# Department of Administration

## Financial Audit
## Fiscal Year Ended June 30, 1997

February 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota


98-7


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

Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Elaine Hansen, Commissioner
Department of Administration

We have audited selected aspects of the Department of Administration for the fiscal year ended June 30, 1997, as further explained in Chapter 1. Our audit scope included various activities of the Internal Service Funds and the Building Fund. This was not a complete audit of all financial activities of the Department of Administration. The work conducted in the department is part of our Statewide Audit of the state of Minnesota's fiscal year 1997 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our report dated December 8, 1997. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

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. These standards also require that we design the audit to provide reasonable assurance that the department complied with provisions of laws and regulations that are significant to the audit. The management of the Department of Administration is responsible for establishing and maintaining the internal control structure and ensuring compliance with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Administration. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 20, 1998.

James R. Nobles
Legislative Auditor

Claudia Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 2, 1997

Report Signed On: February 13, 1998

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# SUMMARY

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## Department of Administration

### Financial Audit
### For the Fiscal Year Ended June 30, 1997

Public Release Date: February 20, 1998 No. 98-7

### Background

The Department of Administration provides a variety of business management and administrative services to state and local government agencies. Its major programmatic areas include the InterTechnologies Group, the Operations Management Bureau, the Facilities Management Bureau, and the Technology Management Bureau. The department's funding sources include user fees, legislative appropriations, gifts, and federal grants. Ms. Elaine Hansen serves as the commissioner of the department.

### Audit Scope and Conclusions

Our audit scope was limited to those activities material to the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1997.

Our scope included InterTechnologies Group revenues, professional and technical services, computer and system services, network services, and fixed assets. It also included Central Stores sales revenue and cost of goods sold, PrintComm fee revenue, Risk Management insurance revenue, Central Motor Pool vehicle rental revenue and fixed assets, Plant Management lease revenue, electric power expenses and transfers, and selected Building Construction project expenditures.

In all cases, we concluded that the amounts reported in the state's financial statements are fairly stated. We noted no matters in our report relating to internal control or compliance.

# Table of Contents



## Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

| | |
|---|---|
| Claudia Gudvangen, CPA | Deputy Legislative Auditor |
| Jeanine Leifeld, CPA, CISA | Audit Manager |
| Janet Knox, CPA, CISA | Auditor-in-Charge |
| Connie Stein | Auditor |
| Chege Ngigi | Auditor |
| Michelle Breault | Intern |

## Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Department of Administration on February 9, 1998:

| | |
|---|---|
| Elaine Hansen | Commissioner |
| Marcia Hansen | Executive Assistant |
| Douglas Schneider | Assistant Commissioner for InterTech - Computer Services |
| Kent Allin | Assistant Commissioner for Operations Management |
| Tom Ulness | Assistant Commissioner for Facilities Management |
| Beverly Schuft | Assistant Commissioner for InterTech - Technology Management Bureau |
| Larry Freund | Director of Financial Management and Reporting |
| Judy Plante | Director of Management Analysis |
| Sheila Reger | Director of Human Resources |
| Veronica Legan | Accounting Director |
| Judy Hunt | Internal Auditor |

# Chapter 1. Introduction

The Department of Administration provides a variety of business management and administrative services to state and local government agencies. Its major programmatic areas include the InterTechnologies Group, the Operations Management Bureau, the Facilities Management Bureau, and the Technology Management Bureau. The department's funding sources include user fees, legislative appropriations, gifts, and federal grants. Many of Administration's activities are self-supporting. To monitor the financial status of these activities, the department prepares quarterly financial statements for these funds. Ms. Elaine Hansen serves as the commissioner of the department.

Our scope was limited only to those aspects of the Department of Administration's financial activities which were material to the financial activities of the state of Minnesota for the year ended June 30, 1997. The activities included in our audit scope are shown on Table 1-1.

