OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Department of Finance
Fiscal Year Ended June 30, 2001

MARCH 21, 2002 **02-20**

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

Ms. Pamela Wheelock, Commissioner
Department of Finance

We have preformed certain audit procedures at the Department of Finance as part of our audit of the general purpose financial statements of the State of Minnesota as of and for the year ended June 30, 2001. We also audited the department's compliance with applicable requirements governing the administration of federal awards for the year ended June 30, 2001, as described in the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement.* In addition, this year we expanded our audit scope and objectives to address internal control and compliance over the department's administrative operations for the two years ended June 30, 2001.

The Department of Finance is responsible for statewide financial planning and resource management. The department prepares the *Comprehensive Annual Financial Report* that contains the state's general purpose financial statements. The department also prepares the *Financial and Compliance Report on Federally Assisted Programs* (Single Audit report) each year. The department manages the state's main accounting systems, coordinates the sale of state general obligation bonds, enters into master lease purchase agreements for state agencies, processes payments of some appropriations and grants, and provides guidance to other state agencies in areas of financial management.

Our audit of the Department of Finance's administrative operations included the following expenditure areas: payroll, computer system services, professional/technical services, rent, communications, supplies, and equipment. We also audited the department's non-operating activities such as grants to the Mayo Clinic, the Minneapolis Employees' Retirement Fund (MERF), and the first class teachers retirement funds, as well as tort claims. Our objective was to determine whether the department accurately recorded these transactions in the accounting records and whether the transactions complied with applicable legal provisions or other rules or regulations.

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

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Department of Finance

Conclusions

We issued an unqualified audit opinion, dated December 7, 2001, on the State of Minnesota's general purpose financial statements for the year ended June 30, 2001. In accordance with *Government Auditing Standards*, we also issued a report dated December 7, 2001, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. In March 2002, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with the U.S. Office of Management and Budget's Circular A-133.

As a result of our financial statement and Single Audit work in the Department of Finance, we did not identify any internal control weaknesses or instances of noncompliance that would be required to be reported under *Government Auditing Standards*.

Our review of the Department of Finance's administrative expenditures concluded that the department's internal controls provided reasonable assurance that financial transactions were accurately recorded in the state's accounting records. We also concluded that the department complied with material finance-related legal provisions and bargaining unit agreements with respect to the items tested. The following report provides further information about our objectives and conclusions on the department's administrative operations.

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 21, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 1, 2002

Report Signed On: March 15, 2002

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
David Poliseno, CPA, CISA	Auditor-In-Charge
Susan Kachelmeyer, CPA, CISA	Team Leader
Susan Mady	Senior Auditor
Doreen Bragstad	Auditor
Ching-Huei Chen	Auditor
Tessa Lee	Intern

Exit Conference

We discussed the audit report and other issues with the following representatives of the Department of Finance at the exit conference held on March 12, 2002:

Anne Barry	Deputy Commissioner
Lori Mo	Assistant Commissioner, Accounting Services
Carole Charbonneau	Assistant Commissioner, Administrative Services
Barb Ruckheim	Financial Reporting Director
Donna Visness	MAPS IS Director
Steve Olson	MAPS Security Officer
Ron Mavetz	Supervisor, General Ledger

Report Summary

Key Audit Conclusions

- We issued an unqualified audit opinion on the State of Minnesota’s general purpose financial statements for the year ended June 30, 2001. We concluded the material programs administered by the Department of Finance were fairly presented in the financial statements.
- The State of Minnesota’s *Financial and Compliance Report on Federally Assisted Programs* for the year ended June 30, 2001 (to be issued by the Department of Finance in March 2002) will contain our overall conclusions on the state’s internal controls and compliance over financial reporting and federal awards. Both reports include comprehensive schedules of financial statement findings and internal control and compliance findings for the state as a whole.
- We reviewed administrative expenditures of the Department of Finance for the two fiscal years ended June 30, 2001. We concluded the department’s internal controls provided reasonable assurance that expenditures were made in accordance with management’s authorization, and expenditures were recorded accurately in the accounting system. We found that, for the items tested, the department complied with significant finance-related legal provisions.

