Department of Commerce

Selected Scope Financial Audit
For the Period July 1, 1992, through June 30, 1995

August 1996

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

96-31

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

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. David Gruenes, Commissioner
Department of Commerce

We have audited the Enforcement and Licensing Division of the Department of Commerce, and payroll for the department overall, for the period July 1, 1992, through June 30, 1995, as further explained in Chapter 1. Therefore, we emphasize that this has not been a complete audit of all of the financial activities of the Department of Commerce. In addition to department payroll, we audited the following Enforcement and Licensing Division financial operations: license revenues, unclaimed property receipts and disbursements, Real Estate Education, Research and Recovery Fund and Contractors' Recovery Fund revenues and expenditures, and administrative expenditures. The following Summary highlights the audit objectives and conclusions. We discuss these issues more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards also require that we design the audit to provide reasonable assurance that the department complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the department is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws and regulations.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Commerce. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 9, 1996.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: May 9, 1996

Report Signed On: August 5, 1996

SUMMARY

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

Department of Commerce

Selected Scope Financial Audit
For the Period July 1, 1992, through June 30, 1995

Public Release Date: August 9, 1996 No. 96-31

Background Information

The mission of the Department of Commerce is to enforce state laws and safeguard consumers' rights and investments, resolve conflicts between consumers and industry, and enhance the stability and strength of the financial and regulated industries. David Gruenes became commissioner of the department in December 1995. During the period covered by our audit, Bert McKasy was commissioner until July 1993, and James Ulland served as commissioner from September 1993 until December 1995.

The Enforcement and Licensing Division was the primary focus of this audit (in addition to payroll for the department overall). It is one of four operating divisions. The Enforcement and Licensing Division is responsible for ensuring that the licensees in the regulated industries of insurance, real estate, cosmetology, and others, meet the standards of knowledge, training, and conduct to receive and maintain a license. The division also receives and investigates complaints regarding these industries and licensees.

Audit Scope and Objectives

We audited the following financial activities of the Enforcement and Licensing Division (division), and payroll for the Department of Commerce overall, for the three years ended June 30, 1995: license revenues, unclaimed property receipts and disbursements, Real Estate Education, Research and Recovery Fund, Contractors' Recovery Fund revenues and expenditures, and administrative expenditures.

Conclusions

The division administered unclaimed property receipts and payments to individuals in compliance with applicable finance related legal provisions. We could not, however, verify the propriety of unclaimed property payments to other states on behalf of relocated Minnesota residents because of the lack of supporting documentation. Also, the department needs to improve controls over unclaimed property it receives.

The division collected the appropriate license fees and recovery fund fees as set in statute for the audit period. However, the department did not verify the accuracy of the amounts submitted by building contractors for the Contractors' Recovery Fund. The division adequately safeguarded and properly recorded the fees in the statewide accounting system.

The Department of Commerce processed department payroll, division recovery funds expenditures, and administrative expenditures in accordance with applicable laws and regulations. These expenditures were made for a proper purpose and accurately recorded in the statewide accounting system. The division needs to improve internal controls over payments made from the recovery funds.

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

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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
Jim Riebe, CPA	Audit Manager
Tony Toscano	Auditor-in-Charge
Pat Ryan	Auditor
Geniene Herrlich, CPA	Auditor
Susan O'Connell	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Department of Commerce on July 23, 1996. We also noted other matters involving the internal control structure and its operation and compliance with laws and regulations that we reported to the management of the Department of Commerce at this meeting.

David Gruenes	Commissioner
Laurie Esau	Deputy Commissioner - Administration
Scott Borchert	Enforcement and Licensing Director
Mary Lippert	Staff Attorney
Tammy McGloue	Administrative Services Director
Pat Durbin	Information Systems Director

Chapter 1. Introduction

The Minnesota Legislature established the Department of Commerce in 1983. At that time, the Banking, Insurance, and Securities and Real Estate Departments were organized into a single agency to better coordinate regulatory functions.

The mission of the Department of Commerce is to:

- enforce state laws and safeguard consumers' rights and investments;
- resolve conflicts between consumers and industry; and
- enhance the stability and strength of the financial and regulated industries.

The department is organized into the following divisions: the Administrative Services Division, the Financial Examinations Division, the Enforcement and Licensing Division, and the Insurance and Registration Division. The focus of our audit was the financial activities of the Enforcement and Licensing Division and payroll for the Department of Commerce overall.

