OFFICE OF THE STATE TREASURER
FINANCIAL AUDIT
FOR THE TWO YEARS ENDED JUNE 30, 1990

APRIL 1991

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

91-17

Veterans Service Building, Saint Paul, Minnesota 55155 • 612/296-4708

OFFICE OF THE STATE TREASURER

FINANCIAL AUDIT
FOR THE TWO YEARS ENDED JUNE 30, 1990

Public Release Date: April 5, 1991 No. 91-17

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: State depository receipts and cash control, warrant redemption and control, investment transaction processing, debt service expenditures, and fee, assessment and surcharge receipts.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

We found one area where the internal control structure needed improvement:

- The State Treasurer's monitoring system has not identified certain material collateral deficiencies.

We found that the Office of the State Treasurer had complied with finance-related legal provisions, except for monitoring collateral pledged to secure state deposits.

Contact the Financial Audit Division for additional information.
(612) 296-1730

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Michael A. McGrath
State Treasurer

Audit Scope

We have conducted a financial related audit of the Office of the State Treasurer for the two years ended June 30, 1990. In addition, we reviewed selected financial transactions of the Office of the State Treasurer for the period July 1 through December 31, 1990. Our audit was limited to that portion of the State of Minnesota's financial activities attributable to the transactions of the Office of the State Treasurer, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Office of the State Treasurer in effect during June 1990.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transactions of the Office of the State Treasurer are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Office of the State Treasurer's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Office of the State Treasurer is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and

- transactions are recorded properly on the statewide accounting system in accordance with Department of Finance policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Accounting Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- state depository receipts and cash control;
- warrant redemption and control;
- investment transaction processing;
- debt service expenditures; and
- fee, assessment and surcharge receipts.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Conclusions

Our study and evaluation disclosed the condition discussed in finding #1 involving the internal control structure of the Office of the State Treasurer. We consider this condition to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We do not believe the reportable condition described above is a material weakness.

The results of our tests indicate that, except for the issue discussed in finding #1, with respect to the items tested, the Office of the State Treasurer complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Office of the State Treasurer has not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and management of the State Treasurer's Office. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 5, 1991.

We would like to thank the State Treasurer's Office staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELD WORK: January 28 1991

REPORT SIGNED ON: March 29, 1991

STATE TREASURER'S OFFICE

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AUDIT PARTICIPATION

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

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Audit Manager
Carl Otto, CPA	Auditor-In-Charge
John Wicklund, CPA	Auditor

EXIT CONFERENCE

The finding and recommendation in this report was discussed with the following staff of the State Treasurer's Office on March 14, 1991.

Michael McGrath	State Treasurer
John Manahan	Deputy Treasurer
Jerry Engebretson	Director of Treasury Operations

I. INTRODUCTION

The State Treasurer is a constitutional officer elected by the citizens of the state to a four year term. One of the primary functions of the Office of the State Treasurer is to receive and account for all monies paid into the state treasury until lawfully disbursed or invested. The office maintains approximately 330 bank accounts in 200 banks throughout the state. Each day staff determine the amount of idle cash available for investment and certify that amount to the State Board of Investment. The office also verifies that the amount of collateral pledged to secure state funds on deposit in the various banks complies with statutory requirements.

The Office of the State Treasurer also must record and verify all warrants redeemed from the state treasury. Agencies request the issuance of warrants to satisfy lawful obligations of the state. The Treasurer's Office verifies the validity of the warrants before transferring funds to appropriate banks for payment. Over 4.5 million warrants were processed during fiscal year 1990. The office also maintains records and makes payments for principal and interest on the state's general obligation bonded debt. Debt service payments during fiscal year 1990 totalled approximately $222 million.

In addition to its general statewide financial management responsibilities, the Treasurer's Office deposits various fees, fines and assessments received from counties. These include monies, as prescribed by law, for traffic offenses, marriage licenses, marriage dissolutions, real estate transactions and various court filings. Receipts collected during the audit period were as follows:

	FY Ended 6/30/89	FY Ended 6/30/90	Six Months Ended 12/31/90
Penalties and Surcharges	$5,984,559	$ 8,380,849	$3,589,454
Other Governmental Fees	318,567	3,703,743	5,871,422
Marriage License/Dissolution Fees	1,616,482	2,322,381	1,481,141
Other	1,160,037	825,274	701,041
Total Receipts	$9,079,645	$15,232,247	$11,643,058

Source: Statewide Accounting System, Estimated Actual Receipts Reports as of September 2, 1989, September 1, 1990 and December 31, 1990.

