
Financial Audit Division Report

Office of the State Auditor
January 1, 2005, through December 31, 2006



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 forty 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.

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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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Rebecca Otto
State Auditor

The Financial Audit Division conducted an audit of the Office of the State Auditor for the period January 1, 2005, through December 31, 2006. Our audit scope included appropriation control, audit practice revenue, payroll, and other administrative expenditures. Our objectives focused on a review of the office's internal controls over these financial activities and its compliance with applicable legal provisions.

The enclosed Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank the staff from the Office of the State Auditor for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: March 27, 2007

Report Signed On: July 10, 2007

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Audit Participation

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

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Mark Allan	Auditor
David Westlund	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of the State Auditor at an exit conference on June 26, 2007:

Rebecca Otto	State Auditor
Greg Hierlinger	Deputy State Auditor
Matthew Lindemann	Director of Budget, Finance, and Technology

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Report Summary

Overall Conclusion:

The Office of the State Auditor's internal controls were adequate, and the office complied with the finance-related legal requirements we tested. However, the office had the following weaknesses in its operations:

Findings:

- The office did not certify the correct costs of audits and exams of police and fire relief associations to the Department of Revenue. ([Finding 1, page 9](#))
- The office did not charge some local units of government interest on past-due accounts. ([Finding 2, page 12](#))

The report contained two findings related to internal control and legal compliance. The prior audit report contained no findings.

Audit Scope:

Audit Period:

January 1, 2005, to December 31, 2006

Programs Audited:

- Appropriation Control
- Audit Practice Receipts
- Payroll
- Administrative Expenditures

Agency Background:

The Office of the State Auditor was established by Article V of the Minnesota State Constitution and operates under [Minnesota Statutes](#) 2006, chapter 6. The mission of the office is to ensure financial integrity, accountability, and cost-effectiveness of Minnesota's local governmental entities. The office's activities are financed primarily through General Fund appropriations. The audit practice receipts collected from local units of government are deposited in the General Fund as nondedicated receipts. Patricia Anderson was the State Auditor during the audit scope. Rebecca Otto was elected State Auditor in November 2006 and took office on January 2, 2007.

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Office of the State Auditor

Chapter 1. Introduction

The Office of the Legislative Auditor audits all constitutional officers every two years according to a Legislative Audit Commission policy. We conduct our audits at the mid-point and at the end of each constitutional officer's term.

Agency Overview

The Office of the State Auditor was established by Article V of the Minnesota State Constitution and operates under *Minnesota Statutes* 2006, chapter 6. Minnesota voters elect the State Auditor to a four-year term. Patricia Anderson was the State Auditor during our audit scope. Rebecca Otto is the current State Auditor, beginning her term on January 2, 2007. The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Minnesota State Housing Finance Agency Board, Public Employees Retirement Association Board, and the Rural Finance Authority Board.

The Office of the State Auditor 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 of some 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 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 Office of the State Auditor's activities are financed primarily through General Fund appropriations. The office's appropriations for fiscal years 2005, 2006, and 2007 were approximately \$8.3 million each year. Chapter 2 provides more detail about the office's appropriations.

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Minnesota Statutes 2006, 6.58 requires that the office collect fees from audited organizations to cover its audit costs. The Audit Practices Division bills the political subdivisions it audits based on a fee schedule that the office adjusts annually, if necessary. The fees collected for audit services are deposited in the General Fund. Chapter 3 discusses the office's audit practice revenue.

The Office of the State Auditor 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. Chapter 4 provides more detail about the office's expenditures.

Table 1-1 summarizes the financial activity of the State Auditor for fiscal year 2006.

Table 1-1
Summary of Financial Activity
Fiscal Year 2006

Sources:

General Fund:

Operating Appropriation	\$ 8,273,000
Balance Forward In	281,244
Transfer In – Tax Increment Financing Account ^(Note 1)	931,542
Balance Forward In – Tax Increment Financing Account ^(Note 1)	1,083,269

Special Revenue Fund:

Dedicated Revenue ^(Note 2)	33,300
Balance Forward In	1,113
Total Sources	<u>\$10,603,468</u>

Uses:

Expenditures:

Payroll	\$ 7,695,594
Rent	382,496
Travel, In-State and Out-of-State	94,182
Supplies and Equipment	133,123
Professional and Technical Services	101,540
Miscellaneous Expenditures	<u>282,586</u>
Total Expenditures	<u>\$ 8,689,521</u>

Other Uses:

Balance Forward Out – General Fund	\$ 1,911,275
Balance Forward Out – Special Revenue Fund	2,672
Total Other Uses	<u>\$ 1,913,947</u>
Total Uses	<u>\$10,603,468</u>

Notes:

- (1) *Minnesota Statutes* 2006, 469.177, *subd. 11* created the Tax Increment Finance Division. The division received funding from a .36 percent charge on tax increment financing districts in fiscal year 2006. The Treasury Division of the Department of Finance collected the funds, deposited the money in the General Fund, and then transferred the funds to the office.
- (2) Dedicated revenue is collected for seminar and workshop activities.