The Enforcement and Licensing Division is responsible for ensuring that the licensees in the regulated industries of insurance, real estate, cosmetology, and others, meet the standards of knowledge, training, and conduct to receive and maintain a license. The division also receives and investigates complaints regarding these industries and licensees.

The division also administers the state's unclaimed property program. The division attempts to locate the owners of unclaimed personal property. The unclaimed property includes items such as savings accounts, uncashed paychecks, travelers' checks, stock, insurance, and uncashed tax refunds.

David Gruenes became commissioner of the department in December 1995. During the period covered by our audit, Bert McKasy was commissioner until July 1993, and James Ulland served as commissioner from September 1993 until December 1995.

During the time period covered by our audit, the Department of Commerce had total revenues of $151,206,879. The Enforcement and Licensing Division collected revenues of $15.9 million in fiscal year 1993, $33 million in fiscal year 1994, and $28.9 million in fiscal year 1995, totaling $77.8 million for the audit period. Total department expenditures were $168,795,554. Table 1-1 shows the expenditures of the Enforcement and Licensing Division for each year of the audit period.

Table 1-1
Enforcement and Licensing Division
Administrative Expenditures

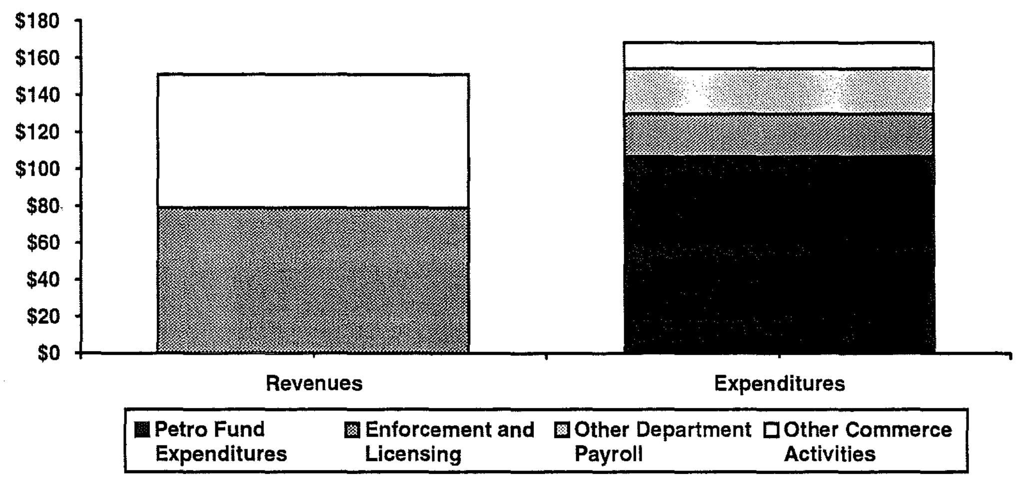
	Fiscal Year 1993	Fiscal Year 1994	Fiscal Year 1995
Payroll	$2,766,594	$2,707,591	$ 2,958,793
Unclaimed Property Refunds	1,633,195	1,386,898	5,973,607
Claims Against Recovery Funds	896,948	902,129	810,032
Professional Services	284,185	205,048	303,105
Advertising	226,628	185,537	65,679
Communications	146,014	127,123	184,976
Supplies and Materials	107,046	72,924	147,269
Other	262,905	224,807	425,417
Total	$6,323,515	$5,812,057	$10,868,878

Source: Statewide Accounting System.

As shown in Table 1-1, unclaimed property refunds increased approximately $4.6 million in fiscal year 1995 from the prior year. In contrast, advertising expenditures decreased during the same time period. These fluctuations resulted from legislative changes. Laws of Minnesota 1992, Chapter 513, Article 3 changed the period of abandonment from five years to three years for property held by banking or other financial institutions. This change resulted in both a one-time increase in the amount of property transferred to the department and a corresponding increase in refunds paid. Laws of Minnesota 1993, Chapter 31, Section 2 changed the requirements for publishing property owner names. Now the department is only required to publish the names of owners of property valued at $100 or more. This change resulted in a decrease in advertising costs.

Figure 1-1 highlights the scope of our audit, including department payroll and Enforcement and Licensing Division revenues and expenditures, compared to total department revenues and expenditures for the three year audit period. Note that Petroleum Tank Cleanup Fund expenditures receive audit coverage during our annual Statewide audit and were not included as part of the scope of this audit.

Figure 1-1
Selected Revenues and Expenditures
Compared to Total Department Financial Activities
Fiscal Years 1993-1995 (In Millions)



Source: Statewide Accounting System reports.

