



**OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA**

FINANCIAL AUDIT DIVISION REPORT

Supplemental Payments to Employees

Overtime and Expense Reimbursements

Internal Controls and Compliance Audit

July 2013 through June 2016

October 6, 2016

Report 16-13

FINANCIAL AUDIT DIVISION
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Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Generally Adequate	With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Not Adequate	The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

October 6, 2016

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This report presents the results of our internal controls and compliance audit of the state's overtime payments and employee expense reimbursements for the period July 1, 2013, through June 30, 2016. The objectives of the audit were to determine whether state agencies that paid the highest amounts of overtime and employee business expense reimbursements had adequate internal controls over those expenditures and complied with applicable payroll and other legal requirements.

This audit was conducted by Sonya Johnson, CPA, CFE (Auditor-in-Charge); assisted by auditors Jordan Bjonfald, CPA, and Joe Kuschke, CPA.

We received the full cooperation of the departments' staff while performing this audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

The Office of the Legislative Auditor conducted this audit to determine whether state departments that paid the highest amounts of overtime and employee business expense reimbursements had adequate internal controls over those expenditures and complied with applicable payroll and other legal requirements. Over fiscal years 2014, 2015, and 2016, the state paid approximately \$270 million in overtime and approximately \$96 million in employee business expense reimbursements.

Conclusion

The departments of Corrections, Human Services, Natural Resources, Public Safety, and Veterans Affairs had adequate internal controls to ensure that they accurately paid employees for authorized overtime hours worked. These departments also complied with the payroll and other legal requirements related to overtime we tested. However, the Department of Transportation needs to strengthen some controls.

The departments of Health, Human Services, Natural Resources, Transportation, and the Minnesota State Colleges and Universities system had adequate internal controls over employee expense reimbursements to ensure that employees received proper reimbursement for reasonable and necessary costs. These departments also complied with the payroll and other legal requirements related to employee expense reimbursements we tested.

Audit Finding

- The Department of Transportation had some control weaknesses over ensuring the accuracy and authorization of its payroll transactions, including overtime. (Finding 1, page 11)

Background

Overtime and employee expense reimbursements have a higher risk of calculation errors and noncompliance with applicable federal requirements, including the Fair Labor Standards Act,¹ state statutes, laws, policies, and the respective employee bargaining agreements or compensation plans. This higher risk exists because of the complexity of the laws and differences between the various bargaining agreements and compensation plans.

The state classifies about 30,000 of its approximately 52,000 employees as “nonexempt” employees, meaning that these employees are not exempt from the federal overtime requirements of the Fair Labor Standards Act. Because they are nonexempt, the federal law requires the state to pay overtime to these employees when they meet certain conditions, such as the number of hours worked in a week.

The state reimburses employees for expenses they incur to perform state business. Typically, the state reimburses employees for mileage, lodging, meals, and other incidental travel or other business-related expenses. The bargaining unit agreements, other legal requirements, and individual agency internal policies and procedures determine the types of costs that are eligible for reimbursement and the limits associated with certain types of expenses.

Overtime

The state’s overtime expenditures from July 1, 2013, to June 30, 2016, were approximately \$270 million. Large agencies, with more employees, incurred most of the overtime expenditures. Overtime was often related to road construction projects, emergency weather and public safety situations, and human services and correctional facilities that operate 24 hours a day. Table 1 shows the state’s overtime payments for fiscal years 2014 through 2016, by agency.

¹ Fair Labor Standards Act (FLSA) is a federal law establishing minimum wage and overtime pay eligibility that affects both full-time and part-time workers in federal, state, and local governments, and the private sector. There are changes to the current FLSA regulations effective December 1, 2016, which could increase the number of people eligible for overtime.

Table 1
Overtime Expenditures
July 1, 2013, through June 30, 2016

<u>Agency</u>	<u>Fiscal Years</u>			
	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Total</u>
Minnesota State Colleges and Universities	\$21,699,239	\$21,477,324	\$21,504,711	\$64,681,274
Human Services	17,847,646	19,755,141	21,287,880	58,890,667
Transportation	15,569,162	11,240,619	10,697,603	37,507,384
Public Safety	8,391,890	8,749,487	8,353,144	25,494,521
Corrections	6,732,209	7,441,438	7,888,410	22,062,057
Natural Resources	5,406,148	6,485,617	7,314,577	19,206,342
Veterans Affairs	4,519,269	4,374,913	4,760,672	13,654,854
MN.IT Services ¹	4,116,473	4,497,646	4,718,484	13,332,603
Other Agencies ²	<u>4,886,566</u>	<u>5,129,163</u>	<u>4,837,908</u>	<u>14,853,637</u>
Total	<u>\$89,168,602</u>	<u>\$89,151,348</u>	<u>\$91,363,389</u>	<u>\$269,683,339</u>

¹ The amounts for MN.IT Services include some information technology employees who stayed on department payrolls for time reporting and payroll processing purposes. We included some MN.IT Services employees in our sample who reported their time through Human Services for fiscal years 2014 and 2015. See Footnote 2 for more information.

