

# **Office of the State Auditor**

## **Financial and Compliance Audit For the Two Years Ended December 31, 1996**

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**May 1997**

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

**97-30**





STATE OF MINNESOTA

**OFFICE OF THE LEGISLATIVE AUDITOR**

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Senator Deanna Wiener, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Judith Dutcher  
State Auditor

We have audited the Office of the State Auditor for the period January 1, 1995, through December 31, 1996, as further explained in Chapter 1. Our audit scope included a review of audit practice receipts, payroll, travel, capital equipment, and other administrative expenditures, as well as appropriation control. The following summary highlights the audit objectives and conclusions. We discuss these areas more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government 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 also require that we design the audit to provide reasonable assurance that the Office of the State Auditor complied with provisions of laws, regulations, and contracts that are significant to the audit. The management of the Office of the State Auditor is responsible for establishing and maintaining the internal control structure and compliance with applicable laws and regulations.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of the State Auditor. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 16, 1997.

James R. Nobles  
Legislative Auditor

John Asmussen, CPA  
Deputy Legislative Auditor

End of Fieldwork: March 25, 1997

Report Signed On: May 9, 1997



# SUMMARY

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## Office of the State Auditor

### Financial and Compliance Audit For the Two Years Ended December 31, 1996

Public Release Date: May 16, 1997

No. 97-30

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#### Agency Background

The Office of the State Auditor (OSA) was established by Article V of the state Constitution and operates under Minnesota Statute Chapter 6. The State Auditor is elected for a four-year term. Judith Dutcher, the current State Auditor, began her term on January 2, 1995. The State Auditor serves on the state's Executive Council, State Board of Investment, Land Exchange Board, State Housing Finance Agency Board, Board of Government Innovation and Cooperation, the Public Employees Retirement Association Board, and the Rural Finance Authority.

The OSA receives support for its operations in the form of state appropriations. Minn. Stat. Section 6.58 requires the OSA to bill audit clients for the costs of audits and examinations at a rate sufficient to cover the cost of its audits. The audit practice receipts collected from clients are deposited as nondedicated receipts in a special revenue account.

#### Selected Audit Areas and Conclusions

Our audit scope included a review of the Office of the State Auditor's appropriation, audit practice revenue, personnel services, and administrative expenditures for the period from January 1, 1995, through December 31, 1996.

We audited the OSA's compliance with its legal appropriation authority. The OSA spent its state appropriation within the appropriation authority.

We also audited the OSA's audit practice revenue obtained through reimbursements of OSA client audit costs. For the transactions tested, we concluded that the OSA properly billed for audit costs and properly processed and collected audit practice receipts. The State Auditor generated sufficient revenues to recover reimbursable audit costs for fiscal years 1995 and 1996 combined.

Finally, we reviewed OSA's expenditures. We audited the OSA's personnel services during the audit period for compliance with applicable legal requirements and to verify transactions were properly processed and recorded. For the transactions tested, the OSA properly processed and recorded payroll transactions.

The administrative expenditures we reviewed were: travel, rent, and capital expenditures. We verified the reliability of procedures and accurate processing of transactions. For transactions tested, the OSA properly and accurately processed, recorded, and paid expenditures through the state 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
Warren Bartz, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
Steve Johnson	Auditor
Anna Lamin	Student Worker

### Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Office of the State Auditor on April 23, 1997:

Greg Hierlinger	Deputy State Auditor, Audit Practice
Bernadine Howard	Deputy State Auditor, Legal Counsel
Virginia Davis	Finance Director





# Office of the State Auditor

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## Chapter 1. Introduction

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The Office of the State Auditor (OSA) was established by Article V of the State Constitution and operates under Minnesota Statute Chapter 6. Minnesota voters elect the State Auditor to a four-year term. Judith Dutcher is the current State Auditor, and her term began on January 2, 1995. The State Auditor serves on the state's Executive Council, State Board of Investment, Land Exchange Board, State Housing Finance Agency Board, Rural Finance Administration Board, the Public Employees Retirement Association Board, and the Board of Government Innovation and Cooperation.