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Chapter 2. Unclaimed Property

Chapter Conclusions

The Department of Commerce administered unclaimed property receipts and payments to individuals in compliance with applicable finance related legal provisions. We could not verify the propriety of unclaimed property payments to other states on behalf of relocated Minnesota residents because of the lack of supporting documentation. Also, the department needs to improve controls over the safeguarding of unclaimed property it receives.

Minn. Stat. Chapter 345 requires the holders of unclaimed property to transfer the property to the Department of Commerce. Holders of unclaimed property must report the names and last known addresses of the owners of the unclaimed property in their possession by November 1 each year. On April 1 of the following year, the department publishes the list of owners' names in major newspapers throughout the state. The owners of the property can find out who the holder of their property is by contacting the Department of Commerce.

If the property remains unclaimed 85 days after the publication of the names, the holders must transfer the property to the department. The fiscal services section deposits checks received in the General Fund, and sends the holder reports to the unclaimed property section. The division deposited $10 million, $25.8 million, and $18.3 million in unclaimed property receipts into the General Fund in fiscal years 1993, 1994, and 1995, respectively. Holders of unclaimed property also turn over the contents of safe deposit boxes containing unclaimed property annually. The department stores property received from the holders in one of two secured storage areas at the department. Clerks in the unclaimed property section enter the information from the holder reports into the unclaimed property database.

Owners must submit a notarized claim form that includes identifying information in order to receive their property. Unclaimed property clerks receive the claim forms and verify the property or amount to pay to the claimant from information in the unclaimed property database. The clerks then prepare a payment document to submit to fiscal services for payment. The department paid claims of $1.6 million, $1.4 million, and $6 million in fiscal years 1993, 1994, and 1995, respectively.

Unclaimed property is particularly susceptible to theft because the original owners have unknowingly abandoned the property. Therefore, it is essential that the department maintain strong internal controls over the unclaimed property in its possession and only makes payments to the legitimate owners of the property.

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Scope and Objectives

Our audit of unclaimed property addressed the following objectives:

- Were controls adequate to safeguard unclaimed property that the Enforcement and Licensing Division received?
- Did the department properly deposit receipts from the holders of unclaimed property in the General Fund?
- Were disbursements properly supported and made in accordance with applicable finance related legal provisions?

Audit Procedures and Results

We interviewed agency staff to gain an understanding of the controls in place over unclaimed property receipt and disbursement of both money and property. We tested receipts from holders of unclaimed property, payments made to claimants during the audit period, and the recording of information on the unclaimed property database.

We concluded that the department deposited unclaimed property receipts in the state's General Fund as required by statute. The department also paid claims to individuals in accordance with applicable finance related legal provisions. The department needs to improve controls, however, over the safeguarding of unclaimed property it receives and the recording of unclaimed property transactions on the unclaimed property database. Also, we could not verify the propriety of unclaimed property payments to other states on behalf of relocated Minnesota residents because of the lack of supporting documentation. Findings 1 through 3, respectively, discuss our concerns over physical inventory, lack of verification of entries made to the unclaimed property database, and the lack of documentation supporting reciprocity payments made to other states.

1. The Department of Commerce needs to improve control over unclaimed property inventory.

The Department of Commerce did not conduct a periodic physical inventory of the unclaimed property held in its storage areas for the past three years. The department receives unclaimed property annually from the holders of abandoned safe deposit boxes. The packages come with a notarized seal and a list of the package contents. Unclaimed property personnel enter the name of the owner and an identification number on to the unclaimed property database.

To maintain effective control over the unclaimed property in its possession, the department needs to provide reasonable assurance that the assets are properly safeguarded. Without periodic physical inventories of unclaimed property, the department cannot be assured that its inventory remains intact. At a minimum, the department could improve controls over unclaimed property by periodically verifying the existence of high dollar and particularly sensitive assets in its possession.

Recommendation

- *The Department of Commerce needs to institute procedures to periodically confirm the physical existence of unclaimed property.*

2. The Department of Commerce needs to improve internal controls over the recording of unclaimed property receipts in the unclaimed property database and over payment of unclaimed property refunds.

The Department of Commerce needs to verify the accuracy of receipt entries to the unclaimed property database from holder reports. The department also should improve the process for making payments of unclaimed property to original owners of the property. Holders submit payment to the department for unclaimed accounts and insurance policies, etc. The cashier section deposits the money in the General Fund and then sends the holder reports to the unclaimed property section. Unclaimed property personnel enter the information in the unclaimed property database and file the holder reports. There is no verification, however, of the accuracy of the input to the database. The department pays claimants based on the information recorded in the unclaimed property database. Therefore, without verifying the accuracy of the receipt information recorded in the unclaimed property database, inaccurate payments could be made and not detected by department personnel.

