

Office of the State Treasurer

Financial Audit

Fiscal Year 1996 Statewide Audit

February 1997

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

97-9



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Members of the Legislative Audit Commission

The Honorable Michael A. McGrath
State Treasurer

We have audited the Office of the State Treasurer for the fiscal year ended June 30, 1996, as further explained in the Background section. The work conducted in the Office of the State Treasurer is part of our Statewide Audit of the state of Minnesota's fiscal year 1996 financial statements. The state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 1996, includes our report, issued thereon, dated December 2, 1996. The following Summary highlights the audit objectives and conclusions.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Office of the State Treasurer complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Office of the State Treasurer is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the 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 February 14, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 9, 1996

Report Signed On: February 7, 1997

SUMMARY

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Office of the State Treasurer

Financial Audit Fiscal Year 1996 Statewide Audit

Public Release Date: February 14, 1997

No. 97-9

Background

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 Office of the State Treasurer provides banking services for most state agencies. This function includes cash control, receipt processing, and warrant redemption. In addition, the office makes debt service payments on outstanding general obligation bonds and collects various fees and assessments transmitted from county units of government. The State Treasurer also serves as a member of the State Board of Investment, the Minnesota State Retirement System Board, and the Executive Council.

Selected Audit Areas and Conclusions

Our work in the Office of the State Treasurer is completed as part of our annual Statewide Audit. Our audit scope focused on those areas material to the state of Minnesota's financial statements, including state depository cash control and debt service expenditures. In addition, we expanded our audit scope beyond Statewide Audit objectives to review Office of the State Treasurer revenue collections and administrative expenditures for fiscal years 1995 and 1996.

We concluded that internal controls over the areas reviewed provide reasonable assurance that assets were adequately safeguarded, and that transactions were authorized and properly reported in the accounting records. We also concluded that the office complied with material legal provisions related to the areas reviewed. However, the Office of the State Treasurer needs to work with the Departments of Finance and Public Safety to improve the timeliness of investing deputy registrar receipts. In addition, the office did not have an adequate separation of duties over the receipt process and did not effectively limit access to the state's centralized accounting system.

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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
Charlie Gill	Auditor-in-Charge
Karen Klein, CPA	Auditor
Beaujon Guerin	Auditor
Dale Ogren, CPA	Auditor
Becky Hoese	Intern
Trent Usitalo	Intern

Exit Conference

We discussed the results of the audit with the following staff of the Office of the State Treasurer at an exit conference on January 23, 1997:

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

Chapter 1. Background

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.

Our work in the Office of the State Treasurer is completed as part of our annual Statewide Audit. The primary objective of the Statewide Audit is to render an opinion on the state of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1996. This includes determining whether the financial statements of the state present fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether the state complied with laws and regulations that may have a material effect on its financial statements.

The state of Minnesota's Comprehensive Annual Financial Report for the fiscal year ended June 30, 1996, includes our unqualified audit opinion issued thereon, dated December 2, 1996. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the fiscal year ended June 30, 1996, will include our reports on the supplementary information schedule of federal expenditures, on the state's internal control structure, and on compliance with laws and regulations. We anticipate issuing this report in June 1997.

Our financial statement audit scope focused on the State Treasurer's responsibilities in the following areas that were material to the state's financial statements in the fiscal year ended June 30, 1996:

- state depository cash control, including receipt collections and warrant redemptions, and
- debt service expenditures.

In addition to the statewide audit scope, we reviewed other financial activities administered by the Office of the State Treasurer for fiscal years 1995 and 1996. Our audit scope included the following areas:

- revenue, and
- administrative expenditures.

To address our financial statement and agency objectives, we interviewed key agency employees, reviewed applicable policies and procedures, tested representative samples of financial transactions, and performed analytical procedures, as appropriate. Our specific audit work is discussed more fully in the following chapters.

Chapter 2. Cash Control

Chapter Conclusions

State depository internal controls provide reasonable assurance that cash was adequately safeguarded, and that transactions were authorized and properly reported in the accounting records. The cash balance recorded on the State Treasurer's records was supported by the underlying transactions and bank account records. In addition, the Office of the State Treasurer materially complied with applicable legal provisions relating to cash transactions tested. However, the office needs to work with the Departments of Finance and Public Safety to improve the timeliness of investing deputy registrar receipts.

