c) following up on overdue fees from manufacturers; and (3) developed a process for Admin's FMR staff to reconcile ACTS cash receipts to the amount reported in MAPS.

Person Responsible: Paul Stembler, Materials Management Division Assistant Director

3. Audit Finding: The Print Communications Division did not monitor certain portions of its accounts receivable.

Resolution

Effective January 17, 2002, Print Communications (PrintComm) implemented the Sales/Service Manager's review and reconciliation of the Work in Progress Report and the Completed Jobs Report on a daily basis. This control measure is designed to ensure early detection of, attention to and resolution of any unusual jobs, duplication errors, or other errors. PrintComm initiated a process in January 2002 to ensure the accurate identification and valuation of orders shipped at the end of the reporting period. This process includes the Production Manager tracking, during the last week of the fiscal year, all jobs scheduled to be shipped. After close-of-business on the last working day of the fiscal year, the Business Manager will identify and adjust the accounts receivable and work-in-process balances accordingly.

Person Responsible: Mary Mikes, Communications Media Director

Very truly yours,

/s/ Kirsten Cecil, Deputy Commissioner, for

David F. Fisher
Commissioner