**Table 1-1**
**Selected Financial Activities**
**Year Ended June 30, 1997**

| | |
|---|---|
| **Revenue Programs** | |
| InterTechnologies Fund: | |
| Computer Services fee revenue | $34,388,766 |
| Telecommunications fee revenue | 28,599,836 |
| Central Stores Fund sales revenue | 7,346,792 |
| PrintComm Fund fee revenue | 4,993,545 |
| Risk Management Fund insurance revenue | 6,122,188 |
| Central Motor Pool Fund vehicle rental revenue | 6,789,012 |
| Plant Management Fund lease revenue | 26,259,924 |
| Agency Fund postage sales | 9,957,406 |
| **Expense/Expenditure Programs** | |
| InterTechnologies Fund: | |
| Professional and technical services | 1,082,041 |
| Computer and system services | 5,434,118 |
| Network services | 25,704,556 |
| Fixed asset purchases | 6,747,365 |
| Central Stores Fund cost of goods sold | 6,174,559 |
| Central Motor Pool Fund fixed asset purchases | 7,132,951 |
| Plant Management Fund: | |
| Electric Power | 3,197,189 |
| Transfers | 9,517,558 |
| Building Construction Division expenditures (selected) | 25,734,746 |

Source: State of Minnesota Comprehensive Annual Financial Report for the year ended June 30, 1997.

Our audit of the Department of Administration was performed as part of the Statewide Audit of the state of Minnesota's financial statements. 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 1997. 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 Department of Administration sets rates based on anticipated usage and estimated expenses for some of the programs we audited. The Department of Finance has statutory responsibility to approve the rates these programs charge. We did not review or evaluate the rate setting process for any of the department's programs.

# Chapter 2. InterTechnologies Group

## *Chapter Conclusions*

***The InterTechnologies Group (InterTech) computer service fee revenue, telecommunications fee revenue, fixed assets, professional and technical services expenses, computer and system services expenses, and network services expenses, as reported in the state's financial statements, were fairly stated in compliance with generally accepted accounting principles. We noted no matters in this report involving internal control over InterTech's financial reporting.***

The InterTechnologies Group (InterTech) is the core computer and telecommunications organization for state agencies. Table 2-1 shows the significant operating activities of the bureau for the year ended June 30, 1997.

**Table 2-1**
**InterTechnologies Group Operating Statement**
**Year Ended June 30, 1997**

| | |
|---|---|
| Operating Revenues: | |
| Computer Service Fees | $34,388,766 |
| Telecommunications Fees | 28,599,836 |
| Other Income (2) | 388,828 |
| Total Operating Revenues | $63,377,431 |
| Operating Expenses: | |
| Network Services | 25,704,556 |
| Professional and Technical Services | 1,082,041 |
| Computer and System Services | 5,434,118 |
| Depreciation | 14,227,486 |
| Salaries and Fringe Benefits | 12,188,185 |
| Other Expenses (2) | 7,854,116 |
| Total Operating Expenses | $66,490,502 |
| Operating Loss (1) | ($ 3,113,071) |

(1) Depreciation was adjusted to reflect change in fixed asset minimum reporting requirement from $500 to $2,000.
(2) Areas not audited.

Source: InterTech financial statements prepared by the Department of Administration's Financial Management and Reporting Division.

InterTech sustained an operating loss during fiscal year 1997. InterTech originally lowered its fiscal year 1997 rates in several service areas. However, due to customer volume variances, InterTech did not meet its projected revenue targets as the fiscal year began. In response, InterTech reduced its planned expenses and increased its rates effective February 1, 1997. In addition, during fiscal year 1997, InterTech paid a penalty of $758,240 to the federal government for excessive retained earnings in previous years. Finally, InterTech wrote off $1,529,522 during fiscal year 1997 due to a change in the department's fixed asset capitalization policy.

