



Office of the State Auditor

Internal Controls and Compliance Audit

February 2021

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division

The Financial Audit Division conducts audits focusing on government entities in the executive and judicial branches of state government. In addition, the division periodically audits metropolitan agencies, several “semi-state” organizations, and state-funded higher education institutions. Overall, the division has jurisdiction to audit approximately 180 departments, agencies, and other organizations.

Policymakers, bond rating agencies, and other decision makers need accurate and trustworthy financial information. To fulfill this need, the Financial Audit Division allocates a significant portion of its resources to conduct financial statement audits. These required audits include an annual audit of the State of Minnesota’s financial statements and an annual audit of major federal program expenditures. The division also conducts annual financial statement audits of the three public pension systems. The primary objective of financial statement audits is to assess whether public financial reports are fairly presented.

The Financial Audit Division conducts some discretionary audits; selected to provide timely and useful information to policymakers. Discretionary audits may focus on entire government entities, or on certain programs managed by those entities. Input from policymakers is the driving factor in the selection of discretionary audits.

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OLA also conducts special reviews in response to allegations and other concerns brought to the attention of the Legislative Auditor. The Legislative Auditor conducts a preliminary assessment in response to each request for a special review and decides what additional action will be taken by OLA.

For more information about OLA and to access its reports, go to: www.auditor.leg.state.mn.us.



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 3, 2021

Members

Legislative Audit Commission

The Honorable Julie Blaha, State Auditor
Office of the State Auditor

This report presents the results of our internal controls and compliance audit of the Office of the State Auditor for the period July 2017 through February 2020. The objectives of this audit were to determine if the department had adequate internal controls over selected financial activities and complied with significant finance-related legal requirements.

This audit was conducted by Lori Leysen, CPA (Audit Director), Shannon Hatch, CFE (Auditor-in-Charge), Paul Rehschuh, CFE (Senior Auditor), Kris Schutta (Senior Auditor), and Zakeeyah Taddese (Staff Auditor).

We received the full cooperation of the Office of the State Auditor's staff while performing this audit.

Sincerely,

Lori Leysen, CPA
Deputy Legislative Auditor



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Report Summary

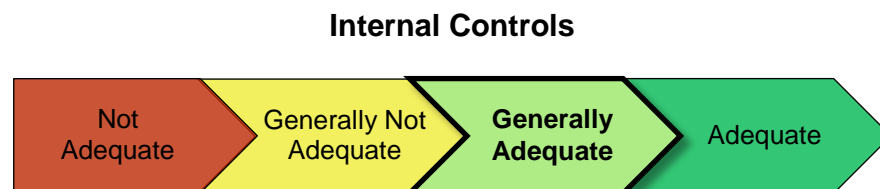
The Office of the State Auditor (OSA) has oversight responsibility for all units of local government, including counties, cities and townships, school districts, fire relief association pension funds, housing and redevelopment authorities, port authorities, soil and water conservation districts, and approximately 150 other special districts. Work with these entities involves auditing, reviewing, investigating, reporting, and educating.

The Office of the Legislative Auditor (OLA) conducted this audit to determine whether the Office of the State Auditor had adequate internal controls and complied with significant finance-related legal requirements. The audit scope included revenues collected from audit charges; payroll expenditures and employee expense reimbursements; rent expenditures; other administrative expenditures; and system security access. The period under examination went from July 1, 2017, through February 29, 2020.

Conclusions

Internal Controls

OLA found that the Office of the State Auditor's internal controls over the areas in our audit scope were generally adequate to ensure that it safeguarded assets and ensured compliance with applicable legal requirements.

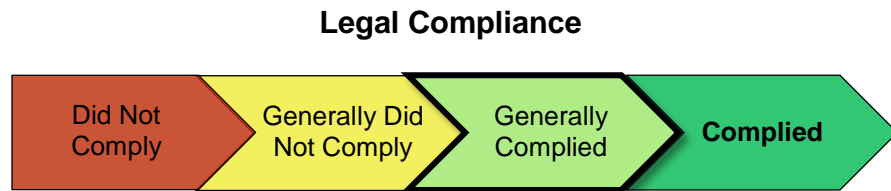


We identified an internal control weakness related to safeguarding fixed assets, discussed more thoroughly in the findings and recommendations in this report.