The Office of the State Treasurer provides banking services for most state agencies. The office interacts with the Department of Finance, which provides accounting and other services, and the State Board of Investment, which invests state monies. The office accounts for money deposited by state agencies in the state treasury until it is lawfully disbursed or invested. Receipt transactions, including investment redemptions and maturities, totaled \$18.7 billion in fiscal year 1996. The office works with state agencies to resolve any discrepancies between accounting and bank records.

The State Treasurer maintains 370 accounts in 170 banks throughout the state. The total cash balance for state accounts, as recorded on the State Treasurer's records at June 30, 1996, was \$40 million. 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 that the items submitted by the banks are valid outstanding warrants before transferring funds to the banks for payment. The Treasurer also maintains records detailing the daily balance of outstanding warrants. During fiscal year 1996, the Treasurer's Office processed warrants totaling \$12.9 billion. In addition, the office initiated \$4.4 billion automatic clearing house transactions based on Department of Finance and other state agency authorizations.

The Office of the State Treasurer monitors collateral pledged to secure funds deposited in the various state depository accounts. Pursuant to statutory requirements, state deposits cannot exceed 90 percent of the market value of the collateral pledged by the bank. The State Treasurer's system monitors the collateral balance and identifies when insufficient coverage exists. As of June 30, 1996, banks pledged \$88 million in collateral to secure depository accounts.

Office of the State Treasurer

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that cash was adequately safeguarded, and that transactions were authorized and properly reported in the accounting records?
- Is the cash balance reported on the Office of the State Treasurer's accounting records supported by bank account records?
- Did the Office of the State Treasurer comply with material legal provisions in administering state depository accounts?

To address our financial statement objectives, we interviewed key department employees to gain an understanding of applicable policies and procedures. We confirmed bank balances and tested the State Treasurer's bank account reconciliations. In conjunction with our audit of the Department of Finance, we reviewed and tested supporting documentation for reconciliations of cash receipt and disbursement transactions recorded on the Minnesota Accounting and Procurement System (MAPS) and the State Treasurer's depository accounting system. We reviewed the controls over warrant and automatic clearing house transactions and verified the reconciliation of outstanding warrants as recorded on MAPS to the Treasurer's outstanding warrant balance at June 30, 1996. We also tested compliance with Minn. Stat. Section 9.031, pertaining to the adequacy of collateral coverage.

Conclusions

State depository internal controls provide reasonable assurance that cash was adequately safeguarded, and that transactions were authorized and properly reported in the accounting records. The cash balance recorded on the State Treasurer's records was supported by the underlying transactions and bank account records. In addition, the Office of the State Treasurer materially complied with applicable legal provisions relating to cash transactions tested. However, as discussed in Finding 1, the timeliness of investing deputy registrar receipts needs improvement. Because the Departments of Finance and Public Safety and the Office of the State Treasurer all play a part in resolving this problem, we are including this finding in all three reports.

1. The deputy registrars' receipts are not being invested timely.

The process used to record deputy registrar receipts in the State Treasury includes unnecessary delays and does not result in a timely investment of funds. The deputy registrars collected approximately \$770 million in tax revenue during fiscal year 1996. They deposit receipt collections in non-interest bearing local depository accounts. After they make the deposit, the deputy registrars mail a notification to the Office of the State Treasurer. Each day, the State Treasurer transmits the deposit documents to the Department of Finance, which subsequently records the transactions in MAPS. At times during fiscal year 1996, Finance did not record the transactions on a daily basis. The State Treasurer's depository accounting system receives daily

Office of the State Treasurer

electronic updates of all receipt transactions recorded in MAPS. Based on the MAPS information, the State Treasurer transfers the monies out of the local bank accounts into the state's general account, and the funds are available for investment.

Of the 36 receipt transactions we tested, 27 were recorded by the State Treasurer more than three days after the deputy registrars deposited the funds in local accounts. Delays ranged from 4 to 12 days because the State Treasurer could not withdraw these monies until Finance recorded them in MAPS. Assuming this pattern continues, we conservatively estimate an annual investment income loss of approximately \$800,000 because of delays in recording deputy registrar receipts.