² Other Agencies include overtime expenditures for 68 other state agencies. We did not perform any audit work specifically at these agencies.

Source: State of Minnesota's accounting system.

We focused our review of overtime on employees working at the departments of Corrections, Human Services (including the Office of MN.IT Services' employees in Table 2), Natural Resources, Public Safety, Transportation, and Veterans Affairs.² We specifically examined the employees that earned the most overtime at these agencies. We did not perform work at Minnesota State Colleges and Universities as the majority of their overtime expenditures were for supplemental pay for specific assignments in excess of faculty members' workloads. This type of compensation is calculated as a percentage of the employee's base salary and is administered differently than overtime calculated on an hourly basis.

² Following the state's consolidation of its information technology services in fiscal year 2012, outlined in *Minnesota Session Laws* 2011, First Special Session, Chapter 10, art. 4, information technology employees transitioned their employment from specific departments to the Office of MN.IT Services. However, for time reporting and payroll processing purposes, the information technology employees of some departments, including those employees we tested who provided services to the Department of Human Services, stayed on department payrolls through fiscal year 2015. As of the start of fiscal year 2016, all of the state's information technology employees report their time through the Office of MN.IT Services.

Employees earn large amounts of overtime for a variety of reasons, including:

- Employees voluntarily working vacant shifts on their off days or in addition to their scheduled shift.³
- Employers requiring employees to fill vacant shifts at 24-hour facilities.
- Employees working on special projects with deadlines, such as the MNsure information technology system.

Table 2 shows the top ten employees receiving the highest amount of overtime from the state.

Table 2
State Overtime Expenditures to the Top Ten Employees
July 1, 2013, through June 30, 2016

Employee's Position	Agency	Fiscal Years		
		2014	2015	2016
Security Counselor	Human Services	\$75,518	\$101,184	\$117,791
Information Technology Specialist 4	MN.IT Services ¹	\$78,234	\$77,133	\$87,885
Information Technology Specialist 5	MN.IT Services ¹	\$97,680	\$71,641	\$63,483
Security Counselor Lead	Human Services	\$32,854	\$68,323	\$65,601
Registered Nurse	Veterans Affairs	\$26,049	\$52,867	\$66,573
Systems Architect	MN.IT Services ¹	\$47,845	\$52,140	\$45,354
Corrections Officer 2	Corrections	\$42,690	\$52,696	\$48,855
Mental Health Program Assistant	Human Services	\$28,275	\$44,691	\$62,547
Information Technology Specialist 4	MN.IT Services ¹	\$7,271	\$59,172	\$66,613
Transportation Specialist	Transportation	\$43,671	\$46,947	\$41,825

¹These Office of MN.IT Services employees provided services to the Department of Human Services and remained on the department's payroll for time reporting and payroll processing purposes for fiscal years 2014 and 2015. See Footnote 2 on the previous page for more information.

Source: State of Minnesota's accounting system.

In October 2015, the State of Minnesota was named as a defendant in a class action lawsuit claiming the state failed to properly calculate overtime pay when employees also earned shift differential pay, in violation of the Fair Labor Standards Act. The lawsuit was still pending as of the release of this report.

³ Bargaining agreements and compensation plans establish the requirements for how employers should distribute overtime work amongst employees.

Employee Expense Reimbursements

Over fiscal years 2014 through 2016, the state reimbursed employee business expenses totaling about \$96 million. In this audit of employee expense reimbursements, we focused our review on the departments of Health, Human Services, Natural Resources, and Transportation, and the Minnesota State Colleges and Universities system. We focused on these agencies because they had the highest amount of expense reimbursements and comprise 60 percent of total expense reimbursements. Table 3 shows the state's employee expense reimbursements from July 1, 2013, to June 30, 2016.