Our audit scope included InterTech's computer service and telecommunications fees revenue reported in the state's financial statement for fiscal year 1997. We also audited expenses for professional and technical services, computer and system services, network services, and fixed asset purchases reported in the state's financial statements for fiscal year 1997. Our audit procedures included gaining an understanding of controls over InterTech's revenue, expenses, and fixed assets. We reviewed the process used to invoice and collect receipts from customers and the processes used to procure services and to purchase and dispose of capital equipment. We also obtained evidential matter through inquiries of key personnel, inspection of documents, and analysis of financial data. As part of our work, we ascertained whether the department complied with laws and regulations that may have a material effect on InterTech's financial statements.

## Revenues

InterTech charges fees for storing, processing, and transporting information for state agencies. It provides various types of computer services to its customers. These services include maintaining customer access to mainframe applications, storing data using various storage media, and providing electronic and voice mail service. InterTech bills customers based on usage at rates approved by the Department of Finance. Examples of usage units include computer processing unit seconds, storage units, such as megabyte days, and number of subscribing users.

InterTech also manages and operates telecommunications products and services for the state. Additionally, it manages long distance voice, network, video conferencing, and other services such as broadcast fax and never busy fax. Telecommunications service providers invoice InterTech for services provided to customers. InterTech then allocates usage units to its customers and invoices customers at rates approved by the Department of Finance.

InterTech reported operating revenue of $63,377,431 for fiscal year 1997. We found that InterTech's commuter service and telecommunications fee revenues, as reported on the state's financial statement's, were fairly stated.

## Fixed Assets

InterTech purchases and maintains equipment necessary for its business operations. In accordance with Minn. Stat. Section 16A.85, InterTech uses a master lease program to provide financing for many of its asset purchases. During fiscal year 1997, InterTech invested over $6.7 million in new fixed assets. In some cases, InterTech purchases equipment and then leases the equipment to certain customers under noncancellable four-year capital leases.

Effective July 1, 1996, the department increased the fixed asset minimum dollar reporting requirement for all state agencies from $500 to $2,000. The department also issued an internal policy to expense personal computers (excluding those used for LAN servers) and all their component parts at the time of purchase. This resulted in a net adjustment of $1,529,522 in InterTech's financial statements. Reductions to fixed assets and the related depreciation accounts totaled $7,190,283 and $5,660,762, respectively.

InterTech reported a net fixed asset balance of $18,948,942 as of June 30, 1997. We found that InterTech's fixed assets, as reported on the state's financial statements, were fairly stated.

## Operating Expenses

InterTech expenses include system development contracts, software usage and licensing fees, as well as production and maintenance services. The department classifies these items as professional and technical services or computer and system services. InterTech pays some maintenance agreements and software licensing fees in advance for a time period that spans fiscal years. This type of payment gives rise to prepaid expenses in the financial statements. InterTech also purchases network services consisting primarily of telephone services, video conferences, and fax charges.

InterTech reported operating expenses of $66,490,502 for fiscal year 1997. We found that InterTech's expenses for professional and technical services, computer and system services, and network services, as reported on the state's financial statement's, were fairly stated.

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# Chapter 3. Operations Management Bureau

## *Chapter Conclusions*

***Central Stores net sales and cost of goods sold, PrintComm printing revenue, Risk Management insurance premium revenue, and Central Motor Pool fixed assets and rental revenue, as reported on the state's financial statements, were fairly stated in compliance with generally accepted accounting principles. We noted no matters in this report involving internal controls over the Operations Management Bureau's financial reporting.***

The Operations Management Bureau consists of five divisions that offer services such as a central motor pool, printing services, and the state's self-insurance program. It is comprised of the following divisions:

- Materials Management,
- Minnesota Office of Citizenship and Volunteer Services,
- Communications.Media,
- Risk Management, and
- Travel Management.

From the Operations Management Bureau, we audited selected components of Materials Management, Communications.Media, Risk Management, and Travel Management.

Our audit scope included revenue and expenses reported on the state's financial statements for fiscal year 1997. Our audit procedures included gaining an understanding of the controls over significant accounting transactions. We also obtained evidential matter through inquiries of key personnel, inspection of documents, and analysis of financial data. As part of our work, we ascertained whether the department complied with laws and regulations that may have a material effect on the Central Stores, PrintComm, Risk Management, or Central Motor Pool financial statements.