II. CURRENT FINDING AND RECOMMENDATION

1. The State Treasurer's monitoring system has not identified certain material collateral deficiencies during fiscal year 1990.

Various depository banks did not pledge sufficient collateral to secure state funds during fiscal year 1990. Pledged collateral was short of legal requirements by more that $10 million on at least 13 days during the year. The majority of the collateral deficiencies related to the St. Paul bank through which the Treasurer processes most receipt and investment transactions. Deposits in that bank were undercollateralized by over $10 million on at least 12 days.

Timing differences have resulted in shortages not identified by the State Treasurer's monitoring procedures. Currently, the Treasurer's Office reviews bank balances as recorded on its computerized state depository accounting system. Staff calculate collateral shortages on a daily basis. If collateral is insufficient for several days, additional action is taken to correct the problem. However, due to timing differences in recording receipt and withdrawal transactions, the actual bank balance may differ from the Treasurer's recorded balance. The Treasurer's system determined that collateral was short by $10 million on 6 days during the year. Because of the timing of certain tax revenue receipts, collateral deficiencies may occur more often the last week of the month. We reviewed the actual month end bank balances for six of the banks with larger accounts. Collateral fell short by $10 million on seven of the 12 days reviewed. The Treasurer's system did not identify these shortages.

The Treasurer's Office can determine daily balances at the St. Paul bank and should use this information to verify collateral sufficiency. For other depository banks, state agencies make direct deposits and then send deposit slips to the Treasurer's Office. The Treasurer should work with these agencies to get more timely information on deposits. In addition, the Treasurer should review bank statements for larger accounts and require banks which are regularly undercollateralized to pledge additional amounts.

Minn. Stat. Section 9.031 requires that deposits be secured by insurance or a combination of insurance and collateral. State deposits should not exceed 90 percent of the sum of the insured amount and the market value of the collateral. Daily verification of collateral protects state funds on deposit in the various banks.

RECOMMENDATION

- **The Office of the State Treasurer should revise its method of monitoring collateral shortages for the larger bank accounts. Where information is available, staff should review actual bank balances periodically to ensure collateral sufficiency.**

STATE OF MINNESOTA
OFFICE OF THE STATE TREASURER

303 State Administration Building
50 Sherburne Avenue
Saint Paul, Minnesota 55155

MICHAEL A. McGRATH
Treasurer

(612) 296-7091
Fax (612) 296-8615

March 25, 1991

James R. Nobles
Legislative Auditor
and
John Asmussen
Deputy Legislative Auditor
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles and Mr. Asmussen:

Thank you for the opportunity to respond to the comment and recommendation in your financial audit report for the two year period ending June 30, 1990. Our response is attached.

We appreciate your assistance and recommendations. Your staff conducted itself in a very responsible and professional manner during the entire process.

As always, we are available for further discussions to improve the operation of the Office of the State Treasurer.

Sincerely,

Michael A. McGrath
Treasurer
State of Minnesota

MAM/bhs

OFFICE OF THE STATE TREASURER

RESPONSE TO

LEGISLATIVE AUDITOR RECOMMENDATIONS

FOR

TWO YEAR PERIOD ENDED JUNE 30, 1990

Recommendation

The Office of the State Treasurer should revise its method of monitoring collateral shortages for the larger bank accounts. Where information is available, staff should review actual bank balances periodically to ensure collateral sufficiency.

Response

The Office of the State Treasurer agrees with the recommendations of the Legislative Auditor. However, I would note that our aged information system is significantly limited for current day applications and requirements. We will put in place a manual review process to reduce collateral deficiencies. Collateral shortfalls of $10 million or more were primarily caused by Department of Revenue afternoon deposits in amounts from $30 to $70 million when it is impossible to secure more collateral on such short notice. In addition, if these uncollected funds were not required to be collateralized, we would have had sufficient collateral. We are in the process of trying to get this issue resolved through legal opinions.

Jerry Engebretson and Michael Hager are responsible for implimenting our collateral procedures.