- **Finding 2 – Prior Audit Finding.** The Office of the State Auditor did not have sufficient internal controls to safeguard its fixed assets. (p. 11)

Legal Compliance

The Office of the State Auditor generally complied with finance-related legal requirements.



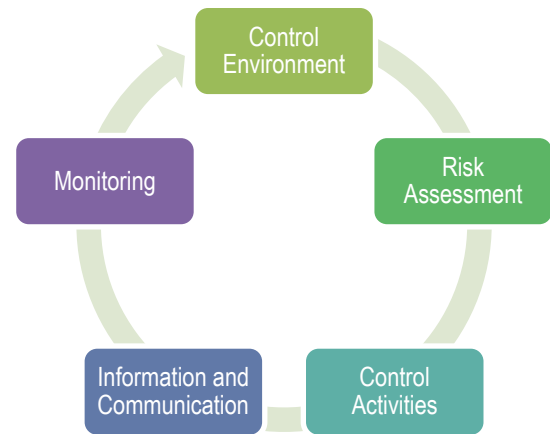
We identified an issue of noncompliance related to overtime, discussed more thoroughly in the findings and recommendations in this report.

- **Finding 1.** The Office of the State Auditor incorrectly paid overtime to some employees. (p. 9)

Audit Overview

This report presents the results of an internal controls and compliance audit of selected activities in the Office of the State Auditor. Management is responsible for establishing internal controls to safeguard assets and ensure compliance with applicable laws, regulations, and state policies.

A strong system of internal controls begins with management's philosophy, operating style, and commitment to ethical values. It also includes processes to continuously assess risks and implement control activities to mitigate risks. A successful internal controls system includes iterative processes to monitor and communicate the effectiveness of control activities.



Office of the State Auditor Overview and History

The Office of the State Auditor (OSA) is a constitutional office in the executive branch of state government.¹ The State Auditor is elected to a four-year term. Two State Auditors served during the scope of the audit. Rebecca Otto served from 2007 through 2018, and Julie Blaha began her term in January 2019. The State Auditor serves on the boards of the following seven entities: Department of Natural Resources' Land Exchange, Minnesota Historical Society, Minnesota Housing Finance Agency, Public Employees Retirement Association, Rural Finance Authority, State Board of Investment, and State Executive Council.

OSA oversees local government finances for Minnesota taxpayers. The mission of the office is to ensure financial integrity and accountability in local governmental financial activities. In order to ensure that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability, OSA performs audits of local governmental financial statements and reviews documents, data, reports, and complaints reported to the office.

OSA has six locations throughout the state, which include Duluth, Mankato, Marshall, Moorhead, Rochester, and Saint Paul. Employees at the Saint Paul location perform all accounting and human resources duties.

¹ *Minnesota Constitution*, art. V, sec. 1.

Audit Scope, Objectives, Methodology, and Criteria

Receipts

This part of the audit focused on the collection and deposit of audit charges. We designed our work to address the following questions:

- Did OSA have adequate controls over audit fee receipts?
- Did OSA charge the correct rate to its clients?
- Did OSA collect, safeguard, and properly deposit all receipts in accordance with legal and administrative requirements?

To answer these questions, we interviewed OSA staff to gain an understanding of internal controls and compliance over receipts. To determine whether OSA had adequate internal controls and complied with legal requirements, we:

- Performed a reconciliation of receipts recorded in OSA's billing system to the state's accounting system.
- Reviewed the billing rates for calendar years 2017 through 2020 to determine if the rates were sufficient to cover the cost of audits performed and to ensure Minnesota Management and Budget approved the rates prior to charging its clients.
- Randomly tested 40 of 392 daily check deposits to ensure that all deposits were accurate and timely.
- Randomly tested 40 of 1,722 billed audit fees to determine if the amounts charged and collected by OSA were accurate.