## Materials Management Division

Within the Materials Management Division, we audited Central Stores net sales and cost of goods sold. Central Stores is a centralized supply purchasing, storage, and distribution center. Central Stores purchases paper and office supplies from vendors then sells these items to state agencies and other governmental agencies.

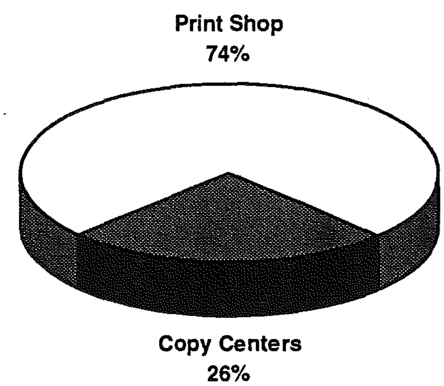
Central Stores participates in a "stockless" inventory program with one vendor for certain items. In the stockless system, customers pass orders through Central Stores, who then forwards the order to the vendor. The vendor ships the goods directly to the customer. The customer pays Central Stores, which in turn pays the vendor.

Central Stores reported $7,346,792 in net sales and $6,174,559 in cost of goods sold on the state's financial statements for the year ended June 30, 1997. We found that the Central Stores net sales and cost of goods sold, as reported on the state's financial statements, were fairly stated.

## Communications.Media

The Communications.Media Division encompasses four main businesses: retail and editorial services, printing and copying, mailing and distribution, and records management services. Our audit focused on selected activities within the printing and copying business, called PrintComm. PrintComm runs a print shop and three photocopy centers. The department does not require state agencies to use the print shop or copy centers. Rather, PrintComm must compete with outside vendors for state business. Figure 3-1 shows PrintComm revenue sources for fiscal year 1997.

**Figure 3-1**
**PrintComm**
**Revenue Sources**
**Year Ended June 30, 1997**




Source: Revenue information from PrintComm for the year ended June 30, 1997.

We also audited Communications.Media's postage operation. Through the Central Mail operation, the department accounts for the cost of postage for state agencies. Expenditures represent postage purchases from the United States Postal Service. Revenues represent receipts from state agencies to pay for their postage either for metered mail, bulk mail, or postage stamps. There is no additional overhead charged to agencies for the central mailing service.

PrintComm reported net revenue of $4,993,545 on the state's financial statements for fiscal year 1997. Central Mail reported sales of $9,957,406 for fiscal year 1997. We found that PrintComm's printing revenue and Central Mail's sales, as reported on the state's financial statements, were fairly stated.

## Risk Management

The Risk Management Division is responsible for the development and operation of the state's risk and insurance program. The division's mission is to minimize the state's exposure to financial loss while providing economically sound insurance coverage. The division offers a variety of self-insured and outside vendor (purchased) options. Although originally intended to focus on automobile liability exposure, in recent years, Risk Management has expanded to include developing a comprehensive property insurance program for all state agencies. Table 3-1 shows the Risk Management insurance premium revenue categories.

**Table 3-1**
**Risk Management**
**Insurance Premium Revenues**
**Year Ended June 30, 1997**

| | |
|---|---|
| Type of Insurance Premium: | |
| Self Insurance (1) | $4,929,883 |
| Workers' Compensation (2) | 516,498 |
| Billback Premiums (3) | 675,807 |
| Total | $6,122,188 |

(1) Self Insurance includes automobile liability and comprehensive and collision.
(2) Allocations of workers' compensation premiums within the Department of Administration only.
(3) Insurance coverage purchased from an outside vendor and billed back to an agency.

Source: Risk Management Division's Statement of Revenues and Expenses for the year ended June 30, 1997.

