OFFICE OF THE STATE TREASURER

FINANCIAL AUDIT

FOR THE YEAR ENDED JUNE 30, 1991

JANUARY 1992

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

92-6

Centennial Office Building, Saint Paul, Minnesota 55155 ● 612/296-4708

OFFICE OF THE STATE TREASURER

FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1991

Public Release Date: January 31, 1992 No. 92-6

OBJECTIVES:

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

CONCLUSIONS:

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

- The State Treasurer's Office has not resolved 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
CENTENNIAL 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 as of and for the year ended June 30, 1991. Our audit was limited to only that portion of the State of Minnesota 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 as of June 30, 1991.

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 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,
- fee, assessment and surcharge receipts,
- payroll expenditures, and
- miscellaneous expenditures.

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 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 indicated 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 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 State Treasurer. This restriction is not intended to limit the distribution of this report, which was released as a public document on January 31, 1992.

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 Fieldwork: November 21, 1991

Report Signed On: January 28, 1992

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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
Judy Cammack, CPA	Auditor-in-Charge
Mary Annala, CPA	Auditor
Melissa Gamble	Auditor
Sonya Hill	Auditor
Janet Knox, CPA	Auditor

Introduction

The State Treasurer is a constitutional officer elected by the citizens of the state to a four year term. The State Treasurer's Office has three major functions. The first function is to account for monies paid into the state treasury until lawfully disbursed or invested. The office maintains 334 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. As part of the cash control function, the office is responsible for ensuring that the amount of collateral pledged to secure state funds on deposit in the various banks complies with statutory requirements.

The second major function of the State Treasurer's Office is to record and verify 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 the appropriate banks for payment. Nearly five million warrants were processed during fiscal year 1991.

The third major function of the State Treasurer's Office is to maintain records and make payments for principal and interest on the state's general obligation bonded debt. Debt service payments during fiscal year 1991 totalled approximately $235 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 for traffic offenses, marriage licenses & dissolutions, real estate transactions, and various court filings. The office also receives direct appropriations from which it pays administrative and operating expenses. The fiscal year 1991 receipts and expenditures for these activities are as follows:

Receipts:	
Penalties and Surcharges	$ 6,574,399
Other Governmental Fees	12,922,471
Marriage License/Dissolution Fees	2,671,396
Other	1,132,934
Total Receipts	$23,301,200
Expenditures:	
Payroll	$ 513,737
Miscellaneous	236,628
Total Expenditures	$ 750,365

Sources: Statewide Accounting System, Estimated/Actual Receipts Report as of August 31, 1991 and Manager's Financial Report as of August 31, 1991.

Current Finding and Recommendation

1. PRIOR YEAR AUDIT FINDING NOT RESOLVED: The State Treasurer's Office has not resolved certain material collateral deficiencies.

The State Treasurer's Office does not properly monitor collateral pledged to secure state funds. We tested collateral pledged at 25 banks as of June 30, 1991, and found that 10 banks had collateral shortages ranging from $24,000 to $31 million. 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 more than $10 million on 19 of 41 days tested during fiscal year 1991. The state's contract with the bank provides that the bank will collateralize account balances as required by the State Treasurer in accordance with Minn. Stat. Section 9.031. Collateral pledged by the bank during the year ranged from $33 to $35 million.

Because of timing differences, the Treasurer's Office monitoring procedures do not accurately identify collateral shortages. The Treasurer's Office calculates daily shortages using bank balances as recorded on its computerized state depository accounting system. If collateral is insufficient for several days, action is taken to correct the problem. However, due to the timing differences in recording receipt and withdrawal transactions, the actual bank balance usually differs from the Treasurer's recorded balance. The Treasurer's system determined that collateral was short by at least $10 million on only one day during the year. The system also identified only two of the ten banks that we had determined to be undercollateralized on June 30, 1991.

The Treasurer's Office can determine daily balances at the St. Paul bank and should use this information to verify the sufficiency of collateral. 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. The statute limits state deposits to 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 improve its method of monitoring collateral shortages. Staff should periodically review actual bank balances to ensure the sufficiency of collateral pledged.*

STATE OF MINNESOTA
OFFICE OF THE STATE TREASURER

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MICHAEL A. McGRATH
Treasurer

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January 27, 1992

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, 1991. 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

RESPONSE OF THE OFFICE OF THE STATE TREASURER

TO

LEGISLATIVE AUDITOR RECOMMENDATIONS

FOR

ONE YEAR PERIOD ENDING JUNE 30, 1991

Auditor's Recommendation

The Office of the State Treasurer should improve its method of monitoring collateral shortages. Staff should periodically review actual bank balances to ensure the sufficiency of collateral pledged.

State Treasurer's Response

The Office of the State Treasurer has responded to the complex issues involved with collateralizing bank balances, including uncollected balances (those with the lowest level of risk), in a number of ways. In addition to the current process of daily systematic monitoring, a plan, developed before the Auditor's comments, has resulted in adopted and proposed legislation, upgrading of our data processing system and analysis of alternatives to the use of collateral to protect state funds.

Legislation authorizing ACH cash transfers beginning in 1991 has reduced uncollected funds, thereby reducing collateral needs. Proposed legislation has been developed to clarify the ability to choose alternative methods of insuring state funds on deposit.

Our new data processing system, scheduled to be operational in May, 1992, will insure more timely data to identify collateral shortages.

Furthermore, shortages of collateral identified by the Auditor refer primarily to uncollected funds. These deposits represent the least level of risk because they represent funds not yet in possession of the state's depository banks. (Please refer to our response to your audit as of June 30, 1990 dated March 25, 1991).

Alternatives to collateral protection of deposits are being researched. Surety bonds or insurance may be less costly than collateral. Under current procedures, additional collateral in conformance to the Auditor's recommendation for the largest account alone would add costs to the General Fund of approximately a quarter of a million dollars annually.

The State Treasurer's Office has been working to resolve the remaining questions about collateral security because the safety of state funds is fundamental to our mission.