In order to process a refund of unclaimed property, the department requires owner identification, proof of address, and documentation that the claimant had a business relationship with the previous holder of the unclaimed property. The department did not, however, have an independent employee verify that all required documentation was obtained before a claim was paid. As a result, the department cannot be assured that it is only paying legitimate claims. During the three years covered by the audit, the department paid approximately $9 million in claims. The department needs to take steps to ensure that the receipt information entered into the unclaimed property database is accurate, and that it is only processing legitimate claims.

Recommendations

- *The Department of Commerce should reconcile the receipt information entered into the unclaimed property database to the deposits recorded on the statewide accounting system.*

- *The department should ensure that an independent employee verifies the legitimacy of the claim before processing unclaimed property payments.*

3. The Department of Commerce did not maintain supporting documentation for unclaimed property payments made to other states on behalf of relocated Minnesota residents.

The Department of Commerce did not retain documentation supporting unclaimed property reciprocity payments made to other states during the audit period. The department has reciprocity agreements with 25 other states. Under these agreements, the department sends the unclaimed property to the state of the owner's last known address. The department prepares reports showing owners whose last known address is in another state and the amount currently unclaimed by those owners. The department notifies the reciprocal state and sends the corresponding amount to that state.

Without supporting documentation, we were unable to verify the accuracy of the payments made to the other states under the reciprocity agreements. The department was unable to recreate the documents that supported the payments. Reciprocity payments represent a significant amount of the unclaimed property disbursements. For example, four states received payments over $90,000 each; the largest payment was approximately $270,000.

The department either needs to be able to recreate the payment documentation after adjustments from its electronic files, or retain the paper documentation supporting reciprocity payments.

Recommendation

- *The department should ensure that it maintains supporting documentation for unclaimed property payments to other states.*

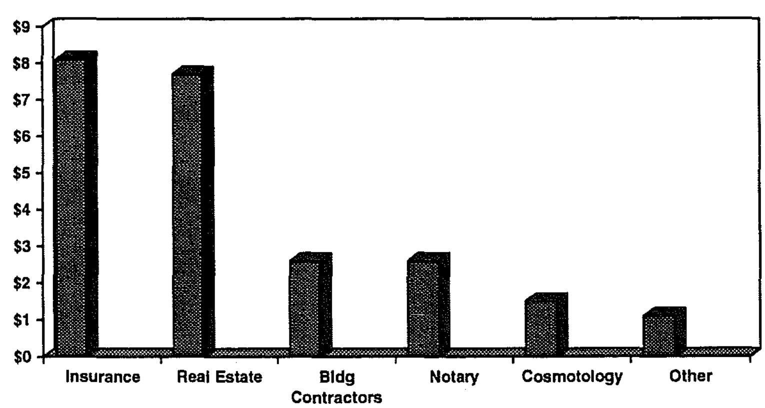
Chapter 3. License Revenues

Chapter Conclusions

The Department of Commerce collected the appropriate license fees as set in statute for licenses issued during the audit period. The department adequately safeguarded and properly recorded the fees in the statewide accounting system.

The licensing section of the Department of Commerce is responsible for licensing insurance agents and agencies, real estate agents and brokers, residential building contractors, cosmetologists, and notaries, among other professions. Licensees submit their application or renewal forms to the department. The cashier section initially verifies the accuracy of the fees submitted, then deposits the receipts into the state's General Fund. The cashiers send the applications to the licensing section where they are reviewed for accuracy and completeness. Licensing clerks enter the information into the licensing system and licenses are issued. During the three years ended June 30, 1995, Enforcement and Licensing collected approximately $24 million in licensing fees. Figure 3-1 shows the breakdown of the fees by license type.

Figure 3-1
Division License Revenues by Type
Fiscal Years 1993-1995 (in Millions)



Source: Statewide Accounting System.

Scope and Objectives

We focused our review of license revenues on the following objectives:

- Did the department assess fees at the rates established in statute?

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- Did the department adequately safeguard and properly recorded the fees in the statewide accounting system?

Audit Procedures and Results

We interviewed agency staff to gain an understanding of the controls in place over the processing of license receipts. We also selected samples of the major license types from the licensing database and verified that the department collected and deposited the proper fee in the state treasury.

Based on the testing performed, we concluded that the department collected the appropriate fees for licenses issued. The department adequately safeguarded and properly deposited the licensing receipts in the state treasury.