The Office of the State Treasurer, the Department of Finance, and the Department of Public Safety, which is administratively responsible for the deputy registrars, all have a role in ensuring the timely deposit of these revenues. We believe that with available technology, the three agencies should be able to record this revenue and transfer deputy registrar receipts to investment accounts in a more timely manner.

Recommendation

- *The Office of the State Treasurer should work with the Departments of Finance and Public Safety to improve the process for deposit of deputy registrar receipts to ensure monies are invested in a timely manner.*

Chapter 3. Debt Service Expenditures

Chapter Conclusions

Internal controls over general obligation bond debt service payments provide reasonable assurance that expenditures are accurate and properly reported in the accounting records. The Office of the State Treasurer appropriately paid \$273 million in principal and interest on general obligation bonds during fiscal year 1996. The Office materially complied with applicable legal provisions for debt service payments.

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, 1996, the outstanding general obligation bonds payable totaled \$2.16 billion. During fiscal year 1996, the State Treasurer made debt service payments totaling \$273 million.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that debt service expenditures were authorized and properly reported in the accounting records?
- Did debt service payments comply with applicable amortization schedules and other material legal provisions?

To address our financial statement objectives, we interviewed key department employees to gain an understanding of applicable policies and procedures and performed analytical procedures, as appropriate. In addition, we verified the debt service payments to the amortization schedules prepared by the Department of Finance.

Conclusions

Internal controls over general obligation bond debt service payments provide reasonable assurance that expenditures are accurate and properly reported in the accounting records. The Office of the State Treasurer appropriately paid \$273 million in principal and interest on general obligation bonds during fiscal year 1996. The Office materially complied with applicable legal provisions for debt service payments.

Chapter 4. Revenue

Chapter Conclusions

The Office of the State Treasurer has designed internal controls over the receipt process to provide reasonable assurance that all revenue is collected and properly reported in the accounting records. The fiscal years 1995 and 1996 revenue collections that we tested materially complied with applicable legal provisions. However, the agency did not have an adequate separation of duties over the receipt process.

The Office of the State Treasurer collects various fees, fines, and assessments. Substantially all of the receipts are transmitted by county governments that collect the amounts in accordance with various statutory provisions. The Office of the State Treasurer deposits the majority of the receipts in the General Fund as nondedicated revenue. Table 4-1 shows the receipts collected by the Office of the State Treasurer during fiscal years 1995 and 1996. Civil and probate filing fees, the largest individual category, account for approximately 30 percent of total receipts each year.

**Table 4-1
Summary of Receipts
Fiscal Years 1995 and 1996**

	<u>FY 1995</u>	<u>FY 1996</u>
Civil and Probate Fees	\$13,367,745	\$13,054,552
Petty and Gross Misdemeanor Fees	7,693,732	8,247,290
Officer Training Surcharge	5,124,851	5,394,131
Land Recording and Registration Surcharge	4,245,939	4,462,762
Court Fines	4,101,389	3,409,386
Marriage License	1,717,845	1,711,318
Chemical Related Fines	1,394,508	1,681,477
Court Filing and License Fees	1,607,724	1,635,556
Victims and Assault Surcharge	1,366,284	1,352,022
Seat Belt and Highway Work Zone Fines	891,240	923,458
Bail Forfeits	808,036	831,492
Birth Certificate Surcharge	581,600	416,716
Public Defender Reimbursements	180,130	197,314
Other	<u>595,524</u>	<u>858,497</u>
Total	<u>\$43,676,547</u>	<u>\$44,175,971</u>

Source: Minnesota Accounting and Procurement System.

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Audit Objectives and Methodology

The primary objectives of our audit of revenue were to address the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that the appropriate amount of revenue is collected and properly reported in the accounting records?
- Did revenue collections comply with applicable financial legal provisions?

The methodology we used to audit revenue included interviewing key agency employees to gain an understanding of applicable policies and procedures, testing receipt transactions and supporting documentation, including county remittance reports, and performing analytical procedures, as determined appropriate.

