



FINANCIAL AUDIT DIVISION REPORT

Office of the Attorney General

Internal Controls and Compliance Audit

January 1, 2009 through December 31, 2010

August 26, 2011

Report 11-21

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

August 26, 2011

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Lori Swanson
Attorney General

This report presents the results of our internal controls and compliance audit of the Office of Attorney General for the period January 1, 2009, through December 31, 2010.

We discussed the results of the audit with the Office of Attorney General's staff on August 10, 2011. This audit was conducted by Jim Riebe, CPA (Audit Manager) and Pat Ryan (Auditor-in-Charge), assisted by auditors Ted Bethell, Carissa Moritz, and Kelsey Nistler.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Office of Attorney General. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 26, 2011.

We received the full cooperation of the Office of Attorney General's staff while performing this audit.

A handwritten signature in black ink that reads 'James R. Nobles'.

James R. Nobles
Legislative Auditor

A handwritten signature in black ink that reads 'Cecile M. Ferkul'.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Office of the Attorney General's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, and complied with finance-related legal provisions. However, the office had some weaknesses in its internal controls related to the processing of restitution payments, billing state agencies for legal services, and verifying the accuracy of payroll expenses.

For the items tested, the office generally complied with finance-related legal requirements. However, the office had some instances of noncompliance in its receipts process.

The office implemented four of our six prior audit recommendations, and partially implemented a fifth recommendation.¹ The office completed physical inventories of fixed assets, limited pay increases to conform to the office's compensation plan, and reimbursed employee travel expenses in accordance with state policies. Although the office improved its deposit procedures, we have repeated the recommendation to promptly deposit some receipts. One prior audit finding is no longer relevant because of changes in state policies pertaining to overtime.²

Key Findings

- Prior Finding Partially Resolved: The office did not always promptly deposit legal settlement receipts. ([Finding 1, page 7](#))
- The office did not adequately segregate duties over the processing of restitution payments. ([Finding 2, page 7](#))
- The office did not ensure that it received accurate payments from some state agencies for legal services. ([Finding 3, page 8](#))

Audit Objectives and Scope

<u>Objectives</u>	<u>Period Audited</u>
• Internal Controls	January 1, 2009 through December 31, 2010
• Finance-related Legal Compliance	

¹ Office of the Legislative Auditor, Financial Audit Division Report 09-33, [Office of the Attorney General](#), issued September 24, 2009.

² The Department of Management and Budget's Policy PAY0012 "Requesting and Reporting Overtime" eliminated the requirement that agencies retain overtime requests and authorization slips. Instead, the policy established the supervisor's authorization of the employee's timesheet as evidence of overtime approval. All timesheets we tested that included overtime hours had been approved by the employee's supervisor.

Programs Audited

- Payroll Expenditures
- Travel Expenditures
- Administrative Expenditures
- Restitution Payments
- Legal Settlement and Legal Services Receipts

Office of the Attorney General

Agency Overview

Article V of the *Minnesota Constitution* established the Office of the Attorney General. The office operates under *Minnesota Statutes* 2010, Chapter 8. The Attorney General is the state's chief legal officer and is elected for a four-year term. Lori Swanson was first elected in November 2006 and was reelected in November 2010. This audit covered the last two years of her first term in office.

The office received most of its funding through General Fund appropriations. Appropriations for fiscal years 2009, 2010, and 2011 were about \$24.9 million, \$24.9 million, and \$24.4 million, respectively. As authorized by statute, the office also received reimbursements from state agencies for the cost of legal services for activities not funded by the General Fund.³ In addition, the office collected receipts that it deposited back to the state's General Fund for registrations of charities and clubs, fines, settlements, and restitutions.⁴ Payroll was the most significant administrative cost for the office. Table 1, on page 5, summarizes the office's sources and uses of financial resources for the period July 2009 through June 2010.

Objective, Scope, and Methodology

The objective of our audit of the Office of the Attorney General's Office was to answer the following questions for the period January 1, 2009, through December 31, 2010:

- Were the office's internal controls adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?
- Did the office comply with finance-related legal requirements?
- Did the office resolve prior audit findings?⁵

³ *Minnesota Statutes* 2010, 8.15, subd. 5.

⁴ These nondedicated receipts reverted to the General Fund and were not available to fund the office's operations.

⁵ Office of the Legislative Auditor, Financial Audit Division, Report 09-33, *Office of the Attorney General*, issued September 24, 2009.

To answer these questions, 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 requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of transactions and evidence supporting the office's internal controls and compliance with laws, regulations, policies, and contracts.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used various criteria to evaluate internal controls and compliance. As our criteria to evaluate agency controls, we used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.⁶ We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and the office's internal policies and procedures as evaluation criteria over compliance.