Chapter 4. Special Revenue Funds

Chapter Conclusions

The required fees for the Real Estate Education, Research and Recovery Fund were assessed at the statutory rates and deposited into the fund. However, the department did not verify the accuracy of the amounts submitted for deposit to the Contractors' Recovery Fund by building contractors.

Expenditures from the Real Estate Education, Research and Recovery Fund and the Contractors' Recovery Fund were made in accordance with applicable finance related legal provisions. However, the department needs to improve the internal controls over payments made from the recovery funds.

The Department of Commerce is responsible for administering the Real Estate Education, Research and Recovery Fund and the Contractors' Recovery Fund. A $50 fee charged to licensed real estate brokers, salespersons, and closing agents finances the fund. A fee charged to licensed residential contractors finances the Contractors' Recovery Fund.

The Legislature established the Real Estate Education, Research and Recovery Fund in 1973, per Minn. Stat. Section 82.34. The fund finances real estate-related educational activities and is used to provide information to the public on housing issues and to reimburse consumers for losses resulting from fraudulent practices committed by licensed brokers, salespersons, and closing agents. Payments to claimants for fiscal years 1993 through 1995 totaled $2,594,109 or 82 percent of all payments from the fund. Claimants must obtain a judgment against the licensee prior to receiving payment. The limit on payments from the fund is $150,000 per claimant, per transaction. The limit for claims against a licensee is $250,000.

In 1993, the Legislature created the Contractors' Recovery Fund. Minn. Stat. Section 326.975 governs the operation of the fund. A fee charged to the state's licensed residential contractors finances the fund. The fee ranges from $100 to $200, depending on the contractor's gross annual receipts. Contractors began paying the fee in fiscal year 1994. The fund compensates consumers defrauded by the activities of licensed residential contractors. Consumers must also obtain a judgment in court against the contractor before applying for reimbursement from the fund. Claims are limited to $50,000 per claimant and $50,000 per licensee. In fiscal year 1995, the first year funds were disbursed from the fund, claimants received $15,700.

Scope and Objectives

Our audit objectives for the Real Estate Education, Research and Recovery Fund and the Contractors' Recovery Fund were:

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- Did the department assess fees at the statutory rates and deposit the fees into the appropriate fund?
- Did the department make disbursements from the funds in accordance with applicable finance related legal provisions?

Audit Procedures and Results

We interviewed agency personnel to gain an understanding of the controls over the collection of fees for the two funds and the payment of claims from the funds. We tested the receipts in conjunction with the licensing fees. We verified that the licensee submitted the appropriate fee and that the cashier deposited the fees into the appropriate fund. Internal controls over these revenues were generally adequate. As discussed in finding 4, however, the department needs to verify the accuracy of the fee collected from building contractors.

We also tested the claims paid from the Real Estate Education, Research and Recovery Fund and the Contractors' Recovery Fund. Fiscal year 1995 was the first year claims were paid out of the Contractors' Recovery Fund. The department only paid four claims during the year; therefore, we tested all of the claims paid from this fund. We also selected a sample of claims from the Real Estate Education, Research and Recovery Fund for detailed testing. We found that the department paid claims in accordance with applicable finance related legal provisions. However, we noted that there is a lack of separation of duties over the payment of claims. Finding 5 discusses our concern relating to claim payments.

4. The Department of Commerce did not verify the accuracy of the fees submitted by building contractors.

The Department of Commerce did not verify that contractors submitted the appropriate fee to the Contractors' Recovery Fund. The department is responsible for collecting the fees that support the Contractors' Recovery Fund. Contractors are required to pay a fee that is based on their gross receipts. Minn. Stat. Section 326.975, Subd. 1 states in part that:

> The amount of the fee shall be based on the licensee's gross annual receipts for the licensee's most recent fiscal year preceding the renewal, on the following scale:

Fee	Gross Receipts
$100	under $1,000,000
$150	$1,000,000 to $5,000,000
$200	over $5,000,000

> Any person who receives a new license shall pay a fee based on the same scale . . . .

Contractors submit the fee along with their license application or renewal. The contractor indicates the amount of the fee they are submitting. The department assumes that the contractor has submitted the appropriate fee. The fees support paying claimants defrauded by licensed contractors. The department cannot be sure that it is collecting the appropriate fees without verifying the gross receipts reported. The department has several options available to remedy this concern. It could require building contractors to submit copies of income tax returns, or could possibly work with the Minnesota Department of Revenue to verify the contractor's gross receipts in another way. Alternatively, the department may want to seek legislative approval to change the fee structure.