Audit Scope

Our financial statement audit scope in the Department of Finance was limited to those activities administered by the department that are material to the State of Minnesota's general purpose financial statements. Our scope included cash management, debt management, various loan programs, and statewide indirect costs.

Our audit of the Department of Finance's administrative expenditures included payroll, computer system services, professional/technical services, among other areas. We also audited the department’s non-operating activities, including tort claims and grants to the Mayo Clinic, the Minneapolis Employees’ Retirement Fund (MERF), and the first class teachers retirement fund associations.

Agency Background

The Department of Finance maintains the state's accounting systems and manages its accounting, budgetary, and debt management activities. It establishes policies and procedures to ensure consistent and reliable financial data and compliance with financial-related statutory provisions. The department is responsible for preparing the state’s annual financial statements.

Chapter 1. Introduction

The Department of Finance directs statewide financial planning and resource management. The department derives its authority from Minn. Stat. Section 16A. The department maintains the state's accounting systems and manages the state's accounting, budgetary, and debt management activities. It establishes policies and procedures to ensure consistent and reliable financial data among state agencies and compliance with financial-related statutory provisions. The department annually prepares the state's general purpose financial statements, processes payments of some appropriations and grants, and provides guidance to other state agencies in areas of financial management. The commissioner of Finance, appointed by the Governor, directs the department's operations. Pamela Wheelock was appointed commissioner in February 1999.

The Department of Finance's activities are primarily funded by General Fund appropriations. The Legislature appropriated $24,448,000 and $17,935,000 for fiscal years 2000 and 2001, respectively. The fiscal year 2000 appropriation included $6.8 million to upgrade the state's human resources and payroll system (SEMA4).

In addition to its appropriation, the department received about $7.5 million each year through statewide systems billings. The department bills state agencies for the use of the main accounting systems. The department uses the receipts to reimburse the Intertechnologies Division of the Department of Administration for its mainframe computer usage and for site licenses for the accounting software applications. The statewide system reimbursements are administered as a part of the department's indirect cost billing and collection process.

The department's budget is separated into two service delivery programs. The state financial management program provides the budget, accounting, personnel, and payroll systems that are used by all state agencies. The information and management services program provides technical and management support to the state financial management program and the statewide administrative systems.

The department separates its financial activities into operating and non-operating activities. The department uses its operating account to fund the activities consistent with its mission. The department uses its two non-operating accounts to record transactions for debt management, indirect costs, invested treasurer's cash, and grants to certain local units of government.

Chapter 2. Administrative Expenditures

Chapter Conclusions

The Department of Finance's internal controls provided reasonable assurance that employees were accurately compensated in compliance with the applicable bargaining agreements and management's authorization, and payroll expenditures were properly recorded in the accounting and payroll systems. The department's internal controls provided reasonable assurance that it accurately paid administrative expenditures and that these transactions were authorized by management and properly recorded in the accounting system. For the items tested, the department complied with applicable payroll and procurement requirements.

The Department of Finance incurs costs to fund its operations and fulfill its mission. Table 2-1 summarizes the department's expenditures for fiscal years 2000 and 2001.

Table 2-1
Summary of Expenditures
By Budget Fiscal Year

Expenditures	2000	2001
Payroll	$12,090,555	$13,022,937
Computer and System Services	7,586,738	9,505,342
Professional/Technical Services	2,576,400	3,522,241
Communications	739,720	791,643
Rent	536,125	588,231
Supplies	461,295	791,311
Equipment	392,785	412,609
Other Expenditures	708,620	715,963
Total Expenditures	$25,092,238	$29,350,277

Note: Expenditure amounts are only for the Department of Finance's operating accounts.

Source: Minnesota Accounting and Procurement System as of September 7, 2001.

The following sections provide a brief explanation of these expenditure classifications.

Payroll

Employee payroll represents the largest administrative expenditure for the Department of Finance. For fiscal years 2000 and 2001, the department's payroll costs were approximately

$12 million and $13 million, respectively. The department employed approximately 175 full-time employees as of June 30, 2001. Employees are represented by a number of state bargaining units.