⁶ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 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. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

Table 1
Summary of Financial Activity
Fiscal Year 2010¹

Sources	General Fund²	Special Revenue Funds³	Agency Fund⁴	Federal Fund⁵
Operating Appropriation	\$24,985,000	\$ 395,000	\$ 0	\$ 0
Balance Forward In from FY 2009	14,130	2,583,401	1,255,820	0
Transfers In	0	14,465	0	0
Fees for Legal Services	9,453,232	0	0	0
Legal Settlement Receipts	0	0	410,344	0
Other Receipts	5,419	220,435	20,128	0
Reverted to General Fund ⁶	(436,000)	0	0	0
Federal Grants	0	0	0	1,067,662
Total Sources	\$34,021,781	\$3,213,301	\$1,686,292	\$1,067,662
Uses				
Payroll	\$26,035,745	\$ 267,310	\$ 0	\$ 796,116
Rent	2,734,068	5,118	0	65,067
Other Administrative Expenditures	949,069	23,877	0	192,962
Travel	143,522	3,221	0	13,517
Restitution Payments	0	0	489,907	0
Transfers Out	14,465	0	592,911	0
Balance Forward Out to FY 2011	4,144,912	2,913,775	603,474	0
Total Uses	\$34,021,781	\$3,213,301	\$1,686,292	\$1,067,662

¹ Our audit scope was January 1, 2009, through December 31, 2010. This scope included the last half of fiscal year 2009, all of fiscal year 2010, and the first six months of fiscal year 2011. This table presents activity from the only full fiscal year in our audit scope and not the full scope of financial activity subjected to our audit.

² The General Fund accounts for the office's state appropriation and main financial operations.

³ This column consists of the Special Revenue Fund, Environmental Fund, and Remediation Fund.

⁴ The Agency Fund accounts for the portion of legal settlement receipts that fund restitution payments to injured parties.

⁵ The Office of the Legislative Auditor annually examines the state's major federal grants in compliance with federal audit requirements. The Office of the Attorney General received federal funds primarily for its State Medicaid Fraud Control Unit, a part of the federal Medical Assistance Program (Catalog of Federal Domestic Assistance 93.778). Because the Medical Assistance Program is a major federal program and was included in the scope of our federal compliance audit for fiscal years 2009 and 2010, we did not perform any additional procedures related to federal program compliance.

⁶ Laws of Minnesota 2010, chapter 215, article 12, section 6.

Source: Minnesota Accounting and Procurement System.

Conclusion

The Office of the Attorney General's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, and complied with finance-related legal provisions. However the office had some weaknesses in its internal controls related to the processing of restitution payments, billing state agencies for legal services, and verifying the accuracy of payroll expenses.

For the items tested, the office generally complied with finance-related legal requirements. However, the office had some instances of noncompliance in its receipt process.

The office implemented four of our six prior audit recommendations, and partially implemented a fifth recommendation. The office completed physical inventories of fixed assets, limited pay increases to conform to the office's compensation plan, and reimbursed employee travel expenses in accordance with state policies. Although the office improved its deposit procedures, we have repeated the recommendation to promptly deposit some receipts. One prior audit finding is no longer relevant because of changes in state policies pertaining to overtime.⁷

The following *Findings and Recommendations* further explain the office's internal controls and compliance weaknesses.

⁷ The Department of Management and Budget's Policy PAY0012, "Requesting and Reporting Overtime" eliminated the requirement that agencies retain overtime requests and authorization slips. Instead, the policy established the supervisor's authorization of the employee's timesheet as evidence of overtime approval. All timesheets we tested that included overtime hours had been approved by each employee's supervisor.

Findings and Recommendations

Prior Finding Partially Resolved:⁸ The Office of Attorney General did not always promptly deposit legal settlement receipts.

Finding 1

The office did not always deposit legal settlement receipts daily. State statutes require the office to “deposit receipts totaling \$1,000 or more in the state treasury daily.”⁹ Since the last audit, the office corrected its deposit procedures for fines and registrations of charities and clubs; however, it continued to have some delays in depositing legal settlement receipts. For the three months of receipts in calendar year 2010 we tested, the office deposited 14 checks, totaling about \$342,000, one to five days late. In addition, the office did not deposit one check in excess of \$500,000 until five days after it was received. According to office staff, the process for these receipts, which sometimes delayed deposits for several days, required verifications by attorneys that the amounts received agreed with the settlement terms. If the office determines it is unable to comply with the prompt deposit requirement, it could request a waiver from the Department of Management and Budget.