Recommendation

- *The Department of Commerce needs to take steps to ensure the accuracy of the fees submitted by contractors to the Contractors' Recovery Fund.*

5. The Department of Commerce needs to improve controls over recovery fund payments.

There is an inadequate separation of duties over the payment of claims from both the Real Estate Education, Research and Recovery Fund and the Contractors' Recovery Fund. Both of these funds exist to compensate consumers for fraudulent practices committed by the licensees represented by the funds. Claimants must first obtain a judgment against the licensee in court. Claimants must then submit a copy of the judgment to the department prior to payment being authorized. The recovery funds paid claims totaling $896,948, $902,129, and $810,032 in fiscal years 1993, 1994, and 1995, respectively.

The same employee reviews the documentation supporting a claim, authorizes the payments, and prepares the payment document. The fiscal services section processes the payments based on a list of claimants and the amounts to be paid. There is no supporting documentation submitted with the payment documents. Without a proper separation of duties, the department cannot be assured that the amounts being paid to claimants are accurate or that only actual claimants are receiving payments. Effective internal controls should either prevent or detect errors or irregularities. The department could achieve a proper separation of duties by having a separate person approve the payments or, at a minimum, review the documentation to ensure that the claimants have, in fact, received a judgment in the amount being paid out.

Recommendation

- *The department needs to ensure that there is a proper separation of duties over the processing of recovery fund claims.*

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Chapter 5. Payroll and Administrative Expenditures

Chapter Conclusions

The Department of Commerce processed payroll in accordance with applicable bargaining unit agreements and properly recorded payroll transactions in the payroll and personnel accounting system. In addition to department payroll, administrative expenditures of the Enforcement and Licensing Division were authorized, made for a proper purpose, and accurately recorded in the statewide accounting system.

The Department of Commerce receives an appropriation to fund its operations. The Administrative Services Division processes payroll and other administrative disbursements centrally. The department employs approximately 250 staff. Department payroll costs totaled approximately $11 million in each of the three years of our audit scope. Approximately 92 percent of department employees are in the classified service and 8 percent are in the unclassified service. For the three year period, the department made severance payments of $217,829, and overtime payments of $43,276.

The Enforcement and Licensing Division had total payroll costs of $8,432,978, and other administrative expenditures of $2,968,663 for the period covered by the audit. Table 5-1 classifies Enforcement and Licensing Division administrative expenditures by type.

Table 5-1
Enforcement and Licensing Division
Administrative Expenditures

	Fiscal Year		
	1993	1994	1995
Payroll	$2,766,594	$2,707,591	$ 2,958,793
Professional Services	284,185	205,048	303,105
Advertising	226,628	185,537	65,679
Communications	146,014	127,123	184,976
Supplies & Materials	107,046	72,924	147,269
Other	262,905	224,807	425,417
Total	$3,793,372	$3,523,030	$4,085,239

Source: Statewide Accounting System.

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Payroll

Our audit scope included all payroll disbursements made to Department of Commerce employees during the three years ended June 30, 1995. We included payroll for the entire department because the Administrative Services Division processes payroll centrally. Our audit objectives for payroll focused on the following questions:

- Were Department of Commerce payroll expenditures processed in accordance with applicable bargaining unit agreements; and

- Were payroll transactions properly recorded in the state's accounting system.

We interviewed agency staff to gain an understanding of the controls in place over payroll. We analyzed payroll expenditures and decided to test regular classified payroll, regular unclassified payroll, and severance pay. During our testing of classified and unclassified payroll, we reviewed time sheets, leave slips, bargaining agreements, and leave records. We also verified the eligibility of employees who received discretionary raises. We also determined that severance payments were correct and made to eligible employees.

Our review of payroll found that Department of Commerce employees were paid at the proper amounts according to the applicable bargaining unit agreements, and that the payroll transactions were properly recorded in the state's accounting system.

Administrative Expenditures

Our audit also included administrative expenditures of the Enforcement and Licensing Division. We addressed the following objectives:

- Were administrative expenditures authorized and made for a proper purpose?

- Were administrative expenditures made in accordance with applicable finance related legal provisions?

The methodology we used to audit administrative expenditures included interviewing agency personnel to gain an understanding of the controls in place. We performed analytical reviews to determine the classes of administrative expenditures that were material or posed the most risk and performed additional tests on those expenditure types. As a result, we focused our testing on the following areas: travel and computer services.

