



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Commerce

Fiscal Year Ended June 30, 2002



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
Brad White, CPA, CISA	Audit Manager
Ken Vandermeer, CPA	Auditor-in-Charge
Scott Tjomsland, CPA	Team Leader
Linda Pha	Auditor
Irene Hass	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Commerce at an exit conference on March 5, 2003:

Mike Blacik	Assistant Commissioner
Mim Stohl	Chief Financial Officer
Bob Schiam	Accounting Officer
John Harvanko	Director
Sandy Mackenthun	Director
Jim Alan	TACIP Board Administrator

Report Summary

Key Findings and Recommendations

- The department omitted certain investments and did not properly report financial activities for the Unclaimed Property Program. Unclaimed mutual fund shares and unclaimed stocks in dividend reinvestment plans, valued at \$7.3 million and \$1.7 million, respectively, were omitted from balances reported to the Department of Finance. These assets had accumulated for several years; however, they had never been reported for inclusion in the state's financial statements. In addition, the department has not used its statutory authority to sell the unclaimed investments, held for three years. Proceeds from such sales would go to the General Fund. Finally, several financial statement accruals were either not calculated or incorrectly calculated. We recommended that the department should determine the fair market value of omitted investments and accurately determine accruals as of June 30 each year. In addition, we recommended the sale of unclaimed shares in mutual funds and unclaimed stocks in dividend reinvestment plans, held for over three years, in accordance with Minn. Stat. Section 345.47. (Finding 1, page 3)
- The department did not establish internal controls to ensure the accuracy of its unclaimed property records. We recommended a periodic reconciliation of internal records to actual receipts of cash and securities. (Finding 2, page 5)

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 work in individual agencies is limited. During the fiscal year 2002 audit, our work at the Department Commerce focused on financial activities of the Unclaimed Property Division, securities fees receipts, and one federal program administered by the department. The department's response to our recommendations is included in the report.



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

Mr. Glenn Wilson, Commissioner
Department of Commerce

We have performed certain audit procedures at the Department of Commerce as part of our audit of the financial statements of the State of Minnesota for the year ended June 30, 2002. We also have audited a federal financial assistance program administered by the Department of Commerce as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Commerce.

The scope of our work at the Department of Commerce included financial activities of the Unclaimed Property Program and securities fee revenue recorded in the state's General Fund. Unclaimed Property net revenues totaled \$30 million in fiscal year 2002, after reducing \$10 million for refunds to owners. In addition, we examined securities fees revenue totaling \$25 million, net of refunds. We performed certain audit procedures on these Department of Commerce programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2002, were free of material misstatement.

Table 1 identifies a State of Minnesota major federal program administered by the Department of Commerce. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs.

Table 1
Major Federal Program Administered by the
Department of Commerce
Fiscal Year 2002
(in thousands)

<u>CFDA #</u>	<u>Program Name</u>	<u>Federal</u>
93.568	Low Income Home Energy Assistance	\$62,030

Note: The program transferred to the Department of Commerce effective October 1, 2001, but was administered under an interagency agreement with the Department of Economic Security from October 1, 2001, to March 31, 2002. Expenditures include amounts expended for the nine-month period from October 1, 2001, through June 30, 2002.

Source: *State of Minnesota Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2002.

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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 *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 6, 2002, report included an unqualified opinion on the State of Minnesota's basic financial statements for fiscal year 2002. In accordance with *Government Auditing Standards*, we also issued our report, dated December 6, 2002, 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 *Circular A-133*.

As a result of our procedures, we identified the following weaknesses in internal controls over financial reporting and noncompliance with federal regulations at the Department of Commerce.

1. The Department of Commerce omitted certain unclaimed assets and did not properly determine unclaimed property accruals in accordance with accounting standards.