In fiscal year 1997, Risk Management paid policy dividends of $190,236. Dividends were paid to certain agencies that had paid premiums for general liability insurance for the policy years of 1988 to 1993. For this time period, the final resolution of all remaining outstanding claims resulted in the premium dividend.

Risk Management reported operating revenue of $6,122,188 for fiscal year 1997. We found that Risk Management's insurance premium revenue, as reported on the state's financial statements, was fairly stated.

## Travel Management

The Travel Management Division offers three major services to state agencies. First, Central Motor Pool provides vehicle rentals, including vehicle maintenance and repair. Second, the division provides a fleet of passenger vans for state employees who commute to work in a van pool. Finally, the division offers a corporate credit card program, preferred travel vendors, and monthly bus cards. Minn. Stat. Section 16B.54 establishes Central Motor Pool and the Motor Pool Fund.

Vehicles comprise over 98 percent of the division's total fixed assets. Central Motor Pool receives most of its revenues through daily, weekly, and monthly vehicle rental to state agencies. Central Motor Pool charges customers a daily or monthly rate plus a variable rate. Travel

Management bases the variable rate on mileage. The rates cover gasoline, oil, tires, normal operating maintenance, and insurance costs.

Central Motor Pool reported a net vehicle asset balance of $15,022,025 as of June 30, 1997. Central Motor Pool reported vehicle rental fees of $6,789,012 on the state's fiscal year 1997 financial statements. We found that Central Motor Pool's vehicle asset balance and its rental revenue, as reported on the state's financial statements, were fairly stated.

# Chapter 4. Facilities Management Bureau

## *Chapter Conclusions*

***The Building Construction Division's construction expenditures, as well as Plant Management rental revenue, operating transfers, and electric power expenses, as reported on the state's financial statements, were fairly stated in compliance with generally accepted accounting principles. We noted no matters in this report involving internal control over the Facilities Management Bureau's financial reporting.***

The Facilities Management Bureau is responsible for managing the state's real property, including land and physical plant. It is comprised of the following divisions:

- Building Construction,
- Plant Management,
- Building Codes and Standards, and
- Real Estate Management

From the Facilities Management Bureau, we audited selected components of Building Construction and Plant Management.

## Building Construction Division

The Building Construction Division coordinates and monitors capital construction and improvement projects for state-owned buildings. Building Construction helps agencies develop project predesigns, estimate project budgets, and obtain project authorization. Once projects are approved, Building Construction assists with establishing final project designs and budgets, selecting and contracting with building contractors, monitoring project progress, and authorizing and disbursing capital fund expenditures. During the audit, we looked at seven projects that accounted for $25,735,000 of the division's construction expenditures.

The primary objective of our audit of the Building Construction Division was to verify the reasonableness of building construction expenditures reported on the state's financial statements for fiscal year 1997. To meet this objective, we gained an understanding of the controls over building construction expenditures. We reviewed Building Construction's process to select and establish contracts with consultants and building contractors, to monitor and review project progress, to authorize capital expenditures, and to disburse capital funds. We also obtained evidential matter through inquiries of key personnel, inspection of documents, and analysis of financial data. As part of our work, we ascertained whether the department complied with laws and regulations that may have a material effect on the state's building fund financial statements.

## Department of Administration

We found that, for the seven Building Construction projects we reviewed, the division's construction expenditures, as reported on the state's financial statement's, were fairly stated.

## Plant Management Division

The Plant Management Division maintains buildings under the control of the Department of Administration, manages parking facilities in the capitol complex, and promotes energy conservation and recycling on a statewide basis. A breakdown of its operations follows:

- Complex Operations includes housekeeping, engineering, monitoring automated systems, and installing electronic systems.

- Complex Services includes material transfer services, grounds keeping, snow removal, recycling center operation, resource recovery assistance, and special event coordination.

- Support Operations includes coordinating parking and carpooling, scheduling services in response to tenant or building issues, scheduling conference rooms, and providing administrative and accounting support for the division.

- Technical Services provides building maintenance coordination and trade services such as painting, carpentry, plumbing, electrical, and refrigeration. It also focuses on statewide energy efficiency improvements.

