

**OFFICE OF THE ATTORNEY GENERAL
FINANCIAL AUDIT
FOR THE PERIOD JULY 1, 1988 - DECEMBER 31, 1990**

APRIL 1991

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

OFFICE OF THE ATTORNEY GENERAL
FINANCIAL AUDIT
FOR THE PERIOD JULY 1, 1988 - DECEMBER 31, 1990

Public Release Date: April 12, 1991

No. 91-22

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: billing revenue, litigation settlements, payroll, travel expenditures, and professional/technical contracts.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

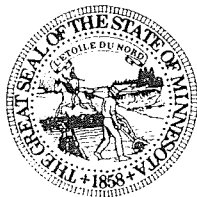
CONCLUSIONS:

We found two areas where the internal control structure needed improvement:

- The Office of the Attorney General does not review adjustments to client billings for propriety.
- The office does not properly process contractual agreements or verify compliance with contract terms.

We found that the Office of the Attorney General had complied with finance-related legal provisions, except for processing contractual agreements.

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 Hubert H. Humphrey, III
Attorney General

Audit Scope

We have conducted a financial related audit of the Office of the Attorney General as of and for the two years ended June 30, 1990 and the six months ended December 31, 1990. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Office of the Attorney General, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Office of the Attorney General in effect during December 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 Attorney General 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 Attorney General's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Office of the Attorney General is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. 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 Control Structure

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

- billing revenue,
- litigation settlements,
- payroll,
- travel expenditures, and
- professional/technical contracts.

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 conditions discussed in findings 1 and 2 involving the internal control structure of the Office of the Attorney General. We consider these conditions to be reportable conditions 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 believe none of the reportable conditions described above is a material weakness.

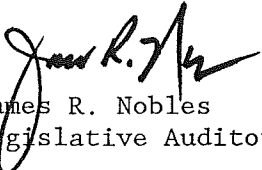
We also noted other matters involving the internal control structure and its operation that we reported to the management of the Office of the Attorney General at the exit conference held on March 19, 1991.


Representative Ann Rest, Chair
Members of the Legislative Audit Commission
The Honorable Hubert H. Humphrey, III
Page 3

The results of our tests indicate that, except for the issues discussed in finding 2, with respect to the items tested, the Office of the Attorney General 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 Attorney General had 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 Office of the Attorney General. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 12, 1991.

We would like to thank the Office of the Attorney General staff for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: February 21, 1991

REPORT SIGNED ON: April 8, 1991

OFFICE OF THE ATTORNEY GENERAL

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. CURRENT FINDINGS AND RECOMMENDATIONS	2
AGENCY RESPONSE	5

AUDIT PARTICIPATION

The following staff from the Office of the Legislative Auditor participated in this audit:

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Audit Manager
Lori Pellicci, CPA	Auditor-In-Charge
Mary Jacobson, CPA	Staff Auditor
Ron Mavetz, CPA	Staff Auditor

EXIT CONFERENCE

An exit conference was held with the following staff from the Office of the Attorney General on March 19, 1991:

John Tunheim	Chief Deputy Attorney General
Joseph Reid	Administrative Manager
Rebecca Spartz	Assistant Administrative Manager

OFFICE OF THE ATTORNEY GENERAL

I. INTRODUCTION

The Office of the Attorney General was established by Article V of the Constitution of the State of Minnesota. Hubert H. Humphrey III is currently serving his third term as Attorney General. The Attorney General's main duties include providing legal advice, representing state agencies and their officials, and offering direct assistance to citizens of Minnesota. The Attorney General also represents Minnesota in civil and criminal cases. He is also a member of the Executive Council, the Pardons Board, the Land Exchange Board, and the State Board of Investment.

The Office of the Attorney General finances its activities primarily through general fund appropriations and federal grants. The majority of office expenditures are for personnel costs. The office collects fees for services provided to state agencies and other entities. The fees are deposited as nondedicated receipts to the General Fund. The summary below shows revenues and expenditures of the office for the year ended June 30, 1990.

	<u>Fiscal Year</u> <u>1990</u>
Revenues:	
Billing Fees	\$ 5,031,952
Litigation Settlements	179,173
Other revenues	<u>1,293,356</u>
Total revenues	<u>\$ 6,504,481</u>
Expenditures:	
Payroll	\$16,557,239
Travel expenditures	287,009
Professional/Technical contracts	193,419
Other expenditures	<u>3,916,253</u>
Total expenditures	<u>\$20,953,920</u>

Source: Manager's Financial Report for Fiscal Year 1990 as of September 1, 1990. Estimated Actual Receipts Report for Fiscal Year 1990 as of September 1, 1990.

OFFICE OF THE ATTORNEY GENERAL

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. The Office of the Attorney General does not review adjustments to client billings for propriety.