The OSA is divided into seven divisions:

- The Constitutional Office Division oversees the operation of the Office of the State Auditor.
- The Audit Practices Division conducts annual financial audits of organizations affiliated with counties and cities, police and fire relief associations, and other local governments throughout the state.
- The Research and Information Division analyzes local government financial data to assist the state and local governments.
- The Special Investigations Division works to assure integrity and accountability in local government by investigating wrongdoing uncovered or suspected.
- The Police and Fire Relief Oversight Division monitors the financial and actuarial reporting for the various police and fire relief associations throughout the state.
- The Single Audit Division determines if single audit reports submitted to the OSA comply with reporting requirements of the Single Audit Act of 1984, Office of Management and Budget Circulars A-128 or A-133, and the American Institute of Certified Public Accountants, Audit, and Accounting Guide, "Audits of State and Local Governmental Units".
- The Tax Increment Financing (TIF) Division is a new division created by Minn. Stat. Section 469.177, Subd. 11, to provide funding for the State Auditor to examine the use of tax increment financing districts.

OSA activities, except for those of the Tax Increment Financing Division, are fully funded by General Fund appropriations. The OSA's appropriations for fiscal years 1995, 1996, and 1997 were \$7,439,000, \$7,136,000, and \$7,144,000, respectively. We discuss

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appropriations more fully in Chapter 2. Minn. Stat. Section 6.58 requires that the State Auditor collect fees from audited organizations to cover the cost of audit examinations. The Audit Practices Division bills the political subdivisions audited based on a fee schedule developed by the State Auditor. In the past, the OSA deposited these fees to the credit of the General Fund. However, under Minn. Stat. Section 16A.6701, the OSA now deposits these fees to a special revenue account. We discuss the audit practice revenue in Chapter 3. The Department of Revenue, in accordance with Minn. Stat. Section 69.021, Subd. 5, and Minn. Stat. Section 477.014, Subd. 4, reduces police and fire state aid and local government aid for other OSA expenses (see footnotes in Table 2-1). We discuss OSA expenditures in Chapter 4.

Our audit scope is for the period of January 1, 1995, through December 31, 1996. Table 1-1 summarizes the financial activity of the State Auditor for fiscal year 1996.

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**Table 1-1**  
**Summary of OSA Financial Activity**  
**Fiscal Year 1996**

	<u>Fiscal Year 1996</u>
Sources:	
General Fund:	
Operating Appropriation - Note (1)	\$7,136,000
Revolving Funds:	
Dedicated Revenue - Note (2)	16,045
Transfers In - Note (3)	18,973
Balance Forward In	<u>8,762</u>
Total Sources	<u>\$7,179,780</u>
Uses:	
Expenditures (All funds combined):	
Payroll	\$5,360,098
Rent	256,613
Travel	159,147
Capital Equipment	120,020
Other Administrative Expenditures	<u>251,272</u>
Total Expenditures (All funds combined)	<u>\$6,147,150</u>
Other Uses:	
Balance Forward Out - Operating Appropriation	\$1,033,743
Balance Forward Out - Dedicated Revenue	7,327
Balance Forward Out - Note (3)	<u>(8,440)</u>
Total Other Uses	<u>\$1,032,630</u>
Total Uses	<u>\$7,179,780</u>

**Notes:**

- (1) Under Minn. Stat. Section 6.58, the General Fund shall be used to provide personnel, pay other expenses, and for the acquisition of equipment used in connection with reimbursable examinations and other duties pursuant to law. Under Minn. Stat. Section 6.56, the state auditor, upon the examination of the books and records of any political subdivision, shall collect the cost of such examination, and under Minn. Stat. Section 16A.6701, deposit the receipts to a special revenue fund. See Chapter 3 for a discussion of audit practice division receipts and the amounts collected during the audit period. The Department of Revenue reduced some state aids to offset OSA audit costs (see Table 2-1 notes for more information).
- (2) Dedicated revenue is collected for seminar and workshop activities.
- (3) Minn. Stat. Section 469.177, Subd. 11, created the TIF division. The division receives funding from a .1 percent charge on TIF districts. The State Treasurer collects the funds and transfers the funds to the State Auditor. The division started during FY96. Because of cash flow problems it had to obtain a cash flow loan from the Department of Finance. It ultimately collected sufficient revenues to cover its expenditures for fiscal year 1996.