The Department processes bi-weekly payroll transactions and pay rate changes through the Department of Employee Relations' State Employment Management System (SEMA4). The department records these transactions in the Minnesota Accounting and Procurement System through a system interface.

Computer and System Services

These costs represent expenditures for operation and maintenance of the statewide computer systems. Services also include software purchases and rentals. The Department of Finance uses these services to maintain the state's accounting and payroll systems and its data warehouse. The department operates these systems on mainframe computers in the Department of Administration's Intertechnologies Division (Intertech). The department uses Intertech's computer services to allow state agencies access to the accounting systems. Intertech bills the Department of Finance for the actual cost of services incurred, such as central processing unit (or CPU) time. In addition to the mainframe costs to operate the applications, the department incurs software costs to maintain and upgrade the computer software packages.

Professional/Technical Services

The department uses outside contractors or consultants to supplement its staff to deliver services to all state agencies. During the audit period, the majority of the department's contracts with outside vendors pertained to computer systems development, including a contract to upgrade SEMA4. A consultant also assists the department with economic forecasts.

Communications

Communication expenditures include items such as postage, mailings, and network services. Network services includes telephone service, computer communications, cellular telephone use, fax charges, and pager charges.

Supplies and Equipment

The department purchases office supplies and equipment, such as office furniture, computers, and peripherals. When a division needs supplies or equipment, it completes a requisition form that is approved by the appropriate supervisor. The divisions submit the requisition forms to the accounting section to complete the purchase.

Department of Finance

Audit Objectives and Methodology

We focused on the following objectives during our audit of administrative expenditures:

- Did the department's internal controls provide reasonable assurance that it accurately compensated its employees in compliance with the bargaining agreements and management's authorization and properly recorded payroll expenditures in the state's accounting system?

- Did the department's internal controls provide reasonable assurance that it accurately paid administrative expenditures, obtained management authorization, and properly recorded transactions in the accounting system?

- Did the department comply with material finance-related legal provisions including the bargaining agreements and procurement requirements?

To address these objectives, we interviewed department staff to gain an understanding of the internal control structure over personnel and payroll processing and administrative disbursements. We analyzed biweekly payroll transactions and verified that hours processed were supported by timesheets authorizing hours worked and leave taken. We tested the commissioner's salary to ensure it did not exceed 95 percent of the Governor's salary. We reviewed employee access to update SEMA4 human resource and payroll data. We compared rent payment transactions to authorized leases. We analyzed professional/technical expenditures, computer and system services payments, and supply and equipment expenditures. We performed detailed tests of transactions and tested compliance with procurement requirements and management's authorization.

Conclusions

The Department of Finance's internal controls provided reasonable assurance that employees were accurately compensated in compliance with the applicable bargaining agreements and management's authorization, and payroll expenditures were properly recorded in the accounting and payroll systems. The department's internal controls provided reasonable assurance that it accurately paid administrative expenditures for rent, professional/technical services, computer and systems services, communications, and supplies and equipment. These transactions were authorized by management and properly recorded in the accounting system. For the items tested, the department complied with applicable payroll and procurement requirements.

Chapter 3. Non-operating Activities

Chapter Conclusions

The Department of Finance's internal controls provided reasonable assurance that it accurately paid grants to the Mayo Medical School, Minneapolis Employee's Retirement Fund (MERF), and the first class city teachers retirement fund associations, as well as tort claims. Controls provided assurance that these transactions were authorized by management and properly recorded in the accounting system. For the items tested, the department complied with applicable legal requirements.

In addition to the operating activities discussed in Chapter 2, the department has responsibility for various non-operating activities. During our annual statewide financial audit, we audit the material non-operating activities such as debt management, indirect costs, master lease, and invested treasurer's cash. This chapter focuses on grants to the Mayo Medical School, the Minneapolis Employee's Retirement Fund (MERF), the first class city teachers retirement fund associations, and tort claims. Each type of payment is discussed below.