The department did not properly report certain investments and accruals to the Department of Finance for inclusion in the state's financial statements. Unclaimed property assets and related revenue should be recognized in the financial statements in accordance with Government Accounting Standards Board (GASB) #21 *Accounting for Escheat Property* and GASB #33 *Accounting for Nonexchange Transactions*. Adjustments were necessary to correctly report balances in accordance with these prescribed accounting standards. The omitted unclaimed property balances and accruals included the following:

- The department did not report the fair market value of two pools of investments held as unclaimed property: shares in mutual funds and stocks in dividend reinvestment plans. We found that the department has collected these unclaimed investments for several years, but has never reported them to Finance for inclusion in the state's financial statements. As of June 30, 2002, the estimated fair market value of the unclaimed shares in mutual funds was \$7.3 million, and estimated value of unclaimed stocks in dividend reinvestment plans was \$1.7 million. We noted, however, that many of these investments had valuations that were not updated to June 30, 2002, fair market prices. In addition, the department has not converted any of these investments into cash. Minn. Stat. Section 345.47 authorizes the department to sell unclaimed mutual funds and dividend reinvestment stocks held for a minimum of three years. The proceeds from such sales would benefit the state's General Fund.
- The department did not properly determine unclaimed property revenue and obligation accruals for three areas.
 - Revenues accruals were not estimated for delinquent holder reports. The department requires holders, such as banks and investment companies, to file annually and submit

Department of Commerce

holder reports along with the actual unclaimed property. Accounting standards require that unclaimed property revenue be recognized when received from holders or when holder reports are due, whichever is first. Therefore, accrued revenue from delinquent holder reports should be recognized in the financial statements, even though they have not yet been received as of June 30. Since the department does not know the exact amount until it receives the reports, it must estimate the accrued revenue as of June 30 and report that amount to the Department of Finance. The Department of Commerce will have to develop a methodology for determining this estimated accrual.

- Unclaimed property reciprocity payables of \$770,510 and unclaimed property reciprocity receivables of \$512,788 as of June 30 were not reported. The department has unclaimed property reciprocity agreements with 25 states. The department periodically sends each state any unclaimed property it collected where the last known owner resided in that state; and in turn, those states periodically send the department any unclaimed property they collected where the last known owner address is in Minnesota. Unclaimed property reciprocity payables and receivables should be recognized when the amount owed between the states is determined and payment is approved. Any reciprocity payables and receivables authorized, but not yet paid, as of June 30 should be recognized in the financial statements.
- The department did not properly accrue unclaimed property obligations totaling \$172,909 as of June 30, 2002. The department authorized claims for payment before June 30, 2002, but did not disburse the claim payments until after July 1, 2002. Unclaimed property obligations should be recognized when the department determines a claim is legitimate and authorizes it for payment. The Minnesota Accounting and Procurement System uses the transaction record date to aid in the determination of fiscal year-end liabilities; however, the department did not use the authorization date when recording the financial transactions.

Recommendations

- *The Department of Commerce should determine the fair market value of unclaimed shares in mutual funds and unclaimed stocks in dividend reinvestment plans held as of June 30 each year and report those values to the Department of Finance. In addition, the department should consider selling unclaimed shares in mutual funds and unclaimed stocks in dividend reinvestment plans, held for over three years, in accordance with Minn. Stat. Section 345.47.*
- *The department should accurately determine unclaimed property revenue and obligation accruals as of June 30 each year by:*
 - *establishing a methodology to estimate the accrued revenue from delinquent holder reports;*
 - *accurately determining payable and receivable accruals from interstate reciprocity agreements; and*
 - *properly measuring liabilities by coding accounting transactions with record dates based on the date the claim is authorized for payment.*

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2. PRIOR FINDING NOT RESOLVED: The department did not establish internal controls to ensure the accuracy of its unclaimed property database.

The department did not periodically reconcile its unclaimed property database to actual unclaimed assets, such as cash and securities. Without a comparison, the department cannot be assured that it accurately recorded all unclaimed property that it collected. The department is exposed to several types of errors that could occur without detection. For example, unclaimed property could be unrecorded or recorded at the wrong amount, or recorded assets may not actually exist.

The department publishes unclaimed property records on its web site and periodically in publications throughout the state to attempt to locate rightful owners. If those unclaimed property records are inaccurate, the department could pay claims in inappropriate amounts. In addition, the Department of Finance uses the department's unclaimed property records to report balances for the state's financial statements. Inaccurate unclaimed property records affect the Department of Finance's ability to make a reasonable estimate of financial statement liabilities.

Recommendation

- *The department should periodically reconcile its unclaimed property records to actual unclaimed property cash and securities.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Commerce. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 20, 2003.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 6, 2003

Report Signed On: March 17, 2003

Status of Prior Audit Issues As of January 6, 2003

Fiscal Year 2001 Statewide/Single Audit

We examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2001. We issued an unqualified opinion on the *State of Minnesota's Comprehensive Annual Financial Report* for the year ended June 30, 2001. We did not identify any reportable weaknesses as a result of our audit work.