Table 3
Expense Reimbursements by Agency
July 1, 2013, to June 30, 2016

<u>Agency</u>	<u>Fiscal Years</u>			
	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Total</u>
Minnesota State Colleges and Universities	\$11,086,908	\$11,012,899	\$10,308,135	\$32,407,942
Transportation	2,932,882	2,939,262	2,683,515	8,555,659
Natural Resources	1,952,713	1,940,254	1,823,521	5,716,488
Human Services	1,941,067	1,798,723	1,506,346	5,246,136
Health	1,926,361	1,981,205	1,816,886	5,724,452
Other Agencies ¹	<u>12,458,579</u>	<u>13,157,207</u>	<u>12,517,314</u>	<u>38,133,100</u>
Total	\$32,298,510	\$32,829,550	\$30,655,717	\$95,783,777

¹ Other Agencies consist of 83 state agencies, boards, councils, and commissions. These agencies reimbursed employees for business expenses totaling from \$702 to \$4.3 million over fiscal years 2014 through 2016. We did not perform detailed testing of these agencies' reimbursements of employee business expense reimbursements.

Source: State of Minnesota's accounting system.

Table 4 shows the types of expense reimbursements paid during our audit period.

Table 4
Expense Reimbursements by Type
July 1, 2013, through June 30, 2016

Expense Type	Fiscal Years				Percentage of Total
	2014	2015	2016	Total	
Mileage Instate	\$13,192,571	\$13,527,147	\$12,566,295	\$39,286,013	41
Instate Travel Expense	6,936,929	7,559,709	6,992,438	21,489,076	22
Outstate Travel Expense	6,589,897	6,433,514	6,098,908	19,122,319	20
Tuition and Registration	2,150,880	2,063,916	1,918,413	6,133,209	6
Relocation Expense	1,077,522	946,447	998,178	3,022,147	3
Supplies, Materials, and Parts	784,871	770,314	599,584	2,154,769	2
Mileage Outstate	495,178	471,281	414,908	1,381,367	1
Memberships	403,073	403,324	402,789	1,209,186	1
Clothing Allowance	324,280	303,656	349,695	977,631	1
Other ¹	<u>343,309</u>	<u>350,242</u>	<u>314,509</u>	<u>1,008,060</u>	<u>3</u>
Total	\$32,298,510	\$32,829,550	\$30,655,717	\$95,783,777	100

¹ Other includes network services, other communication, and other purchased services.

Source: State of Minnesota's accounting system.

Audit Objective, Scope, and Methodology

Our objective for this audit was to answer the following questions:

- Did state agencies have adequate controls to ensure that they accurately paid employees for authorized overtime worked and reasonable and necessary business expenses incurred?
- Did state agencies comply with select payroll and other legal provisions related to employee overtime and employee expense reimbursements?

Our audit scope was comprised of overtime paid and business expense reimbursements made by state agencies for the period July 1, 2013, through June 30, 2016. To meet our audit objective, we used the following methodology: We gained an understanding of statewide policies issued by the Department of

Management and Budget, employee bargaining unit agreements, and internal agency policies and procedures for overtime and employee business expenses. We considered the risk of errors in the accounting records and noncompliance with relevant legal requirements.

In addition, we selected a sample of financial transactions and reviewed supporting documentation to determine whether the state agencies' controls over overtime and employee expense reimbursements were effective. To determine how to select our samples, we identified the agencies that paid the most overtime and expense reimbursements and selected those agencies for testing. We selected individual samples based on the following criteria: the top 25 employees statewide, the top 5 employees at the top agencies, and a judgmental sample of employees. We selected 120 business expense reimbursements and 117 overtime sample items for testing. We also tested whether overtime and employee expense reimbursements complied with applicable legal criteria.

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 objective.

We did not evaluate management practices regarding overtime use as that was not an objective of this audit.

Audit Criteria

We assessed the state agencies' internal controls against the most recent edition of the internal control standards, published by the U.S. Government Accountability Office.⁴ For the Minnesota State Colleges and Universities system, we used, as our criteria, the guidance contained in the Internal Control-Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission.⁵

To establish legal compliance criteria for the transactions we tested, we examined the requirements in the following documents:

- Federal law and regulations.

⁴ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington D.C., September 2014.) In September 2014, the State of Minnesota adopted these standards as the internal control framework for the executive branch.

⁵ 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.

- Department of Management and Budget policies and procedures.
- Agencies' policies and procedures.
- Employee bargaining unit agreements and compensation plans.