We concluded that administrative expenditures were authorized, made for a proper purpose, and complied with applicable finance related legal provisions.

OFFICE OF THE COMMISSIONER

STATE OF MINNESOTA

DEPARTMENT OF COMMERCE

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July 29, 1996

Mr. James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to your financial audit report of the Department of Commerce, Enforcement and Licensing Division and department payroll overall for the three year period ending June 30, 1995. We are very pleased with the outcome of this audit and feel the recommendations are very helpful in evaluation of our business practices. We feel we will be able to successfully implement most of the recommendations. The details as to implementation of the recommendations of this report are addressed here in the order presented in the audit report.

Chapter 1

Introduction of the Department and report, contains no specific findings or recommendations.

Chapter 2

Conclusions and recommendations for this chapter address the administration of the unclaimed property program within the Licensing Division of the program. The first recommendation states "The Department of Commerce needs to institute procedures to periodically confirm the physical existence of unclaimed property". We have had lengthy discussions internally and with the staff of the Office of the Legislative Auditor regarding this recommendation. While we feel it is extremely important to maintain the inventory of property on a regular basis, we also feel it is important to maintain the integrity of the envelopes "seal" in an effort to retain the responsibility of the holder for the property within the contents bag. Once a seal is broken the responsibility for the envelope contents moves from the holder to the agency. Therefore, if an item is missing after the seal is broken, the agency can no longer hold the property holder that remitted the property as responsible for the missing item.

By way of background information not provided in the report, holders of safety deposit box contents, primarily banks, submit the contents of the box in a sealed, notarized envelope containing an inventory of the contents. The envelopes are maintained in a secure location within the department until such time as an auction of box contents is held. At the time of the auction, two employees open the sealed envelopes, inventory the contents, identify items needing appraisal and have contents reviewed by the Minnesota Historical Society in the event the contents may have significant historical value. Items are appraised and prepared for public auction. The auction proceeds are recorded and held in the State Treasury until such time as an owner or heir can be identified and claimed pursuant to the unclaimed property statutes. In the event that an item from the inventory list is missing, the Department can return to the holder who then has the obligation to produce the item or value of the item missing. In checking with staff, it is important to note that we have no record of ever having an inventory item from a safe deposit box missing.

After discussion of this issue internally, to open the envelopes earlier and have the State assume the risk of the original holder does not seem to be a responsible decision. To open the seal of the bag would move the burden of responsibility from the holder to the State. It would seem that the best way to protect the integrity of the box contents is to leave the bags sealed and continue to place the responsibility for the inventory on the holder who submits the property. We do feel that an inventory of the "bags" is required and should occur on an annual basis. Licensing supervisors will take responsibility for implementing an annual inventory of safe deposit box content bags to assure all are accounted for. The bags will remain sealed. Two employees will handle the actual physical inventory and the supervisor will be responsible to report findings to the enforcement director and commissioner.

The second recommendation deals with recording unclaimed property receipts in the database. The recommendations here state "The Department of Commerce should reconcile the receipt information entered into the unclaimed property database to the deposits recorded on the statewide accounting system. The department should ensure that an independent employee verifies the legitimacy of the claim before processing the unclaimed property refunds." The first part of recommendation will be addressed immediately by changing procedures to do two things. First, when an employee is entering holder information on the database, the employee will check that holder list off on the deposit report forwarded with the list to assure the holder check has been entered into the statewide accounting system. This will provide the control to assure that holder receipts have been entered into the treasury before the unclaimed property is entered into the database. The second part will be to have entries verified by a second employee to assure that data entry errors are corrected before holder reports are filed. The verification employee will check off each entry on the holder report to make sure the name, address and amounts are correct.

The second part of this recommendation will be addressed by changing the claims handling procedures. The supervisor will be responsible to review all claims before they are sent to fiscal services to be sure they are valid, all documentation is complete and the amount corresponds to the holder report. The supervisor will then certify the lot as payable by signing a certification at the bottom of the lot that identifies all payments have been approved. The financial management staff will not make payments on any lot without the appropriate certification. The certification will be the similar to the one used by the Department of Finance for vendor payments and reads as follows:

> I hereby certify that the unclaimed property claims covered by this lot have been reviewed and proper documentation exists to support the claims in accordance with requirements of unclaimed property statutes and payment therefore is hereby recommended and approved.

Other alternatives do exist to address these two recommendations. However, these will take database system changes and may take time to design, develop and implement. Therefore, until such time as the control issues can be adequately addressed by system design and development, we will address the controls in this manner. Because system design and development time is difficult to predict, we cannot commit to a time-frame for automated changes or present an exact picture at this time of what those controls will look like. When we have a model for the changes necessary to address internal controls for this recommendation, your office will be updated.