Payroll Expenditures

This part of the audit focused on the accuracy of the compensation paid to employees. We designed our work to address the following questions:

- Did OSA have adequate internal controls to ensure that it accurately compensated employees in compliance with applicable legal provisions?
- Did OSA accurately compensate employees?

To answer these questions, we interviewed OSA staff to gain an understanding of the internal controls and compliance over payroll expenditures. To ensure OSA accurately paid employees in accordance with state statutes, state policies and procedures, and applicable bargaining agreements or compensation plans, we:

- Randomly tested 40 of 5,512 employee timesheets, 40 of 519 overtime payments, 20 of 125 pay rate changes, 11 of 30 employees receiving FMLA, 30 of 183 retroactive payments, and 3 of 13 separation payments.

- Analyzed general increases, compensatory time, and leave to ensure compliance with state policies and procedures.
- Tested all new-hire pay rates that required additional approval and reviewed the State Auditor's salary.
- Reviewed employee access to the state's payroll system.

Nonpayroll Expenditures

This part of the audit focused on the purchases of rent, equipment, and other administrative expenditures. We designed our work to address the following questions:

- Did OSA have adequate internal controls to ensure that it:
 - Obtained and accurately paid for expenditures in compliance with applicable legal provisions?
 - Reimbursed employees for business expenses in accordance with applicable finance-related legal provisions?
 - Tracked all fixed assets and sensitive items?
- Did OSA comply with applicable finance-related legal provisions and internal policies during the period covered by our audit?

To answer these questions, we interviewed staff from OSA to gain an understanding of internal controls and compliance over nonpayroll expenditures. To ensure OSA had adequate internal controls and complied with legal requirements, we:

- Randomly tested 41 of 592 purchases of goods and services over \$100 and judgmentally selected an additional 2 samples.
- Tested rent expenditures, which included all expenditures related to OSA's six lease agreements, as well as randomly tested 5 of 112 payments for storage space and 1 of 4 miscellaneous rent expenditures.
- Randomly tested 18 of 108 travel expenses and 40 of 1,494 employee reimbursements.
- Randomly tested 16 of 51 equipment expenditures, 12 of 78 employee physical inventory lists, and 39 of 229 asset disposals over \$500, including 3 judgmentally selected items.
- Reviewed employee access to the state's accounting system.

We conducted this performance audit in accordance with generally accepted government auditing standards.² 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 believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. When sampling was used, we used a sampling method that complies with generally accepted government auditing standards and that supports our findings and conclusions. That method does not, however, allow us to project the results we obtained to the populations from which the samples were selected.

We assessed internal controls against the most recent edition of the internal control standards, published by the U.S. Government Accountability Office.³ To identify legal compliance criteria for the activity we reviewed, we typically examine state and federal laws, state administrative rules, state contracts, and policies and procedures established by the departments of Management and Budget and Administration. In addition, we examined OSA policies and procedures.

² Comptroller General of the United States, Government Accountability Office, *Government Auditing Standards* (Washington, DC, December 2018).

³ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government* (Washington, DC, September 2014). In September 2014, the State of Minnesota adopted these standards as its internal control framework for the executive branch.

Receipts

The Office of the State Auditor (OSA) receives a General Fund appropriation to finance the majority of its operating activities. The General Fund appropriation amounts for fiscal years 2018, 2019, and 2020 were \$9,750,000, \$10,058,000, and \$10,338,000, respectively. In addition, state statute requires OSA to bill for audits at a rate that is sufficient to cover the cost to perform the audits.⁴ OSA deposits the fees in the General Fund as nondedicated receipts.⁵ Fees for audit charges collected during the audit scope represented approximately 99 percent of revenues. Exhibit 1 shows the total receipts collected by OSA from July 1, 2017, through February 29, 2020.

