Office of the State Treasurer

Financial Audit
For the Year Ended June 30, 1994

April 1995

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

95-13

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

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

Office of the State Treasurer

Financial Audit
For The Year Ended June 30, 1994

Public Release Date: April 14, 1995 — No. 95-13

Objectives:

- Review Internal Control Structure: State depository receipts and cash control; warrant redemption and control; investment transaction processing; debt service expenditures; county fee and fine remittances; and administrative expenditures.

- Test compliance with certain finance-related legal provisions.

Conclusions:

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

- The Office of the State Treasurer made erroneous interest payments on general obligation debt during fiscal year 1994.

We found that the Office of the State Treasurer complied with finance-related legal provisions.

Contact the Financial Audit Division for additional information.
296-1235

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

Senator Phil Riveness, 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, 1994. In addition, we reviewed selected receipt and administrative expenditure transactions of the Office of the State Treasurer for the period July 1, 1992 through December 31, 1994. 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.

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, it was not our objective 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.

Due to the 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,
- county fee and fine remittances, and
- administrative 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 condition discussed in finding #1 involving the internal control structure of the Office of 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 internal control structure does not sufficiently reduce the risk that errors or irregularities may occur and not be detected by employees performing their assigned functions. We do not believe the reportable condition described above is a material weakness.

The results of our tests indicated that, 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.

We also noted other conditions involving the internal control structure and its operations which we reported to the management of the Office of the State Treasurer at an exit conference held on March 30, 1995.

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 April 14, 1995.

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

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 10, 1995

Report Signed On: April 10, 1995

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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
Cecile Ferkul, CPA	Auditor-in-Charge
Gail Thurmer, CISA	Staff Auditor
Karen Klein, CPA	Staff Auditor
Laura Puig-White	Staff Auditor
Steve Johnson	Intern

Exit Conference

We discussed the finding and recommendation in this report with the following officials of the Office of the State Treasurer at an exit conference held on March 30, 1995:

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

Introduction

The State Treasurer is a constitutional officer elected by the citizens of the state to a four-year term. Michael A. McGrath has served as State Treasurer since January 1987. The State Treasurer also serves as a member of the State Board of Investment, the Minnesota State Retirement System Board and the Executive Council.

The Office of the State Treasurer accounts for money deposited in the state treasury until lawfully disbursed or invested. The office maintains over 300 accounts in 171 banks throughout the state. During fiscal year 1994, the State Treasurer made direct payments totaling $1,180,553 to the state's main depository bank as compensation for depository and lockbox services.

Each day, the State Treasurer's Office determines the amount of idle cash available for investment and certifies that amount to the State Board of Investment. The office processes and verifies investment transactions authorized by the State Board. It also monitors the adequacy of securities pledged as collateral on bank deposits.

Another function of the office is to verify and redeem state warrants used by state agencies to satisfy lawful obligations of the state. The Treasurer's Office determines the validity of the warrants before transferring funds to the banks for payment. During fiscal year 1994, the Treasurer's Office processed warrants totaling over $10 billion.

As provided in the State Constitution, the State Treasurer maintains records and makes payments for principal and interest on the state's general obligation bonds. At June 30, 1994, the outstanding general obligation bonds payable totaled $1,769,435,000. Debt service principal and interest payments during fiscal year 1994, including amounts paid for refunded debt, totaled $512,947,005.

In addition to its general statewide financial management responsibilities, the office deposits various fees, fines, and assessments collected primarily by county governments and remitted to the state. During fiscal year 1994, deposits of these fees and fines exceeded $40 million. Fiscal year 1995 county receipt deposits through December 31, 1994 exceeded $21 million.

The Office of the State Treasurer receives a direct appropriation from which it pays office operating costs. Fiscal year 1994 operating expenditures totaled $1,926,647. The largest expenditure categories were the bank fees discussed above (61 percent) and payroll (30 percent). Fiscal year 1995 operating costs through December 31, 1994, were $1,112,259, with bank fees and payroll comprising 87 percent of these costs.

Current Finding and Recommendation

1. The State Treasurer's Office made erroneous interest payments on general obligation debt during fiscal year 1994.

The State Treasurer's Office (STO) did not accurately pay interest payments due in fiscal year 1994. Errors in August 1993 resulted in a $278,800 overpayment to the state's fiscal agent. STO did not discover the overpayment until August 1994. The fiscal agent repaid the funds to the state, without interest, in September 1994.