The final recommendation of chapter two is "The department should ensure that it maintains supporting documentation for unclaimed property payments to other states." The department will immediately begin maintaining the list of owners reported to other states through reciprocal agreements. A copy of the list of names and amounts will be submitted to the financial management division along with payment requests and will also be maintained with the divisions reciprocal agreement files.

Chapter 3

License revenues contains no findings or recommendations.

Chapter 4

This chapter addresses findings and recommendations relating to the building contractor recovery fund and the real estate education research and recovery fund. The first recommendation states "The Department of Commerce needs to take steps to ensure the accuracy of the fees submitted by contractors to the Contractor's Recovery Fund." As mentioned in the report, the contractors fund has a sliding scale based on income for the fee to be paid to the fund. Several methods have been considered and discussed, they include; verification of income based on tax statements, an agreement with the department of revenue to review tax reporting of gross receipts, audit of financial records of the licensee and a stronger statement of responsibility to accurately report receipts.

There are several problems with the first two items to verify gross receipts. First of all, tax reporting for most of our contractors (individual propritorships) may contain income information from more than licensed activities. Some of the smaller contractors regularly do more in their business experience than the licensed contracting activities. Therefore, their gross receipts would generally include income from all business and would require some separate reporting not currently required by the Department of Revenue or IRS. In addition, our renewal period for licenses is at the same time someone would be preparing tax statements. (Renewals are due April 1) Therefore, current year tax information may not be available for someone at renewal time. It does not appear that the link to tax information will provide any further assurance that the individual is paying the appropriate fee.

Another option is to perform financial audits. Our knowledge of the clientele would indicate that the majority of our licensees as individual proprietors are going to pay the $100.00 fee correctly as they do now. To re-focus staff from consumer protection issues to financial audit for compliance to the fee selection does not appear consistent with the agency mission. In addition, to ask licensees to pay for additional staff (our license fees are required to support cost of operations) seems to exceed the value of the additional receipt the audit procedure would recover. It is unlikely, based on our knowledge and experience, that sending staff out to the contractor location or requiring the contractor to submit financial statements to audit in our office would provide any significant change in the amount of the receipts for the fund. The cost of an actual audit program compared to the potential financial impact on the fund through additional receipt recover does not support the increased cost of regulation.

Therefore, our conclusion is that our immediate response to this recommendation would be to add language to the current contractor license application informing the contractor of the requirement to select the right fee and the penalties or sanctions that can be applied if, in fact a contractor selects an inappropriate fee to benefit by paying a lessor amount. As well, we will explore the option of changing the fee to a flat fee that everyone pays. Because of the political affect of changes to this law and feelings of the regulated industry, we will not be able to move this concept until all parties are consulted and the idea has the appropriate support.

The other recommendation for this chapter is "The department needs to ensure that there is a proper separation of duties over the processing of recovery fund claims." One point to make here is that the department has felt that it had sufficient control over the claims because of the nature of the court orders and documents generating and approving payments and the review by the department legal staff and the attorney general staff (in addition to the court). However, in light of the finding, we will immediately implement a "second check" internally that the recovery fund payments are documented and certified to pay. The financial management division will not make claims payments without the appropriate enforcement director or deputy review and approval. The certification language used for unclaimed property, modified to reflect recovery fund payments, will be required on each payment document. The enforcement director or deputy will have to review the payments supporting documentation to assure the validity of the claims and sign off on the payment memo before it is forwarded to financial management for payment. However, because of the size of the claims files, the documents will not be attached to the actual payment memo's. The enforcement director/deputy review and approval of all payments will provide a separate control and assure that someone has reviewed the files to assure the appropriate nature of the payment from the recovery funds.

Chapter 5

This chapter addressed payroll and administrative expenditures and there were no findings or recommendations in this area.

The Deputy Commissioner for Enforcement and Licensing, Gary LaVasseur will have overall responsibility to see that the recommendations are implemented with assistance from Scott Borchert, Enforcement and Licensing Director and Mary Lippert, Staff Attorney. We appreciate the opportunity to have the department's comments included with your report of the financial activities of the enforcement and licensing unit. The information you have provided has been a helpful tool in assuring adequate controls exist to protect the public interest in fulfilling our agency mission. Thank you for the professional manner in which your staff represented themselves in there audit. We appreciate their efforts.

Sincerely,

David B. Gruenes
Commissioner