Exhibit 1: Receipts, Fiscal Years 2018, 2019, and 2020

| Receipt Type | 2018 | 2019 | 2020 ^a | Total |
|--|-------------|-------------|-------------------|--------------|
| Audit Charges | \$6,001,514 | \$5,479,374 | \$3,303,517 | \$14,784,405 |
| Seminar | 29,502 | 38,700 | 38,040 | 106,242 |
| Deposits for Other Entities ^b | 13,500 | 9,300 | 3,600 | 26,400 |
| Interest Charges | — | — | 44 | 44 |
| Total Receipts | \$6,044,516 | \$5,527,374 | \$3,345,201 | \$14,917,091 |

^a Fiscal Year 2020 includes receipts through the end of the audit scope, February 29, 2020, and not through the end of the fiscal year.

^b "Deposits for Other Entities" includes user fees to cities, towns, and other government entities for the development, maintenance, and distribution of the small city and town accounting system software, as allowed by *Minnesota Statutes* 2020, 6.475(c).

SOURCE: State of Minnesota accounting system.

OSA also receives a special revenue appropriation to operate its Tax Increment Financing Division.⁶ Amounts totaled approximately \$812,000 in Fiscal Year 2018 and \$860,000 in Fiscal Year 2019. OSA does not entirely expend funds each year; unspent funds are carried forward. At the beginning of Fiscal Year 2020, the accumulation of carryover funds totaled \$3,013,850. Exhibit 2 shows the Tax Increment Financing funds by fiscal year.

⁴ *Minnesota Statutes* 2020, 6.581, subd. 3.

⁵ Nondedicated receipts revert to the General Fund and are not available to fund the office's operations.

⁶ A special revenue fund contains money paid by counties to the state, as directed by *Minnesota Statutes* 2020, 469.177, to provide resources for the operations of the office's Tax Increment Financing Division, as allowed by *Minnesota Statutes* 2020, 469.1771, subd. 1. The Tax Increment Financing Division examines and reviews political subdivisions' use of tax increment financing; responds to inquiries from citizens and government officials; and provides compliance training.

**Exhibit 2: Tax Increment Financing Carryover Balance,
Fiscal Years 2018, 2019, and 2020**

| Appropriation | 2018 | 2019 | 2020 |
|-------------------------|-------------|-------------|-------------|
| Tax Increment Financing | \$2,665,548 | \$2,872,894 | \$3,013,850 |

SOURCE: State of Minnesota accounting system.

Our testing of receipts found that OSA had adequate internal controls to ensure all receipts were deposited and were accurately recorded into the state's accounting system. Furthermore, for calendar years 2017 through 2020, we determined that Minnesota Management and Budget approved OSA billing rates, and the approved rates were sufficient to cover the cost of audits performed.

Expenditures

The Office of the State Auditor (OSA) had expenditures totaling approximately \$24.3 million during the period covered by our audit scope. Exhibit 3 breaks down these expenditures by type.

Exhibit 3: Total Expenditures, Fiscal Years 2018, 2019, and 2020

| Expenditure Type | 2018 | 2019 | 2020 ^a | Total |
|-----------------------------------|-------------|-------------|-------------------|--------------|
| Payroll | \$7,968,004 | \$7,908,305 | \$5,110,137 | \$20,986,446 |
| Other Administrative Expenditures | 563,505 | 594,443 | 522,437 | 1,680,385 |
| Rent | 465,012 | 480,993 | 325,274 | 1,271,279 |
| Equipment | 253,853 | 75,493 | 62,577 | 391,923 |
| Total Expenditures | \$9,250,374 | \$9,059,234 | \$6,020,425 | \$24,330,033 |

^a Fiscal Year 2020 includes receipts through the end of the audit scope, February 29, 2020, and not through the end of the fiscal year.

SOURCE: State of Minnesota accounting system.

Payroll

Payroll is OSA's largest expenditure, which is about 86 percent of total expenditures. There are approximately 80 employees at OSA, and 64 percent of those employees are in the Audit Practice division. All employees enter their hours worked in OSA's billing system. Once approved, payroll staff manually enter employees' time in the state's payroll system.

OSA paid approximately \$338,000 in overtime during the audit scope. According to state policy, overtime must be requested and approved in advance, and applicable labor agreements must be reviewed for overtime terms and eligibility.⁷

FINDING 1

The Office of the State Auditor incorrectly paid overtime to some employees.