Adjustments to assessment rates by one client resulted in underpayments to the General Fund totalling \$864,743 for the period July 1, 1988 through September 30, 1990. The Pollution Control Agency (PCA) changed the assessment rates from 100 percent to 5.68 percent in fiscal year 1989 and 10.98 percent in fiscal year 1990 for attorney services relating to its federally funded programs. PCA apparently made the adjustments because it included the Attorney General charges in its indirect cost plan, rather than directly charging the costs to applicable federal programs. We believe PCA's procedures were wrong and that the agency should have paid the full assessment. The Office of the Attorney General accepted these adjustments without questioning or investigating them. Three other agencies adjusted assessment fees from 100 percent to 50 percent and vice-versa. Again the Office of the Attorney General relied on the clients to determine the funding source and rate.

The office bills agencies for its services at an hourly rate approved by the Department of Finance. Minn. Stat. Section 8.15 basically requires that agencies financed by General Fund appropriations pay 50 percent of the assessed amount. Activities financed from nongeneral fund appropriations must pay the full amount assessed. Activities which collect nondedicated fees must include the assessment in the fee calculation, and therefore, are exempt from the billing process. If an agency has multiple funding sources, it must pay the rate which corresponds to the funding source benefited by the service. The Attorney General deposits all fee collections in the General Fund as nondedicated receipts. Because of the variable assessment rates, it is important that the office have adequate procedures to identify the funding sources benefiting from its services.

RECOMMENDATIONS

- The Office of the Attorney General should develop procedures to identify appropriate assessment rates when attorneys begin work on a project.
 - The office should require clients to provide support for any adjustments made to the billing amounts. It should investigate all adjustments to determine their propriety.
2. PRIOR FINDING NOT RESOLVED. The Office of the Attorney General does not properly process contractual agreements or verify compliance with contract terms.

The Office of the Attorney General is allowing contractors to perform services before the parties have signed the contracts and the Department of Finance has encumbered the funds. The staff attorneys and the

OFFICE OF THE ATTORNEY GENERAL

contractors who initiate the agreements are holding them instead of signing them and sending them on for processing. For 12 of the 18 contracts we reviewed, work started before the contract was properly executed and funds encumbered.

The office also is not processing special attorney and expert witness contracts in a timely manner. Eleven of the 13 contracts we reviewed were not properly approved prior to services being performed. The time lag ranged up to six months. In addition, we found two instances, at a total cost of \$331, where the Office of the Attorney General approved the billing for payment even though the vendor provided the services prior to the contract's effective date. The Attorney General may appoint special attorneys or contract with expert witnesses to provide services to other state agencies or entities. Those agencies directly pay the various vendors for the services. Therefore, it is important that the agencies receive the authorized contracts timely, so they can encumber funds prior to the effective date.

Minn. Stat. Section 16A.15, Subd. 3, provides, in part:

an obligation may not be incurred against any fund, allotment, or appropriation unless the commissioner has certified a sufficient unencumbered balance in the fund, allotment, or appropriation to meet it...

To ensure that funds are available to pay contractual obligations, the Attorney General, as well as the other agencies, must requisition and encumber funds before the contractors start work.

In addition, the Office of the Attorney General is not adequately monitoring contract terms. The office is paying contract invoices that are not adequately documented and are in excess of contract amounts. We noted the following problems with contract compliance for internal agreements, as well as with special attorney or expert witness contracts:

- The office is not verifying all invoices for court reporter fees before making payment. Instead, they accept bills from one vendor that do not detail the work done. The bills list the dates of service and a lump sum amount due. During the period July 1, 1989 through December 31, 1990, the office paid this vendor approximately \$13,200.
- It approved reimbursement of expenses totalling \$2,500 for an expert witness without any receipts or other documentation to support the expenses. The contract with this individual provided for reimbursement of expenses in the same manner and in no greater amount than provided in the current Commissioner's Plan.

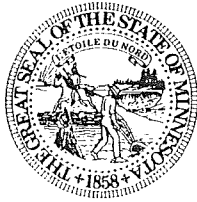
OFFICE OF THE ATTORNEY GENERAL

- The office has paid amounts in excess of the contract to certain vendors. Three contractors provided seminar services for flat fees which, according to the contracts, included all expenses. After the seminars, the contractors submitted bills for miscellaneous expenses incurred during the seminar. The office paid these bills, totalling \$145, even though the contract did not provide for them.
- It allowed a contractor to submit purchase orders for reimbursement of expenses instead of actual invoices. The office therefore, could not verify how much the contractor actually paid for the various items.

The various staff attorneys working with the contractors approve the invoices and submit them to the accounting section for payment. The accounting staff have not questioned the documentation once an invoice is approved by the attorney.

RECOMMENDATIONS

- The Office of the Attorney General should develop appropriate procedures and controls to encumber funds before incurring obligations.
- The office should develop procedures to promptly notify other agencies of contractual obligations incurred on the agencies' behalf.
- The office should verify the accuracy of all invoices before making payment. It should compare the invoices to any applicable contracts or schedules.
- The office should only pay amounts established in the contracts. When appropriate, the contracts should specifically address reimbursement of expenses.



STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

HUBERT H. HUMPHREY, III
ATTORNEY GENERAL

April 2, 1991

102 STATE CAPITOL
ST. PAUL, MN 55157
TELEPHONE: (612) 296-6196
FAX: (612) 296-4193

Mr. James R. Nobles
Legislative Auditor
Veterans Service Building, First Floor
20 West 12th Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

We are pleased to have this opportunity to respond to the recommendations of your staff who recently completed an audit of the Attorney General's Office for July 1, 1988 to December 31, 1990. In addition to making our response, we would like to bring you up to date on what we have done and are doing to improve our procedures and controls.

RECOMMENDATIONS

1. ADJUSTMENTS TO CLIENT BILLINGS MUST BE JUSTIFIED AND DOCUMENTED

Person Responsible for Action: Sharon Gregoire

Completion Date: June 18, 1991

Action Taken:

Under Minn. Stat. § 8.15 the Attorney General is required to assess executive branch agencies a fee for the legal services provided to them by the Attorney General. Because the assessment varies with the type of funding which supports the activity or program served by the Attorney General, the Attorney General must depend upon the client to declare how the assessment should apply. For this purpose client codes have been established for activities and programs within each agency. However, within large agencies with multiple funding sources, the client activity or program may still derive its appropriation from several revenue sources. Again, in these cases we must rely on the client to declare a legitimate assessment rate for that activity or program. When clients do adjust the customary rate, they provide, or we request, justification for the adjustment. In particular, with respect to the Minnesota Pollution Control Agency (MPCA), we did request support for adjustments made to the billing amounts in 1986, the first year Minn. Stat. § 8.15 was effective, and were told that the U. S. Environmental Protection Agency (EPA) would not pay for legal services as a direct expense but that these costs were being recovered through the agency's indirect cost plan.

Due to the very complex funding structure of the MPCA and past practice, the inclusion of the Attorney General's allocation in the agency's indirect cost plan does have its merits. The time involved and the availability of data to determine the correct funding source which is benefited by the service presents a definite question of practicality. Our analysis of this situation supports our opinion that the MPCA did proceed in a responsible manner in the financial structuring of this obligation.

During the audit, the auditor discussed this situation with the MPCA. The MPCA has agreed to change its procedures on this issue to those which the Legislative Auditor feels are correct. The agency will begin charging all Attorney General billings as direct costs to the respective programs, and to the best of its ability, pay the rate which best corresponds to the funding source benefited by the service. The auditor agreed with the MPCA that the most feasible time to implement this change would be with the beginning of fiscal year 1992. This time frame would allow the MPCA to renegotiate its indirect cost plan with the federal government.

The requirements of Minn. Stat. § 8.15 have been absorbed by the Attorney General without additional staffing. Although our automated time reporting system facilitated this effort, it is not feasible to set a new assessment rate for each project as an attorney begins work on the project. We will, however, require an explanation for all adjustments to billings and verify to our satisfaction the propriety of the adjustment.

2. PROCESSING OF CONTRACTUAL AGREEMENTS

The Attorney General's Office has initiated additional controls to assure that contracts and special attorney appointments are signed and funds encumbered prior to work being performed. Prompt notice to the Administrative Services Unit is a necessity for funds to be encumbered prior to a contractor performing services.

Special Attorney Appointments

Person Responsible for Action: Kari Frost

Completion Date: April 1, 1991

Action Taken:

When justified by special circumstances, we appoint outside counsel to represent the state. Because this is a more expensive solution, we negotiate a government rate with all private law firms appointed as special counsel. The negotiation requires additional approvals within the law firms and causes delays in reaching agreement prior to formal appointment. Although this has meant, on occasion, that work may have begun before funds were encumbered, the financial benefit justifies the delay. Nevertheless, quarterly reminders will advise staff members of the need to notify the Administrative Services Unit prior to appointing special counsel. A cover letter to law firms will advise them of the importance of returning signed documents to our office promptly and that work cannot begin until they receive notice that the appointment has been signed by our office.

Contracts

Person Responsible for Action: Rebecca Spartz

Completion Date: April 1, 1991

Action Taken:

Quarterly reminders will advise staff members of the need to notify the Administrative Services Unit prior to engaging the services of any contractor. A cover letter to contractors will advise them of the need for returning signed documents to our office promptly and that work cannot begin until they receive notice that the contract has been signed by our office.

All contractors will be required to provide proper documentation of services performed and expenses incurred. Invoices not having this documentation will be held until it is received. Contract agents will continue to review, approve and sign all invoices verifying acceptability of work product. Then, all invoices will be reviewed for compliance with contract terms and for proper documentation by the Assistant Administrative Manager and signed by the Administrative Manager for final approval for payment.

Contracts - Notification of Other Agencies

Person Responsible for Action: Kari Frost and Rebecca Spartz

Completion Date: April 1, 1991

Action Taken:

A form has been developed which will be used to notify other state agencies of contractual obligations incurred on an agency's behalf. Prompt notice will enable other agencies to encumber funds prior to work being performed.

It has been a pleasure to work with you and your audit staff. We will exercise all due diligence in implementing your recommendations.

Best regards,



HUBERT H. HUMPHREY
Attorney General

cc: Rep. Dee Long, Acting Chair, Legislative Audit Commission
Members of the Audit Commission