The overpayment to the fiscal agent occurred primarily because of complications created by refunding of previously issued bonds. The Department of Finance periodically sells new issues of general obligation debt and refunds previously issued debt when financially beneficial to the state. In fiscal year 1994, a period of low interest rates, the Department of Finance had one new bond issue for $210,000,000 and three refunding issues totaling $273,555,000.

STO historically has relied on the Department of Finance for information on the amounts due each year for principal and interest on outstanding bonds. Finance produces an original amortization schedule for each issue when the bonds are sold. However, the department did not produce a revised amortization schedule when the refunding occurred in 1993. Instead, STO discussed payment changes with Finance.

STO has been developing a debt service module for its new computer system. Ultimately, the system should provide schedules of the amounts due each month for principal and interest. STO attempted to use information from the system for the August 1993 payments. However, the system did not accurately adjust the various amortization schedules when bonds were refunded. The billing from the fiscal agent, which showed a different amount than the Treasurer's system, also was in error because of the refunded debt. Because of the differences, STO discussed the payments with the Department of Finance. Despite these efforts, STO ultimately paid the fiscal agent more than was actually required.

STO made other errors, totaling $470,775, that did not result in overpayments to the fiscal agent. The errors involved payments recorded in incorrrect accounts on the statewide accounting system (SWA). The payments improperly recorded on SWA were also the result of recent refundings. The Department of Finance retained a portion of the refunding bond issue in a locally held escrow account and established an account on SWA to make the refunded interest payments. When STO made the payments, however, it recorded the amounts for refunded interest in regular debt service accounts, rather than the escrow account. The Department of Finance has made correcting transactions on SWA.

Recommendation

- *The State Treasurer's Office should complete development of the debt service module of its computer system. The office should ensure that the system accurately accounts for the effects of refunded bonds when producing payment schedules. Until the system is finalized, STO should request that the Department of Finance produce revised amortization schedules when refundings occur. Staff should also review the debt service account structure and properly record payment transactions on the statewide accounting system.*

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

April 5, 1995

Mr. James R. Nobles
Legislative Auditor
State of Minnesota
658 Cedar Street
Saint Paul, Minnesota 55155

Re: Audit of State Treasurer's Office
Response to Finding and Recommendation

Dear Mr. Nobles:

I again compliment you and your staff for the professional manner in which you conducted your annual audit of the State Treasurer's Office. It is always a pleasure to exchange ideas about how the Treasurer's Office can continue to improve its services to state government and to Minnesota citizens, while at the same time maintaining a careful watch over the billions of dollars of cash which flow through state coffers each year.

The Finding and Recommendation which you make this year reflect our efforts to move the state's cash management processes into the advanced electronic age. We are nearing completion of a computer system design which thoroughly changed the five basic functions of this office: warrant processing, receipt processing, investments processing, debt service payments and record keeping. At the same time, we are adapting our system as the Statewide Accounting System (SWA) is being replaced by a new and improved Minnesota Accounting and Procurement System (MAPS). Finally, interest rates dropped dramatically over the last few years and created an environment well suited to refunding state bonding debt at a much more favorable interest rate, thereby saving taxpayers' money. These momentous changes, all for the better, converged over the past two years. As explained in your Finding, the pressure which they placed on the outdated technology and accounting system was such that it caused an overpayment that took an extended period of time to discover. It also caused some internal account errors.

In response to your finding, I ask that these matters be kept in perspective. You can be assured that appropriate corrective measures have been anticipated in the development of our new financial system.

The accounting error occurred in a similar circumstance. The debt service fund in the Statewide Accounting System contains approximately 500 different accounts. The fund, as a whole, was in balance during 1994; however, certain individual accounts within the debt service fund were either underpaid or overpaid with the net amount equal. I would also add that we expect this to be a problem in F.Y.95 which will be the last fiscal year of the old Statewide Accounting System and our old system.

When completed, the Treasurer's new financial system, combined with the new statewide accounting system (MAPS), will prevent these kinds of errors from occurring. In the meantime, I thank you for your continued support of our efforts to improve the Treasurer's Office.

Sincerely,

Michael A. McGrath
Treasurer
State of Minnesota