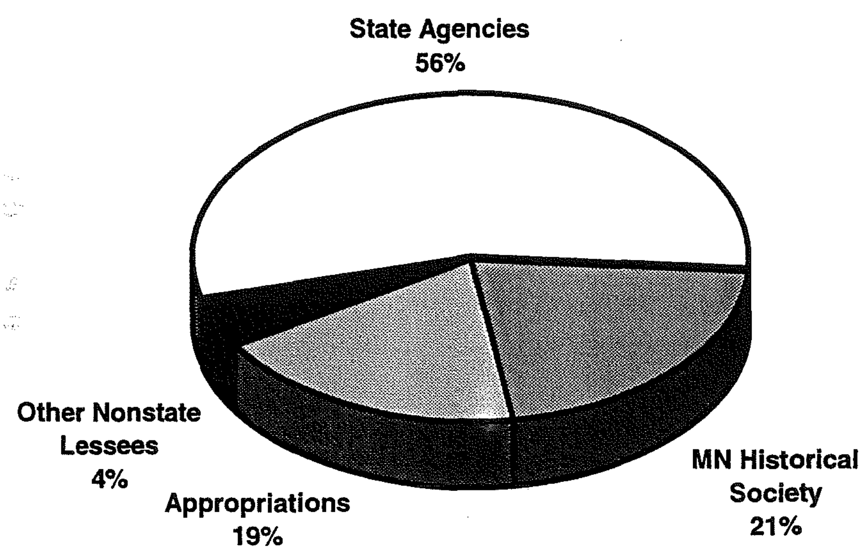
Our audit scope included lease revenue, electric power expenses, and operating transfers reported on the state's financial statements for fiscal year 1997. Our audit procedures included gaining an understanding of controls over revenues, expenses, and transfers. We also obtained evidential matter through inquiries of key personnel, inspection of documents, and analysis of financial data. As part of our work, we ascertained whether the department complied with laws and regulations that may have a material effect on Plant Management's financial statements.

Plant Management invoices lessees for building occupancy based on square footage. It establishes rates based on estimated operating expenses and has them approved by the Department of Finance. Figure 4-1 shows the sources of Plant Management's lease revenues during fiscal year 1997.

During fiscal year 1997, Plant Management transferred $9,517,558 to the General Fund and the Trunk Highway Fund for depreciation and bond interest. The Plant Management Internal Services Fund does not own the state buildings for which it receives lease revenue. The lease rates include depreciation and bond interest on the buildings. The Department of Administration transfers the money collected for building depreciation and bond interest to the fund that financed the original building construction.

Plant Management received $26,259,924 in lease revenue during fiscal year 1997. Plant Management reported total operating expenses of $17,884,271 for fiscal year 1997. We found that Plant Management's revenues and its expenses for electric power, as reported on the state's financial statements, were fairly stated. We also found that Plant Management accurately reported transfers to the General Fund and the Trunk Highway Fund for depreciation and bond interest.

**Figure 4-1**
**Plant Management Revenue Sources**
**Year Ended June 30, 1997**




Source: Plant Management Lease Revenue Spreadsheet, Department of Administration, Financial Management and Reporting.

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# Status of Prior Audit Issues
# As of November 14, 1997

## Most Recent Audit

**February 19, 1997, Legislative Audit Report 97-11** covered fiscal year 1996 and included activities material to the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1996. The report contained three audit findings. First, InterTech did not properly account for certain equipment that it leases to other state agencies. Secondly, InterTech did not pay invoices promptly. Finally, Central Motor Pool did not recognize certain vehicles which it received by June 30 on its financial statements. As of November 14, 1997, the department had resolved all of these audit findings.

### State of Minnesota Audit Follow-up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings that the Department of Finance judges to be significant. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers most state agencies, boards, commissions, and MnSCU institutions. It is not applied to audits of the University of Minnesota, any quasi-state organization, such as the Metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.