Source: Minnesota Accounting and Procurement System.

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Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the office's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission,¹ as our criteria to evaluate office controls. The standards also require that we plan the audit to provide reasonable assurance that the office complied with financial-related legal provisions that are significant to the audit. In determining the office's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the office's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined a sample of evidence supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

¹ The Treadway Commission and its Committee of Sponsoring Organizations were established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of "internal control" that organizations should have in place to prevent inappropriate financial activity.

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Chapter 2. Appropriation Control

Chapter Conclusions

The Office of the State Auditor complied with appropriation laws and operated within its legally authorized funding level. The office recorded its expenditures properly on the state's accounting system and canceled or carried forward funds remaining at the end of the fiscal year as required by law. However, the office did not correctly certify the Pension Division's audit and exam costs to the Department of Revenue.

Audit Objective

The primary objective of our audit of appropriation control was to answer the following questions:

- Did the office comply with appropriation laws?
- Were expenditures properly recorded in the accounting system?
- Were funds remaining at the end of the fiscal year appropriately canceled, carried over, or transferred as required by law?

Background

The office received funding for its operations through a General Fund appropriation. The office allocates the appropriation to six operating divisions and accounts for expenditures by division. Table 2-1 summarizes financial activity for these divisions for fiscal year 2006.

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Table 2-1
Summary of General Fund Appropriation
Allocation for Fiscal Year 2006

Division	Appropriation	Balance Forward In From FY 2005 ⁽¹⁾	Amount Expended	Balance Forward to FY 2007
Audit Practice	\$5,614,660	\$197,645	\$5,516,966	\$295,339
Government Information	737,669	2,321	628,673	111,317
Operations Management	693,737	51,038	689,352	55,423
Special Investigations	438,346	27,152	452,455	13,043
Constitutional Office	294,149	1,542	292,713	2,978
Pension	<u>494,439</u>	<u>1,547</u>	<u>452,647</u>	<u>43,339</u>
Totals	<u>\$8,273,000</u>	<u>\$281,245</u>	<u>\$8,032,806</u>	<u>\$521,439</u>

Note 1: The Legislature allowed agencies to carry forward balances into the next biennium due to the state's budget problems.

Source: Minnesota Accounting and Procurement System.

The portion of the appropriation that the office spent on oversight of police and fire pension funds and the government information function reduced local government aid and police and fire state aid administered by the Department of Revenue.

- The office certified to the Department of Revenue the costs related to the government information function for a reduction in local government aids (limited to \$217,000 per year) as specified in *Minnesota Statutes* 2006, 477A.014, subd. 4.
- The office also certified costs related to the Pension Division to the Department of Revenue in accordance with *Minnesota Statutes* 2006, 69.021, subd. 5. The Department of Revenue reduced police and fire state aids by the amount of costs associated with audits or examinations of the police and firefighters relief associations. For fiscal year 2006, the office certified projected costs for firefighter and police relief oversight of \$312,809 and \$2,191, respectively.

In addition to the General Fund appropriation, the office received funding for the cost of examining the use of tax increment financing. Pursuant to *Minnesota Statutes* 2006, 469.177, subd. 11, the tax increment financing division received funding from a .36 percent charge on tax increment financing districts in fiscal year 2006. The Treasury Division of the Department of Finance collected the funds from the county treasurers, deposited the money in the General Fund, and subsequently transferred the funds to the Office of the State Auditor. Tax increment financing revenue collections in fiscal year 2006 totaled \$931,542. The Tax Increment Financing Division's total expenditures in fiscal year 2006 were \$624,974. The division carried forward about \$1,389,800 to fiscal year 2007.

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Our audit of appropriation control identified the following issue.

1. The office did not certify the correct costs of audits and exams of police and fire relief associations to the Department of Revenue.

The office did not correctly calculate the audit and exam costs for the police and fire relief associations. There was an error in the spreadsheet used to determine audit and exam costs. The calculation did not include all expenditures for fiscal year 2006.