**Sources:**

The following state accounting system reports were used to prepare the above schedule:

Minnesota Accounting and Procurement System (MAPS), Managers Financial Report and the Appropriation Balance by Fund Report as of September 30, 1996.

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## Chapter 2. Appropriation Control

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### *Chapter Conclusions*

*The Office of the State Auditor (OSA) complied with appropriation laws. The OSA stayed within its authorized funding level. The OSA properly cut off expenditures at fiscal year end and carried forward residual funds as permitted by law.*

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### **Background**

The OSA received funding for its operations through one appropriation for each fiscal year. The OSA then distributed the appropriation to the operating divisions as shown in Table 2-1. The accounts for tax increment financing deductions and seminar fees provide OSA with other financing sources.

The OSA recovers Audit Practice Division expenditures by billing the audited organization for reimbursable audit costs as required by Minn. Stat. Section 6.58. We discuss audit practice receipts in Chapter 3.

### **Audit Objectives**

Our audit objectives included the review of OSA appropriations with the following questions:

- Did the office comply with appropriation laws?
- Was the cutoff for expenditures at year end proper?
- Were residual funds disposed of in the manner required by law, such as canceled, carried over, or transferred?

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**Table 2-1**  
**Summary of OSA General Fund Appropriation**  
**Allocation for Fiscal Year 1996**

Activities	<u>Appropriation</u>	<u>Amount Expended</u>	<u>Balance Forward to FY 1997</u>
Audit Practice (1)	\$5,803,000	\$4,944,293	\$858,707
Research and Information (2)	423,000	322,484	100,516
Special Investigations	313,000	266,418	46,582
Constitutional Office	289,000	282,125	6,875
Police/Fire Relief Oversight (3)	230,000	224,938	5,062
Single Audit (4)	<u>78,000</u>	<u>62,000</u>	<u>16,000</u>
Total Appropriation	<u>\$7,136,000</u>	<u>\$6,102,258</u>	<u>\$1,033,742</u>

**Notes:**

- (1) The OSA recovers funds expended by the Audit Practice Division through billings to audit clients. See Chapter 3 for a discussion of Audit Practice Division receipts and amounts collected during the audit period.
- (2) According to Minn. Stat. Section 477A.014, Subd. 4, the Department of Revenue reduces local government aids up to \$217,000 per year to reimburse the state for costs associated with OSA research and information activities.
- (3) According to Minn. Stat. Section 69.021, Subd. 5, the Department of Revenue is to reduce police and fire state aid by the amount required to pay the State Auditor's costs associated with the audits or exams of the police and firefighters relief associations. The OSA's Police and Fire Relief Oversight Division informed the Department of Revenue to reduce police and fire state aid by \$200,600 for fiscal year 1996 for audits of police and fire relief associations. The difference of \$24,338 is composed of amounts not eligible for recovery under Minn. Stat. Section 356.219, Subd. 5.
- (4) Single Audit costs are submitted to the Department of Finance for inclusion in the statewide indirect cost allocation plan, and applicable federal reimbursements are deposited in the General Fund.

**Sources:**

The following state accounting system reports were used to prepare the above schedule:  
MAPS, Managers Financial Report, and the Appropriation Balance by Fund Report as of September 30, 1996.

## Methodology

We obtained and reviewed appropriation legislation, appropriation accounts, and appropriation transfers. We discussed appropriation activity with OSA personnel. We used computer software to analyze financial data.

## Conclusions

The Office of the State Auditor complied with the provisions of the appropriation laws and stayed within its legally authorized funding level. The OSA used six accounts to summarize the appropriation activity. For the fiscal years reviewed, expenditures were properly cut off at fiscal year end. Residual funds were carried forward as permitted by law.