Conclusions

The Office of the State Treasurer has designed internal controls over the receipt process to provide reasonable assurance that revenue is collected and properly reported in the accounting records. Fiscal years 1995 and 1996 revenue collections that we tested materially complied with applicable legal provisions and were properly deposited and recorded. However, the agency did not have an adequate separation of duties over the receipt process, as discussed in Finding 2.

2. The separation of duties over receipts is inadequate.

One employee is responsible for the entire receipt process. This employee opens the mail and prepares a listing of receipts and other deposit documentation. This employee also reconciles the county remittance reports to the amounts recorded in MAPS. Proper internal controls require that the duties be separated so that no one person has complete control over the receipt process. Lack of separation of duties increases the risk that errors or irregularities could occur and not be detected.

The office could correct this control weakness in a number of ways. A person independent of the receipt process could open the mail and record the receipts. This person would then verify that the receipts were properly recorded. Another option is to send counties a confirmation of the receipts deposited and posted. Either of these controls would create an independent verification of the receipt collections.

Recommendation

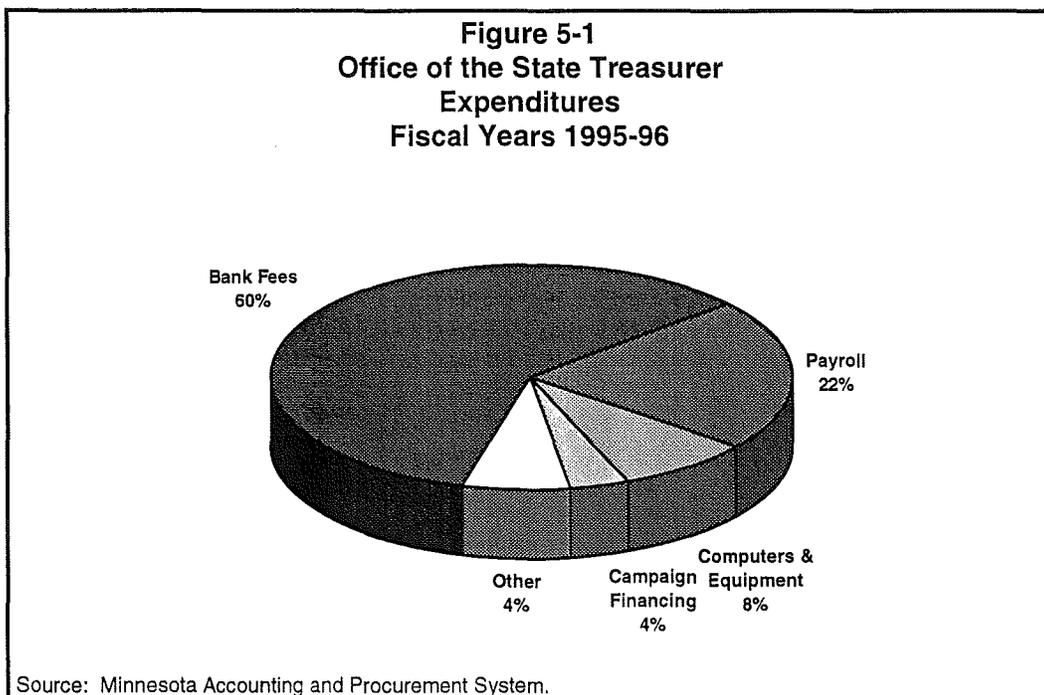
- *The Office of the State Treasurer should separate duties so that no employee has complete control of the receipt process.*

Chapter 5. Administrative Expenditures

Chapter Conclusions

The Office of the State Treasurer spent its state appropriations within appropriation limits and statutory authority. Payroll expenditures were properly authorized, adequately supported and accurately processed. The office followed proper purchasing procedures, paid invoices promptly, and recorded transactions accurately. However, the office has not effectively limited its employees' ability to initiate transactions on the state's centralized accounting system.

The Office of the State Treasurer receives General Fund appropriations to finance the majority of its operating activities. Appropriations totaled \$2,473,000 and \$2,477,000, respectively for fiscal years 1995 and 1996. Figure 5-1 shows the office's major expenditure categories for fiscal years 1995 and 1996.