During our audit scope, eight OSA supervisors were classified as exempt employees under the Middle Management Association Agreement.⁸ For exempt employees, the agreement defines a normal payroll period as follows:

Because of the nature of the duties performed by these supervisors, it is impracticable to apply provisions which prescribe normal work

⁷ Minnesota Management and Budget, Operating Policies and Procedures PAY0012, *Requesting and Reporting Overtime*, issued September 2009.

⁸ According to the Fair Labor Standards Act, employers are not required to pay exempt employees overtime.

hours. However, it is normally expected that eighty (80) hours of work shall constitute a normal payroll period. It is recognized that these supervisors are responsible for managing and accounting for their own hours of work and that they may work hours in excess of the normal work day and/or payroll period and may make adjustments in hours of work in subsequent work days and/or payroll periods, provided such time management does not result in overtime payment or guarantee hour-for-hour time off for extra hours worked.⁹

The agreement then defines when overtime is allowed for these same employees:

Supervisors assigned to a special project that is in addition to their normal duties or workloads and upon having received advance approval shall be compensated as follows....¹⁰

OSA provided advanced approval of overtime for these employees. However, OSA did not classify and approve the overtime earned as a “special project.” Instead, OSA allowed employees to earn overtime to complete audit work that was considered part of their normal work responsibilities. During our audit scope, of the \$338,000 of overtime paid, OSA incorrectly paid eight employees \$138,000, with one employee receiving \$27,120.

OSA told us that this has been its practice for at least the last 35 years. Furthermore, OSA believes the language allows them to offer overtime when it has been determined that the work in question will require the employee to work hours beyond the “normal” 80 hour pay period and when balancing the hours in subsequent pay periods is not possible.

It should be noted that the agreement defines a second group of exempt supervisors who do receive overtime for all hours worked over 80 hours within a pay period.¹¹ If the intent of the agreement was to compensate all exempt employees with overtime for hours worked over 80, the state would not have made a point to differentiate how and when these two groups receive compensation.

We recognize that in past audits, we have not identified this as an issue and in past reports have stated, “The OSA complied with material finance related legal provisions of state bargaining unit agreements for the transactions tested.”¹² However, unidentified issues in previous audits does not prohibit OLA from reporting the issue in future audits.

RECOMMENDATION

The Office of the State Auditor should compensate employees for overtime in accordance with state policies and applicable bargaining agreements.

⁹ Middle Management Association Agreement for 2019-2021, art. 11, sec. 2A.

¹⁰ *Ibid*, sec. 2B.

¹¹ *Ibid*, sec. 1C.

¹² Office of the Legislative Auditor, Financial Audit Division, *Office of the State Auditor* (St. Paul, 2005), 11.

Other Administrative Expenditures and Rent

Other administrative expenditures included computer services, supplies, professional/technical contracts, communications, travel, employee development, repairs, printing, and other operating costs. OSA obtained approximately 93 percent of its other administrative expenditures from state contracted vendors.

Approximately 99 percent of rent expenditures for OSA included six lease agreements for its office locations, totaling just over \$1.3 million. Other rent expenditures included payments made to rent storage space for offsite archiving of paper files and payments to rent space at events, such as a career fair.

We found that OSA had adequate internal controls, and complied with applicable finance-related legal provisions and internal policies over other administrative expenditures and rent.

Equipment

Statewide policy requires agencies to track state property and conduct a biennial physical inventory, which includes capital assets over \$5,000 and sensitive items.¹³ The policy also requires that agencies ensure adequate separation of duties and develop mitigating controls when separation is not possible. According to OSA's internal policy, the office has chosen to track the purchase and disposal of assets over \$1,000 and all sensitive items.¹⁴ In addition, the policy requires an annual physical inventory. OSA has 946 assets totaling approximately \$1.4 million.¹⁵ To track these assets, OSA uses its own software.

FINDING 2 – PRIOR AUDIT FINDING

The Office of the State Auditor did not have sufficient internal controls to safeguard its fixed assets.