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## Chapter 3. Audit Practice Revenue

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### *Chapter Conclusions*

*For the transactions tested, the Office of the State Auditor properly processed and collected audit practice receipts. The State Auditor generated sufficient revenues to recover reimbursable audit costs for fiscal years 1995 and 1996 combined.*

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### **Background**

The State Auditor is responsible for collecting fees from audited organizations to recover audit costs. Minn. Stat. Section 6.58 states that the General Fund shall be used to provide personnel, pay other expenses, and acquire equipment used in connection with reimbursable examinations and other duties pursuant to law. The law also states that the State Auditor shall review and adjust the schedule of charges for such examinations at least annually to insure that the amount collected shall be sufficient to pay all the costs connected with such examinations during the fiscal year. Starting in fiscal year 1996, the OSA, by authority of Minn. Stat. Section 16A.6701, deposited receipts collected for audit practice costs into the special revenue account. These receipts, however, are not available for expenditure by the State Auditor.

To maintain an equitable charge for its audit practice services, the OSA, as required by Minn. Stat. Section 6.56, Subd. 2, completed an annual overall evaluation of revenues and expenditures to determine the accuracy and possible, necessary adjustment of the per diem rates.

Table 3-1 provides a two year summary of operations for the Audit Practice Division. We used the statewide accounting system to obtain the expenditure amounts. The revenues were obtained from the OSA claim journals, which are monthly summaries of billings to audited organizations.

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**Table 3-1**  
**Analysis of Audit Revenues and Expenditures**  
**Fiscal Years 1995 and 1996**

	Fiscal Year <u>1995</u>	Fiscal Year <u>1996</u>
Audit Practice Division expenditures	\$5,050,582	\$4,944,292
Revenues - Note (1)	<u>4,846,253</u>	<u>5,275,030</u>
Revenue overage (underage)	<u>\$(204,329)</u>	<u>\$ 330,738</u>

Note (1): The amounts actually collected and deposited by the OSA were approximately \$5.3 million and \$5.4 million for fiscal years 1995 and 1996, respectively.

Sources:

The following state accounting system reports were used to prepare the above schedule:  
Statewide Accounting System, Allotment Balance Within Appropriation Report as of October 13, 1995; MAPS, Managers Financial Report as of September 30, 1996.  
Revenue is based on information included in the claim journals of the Office of the State Auditor.

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## Audit Objectives

During our review of receipts, we considered the following questions:

- Did the Office of the State Auditor collect and deposit all required receipts?
- Did the State Auditor's method of summarizing employee hours and employee expenses include all amounts on the billings?
- Did the accounts receivable ledger show appropriate transactions?
- Were billings sufficient to recover audit practice costs?

## Methodology

We obtained the appropriate financial data from the statewide accounting system. Through the use of a computer software program, we organized and summarized the financial data. We obtained an understanding of the billing and receipt process. We conducted tests to evaluate controls and verify the accuracy of the billing and receivable system.

## Conclusion

Based on our testing, the State Auditor's billing and receipt records showed that:

- receipts were properly collected and deposited;
- client billings accurately included employee hours and employee expenses;
- the accounts receivable ledgers accurately recorded transactions;
- billings were sufficient to recover audit practice costs on a biennial basis; and
- adjustments to the reimbursement rates allowed the OSA to closely match revenues and expenditures within and between the biennium.

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## Chapter 4. Administrative Expenditures

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### *Chapter Conclusions*

*For transactions tested, the Office of the State Auditor appropriately processed and recorded payroll and other administrative expenditure transactions for the period January 1, 1995, through December 31, 1996. For transactions tested, the OSA was in compliance with material finance-related legal issues regarding payroll and other administrative expenditures.*

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### Personnel Services

Our audit scope for payroll activity included calendar years 1995 and 1996. Payroll transactions for this period were approximately \$10.9 million. Table 4-1 compares the types of payroll expenditures for fiscal year 1996.