Conclusion

The departments of Corrections, Human Services, Natural Resources, Public Safety, and Veterans Affairs had adequate internal controls to ensure that they accurately paid employees for authorized overtime hours worked. These departments also complied with the payroll and other legal requirements related to overtime we tested. However, the Department of Transportation needs to strengthen some controls.

The departments of Health, Human Services, Natural Resources, Transportation, and the Minnesota State Colleges and Universities system had adequate internal controls over employee expense reimbursements to ensure that employees received proper reimbursement for reasonable and necessary costs. These departments also complied with the payroll and other legal requirements related to employee expense reimbursements we tested.

The following Finding and Recommendation section provides further explanation about the exceptions noted above.

Finding and Recommendation

The Department of Transportation had some internal control weaknesses over ensuring the accuracy and authorization of its payroll transactions, including overtime.

Finding 1

The department weakened the integrity of employee time reporting by not reviewing, monitoring, and following-up on some instances when supervisors without direct knowledge of the employees' work approved employees' timesheets and when supervisors modified employee timesheets without the employees' review. Because the employee and the employee's direct supervisor have the best knowledge of the employee's work, they are in the best position to detect time reporting errors. Once completed and approved, the timesheet is the basis for the state's payment to the employee, including payment for any overtime recorded on the timesheet.

We tested a sample of 18 timesheets where employees recorded overtime worked. The department did not have a process to effectively review, monitor, and follow-up on the following types of exceptions:

- Ten of the timesheets were approved by someone other than the supervisor with direct knowledge of the employees' work. Although the department assigns a primary supervisor to each payroll department in its payroll system, if that supervisor is unavailable to approve timesheets, he or she assigns another supervisor to do the approval.
- One timesheet was modified by a supervisor without the employee's approval.

The department does not use the state's self service time entry system and does not have to follow the state's policies for that system. The department used its own time reporting system, Resource Consumption Application. As with the state's system, employees enter hours worked, including overtime, and supervisors review and approve employee time. Information from the department's time reporting system uploads into the state's payroll system and is the basis for payroll payments.

For those state agencies that use the state's self service time entry system, standard reports are available each pay period to notify agencies whenever someone other than the employee completes the timesheet or someone other than the employee's direct supervisor approves the timesheet. Because these types of exceptions weaken the integrity of the timesheet, state policy requires follow-up with the employee and the employee's direct supervisor to ensure the accuracy of

the timesheet and the appropriateness of its approval.⁶ The policy also requires state agencies to monitor and minimize these types of exceptions.

Since Department of Transportation employees do not use the state's self service time entry system, these audit reports are not available. Without some alternate review, monitoring, and follow-up process, the department may be paying employees based on inaccurate or unauthorized time reported.

Recommendation

- *The Department of Transportation should develop a process to identify, review, monitor, and follow-up on timesheets that were approved by someone without direct knowledge of the employees' work or completed by someone other than the employee.*

⁶ Department of Management and Budget Policy PAY0017.



Minnesota Department of Transportation
395 John Ireland Boulevard
Saint Paul, MN 55155

October 3, 2016

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the draft audit report regarding overtime and employee expense reimbursements at the department for the period from July 1, 2013 through June 30, 2016. This letter is the Department of Transportation (MnDOT) response to the draft report issued by the Office of Legislative Auditor.

Finding 1 – The Department of Transportation had some internal control weaknesses over ensuring the accuracy and authorization of its payroll transactions, including overtime.

Recommendation – The Department of Transportation should develop a process to identify, review, monitor, and follow-up on timesheets that were approved by someone without direct knowledge of the employees' work or completed by someone other than the employee.

Response – MnDOT believes strongly in financial integrity. MnDOT continues to refine and improve its internal control process and will address the finding in the following manner:

- Develop exception report to list timesheets approved by someone other than the direct supervisor
- Develop exception report to list timesheets completed by someone other than the employee
- Develop and implement a process for review, monitor and follow-up of timesheets listed on exception reports

Responsible Staff: Sue Stein, Assistant Commissioner, Corporate Services Division

Implementation Date: April 1, 2017

Thank you for the opportunity to respond to your finding and recommendation. MnDOT will monitor the implementation to the successful resolution of this finding. Please contact Mary Ann Fraszak, MnDOT Office of Financial Management Assistant Director, at 651-366-4855 with questions.

Sincerely,

/s/ Charles A. Zelle

Charles A. Zelle
Commissioner of Transportation

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