Recommendation

- *The office should deposit receipts in excess of \$1,000 daily, as required by Minnesota Statutes, or obtain a waiver from the Department of Management and Budget.*

The Office of Attorney General did not adequately segregate duties over the processing of restitution payments.

Finding 2

The office did not have sufficient internal controls over restitution payments.¹⁰ During 2009 and 2010, the office issued 1,686 restitution checks totaling \$1.8 million. The office’s procedures allowed the employee who initiated the restitution payments in the state’s accounting system to also pick up the checks at the Department of Management and Budget.¹¹ These duties are incompatible because they allow one person to generate a payment, record the payment on the accounting system, and physically access the check, which increases the risk of error or fraud. Although the office’s attorneys monitored legal settlement receipts

⁸ Minnesota Office of the Legislative Auditor, Financial Audit Division, Report 09-33, *Office of the Attorney General*, issued September 25, 2009 (Finding 6).

⁹ Minnesota Statutes 2010, 16A.275, subd. 1.

¹⁰ Restitution payments resulted from the resolution of lawsuits that stipulated restitution payments to injured parties.

¹¹ The office picked up the checks so that staff could include other information explaining the payments when it mailed checks to the recipients.

and corresponding restitution payments to injured parties, and staff told us they performed other control procedures, these procedures did not effectively mitigate the risk because they relied on information obtained from the person with incompatible access, rather than transactions recorded in the state's accounting system. We did not identify any improper payments.

As part of its internal control structure, the state's accounting system limits access to processed payments by either electronically paying or mailing most payments directly to recipients. The department only deviates from this process at the request of a paying entity.

Recommendation

- *The office should segregate the duties of processing restitution payments and having physical access to checks, or implement and document internal controls to effectively mitigate the risks related to these incompatible duties. The controls should include independent verification to transactions and balances recorded in the accounting system.*

Finding 3

The Office of Attorney General did not ensure that it received accurate payments from some state agencies for legal services.

The office did not have an adequate process to ensure the accuracy of some billings for legal services. The office entered into agreements with certain state agencies for legal services in addition to those provided through the office's General Fund appropriation. These agreements specified an estimated amount of legal service hours the office would provide and the payment terms. In fiscal year 2010, the office collected about \$9.4 million from 22 agencies. We tested all agreements in fiscal years 2009 and 2010. The office had the following errors or noncompliance issues:

- The office inaccurately invoiced the Department of Education, resulting in an overpayment of about \$57,000 in fiscal year 2010. The agreement stated the department would pay for 2,625 hours of legal services, would not pay for additional services up to 3,125 hours, but that it would pay for services in excess of 3,125 hours. However, the office billed for hours exceeding 2,625, resulting in an overbilling of 500 hours.
- The office failed to identify that the Department of Natural Resources paid \$22,388 less than the fiscal year 2010 agreement specified, and the Iron Range Resources paid \$11,718 and \$5,245 less than the agreement amounts for fiscal years 2009 and 2010, respectively.

Recommendations

- *The office should resolve the billing and payment errors with the respective agencies.*
- *The office should ensure that future billings and collections of legal service fees comply with the terms of agreements.*

The office did not review a key report to validate self service time entry payroll transactions.

Finding 4

The office did not review the self service time entry audit report, as required by the Department of Management and Budget's policy.¹² The office began using self service time entry in December 2009. Self service time entry is the state's automated process for employees to report and supervisors to review payroll hours. As of December 2010, about 75 of the office's 316 employees used the automated system to enter their payroll hours; the other employees continued to use paper timesheets.

Review of the self service time entry audit report is an important control to ensure the accuracy of the office's payroll, which is a major expense of the office. The state's policy states, "The best control over the integrity of employees' payroll information is achieved when employees prepare their own timesheets and supervisors, who have direct knowledge of employees' work, review and approve timesheets." The self service time entry audit report identifies exceptions related to these controls, e.g., timesheets completed by someone other than the employee and timesheets approved by a backup supervisor. The state's policy requires agencies to review this report and obtain and document an explanation for the exceptions. The policy requires a comprehensive review of the report each pay period but, if this is not possible, allows a review of a representative sample of exceptions each pay period and a comprehensive review of the report each quarter.

Recommendation

- *The office should review the self service time entry audit report each pay period to ensure the accuracy and authorization of payroll paid through the state's automated timesheet process, and it should obtain and document explanations for reported exceptions.*

¹² Department of Management and Budget Policy PAY0017.



STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

August 22, 2011

102 STATE CAPITOL
ST. PAUL, MN 55155
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Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
First Floor South, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for your Internal Control Compliance Audit for the period of January 1, 2009 through December 31, 2010. Please accept this response to the Findings and Recommendations:

Finding 1:

The office did not always deposit legal settlement payments within 24 hours of receipt.

Response:

It should be noted that all receipts and funds have been properly accounted for, and no discrepancy has occurred with the system utilized by the Office. It should also be noted that, with the exception of litigation settlements, all other receipts of the Office are deposited within 24 hours.

Litigation settlements involve the courts and generally involve consent decrees where the attorneys must be assured that the respondent is in compliance with the corrective or injunctive provisions in the decree. Once the State deposits the respondent's settlement check, it could arguably be deemed to have waived the respondent's compliance with the remaining portions of the decree. It is sometimes impossible to ensure such compliance with the decree within a 24-hour period.

In any event, I note that all litigation settlement payments were deposited within five days of receipt. You suggest that, under the circumstances, we ask Minnesota Management and Budget to waive compliance with the 24-hour standard. MMB has done so.

Finding 2:

The Attorney General's Office should involve additional administrative staff in the processing of restitution payments so as to further segregate job duties.

Response:

I have been involved with all of the audits on behalf of this Office for the last 28 years, and it was not previously suggested by your office that additional staff should be included in the restitution distribution process. As a result, I am somewhat surprised at this recommendation.

It should be noted that all funds have been properly accounted for, and no discrepancy has occurred with the system utilized by the Office. Restitution payments involve checks issued to a consumer as a result of a litigation settlement. Restitution payments are initiated by the written directive of a licensed attorney, who generally is the attorney who handled the litigation. The directive is issued to an administrative financial officer, who enters the financial data for the check to be issued. The processing of the checks is cross-checked by the chief administrative director. The checks are given to the licensed attorney, who cross-checks the checks against the settlement and mails the checks to the consumers. In some cases, there is a remainder balance, which is deposited in the State's general fund. The licensed attorney is responsible to ensure that the funds have been properly distributed pursuant to the court order.

That having been said, we appreciate your comments and will involve additional administrative staff in the restitution distribution process.

Finding 3:

Three state agencies did not transfer the correct amounts to the Attorney General's Office for legal services.

Response:

The Attorney General's Office enters into contracts for legal services with some executive branch state agencies. The contracts require the agencies to transfer to the Attorney General's Office payments for legal services. In fiscal year 2010, 22 state agencies transferred to the Attorney General's Office about \$9.4 million for legal services. You indicate that three state agencies transferred incorrect amounts to the Attorney General's Office. The total amount was a net \$17,649, representing less than .001 percent of the total transfers.

First, the Department of Natural Resources ("DNR") was supposed to transfer to the Attorney General's Office \$785,500 in four quarterly payments of \$196,375. The DNR transferred the first three payments of \$196,375 correctly, but incorrectly transferred \$173,987 instead of \$196,375 for the fourth quarter, resulting in an under-transfer of \$22,388.

Second, you indicate that the Iron Range Resources and Rehabilitation Board ("IRRRB") was supposed to transfer to the Attorney General's Office \$282,800 in fiscal year 2009 and \$319,200 in fiscal year 2010 but actually transferred \$271,082 in fiscal year 2009 and \$313,955 in fiscal year 2010, resulting in under-transfers of \$11,718 and \$5,245, respectively.

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Finally, the Department of Education (“DOE”) was supposed to transfer to the Attorney General’s Office \$224,808 in four quarterly payments of \$56,202 with a year-end reconciliation for actual hours incurred up to 2,625 hours and over 3,125 hours. DOE correctly transferred the four quarterly payments but, as part of the year-end reconciliation process, incorrectly transferred payment for hours incurred between 2,625 and 3,125, resulting in an over-transfer of about \$57,000.

I have instructed accounting staff to resolve the transfer issues with the state agencies.

Finding 4:

Payroll staff did not review the form FIHR2460, Self Service Time Entry Audit Report.

Response:

I note that all payroll hours were accurately recorded and accounted for on the timesheets.

AGO clerical staff employees record their payroll hours on electronic timesheets. Your audit confirmed that the timesheets are then reviewed and approved for accuracy by the employee’s direct supervisor.

In addition to review of timesheets by the clerical staff employee’s direct supervisor, you recommend that payroll staff separately review form FIHR2460, Self Service Time Entry Audit Report. We appreciate this comment.

If you have any questions, please contact me.

Sincerely,



REBECCA SPARTZ
Director of Administration

AG: #2870315-v2