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Table 4-1  
Payroll Expenditures  
Fiscal Year 1996

<u>Payroll Type</u>	<u>Amount</u>
Full-time salaries	\$5,236,988
Part-time salaries	61,142
Overtime	28,215
Severance/Vacation Payoffs	17,156
Other Payroll	16,597
Total Payroll	<u>\$5,360,098</u>

Sources:

The following state accounting system reports were used to prepare the above schedule:  
MAPS, Managers Financial Report as of September 30, 1996.

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## **Objectives**

During our review of personnel services, we considered the following questions:

- Were payroll transactions for regular classified and unclassified, severance, vacation, and overtime payments accurately processed?
- Were payroll transactions recorded properly on the state's accounting systems?
- Was the OSA in compliance with material finance-related legal issues regarding payroll processing?

## **Methodology**

To achieve our objectives, we summarized payroll transactions. This data allowed us to review, analyze, and generate samples to test payroll transactions. We selected random samples using a software package. We tested sample items for legal compliance provisions, propriety of transactions, reasonableness, proper documentation, and accuracy.

## **Conclusions**

On the basis of our testing, payroll transactions were processed and recorded properly. The OSA was in compliance with material finance-related legal provisions regarding payroll processing.

## **Rent**

The Office of the State Auditor (OSA) employed approximately 125 employees located in facilities throughout the state. The OSA entered into lease agreements for office space to house its employees. The Real Estate Management Division of the Department of Administration processed all lease agreements. The OSA is currently leasing office space for employees in eight separate cities. For the two years ended December 31, 1996, the OSA disbursed \$511,334 for rent. This amount includes payments for office space, equipment rentals, room rentals, and parking spaces. For fiscal year 1996, the OSA paid \$256,613 for rent.

## **Objectives**

During our review of rent, we considered the following questions:

- Were rent payments supported by a properly executed rental contract?
- Were rent payments being made in accordance with the rental contracts?
- Were rent payments being properly recorded in the Minnesota Accounting and Procurement System (MAPS)?

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## Methodology

To achieve our objectives, we summarized rent transactions. This data allowed us to review, analyze, and generate samples to test rent transactions. We gained an understanding of the rent payment cycle through interviews with key personnel. We performed a review of the rental payments made throughout the audit period and focused our testing on all large rental contracts and expenditures. We tested expenditures for propriety of transactions, reasonableness, proper documentation, and accuracy. We tested the parking charges for OSA employees.

## Conclusions

On the basis of our testing, rent transactions were supported by properly executed rental contracts made in accordance with the contracts and were processed and recorded properly. We found a problem with amounts deducted by the Department of Administration for the State Auditor's employee parking.

As part of our review of leases, we estimated that the parking costs of some employees was subsidized about \$5,500. Specifically, at the main office building in St. Paul, the OSA has leased 42 parking spaces. The parking lease was \$20,160 for the two years ended December 31, 1996. The state recovered part of these parking fees through employee deductions. Based on the parking fee charged to employees, the state could have recovered only about \$14,600 if 42 employees had paid for parking during the entire period.