Most Recent Financial-Related Audit

Legislative Audit Report 00-40, issued in August 2000, covered the period from July 1, 1996, through December 31, 1999. The audit scope included various revenue and expenditure areas, including the unclaimed property program. Several findings dealt with the administration of the unclaimed property program. Other findings dealt with fees the department collects. The department has resolved or is continuing to work on these issues. Since that audit, the department developed an internal unclaimed property database. However, we continue to see the need to improve internal controls assuring the accuracy of the database by performing periodic reconciliation, as discussed in Finding 2 of this report.

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.



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March 12, 2003

James R. Nobles, Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for your recent audit of our Unclaimed Property unit, our Securities Registration unit and our Low Income Home Energy Assistance Program. We truly appreciate the work your staff has done to help us bring all of our financial systems into compliance with current accounting standards. Your assistance is particularly valuable in this era of constantly evolving standards. Our responses to your findings and recommendations follow:

Finding #1: The Department of Commerce omitted certain unclaimed assets and did not properly determine unclaimed property accruals in accordance with accounting standards.

Recommendation #1: The Department of Commerce should determine the fair market value of unclaimed shares in mutual funds and unclaimed stocks in dividend reinvestment plans held as of June 30 each year and report those values to the Department of Finance. In addition, the department should consider selling unclaimed shares in mutual funds and unclaimed stocks in dividend reinvestment plans, held for over three years, in accordance with Minn. State. Section 345.47.

Response #1: The department will include the fair market value of mutual fund shares and dividend reinvestment accounts in our reports to the Department of Finance. The department has forwarded the mutual fund and dividend reinvestment records to its' securities custodian, Wells Fargo. Wells Fargo is in the process of transferring the shares from the owner of record to the custody accounts in place for the department. The department holds shares in approximately 722 separate funds and plans. The majority of the shares will be moved to Wells Fargo by the end of March, 2003. A small percentage of the funds and plans are segregated by dividend post date and are scheduled to transfer by May 1, 2003. After that date, the market value of the shares will be reflected in Wells Fargo's monthly reports to the department. Shares from the 722 funds and plans will be transferred into an account to be sold in 2006. Mutual funds and dividend reinvestment shares remitted in 2003 will be held in an account to be sold in 2007.

Recommendation #2: The department should accurately determine unclaimed property revenue and obligation accruals as of June 30 each year by:

- a) Establishing a methodology to estimate the accrued revenue from delinquent holder reports.
- b) Accurately determining payable and receivable accruals from interstate reciprocity agreements.
- c) Properly measuring liabilities by coding accounting transactions with record dates based on the date the claim is authorized for payment.

Response 2a: The Accounting and Unclaimed Property units will work with the Department of Finance to develop and implement a method to estimate accrued revenue from holder reports.

Response 2b: The Unclaimed Property unit will report accrued reciprocal unclaimed property payables and receivables in applicable financial statements at the end of each fiscal year.

Response 2c: The Accounting unit will recognize unclaimed property obligations in the year the claims were authorized.

Finding #2: The department did not establish internal controls to ensure the accuracy of its unclaimed property database.

Recommendation: The department should periodically reconcile its unclaimed property records to actual unclaimed property cash and securities.

Response #1 (Cash Receipts): Our Accounting unit has reconciled cash receipts in the unclaimed property database to the MAPS accounting system. The unit reconciled these receipts through February 28, 2003. The unit will continue to perform a monthly reconciliation. Additionally, the Unclaimed Property unit will complete another reconciliation within the unclaimed property database. This second process will reconcile unclaimed property receipts to unclaimed property holder reports.

Response #2 (Securities): The Unclaimed Property unit receives monthly securities reports from Wells Fargo Bank. The reports detail additions and payments from the department's securities accounts. The Unclaimed Property unit is developing a method to reconcile these monthly reports with the unclaimed property database. We expect to complete this process by May 1, 2003.

Thank you again for your recent audit of three units within the Department of Commerce. We look forward to working with your staff in the future.

Sincerely,



Glenn Wilson, Commissioner