The largest expenditure category was bank fees, which totaled \$3,744,388 for the two years ended June 30, 1996. The State Treasurer has statutory authority to pay depositories for performing banking services relating to the deposit of state funds. Payroll is the next largest expenditure category. The Office of the State Treasurer employs 13 individuals. For the two years ended June 30, 1996, payroll expenditures totaled \$1,373,414.

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Audit Objectives and Methodology

We focused our review of administrative expenditures on the following objectives:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that payroll and other administrative expenditures are properly authorized, adequately supported, and properly reported in the accounting records?
- Did the office comply with applicable appropriation and other legal provisions in the expenditure of funds?

The audit methodology used to review these areas included interviewing key agency employees to gain an understanding of applicable policies and procedures, reviewing supporting documentation for a sample of disbursement transactions, and performing analytical procedures, as determined appropriate.

Conclusions

The Office of the State Treasurer spent its state appropriations within established limits and statutory authority. Payroll expenditures were properly authorized, adequately supported, and accurately processed. The office followed proper purchasing procedures, paid invoices promptly, and recorded transactions accurately. However, access to the state's centralized accounting system for initiating agency transactions was not appropriately limited, as discussed in Finding 3.

3. Some employees have inappropriate access to MAPS for processing Office of the State Treasurer's administrative expenditures.

The Office of the State Treasurer has not effectively limited its employees' access to the state's centralized accounting system for processing agency transactions. Eight of 13 employees have access to both purchasing and disbursement functions in MAPS. Having the ability to initiate transactions in both functional areas increases the risk of improper payments. There are no mitigating controls to prevent or detect unauthorized payments to vendors. Many of the employees have MAPS access that is incompatible with their job duties. Allowing employees incompatible access increases the risk of errors or irregularities occurring and remaining undetected. The agency should grant access to employees based on job responsibilities.

Recommendation

- *The Office of the State Treasurer should limit authorized access to MAPS to compatible functions necessary for an employee's job duties.*



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OFFICE OF STATE TREASURER

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MICHAEL A. McGRATH
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February 4, 1997

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 recommendations in your financial audit report for the year ended June 30, 1996. 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,

A handwritten signature in cursive script, appearing to read "Michael McGrath".

Michael A. McGrath
Treasurer
State of Minnesota

RESPONSE OF THE OFFICE OF THE STATE TREASURER

TO

LEGISLATIVE AUDITOR RECOMMENDATIONS

FOR

THE YEAR ENDED JUNE 30, 1996

Auditor's Recommendation #1

The Office of the State Treasurer should work with the Departments of Finance and Public Safety to improve the process for deposit of deputy registrar receipts to ensure monies are invested in a timely manner.

State Treasurer's Response

The Office of State Treasurer staff works continuously with all agencies in the area of timely depositing and reporting of state funds. Prior to the Audit, we had been working with the Department of Finance to improve this timeliness. The Department of Finance has recently implemented the changes required. However, there remains the existing problem of Deputy Registrars not using current technology to record deposits. The electronic state accounting system was designed for agencies to record deposits without delay. Because Deputy Registrars are not connected to the accounting system, they must mail their deposit information to the State Treasurer. This causes delays of 2 to 7 days. We are working with the Departments of Public Safety and Finance to implement a computer to computer system that Deputy Registrars would use for reporting bank deposits. This would allow the State Treasurer to receive this information electronically and, therefore, have the funds invested within two days.

Jake Manahan and Jerry Engebretson will be the Treasurer's representatives for this project.

Auditor Recommendation #2

The Office of the State Treasurer should separate duties so that no employee has complete control of the receipt process.

State Treasurer's Response

The Office of the State Treasurer is working with a vendor to develop an automated confirmation process. We expect implementation by June 30, 1997.

Jerry Engebretson and Shirley Tigges are responsible for the implementation of this new process.

Auditors Recommendation #3

The Office of the State Treasurer should limit authorized access to MAPS to compatible functions necessary to an employee's job duties.

State Treasurer's Response

During the Audit, we re-evaluated our employee access and reduced the number of access approvals. I would also add that the State Treasurer's Office has maintained and will continue a separate accounting of expenditures.

Jerry Engebretson and Susann Malmstedt are responsible for the oversight of the system security.