*Minnesota Statutes*² require that the Department of Revenue reduce the amount of police and fire state aid available for apportionment by the amount required to pay the State Auditor's costs and expenses of audits or exams of the relief associations. Each year the office sends a letter to the Department of Revenue with the projected audit and exam costs for the current fiscal year. The letter also includes the projected and actual costs for the prior fiscal year. The difference between the projected and the actual costs determines the amount of additional aid to the relief associations. The Department of Revenue relies on the projected and actual costs to determine the reduction for state police and state fire aid. The office's letter dated September 2006 understated the actual audit and exam costs. As a result, the office incorrectly certified additional state fire and police aid of \$37,887 and \$662, respectively, to the Department of Revenue. The correct amounts should have been \$16,152 for fire aid and \$541 for police aid. The error resulted in the Department of Revenue incorrectly adjusting fiscal year 2007 state aid. There should be an appropriate level of review to ensure that calculations used in the certification are correct.

Recommendations

- *The office should notify the Department of Revenue of the error.*
- *The office should establish a review process over audit cost calculations to ensure it detects any errors.*

² *Minnesota Statutes* 2006, 69.021, subd. 5.

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Chapter 3. Audit Practice Revenue

Chapter Conclusions

The Office of the State Auditor's internal control structure helped ensure that it billed for audit practice services at the approved rate and accurately recorded transactions in the accounting records. The office adequately safeguarded audit practice receipts.

For the items we tested, the office complied with applicable finance-related legal requirements regarding audit practice receipts. However, the office did not charge some clients interest on past-due accounts.

Audit Objective

The primary objective of our review of audit practice revenues focused on the following questions:

- Did the office's internal controls help ensure that it billed for audit services at the proper rates and accurately recorded transactions in the accounting records?
- Did the office adequately safeguard audit practice receipts?
- Did the office comply with material finance-related legal provisions regarding receipts?

Background

The office conducted financial and compliance audits of local governments in Minnesota. The office billed local governments for associated audit costs. The office deposited audit practice receipts into the General Fund. These receipts were not available for expenditure by the office, as its spending is limited to the appropriation authority discussed in Chapter 2.

Minnesota Statutes 2006, 6.58 requires the office to review and adjust the schedule of charges for audit examinations at least annually to ensure that it collects an amount sufficient to pay all costs connected with such examinations. The office sets the rate based on estimated costs. The Department of Finance approved a rate increase of 6.75 percent for calendar year 2006. There was no rate increase for calendar year 2007.

In fiscal year 2006, the Office of the State Auditor collected approximately \$6 million in audit practice revenues. The office billed audit clients for audit work on a monthly basis. The basis

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for billing a client included approved hourly audit charges and travel costs. The office can charge interest on delinquent accounts of undisputed bills that are 60 days past due.

The office had the following weakness in its administration of its audit practice revenue:

2. The office did not charge interest on past due balances.

The office did not charge clients for interest on past due, outstanding balances. During the audit period, seven clients had accounts that were past due by more than 60 days. However, no invoice letters for interest were sent. Outstanding balances ranged from \$42 to \$2,941.

*Minnesota Statutes*³ require that the political subdivision pay interest to the State Auditor when the political subdivision has not paid an undisputed bill within 60 days following receipt of the invoice. The statute also states that the State Auditor must invoice political subdivisions for interest at the rate of 1.5 percent per month or any part of a month. Due diligence in pursuing collection of interest charges on outstanding account balances is important to ensure that the state receives all revenues that are due.

Recommendation

- *The office should monitor and pursue collection of any interest charges due on outstanding accounts.*

³ *Minnesota Statutes* 2006, 6.56, subd. 3(a).

Chapter 4. Payroll and Administrative Expenditures

Chapter Conclusions

The Office of the State Auditor's internal control ensured that it properly and accurately recorded payroll and administrative expenditure transactions in the accounting records. The office accurately allocated expenditures to the appropriate divisions.

For the items we tested, the office complied with applicable finance-related legal provisions and bargaining unit agreements.

Audit Objective

The primary objective of our audit of payroll and administrative expenditures was to answer the following questions:

- Did the office properly authorize and accurately record payroll and administrative expenditures in the accounting records?
- Did the office comply with significant finance-related legal provisions and bargaining agreements?

Payroll Expenditures

As of December 2006, the office employed 113 staff located in offices throughout the state. The employees were covered by various bargaining unit agreements. The office administered 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 2006.

Bi-weekly payroll transactions and pay rate changes were processed through the state's payroll system. These transactions were also recorded in the state's accounting system through a computer system interface.