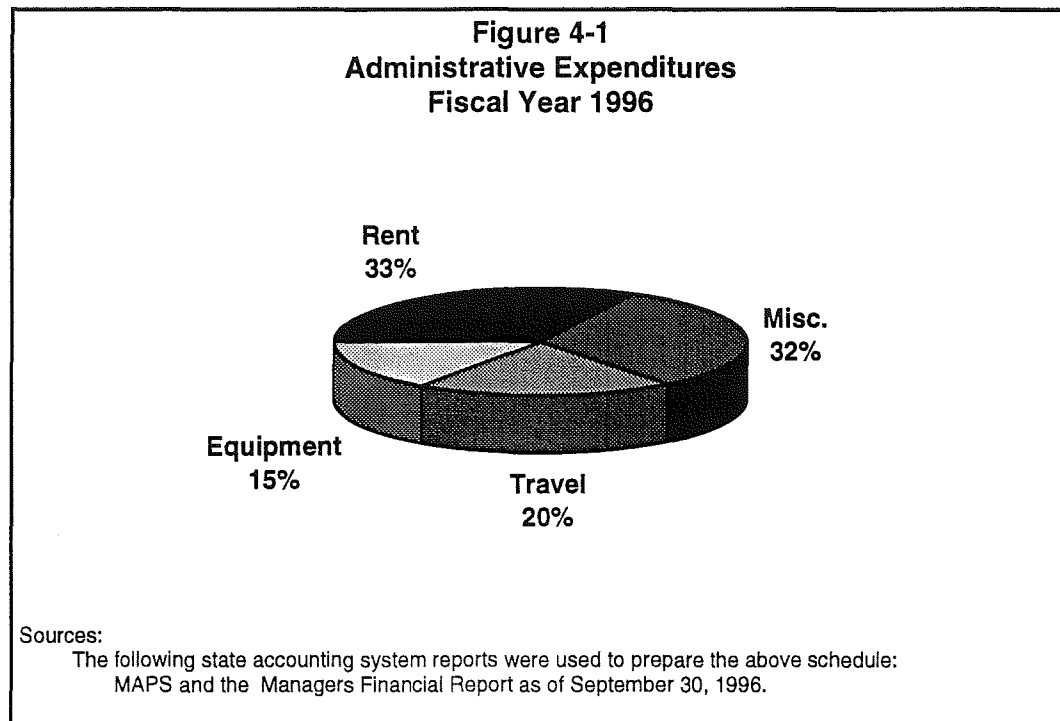
Since the OSA uses General Fund money to pay the parking lease, the Department of Administration was to return the amount collected from the employees to the office that leases privately owned parking. This parking reimbursement was intended to offset the office's lease costs. For fiscal year 1996, the Department of Administration returned \$5,931 to the General Fund as nondedicated receipts in June 1996. Therefore, the reimbursements were not available for use by the OSA. The reimbursements should have been deposited as an expenditure refund and made available for OSA use. The Department of Administration had not returned any money for fiscal year 1997 as of March 1997.

Minn. Stat. Section 16B.58, Subd. 8, provides that "the commissioner (of Administration) shall charge employees for parking facilities used by them and furnished for their use pursuant to any lease entered into between the state and the lessor of any privately owned property situated in the seven-county metropolitan area." The Department of Administration Real Estate Management Division stated that it will review the parking fees during the next renegotiation of the State Auditor lease and adjust them accordingly. We will direct this report to the Department of Administration to insure this issue is resolved.

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## Other Administrative Expenditures

In addition to its rent payments, the OSA incurred administrative expenditures in the following categories: travel, professional/technical services, purchased services, capital expenditures, supplies, and other general expenses. Figure 4-1 illustrates the fiscal year 1996 expenditures by type, excluding personnel services. Personnel services represent over 87 percent of total expenditures. Travel, rent, and equipment represented 68 percent of administrative expenditures. The miscellaneous category on the chart is comprised mainly of repairs, printing, supplies, and purchased services.



## Audit Objectives

During our review of other administrative expenditures, we considered the following questions:

- Were the administrative expenditures properly and accurately processed, recorded, and paid through the state accounting systems?
- Did the OSA follow proper procedures to obtain goods and services?
- Did the OSA have adequate procedures to safeguard the existence of assets?
- Were inventory records consistently and accurately updated?
- Were OSA expenditures reasonable and prudent for a public entity?

# **Office of the State Auditor**

## **Methodology**

We extracted financial data through the use of a computer software package. We summarized and reviewed the financial data. From our review, we generated samples for the following expenditure types: travel, memberships, communication, and equipment. We discussed the expenditure process with appropriate staff and reviewed documentation to support expenditures. We also verified the existence of a sample of assets at the OSA.

## **Conclusion**

For the transactions tested, the Office of the State Auditor followed proper procedures to obtain goods and services. OSA expenditures appear reasonable for office usage. The inventory records were consistently and accurately updated. We were able to verify a sample of assets without exceptions.