We found that OSA did not adequately separate duties for those who had assets assigned to them and had administrative access to the asset tracking software. Specifically, OSA assigned 342 assets, or 36 percent of all assets totaling approximately \$1 million, to one employee who disseminates IT equipment to OSA employees. This employee also had administrative access to the asset tracking system. In addition, this employee, along with two other employees, shared the same administrative login credentials. Administrative access to the asset tracking system allows users to modify content such as adding, deleting, and assigning assets. With a shared login, there is no

¹³ Department of Administration, *Property Management Reporting and Accountability Policy*, issued May 1, 2014. Sensitive items include items for individual use or those that could be easily sold, stolen, or misused.

¹⁴ Minnesota Office of the State Auditor, Accounting Policies and Procedures, *Capital Assets*, issued July 15, 2010.

¹⁵ We relied on data from OSA's asset tracking system. However, OSA did not always include an acquisition price, which prevented us from determining the full value of its assets.

way to identify who made changes in the tracking system. Furthermore, according to OSA, the system does not track modifications, which prevents OSA from identifying whether or when a change has occurred.

OSA has a greater risk of misappropriation of assets because of the lack of separation of duties. An employee with access to the asset tracking system could steal an asset and delete that asset from the asset records to avoid detection.

RECOMMENDATIONS

- **The Office of the State Auditor should segregate incompatible duties in its fixed asset inventory process or develop internal controls to effectively mitigate the risk.**
 - **The Office of the State Auditor should create separate login credentials for employees who have access to the asset tracking system.**
-

List of Recommendations

- The Office of the State Auditor should compensate employees for overtime in accordance with state policies and applicable bargaining agreements. (p. 10)
- The Office of the State Auditor should segregate incompatible duties in its fixed asset inventory process or develop internal controls to effectively mitigate the risk. (p. 12)
- The Office of the State Auditor should create separate login credentials for employees who have access to the asset tracking system. (p. 12)





January 27, 2021

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations included in the internal control and compliance audit of the Office of the State Auditor for the period July 1, 2017, through February 29, 2020.

Finding 1: The Office of the State Auditor incorrectly paid overtime to some employees.

Recommendation:

- The Office of the State Auditor should compensate employees for overtime in accordance with state policies and applicable bargaining agreements.

Response: The Office of the State Auditor (OSA) agrees that its overtime compensation to its employees should be in accordance with state policies and applicable bargaining agreements. In light of the Office of the Legislative Auditor's finding, the OSA plans to develop and implement improved documentation standards for overtime pay approval going forward.

Person Responsible: Matthew Lindemann, Director of Budget, Finance & Technology

Implementation Date: June 30, 2021

Finding 2: The Office of the State Auditor did not have sufficient internal controls to safeguard its fixed assets.

Recommendations:

- The Office of the State Auditor should segregate incompatible duties in its fixed asset inventory process or develop internal controls to effectively mitigate the risk.
- The Office of the State Auditor should create separate login credentials for employees who have access to the asset tracking system.

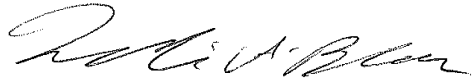
Mr. James R. Nobles
January 27, 2021
Page 2

Response: The Office of the State Auditor (OSA) agrees that internal controls over the fixed asset inventory process are important and that internal controls need to be continually evaluated to ensure they are relevant. In addition to the existing internal controls over fixed assets, the OSA has removed administrative access in the asset tracking system from the staff person who has been assigned approximately 36 percent of the assets, and we have assigned unique login credentials to staff who need administrative rights for development. The OSA has also added fields to the database to automatically record who makes changes to a fixed asset record and the date and time the change was made. The OSA believes these enhancements to the internal controls over fixed assets resolve the concerns identified during the audit.

Person Responsible: Matthew Lindemann, Director of Budget, Finance & Technology

Implementation Date: Completed

Sincerely,

A handwritten signature in black ink, appearing to read "Julie Blaha", written in a cursive style.

Julie Blaha
State Auditor

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