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**Table 4-1
Payroll Expenditures
Budget Fiscal Year 2006**

<u>Payroll Type</u>	<u>Amount</u>
Full-time Salaries	\$7,217,035
Part-time Salaries	190,662
Overtime	117,479
Severance/Vacation Payoffs/Other	<u>170,418</u>
 Total Payroll	 <u>\$7,695,594</u>

Sources: OLA summary of expenditures for budget fiscal year 2006 through December 31, 2006.

Administrative Expenditures

Administrative expenditures accounted for approximately \$1 million or 11 percent of total operating costs. The office incurred various administrative expenditures such as rent, travel, professional and technical services, supplies, and equipment, as well as other miscellaneous categories.

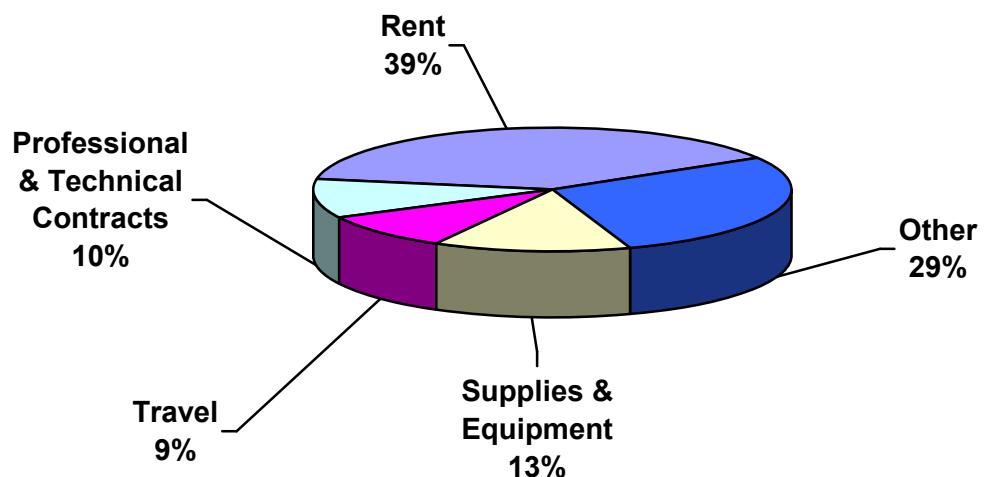
The largest administrative expenditure was for the lease of office space. The Real Estate Management Division of the Department of Administration assisted the office in negotiating lease agreements. The office leased office space for employees in St. Paul and other locations throughout the state. In fiscal year 2006, the office paid approximately \$382,000 for office and storage space rent at seven locations: St. Paul's two locations, Duluth, Marshall, Mankato, Moorhead, and Rochester.

Figure 4-1 illustrates the fiscal year 2006 administrative expenditures by type. The miscellaneous category is comprised mainly of communication and computer and system services.

We had no findings from our work in the payroll and administrative expenditures area.

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Figure 4-1
Other Administrative Expenditures
Fiscal Year 2006



Source: OLA summary of expenditures for budget fiscal year 2006 through December 31, 2006.

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Status of Prior Audit Issues As of March 27, 2007

May 2005, Legislative Audit Report 05-28 covered the two years ended December 31, 2004. The scope of the audit included appropriation control, audit practice revenues, personnel services, and other administrative expenditures. The report contained no findings.

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.

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July 10, 2007

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the audit findings included in the financial and compliance audit of the Office of the State Auditor for the January 1, 2005, through December 31, 2006, audit period which was during the tenure of former State Auditor Pat Anderson. The following are the responses to the two findings included in the June 19, 2007, draft audit report.

Audit Finding # 1: The office did not certify the correct costs of audits and exams of police and fire relief associations to the Department of Revenue.

The Office of the State Auditor has developed new procedures that will result in the correct amount of costs of audits and exams of police and fire relief associations being certified with the Department of Revenue. In addition, the excess amounts certified for fiscal year 2006 with the Department of Revenue will be recertified when the fiscal year 2007 actual costs and fiscal year 2008 projected costs are certified to the Department of Revenue. The process of correcting the actual fiscal year 2006 costs has been approved by the Department of Revenue.

Audit Finding # 2: The office did not charge interest on past due amounts.

The Office of the State Auditor has adopted a new policy that will ensure that all audit clients are charged interest if payment is not received within 60 days of receiving the invoice.

Thank you again for the opportunity to provide you with responses to the audit findings.

Sincerely,

/s/Rebecca Otto

Rebecca Otto
State Auditor