Mayo Medical School Grants

The grants consist of payments to the Mayo Foundation for the medical school capitation, Family Practice and Graduate Residency Program, and the St. Cloud Hospital-Mayo Family Practice Residency Program. The state grants money to these institutions to help defray the education costs for Minnesota resident students. The statutes stipulate certain conditions to be imposed on the grant recipients, such as to increase the number of doctors practicing medicine in rural areas. The grantee submits an invoice, and the department processes the grant payment. The department disbursed $1,473,520 and $1,578,590 for this program during fiscal years 2000 and 2001, respectively.

Minneapolis Employees Retirement Fund (MERF) Grants

The state entered into an agreement to help finance MERF's unfunded liability and to amortize supplemental benefit payments. The Department of Finance pays MERF an annual amount based on the actuarial valuation of the fund. MERF submits an invoice, supported by the actuarial valuation, to the department. The department paid MERF $5,108,000 and $3,774,000 for fiscal years 2000 and 2001, respectively.

Department of Finance

TRA First Class City Grants

There are three first class city teachers retirement fund associations located in Minneapolis, St. Paul, and Duluth. The state makes a direct state aid payment to each city to supplement the employer share of the retirement fund contributions. The amount of each payment is determined by an actuarial valuation. The Department of Finance receives an open appropriation to make the payments. Table 3-1 shows the payment amounts for each city's retirement fund.

Table 3-1
Summary of Grants to First Class City Teachers Retirement Fund Associations
By Budget Fiscal Year

First Class City	2000	2001
Minneapolis	$15,443,048	$15,426,194
St. Paul	2,827,000	2,827,000
Duluth	486,000	486,000
Total	$18,756,048	$18,739,194

Source: Minnesota Accounting and Procurement System as of September 7, 2001.

Tort Claims

The Department of Finance pays tort claims to citizens in accordance with Minn. Stat. Section 3.736. The statute requires the state to compensate individuals for loss of property or personal injury or death caused by an employee of the state acting within the scope of their office or employment. The statute establishes certain exclusions, limits the amount of compensation, and limits the time that a person can file a claim. As part of the process, the Attorney General's Office works with the state agency involved and investigates the claim. At the conclusion of the investigation, the Attorney General's Office prepares a settlement, which is approved by all parties. The Department of Finance receives the agreement, determines the appropriate funding source, and processes the claim. For fiscal years 2000 and 2001, the department paid tort claims totaling $90,438 and $855,988, respectively.

Audit Objectives and Methodology

We focused on the following objectives during our audit of non-operating expenditures:

- Did the Department of Finance's internal controls provide reasonable assurance that it accurately paid grants and tort claims, and were these payments made in accordance with management's authorization and properly recorded in the accounting system?

- Did the Department of Finance comply with material finance-related legal provisions pertaining to the tort claims and the various grants?

To meet these objectives, we interviewed staff from the department to gain an understanding of the internal control structure for the non-operating programs. We analyzed tort claims and grants to the Mayo Medical School, the Minneapolis Employees Retirement Fund (MERF), and the first class city teachers retirement fund associations. We performed detailed tests of transactions and tested compliance with statutory requirements and management's authorization.

Conclusions

The Department of Finance's internal controls provided reasonable assurance that it accurately paid grants to the Mayo Medical School, the Minneapolis Employees Retirement Fund (MERF), the first class city teachers retirement fund associations, and tort claims. These transactions were authorized by management and properly recorded in the accounting system. For the items tested, the department complied with applicable legal requirements.

Status of Prior Audit Issues
As of March 1, 2002

March 15, 2001, Legislative Audit Report 01-11 examined the department's activities and programs material to the State of Minnesota's *Comprehensive Annual Financial Report* and the Single Audit for the year ended June 30, 2000. The scope included general obligation bond sales, debt service transfers, master lease transactions, municipal energy loans, and appropriation transfers to the University of Minnesota. The audit also covered federal requirements relating to cash management and indirect costs. The report contained two findings. The department implemented each of the recommendations.

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 the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.